STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2018-01

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF REVENUE
DIVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908

IN THE MATTER OF:	:	
	:	**SC 17-034; 17-T-050**
	:	**other tobacco products**
Taxpayer.	:	**cigarette dealer's license**

DECISION

I. INTRODUCTION

The above-entitled matter came for hearing pursuant to an Order to Show Cause, Notice of Pre-Hearing Conference and Appointment of Hearing Officer ("Notice) issued on August 29, 2017 to the above-captioned taxpayer ("Taxpayer") by the Division of Taxation ("Division"). A hearing was held on December 15, 2017. The parties were represented by counsel. The parties were represented by counsel who rested on the record.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-20-1 *et seq.*, *Division of Taxation Administrative Hearing Procedures, Regulation AHP 97-01*, and the *Division of Legal Services Regulation 1 Rules of Procedure for Administrative Hearings*.

III. ISSUE

Whether the Taxpayer owes tax on other tobacco products, and if so, should any sanctions be imposed.

IV. MATERIAL FACTS AND TESTIMONY

, Supervisor, Special Investigations Unit, testified on behalf of the Division. He testified that the Taxpayer currently holds a cigarette dealer's license and a permit to make sales at retail. He testified that the Taxpayer has not filed other tobacco products[1] ("OTP") tax with the Division since it received its licenses in 1999. See Division's Exhibits A (business application and registration form from 1999); B (current retail sales permit); and C (current cigarette dealer's license).

"Inspector"), Tax Investigator, testified on behalf of the Division. He testified that on June 27, 2017, he and another investigator conducted a compliance check of the Taxpayer. He testified that "blending" is when a retail dealer buys tobacco products from licensed distributors that have appropriate invoices and sell those products, but also purchase the same products from unlicensed distributors at a lower cost, and try to pass off the licensed distributors' invoices as being for unlicensed products. He testified that different manufacturers use different codes for their packaging to show the day and/or month and/or week and/or year the product was manufactured. He testified that manufacturers use the codes to ensure brand integrity and to protect against fraudulent copies of their products. He testified that he attended Federal Tax Administrator basic training in which tobacco industry members train tax and law enforcement members regarding this enforcement mechanism and he was supplied with training materials. He testified that the coding categories are routinely updated. He testified that the products at issue,

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[1] Section 2.5(H) of 280-RICR-20-15-2 Division of Taxation's *Cigarette Tax/ Other Tobacco Products* defines other tobacco products as follows:

> (h) "Other Tobacco Product/s" (OTP) means any cigars (excluding Little Cigars which are subject to cigarette tax), cheroots, stogies, smoking tobacco (including granulated, plug cut, crimp cut, ready rubbed and any other kinds and forms of tobacco suitable for smoking in a pipe or otherwise), chewing tobacco (including Cavendish, twist, plug, scrap and any other kinds and forms of tobacco suitable for chewing), any and all forms of hookah and shisha tobacco, snuff, and shall include any other articles or products made of tobacco or any substitute therefore, except cigarettes.

"Garcia Vega" are made by He testified that he has previously used the coding information about 10 or 15 times to verify seized tobacco products.

The Inspector testified that during the compliance checks, six (6) products were seized and a few days later, the Taxpayer came to the Division with invoices and based on those new invoices, the Division returned three (3) of the six (6) seized products to the Taxpayer on July 7, 2017. See Division's Exhibits D (June 27, 2017 seizure report); E (initial compliance report); F (further invoices produced by the Taxpayer); G (receipt showing return of the three (3) products); and H (tax assessment adjustment after product returned).

The Inspector testified that white grape and pineapple were the two (2) products that were billed in the revised tax assessment. He testified that based on the codes stamped on these two (2) products, the grape was manufactured in March, 2017 and the pineapple was manufactured in April, 2017. He testified that the white grape was priced at two (2) for $0.99. He testified that the distributor invoice produced by the Taxpayer was for a different type of pineapple product at a different price. He testified that the Taxpayer brought in two (2) invoices from distributors and neither had the seized product on them. He testified that neither product was on the or the invoices. In addition, he testified that the invoice was from September, 2016 so was from before the products were manufactured. He testified that based on the manufacturing codes, he confirmed that the three (3) products that were returned to the Taxpayer were manufactured prior to the invoice dates showing their purchase by Taxpayer from licensed distributors. He testified that he confirmed his reading of the codes with his contact at who confirmed those dates.[2] See Division's Exhibit I (email between the Inspector and regarding the codes on the seized products).

[2] The parties all reviewed the products at issue and the codes, but the products were not entered at hearing because of a concern over the confidentiality of the codes.

On cross-examination, the Inspector testified that the seized products do not match the invoices that the Taxpayer showed him during examination as those invoices were from before the products were manufactured. See Taxpayer's Exhibit One (1) (two (2) invoices from February, 2017). See also Division's Division J (tax and penalty calculation); K (audit report); L (notice of deficiency); and M (notice of revocation).

The Owner testified on the Taxpayer's behalf. He testified that he also produced the invoices from February 15 and 22, 2017. See Taxpayer's Exhibit One (1). He testified that he did not purchase either of the seized products after February 22, 2017 and before they were seized. On cross-examination, he testified that he has a history of violations, but he has no idea how these products got on the shelf. He testified that he is responsible for purchasing products and there is no one else who would have purchased tobacco products.

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.*, 637 A.2d 1047 (R.I. 1994). If a statute is clear and unambiguous, "the Court must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Oliveira v. Lombardi*, 794 A.2d 453, 457 (R.I. 2002) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. DEM*, 553 A.2d 541 (R.I. 1989) (internal citation omitted). In cases where a statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998).

B. Relevant Statutes

R.I. Gen. Laws § 44-20-12 imposes a tax on cigarettes sold. R.I. Gen. Laws § 44-20-13.2 imposes tax on "other tobacco products" and provides as follows:

> Tax imposed on smokeless tobacco, cigars, and pipe tobacco products. – (a) A tax is imposed on all smokeless tobacco, cigars, and pipe tobacco products sold or held for sale in the state by any person, the payment of the tax to be accomplished according to a mechanism established by the administrator, division of taxation, department of administration. Any tobacco product on which the proper amount of tax provided for in this chapter has been paid, payment being evidenced by a stamp, is not subject to a further tax under this chapter. The tax imposed by this section shall be as follows:
>
> (1) At the rate of eighty percent (80%) of the wholesale cost of cigars, pipe tobacco products and smokeless tobacco other than snuff.
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> (2) Notwithstanding the eighty percent (80%) rate in subsection (a) above, in the case of cigars, the tax shall not exceed fifty cents ($.50) for each cigar.
>
> (3) At the rate of one dollar ($1.00) per ounce of snuff, and a proportionate tax at the like rate on all fractional parts of an ounce thereof. Such tax shall be computed based on the net weight as listed by the manufacturer, provided, however, that any product listed by the manufacturer as having a net weight of less than 1.2 ounces shall be taxed as if the product has a net weight of 1.2 ounces.
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> (b) Any dealer having in his or her possession any tobacco, cigars, and pipe tobacco products with respect to the storage or use of which a tax is imposed by this section shall, within five (5) days after coming into possession of the tobacco, cigars, and pipe tobacco in this state, file a return with the tax administrator in a form prescribed by the tax administrator. The return shall be accompanied by a payment of the amount of the tax shown on the form to be due. Records required under this section shall be preserved on the premises described in the relevant license in such a manner as to ensure permanency and accessibility for inspection at reasonable hours by authorized personnel of the administrator.
>
> (c) The proceeds collected are paid into the general fund.

R.I. Gen. Laws § 44-20-8 provides in part as follows:

> Suspension or revocation of license. – The tax administrator may suspend or revoke any license under this chapter for failure of the licensee to comply with any provision of this chapter or with any provision of any other law or ordinance relative to the sale of cigarettes; and the tax administrator may also suspend or revoke any license for failure of the licensee to comply with any provision of chapter 13 of title 6.

R.I. Gen. Laws § 44-20-51.1 provides as follows:

> Civil penalties. – (a) Whoever omits, neglects, or refuses to comply with any duty imposed upon him/her by this chapter, or does, or cause to be done, any of the

things required by this chapter, or does anything prohibited by this chapter, shall, in addition to any other penalty provided in this chapter, be liable as follows:

(1) For a first offense in a twenty-four month (24) period, a penalty of not more than one thousand dollars ($1,000), or not more than five (5) times the retail value of the cigarettes involved, whichever is greater, to be recovered, with costs of suit, in a civil action;

(2) For a second or subsequent offense in a twenty-four-month (24) period, a penalty of not more than five thousand dollars ($5,000), or not more than twenty-five (25) times the retail value of the cigarettes involved, whichever is greater, to be recovered, with costs of suit, in a civil action.

(b) Whoever fails to pay any tax imposed by this chapter at the time prescribed by law or regulations, shall, in addition to any other penalty provided in this chapter, be liable for a penalty of not more than five (5) times the tax due but unpaid.

(c) When determining the amount of a penalty sought or imposed under this section, evidence of mitigating or aggravating factors, including history, severity, and intent, shall be considered.

C. Arguments

The Division argued that the Taxpayer could not provide invoices to support that it had purchased the seized products and the Taxpayer was unable to provide proof it had paid taxes on the seized products. The Division argued that while the amount of tax owed is small, the Taxpayer blended properly and improperly taxed products and this is its sixth offense. The Division argued that the deficiency should be upheld and the cigarette dealer's license be suspended for 30 days.

The Taxpayer argued that it should have been able to examine the tobacco manufacturer and the Division relied on hearsay regarding the codes. The Taxpayer argued that even if it was found that it owed the tax, the violation only merits a monetary penalty and/or suspended sentence.

D. Whether Tax is Owed on the Other Tobacco Products

The evidence was that that the invoices either did not have the seized products on them or were from before the products were manufactured. While the invoices that the Taxpayer showed the Inspector at hearing (Taxpayer's Exhibit One (1)) indicated the products at issue, those invoices were from before the products were manufactured. The Inspector testified to his training on the manufacturing codes and explained the codes. Indeed, based on the codes, some tobacco products

were returned to the Taxpayer. The Inspector testified as to how the codes work and an email from the manufacturer confirming the codes at issue was introduced at hearing. The Taxpayer argued that the manufacturer should have been there to testify to the codes. However, the Inspector testified to his training and his actual knowledge of the codes. He testified that based on his training, the codes showed that one product was manufactured in March, 2017 and the other in April, 2017.[3] Thus, there was no proof of purchase of those seized products by the Taxpayer from a licensed distributor. The Taxpayer has not previously filed any OTP tax with the Division. Based on the evidence, the Taxpayer did not pay tax on the seized products.[4]

E. What Sanctions Should be Imposed

R.I. Gen. Laws § 44-20-51.1 was amended effective June 23, 2014. The amendment changed penalties from specific amounts to be "not more than five (5) times" a certain amount. R.I. Gen. Laws § 44-20-51.1 provides for a penalty in sections (a) and (b), but the only penalty applied to the other tobacco products like this matter is pursuant to R.I. Gen. Laws § 44-20-51.1(b). See Section 2.11 of 280-RICR-20-15-1. Since the new statute is now providing that penalties be calculated as "not more than" rather than the old statute that mandated a specific penalty, the new law added subsection (c) which provides that when determining the penalty to be imposed, mitigating and aggravating factors such as history, severity, and intent shall be considered. Thus, the statute envisions some kind of progressive discipline based on the history of offenses with the penalties becoming greater based on aggravating factors.

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[3] The Taxpayer argued that the Division was relying on hearsay. The Inspector testified to his training and his actual knowledge of the codes and how he applied that knowledge to the codes on the products and that he further confirmed his own analysis with . Nonetheless, pursuant to R.I. Gen. Laws § 42-35-10 hearsay is allowed in administrative hearings. See *DePasquale v. Harrington*, 599 A.2d 314 (R.I. 1991).

[4] The Taxpayer did not challenge the Division's calculation of the tax owed. See Division's Exhibit J. The calculation shows that the Division applied R.I. Gen. Laws § 44-20-13.2 to calculate the tax owed.

The Taxpayer has had prior tobacco tax violations and sanctions imposed against it. *Administrative Decision*, #2016-18 (7/25/16) is a prior decision regarding the Taxpayer. That decision discussed the history of the Taxpayer's tobacco tax violations and found that regardless of how the violations were counted, the Taxpayer had a history of noncompliance with the taxing statute. The decision discussed that seizures were made on January 31, February 5, and March 12, 2013 at the Taxpayer's store which resulted in a settlement that included a 30 day suspension of its cigarette dealer's license and that then an October 30, 2013 seizure resulted in another settlement that included a three (3) day suspension of the cigarette dealer's license. The decision discussed that the Taxpayer previously had a series of small seizures of untaxed tobacco products. The 2016 decision itself revolved around a March 21, 2015 seizure of OTP on which Taxpayer owed tax. In light of the Taxpayer's prior history of noncompliance, the 2016 decision imposed a penalty of five (5) times the tax owed and a suspension of the cigarette dealer's license for 18 days.

Since the statute requires that mitigating and aggravating factors be included in the calculation of penalties, it follows that the maximum penalty is not to be automatically applied. If the severity is to be considered,[5] it would also follow that the higher the tax owed, the higher the penalty imposed. Of course, if it was a taxpayer's second or third offense than the amount of tax owed would not be such a mitigating factor since it would be offset by the history of the taxpayer and the intent in that it would not be a first offense. If the tax owed was extremely high that might offset mitigation for a first offense as it might be that such a taxpayer was well aware of the statute and egregiously flouting the law. Nonetheless, the statute calls for a consideration of aggravating and mitigating factors. The tax here owed is minimal (less than $20). However, the Taxpayer has a history of selling untaxed tobacco products and has had previous seizures of untaxed tobacco

[5] The term "severe" in the statute is not defined and could apply not only to the amount of tax owed, but the method used by a taxpayer to avoid paying the statutory tax.

products and imposition of penalties all related to the nonpayment of tax on tobacco products. Therefore, despite the amount of tax owed, the maximum penalty of five (5) times the tax owed should be imposed.

In addition to the administrative penalty, the Division seeks to impose a 30 day suspension of the cigarette dealer's license. Suspension or revocation of license is allowed pursuant to R.I. Gen. Laws § 44-20-8. The issue comes down to what is the appropriate suspension of license for this violation. While the suspension statute does not contain the same kind of mitigating and aggravating factors as those found in the administrative penalty statute, the same kind of considerations of history, severity, and proportionality should be at play.[6]

In this situation, the Taxpayer has previously had series of small seizures of untaxed tobacco products. The Taxpayer previously had its cigarette dealer's license suspended for 30 days and three (3) days and 18 days. The history of violations justify the maximum administrative penalty. The history of violations also justify a suspension of said license as the Taxpayer has continually failed to comply with the taxing statute. While the amount of tax owed by the Taxpayer is minimal, the Taxpayer has continually failed to comply with the taxing statute. Thus, in light of the several prior violations, a suspension of longer than the 2016 decision of 18 days is warranted. A suspension of the Taxpayer's cigarette dealer's license of 30 days is merited.

VI. FINDINGS OF FACT

1. Other tobacco products were seized from the Taxpayer on June 27, 2017.

2. A Notice was issued on August 29, 2017 to the Taxpayer. A hearing was held on December 15, 2017. The parties were represented by counsel and rested on the record.

3. The facts contained in Section IV and V are reincorporated by reference herein.

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[6] For a good discussion of what should be considered in considering a sanction by an administrative agency, see *Jake and Ella's Inc. v. Department of Business Regulation*, 2002 WL977812 (R.I. Super.).

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq*. and R.I. Gen. Laws § 44-20-1 *et seq*.

2. The Taxpayer violated R.I. Gen. Laws § 44-20-13.2 on June 27, 2017.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows:

Pursuant to R.I. Gen. Laws § 44-20-1 *et seq*., R.I. Gen. Laws § 44-20-51.1, and R.I. Gen. Laws § 44-20-13.2, the tax owed and penalty were properly assessed on the Taxpayer's other tobacco products as set forth in Division's Exhibit L. Pursuant to R.I. Gen. Laws § 44-20-8, the Taxpayer's cigarette dealer's license shall be suspended for 30 days beginning on the 31st day from the execution of this decision.

Date: January 19, 2018

Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

✓ ADOPT
_____ REJECT
_____ MODIFY

Dated: 1/22/2018

Neena S. Savage
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 44-20-48 Appeal to district court.

Any person aggrieved by any decision of the tax administrator under the provisions of this chapter may appeal the decision within thirty (30) days thereafter to the sixth (6th) division of the district court. The appellant shall at the time of taking an appeal file with the court a bond of recognizance to the state, with surety to prosecute the appeal to effect and to comply with the orders and decrees of the court in the premises. These appeals are preferred cases, to be heard, unless cause appears to the contrary, in priority to other cases. The court may grant relief as may be equitable. If the court determines that the appeal was taken without probable cause, the court may tax double or triple costs, as the case demands; and, upon all those appeals, which may be denied, costs may be taxed against the appellant at the discretion of the court. In no case shall costs be taxed against the state, its officers, or agents. A party aggrieved by a final order of the court may seek review of the order in the supreme court by writ of certiorari in accordance with the procedures contained in § 42-35-16.

CERTIFICATION

I hereby certify that on the 23rd day January, 2018 a copy of the above Decision and Notice of Appellate Rights was sent by first class mail to the Taxpayer's attorney's address on record with the Division and by hand delivery to Bernard Lemos, Esquire, Department of Revenue, Division of Taxation, One Capitol Hill, Providence, RI 02908.

Gail Belasco