

STATE OF ARIZONA

Department of Revenue
Office of the Director
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Douglas A. Ducey
Governor

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Director

CERTIFIED MAIL

**The Director's Review of the Decision
of the Administrative Law Judge Regarding:**

[redacted]

ID No. [redacted]

ORDER

Case No. 201500304-L

On May 6, 2016, the Administrative Law Judge ("ALJ") issued a decision regarding the protest of [redacted] ("Taxpayer"). The Tobacco Tax Unit in the Education and Compliance Division ("Division") of the Department of Revenue ("Department") appealed this decision on July 12, 2016. As the appeal was timely, the Director of the Department issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the ALJ's decision and now issues this order.

STATEMENT OF CASE

The Division revoked Taxpayer's tobacco distribution license by letter of June 30, 2015. Taxpayer protested and the matter went to hearing. The ALJ granted Taxpayer's protest and did not uphold the Division's administrative action to revoke Taxpayer's license.

On appeal, the Division argues that it correctly revoked Taxpayer's license, that tobacco license suspension would result in increased costs, inequities and uncertainty, and that license revocation supports the state's efforts in complying with its obligations under the tobacco Master Settlement Agreement with manufacturers. Taxpayer did not timely respond to the Division's appeal.

FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the ALJ and makes additional findings of fact based on the record as set forth below:

1. Taxpayer is located in the State of [redacted] and is engaged in the wholesale distribution of tobacco products.
2. Taxpayer was issued an Arizona Tobacco Distributor's License ("License") effective [redacted], with an initial expiration date of [redacted] 2014, that was later renewed through [redacted] 2015. Effective [redacted], Taxpayer's License was issued with a new license number [redacted] and with an expiration date of [redacted] 2016. The License had to be renewed prior to expiration.
3. In 2014, Taxpayer began filing tobacco tax returns on Arizona Forms 800NR and 819NR for some months. Form 800NR is the prescribed form for nonresident licensed cigarette distributors, and Form 819NR is the prescribed form for returns of cigars and tobacco products sold by nonresident licensed distributors.
4. On January 23, 2015, the Division received Taxpayer's returns for December 2014.
5. On January 28, 2015, the Division received Taxpayer's returns for October and November 2014.
6. By letter of December 17, 2014, the Division requested to have a scheduled conference call with Taxpayer to discuss tobacco reporting issues and noted that it had made several attempts to contact Taxpayer by phone with no response. The Division's letter also informed Taxpayer that failure to respond might lead to further action taken by the Department.
7. The scheduled conference call between Taxpayer and the Division took place on January 28, 2015, and the Division sent Taxpayer a letter dated February 2, 2015, memorializing the phone conversation. The letter outlines multiple issues and errors in Taxpayer's Forms 800NR and 819NR for July through November 2014 that the

Division discovered and discussed with Taxpayer, such as incorrect and missing information, missing invoices, missing forms, unsigned forms, deductions taken incorrectly, unpaid tax and multiple tax filings that were not filed in a timely manner. The letter points out that the Department was requiring Taxpayer to submit corrected documentation within ten business days from the receipt of the Division's letter.

8. On July 15, 2015, the Division received Taxpayer's returns for January, February, March, April and May 2015.
9. From December 15, 2014 through June 10, 2015, the Division sent Taxpayer 13 notices of noncompliance and penalty assessment, demanding that Taxpayer file Form 800NR for September through November 2014, Form 819NR for October 2014, and each of the two Forms for January through April 2015.
10. The Division's written record of communications with Taxpayer shows the mailed notices and, additionally, multiple emails and phone calls during the period of December 15, 2014 through July 14, 2015.
11. By notice dated June 30, 2015, the Division revoked Taxpayer's License to operate as a tobacco product distributor. The revocation was suspended upon the Division's receipt of Taxpayer's appeal of the License revocation.
12. At the formal hearing on March 4, 2016, Taxpayer submitted copies of some filings for December 2015 and January 2016, and the record was held open for Taxpayer to provide documentation showing some of the required returns for earlier periods were timely filed. Taxpayer later conceded being unable to provide those documents and submitted other materials.
13. The ALJ concluded that the Department had authority, with discretion, to revoke or suspend Taxpayer's License, and that the Department could exercise its discretion and suspend the License for a period of time instead of revoking it. In the decision of May 6, 2016, the ALJ granted Taxpayer's protest.

14. Taxpayer's response to the Division's appeal was due by August 15, 2016, but was dated and hand-delivered August 17, 2016. Taxpayer's response was therefore late.

CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the decision of the ALJ insofar as those conclusions are not inconsistent with the following and makes additional conclusions of law as follows:

1. Taxpayer violated the timely filing requirements in A.R.S. §§ 42-3462(A) and 42-3501 more than two times within a three-year period.
2. The Division properly revoked Taxpayer's License pursuant to A.R.S. § 42-3401(G).

DECISION

The Division appealed the ALJ's decision and argues that it correctly revoked Taxpayer's License because it is authorized to revoke a tobacco distribution license for more than two violations of A.R.S. Title 42 within a three-year period, and that Taxpayer had thirteen violations within an eight-month period despite the Division's attempts to bring Taxpayer into compliance and subsequently had two more violations within the same three-year period. The Division also argues that a license suspension would result in increased costs, inequities and uncertainty because it requires a substantially higher level of regulation and continual monitoring of the licensee, there is no guidance in the law as to the appropriate length of a suspension, and retailers will not be able to verify that their supplier is licensed or able to return to licensed status. The Division points out that two years after a license revocation, taxpayers may apply for a new license. The Division further argues that it must diligently enforce tobacco licensing requirements to comply with the tobacco Master Settlement Agreement ("MSA") that resolved litigation between states and major tobacco manufacturers and that connects annual payments received by the State to the diligent enforcement of certain tobacco statutes. In order for the State to enforce those statutes, the Division argues, information obtained from the returns filed by licensed tobacco

distributors is needed, and the Division cannot supply that information timely if distributors like Taxpayer fail to timely file their returns.

Taxpayer failed to file a timely response to the Division's appeal of the ALJ's decision. In his protest of the License revocation, Taxpayer argued that his reports were timely filed in the beginning but conceded errors and later late filings that he attributed to misunderstandings and accounting errors.

The filing of monthly returns by tobacco distributors is required under A.R.S. §§ 42-3462(A), 42-3501. A.R.S. § 42-3462(A), concerning cigarette and roll-your-own tobacco distributors, provides:

Each distributor shall file a return in a form prescribed by the department for each place of business on or before the twentieth day of the month next succeeding the month for which the return is filed. . . .

Arizona Form 800NR is the prescribed form for monthly returns filed by nonresident licensed cigarette distributors.

A.R.S. § 42-3501 concerns distributors of tobacco products other than cigarettes and provides in relevant part:

- A. . . . every distributor of tobacco products other than cigarettes shall pay the tax imposed by this chapter on all those products received within the state and shall add the amount of the tax to the sales price.
- B. The distributor shall pay the tax to the department monthly on or before the twentieth day of the month next succeeding the month in which the tax accrues.
- C. On or before that date the distributor shall prepare a sworn return for the month in which the tax accrues in the form prescribed by the department . . .

The prescribed form for monthly returns of cigars and tobacco products sold by nonresident licensed distributors is Arizona Form 819NR.

Regarding distributor licenses, A.R.S. § 42-3401(G) provides:

In addition to any other civil or criminal penalty and except as otherwise provided in this section, the department may suspend or revoke a license issued under subsection C of this section if the person violates any requirement under this title more than two times within a three-year period.

The Division has shown and Taxpayer previously conceded that Taxpayer filed required tobacco tax returns late prior to the revocation of his License. The Division received Taxpayer's returns for October and November 2014 on January 28, 2015, after the twentieth day of the month succeeding each period and therefore late. Despite extensive contact with Taxpayer, including phone calls, emails, demand letters and notices of noncompliance and penalty assessment, Taxpayer still filed his returns for January, February, March, April and May 2015 late, and the Division did not receive these returns until July 15, 2015. Taxpayer, thus, violated the timely filing requirements in A.R.S. §§ 42-3462(A) and 42-3501 more than two times within a three-year period, and the Division was authorized to revoke or suspend Taxpayer's License pursuant to A.R.S. § 42-3401(G).

The ALJ specifically recognized in the decision that the Department had authority, with discretion, to revoke or suspend Taxpayer's License. The ALJ then discussed Taxpayer's testimony concerning his current reporting activity and concluded that the Department could exercise its discretion and suspend the License for a period of time rather than revoke the License. The ALJ stated:

The Administrative Law Judge does not conclude that the Department abused its discretion, but concludes only that, when the circumstances are viewed and reconsidered, not only back in time but also forward, the Department's authority to suspend is equally supported in this hearing record.

Conclusions of Law at 7. The ALJ then granted Taxpayer's appeal and ordered that the Department's administrative action to revoke Taxpayer's License was "not upheld." In doing so, the ALJ was exercising discretion when A.R.S. § 42-3401(G) has committed that duty to the Department. Taxpayer's License [redacted], as issued in 2015, had an

expiration date of [redacted] 2016 and has now expired, but any determination regarding the Division's License revocation will affect when Taxpayer's License may be renewed or reissued. The Division's arguments and considerations concerning the exercise of its discretion under A.R.S. § 42-3401(G), including the extent to which Taxpayer failed to comply with his reporting and filing obligations, the practicality of a suspension as compared to a revocation of the License, and the possible consequences of any tobacco tax and licensing enforcement deemed not diligent under the MSA, favor revocation of Taxpayer's License. Accordingly, the Division's determination to revoke Taxpayer's License was proper.

ORDER

The ALJ's decision is reversed and the Division's License revocation is upheld.

This Decision is the final order of the Department of Revenue. Taxpayers may contest the final order of the Department in one of two manners. Taxpayers may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-8297.

Dated this day of November 2016.

ARIZONA DEPARTMENT OF REVENUE

David Briant
Director

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Case No. 201500304 – L
Page 8

Certified original of the foregoing
mailed to:

[redacted]

Copy of the foregoing mailed to:

[redacted]

c: Transaction Privilege Tax Appeals
Education and Compliance Division
Tobacco Tax Unit, Special Taxes
Office of Administrative Hearings