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## ARIZONA LUXURY TAX RULING LTR 04-1

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

### **ISSUE:**

Refunding and redemption issues concerning loss or theft of, damage to, and erroneous usage of revenue stamps held by cigarette distributors.

### **APPLICABLE LAW:**

Arizona Revised Statutes ("A.R.S.") § 42-3008 provides that luxury privilege tax must be refunded when the amount of tax has been paid and when either: (a) proof is made to the Department that the cigarettes were exported from Arizona or the stamps were affixed to articles upon which stamps were not required, or (b) the cigarettes are unfit for sale due to breakage or spoilage. The Department may adopt rules setting forth the manner of making proof of a condition that warrants a refund.

A.R.S. § 42-3051 imposes the luxury privilege tax on all cigarettes, smoking tobacco, plug tobacco, snuff and other forms of tobacco, for use as may be prescribed by law.

A.R.S. § 42-3202 provides that a distributor cannot sell or offer for sale any tobacco, cigarettes or cigars upon which luxury privilege tax is imposed to any person in Arizona unless the tax has been paid on the products as evidenced by a stamp. The luxury privilege tax must be collected before the cigarettes are offered for sale. The Department shall not refund any amount of that tax on the grounds that the stamps are not required to be affixed to the cigarettes.

A.R.S. § 42-3203 provides that all cigarettes on which luxury privilege tax is imposed: (a) must be placed in packages or containers that are affixed with an official revenue stamp and (b) must be stamped if sold or delivered by any distributor.

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A.R.S. §42-3209(A) provides that the Department shall redeem unused stamps that a distributor presents for redemption and pay for them from monies collected under A.R.S. Title 42, Chapter 3.

Arizona Administrative Code (“A.A.C.”) R15-3-311 requires that every distributor selling cigarettes subject to the luxury privilege tax on tobacco products file a monthly report showing:

- (1) The quantity of cigarettes and cigarette tax stamps purchased and sold or otherwise disposed of during the calendar month immediately preceding the month that the report is filed; and
- (2) The quantity of cigarettes and stamps on hand at the beginning and at the end of the month.

A.A.C. R15-3-314 provides conditions under which cigarettes or other tobacco products sold by licensed distributors to purchasers outside Arizona are exempt from the luxury privilege tax.

### **DISCUSSION:**

Pursuant to A.R.S. § 42-3203, cigarette distributors are required to affix revenue stamps to cigarette packages sold in Arizona as evidence of payment of luxury privilege tax. They are obliged to file monthly reports providing information on inventories of unstamped cigarette packages, revenue stamps, and stamped cigarette packages pursuant to the requirements of A.A.C. R15-3-311.

Under A.R.S. § 42-3008, refunds of luxury privilege tax are available when tax has been paid and when either: (1) proof is given to the Department as described in A.A.C. R15-3-314 that the cigarettes were exported from Arizona or stamps are affixed to articles or substances upon which stamps are not required, or (2) luxury items are unfit for sale due to breakage or spoilage. Furthermore, under A.R.S. § 42-3209(A), a distributor may present unused stamps to the Department for redemption from monies collected under A.R.S. Title 42, Chapter 3.

### ***Loss or Theft of Stamps***

A cigarette distributor bears the cost of revenue stamps that are not affixed to cigarette packages. With either the loss or theft of revenue stamps, a distributor is still required to bear the cost of the tax for because: (a) none of the circumstances under A.R.S. § 42-3008 necessitating issuance of a refund applies and (b) the distributor is unable to provide the Department with proof that the revenue stamps are unused as required for redemption. The reason for a distributor’s purchase of additional revenue stamps—to compensate for

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the loss or theft of the stamps, or loss of the distributor's stock of unstamped cigarette packages—is irrelevant when considering whether the distributor is required to bear the cost of the luxury privilege tax. The Department does not bear the risk of loss or theft of the stamps once they have been sold to a licensed cigarette distributor and no longer in the Department's possession.

#### ***Mutilated or Unusable Stamps***

Revenue stamps can be mutilated or rendered unusable due to any number of factors, including improper loading into stamp-affixing machines, improper storage by a distributor, or environmental factors beyond a distributor's control. Pursuant to A.R.S. § 42-3209(A), the Department is required to "redeem" and "pay for" *unused* stamps presented by a distributor for redemption with "monies collected" from luxury taxation. To "redeem" is to "buy back" or "repurchase," according to the plain and ordinary meaning of the term.<sup>1</sup>

Consequently, when revenue stamps become damaged *before* being used (e.g., being affixed to cigarette packages), the Department will repurchase the stamps from distributors, provided the stamps to be redeemed are presented to the Department for redemption.

#### ***Overstamping or Understamping***

Cigarette distributors are required to file returns on or before the twentieth day of the first month following the month for which the returns are made, stating on such returns the total number of cigarette packages received during the reporting period and the number of revenue stamps used. When the value of the revenue stamps used does not equal the distributor's actual tax liability, the monthly return will show either "overstamping" or "understamping."

"Understamping" means that the distributor's return shows that it received more cigarette packages during the month than revenue stamps expended. It may result for many reasons, among them: failure to affix stamps to delivered cigarette packages, invoices reported more than once, delivery reported in the wrong period, theft, receipt of less than the invoice show, and unauthorized sales of unstamped cigarette packages.

"Overstamping" means that the distributor's monthly return shows that more revenue stamps were expended than cigarette packages received. It may result for many reasons, among them: unreported deliveries of cigarettes, receipt of more cigarette packages than shown on invoices and excess is unreported, concealment of receipt of contraband cigarettes, stamping packs more times than necessary, and stamp machine meter malfunction.

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<sup>1</sup> See WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 1902 (1993).

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Mistakes on the part of a cigarette distributor in the handling, usage, or recordkeeping of revenue stamps in its possession will not suffice to oblige the Department to issue a refund. Furthermore, there is no general provision for issuance of a credit memorandum or refund in circumstances that occur with over stamping.

An over stamping and an under stamping that occur in adjacent months cannot be offset against each other. The statutes do not allow any offset of over payments from one month to the next.

### **RULING:**

With either the loss or theft of revenue stamps, a distributor is still required to bear the cost of the tax for because: (a) none of the circumstances under A.R.S. § 42-3008 necessitating issuance of a refund applies and (b) the distributor is unable to provide the Department with proof that the revenue stamps are unused as required for redemption. The reason for a distributor's purchase of additional revenue stamps—to compensate for the loss or theft of the stamps, or loss of the distributor's stock of unstamped cigarette packages—is irrelevant when considering whether the distributor is required to bear the cost of the luxury privilege tax. The Department does not bear the risk of loss or theft of the stamps once they have been sold to a licensed cigarette distributor and no longer in the Department's possession.

When the value of the stamps used does not equal the tax liability, the monthly distributor return will show either "over stamping" or "under stamping."

"Under stamping" means that the distributor's return shows that it received more cigarette packages during the month than revenue stamps expended. It may result for many reasons, among them: failure to affix stamps to delivered cigarette packages, invoices reported more than once, delivery reported in the wrong period, theft, receipt of less than the invoice show, and unauthorized sales of unstamped cigarette packages.

"Over stamping" means that the distributor's monthly return shows that more revenue stamps were expended than cigarettes received. It may result for many reasons, among them: unreported deliveries of cigarette packages, receipt of more cigarette packages than shown on invoices and excess is unreported, concealment of receipt of contraband cigarettes, stamping packages more times than necessary, and stamp machine meter malfunction.

Mistakes on the part of a cigarette distributor in the handling, usage, or recordkeeping of revenue stamps in its possession will not suffice to oblige the Department to issue a refund. There is no general provision for issuance of a credit memorandum or refund in circumstances that occur with over stamping.

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An over stamping and an under stamping that occur in adjacent months cannot be offset against each other. The statutes do not allow any offset of overpayments from one month to the next.

#### Example 1:

*Facts:* Distributor has 100 stamps and receives fifty packages to stamp, leaving fifty stamps remaining in Distributor's inventory. When Distributor is inventoried, only forty stamps are found, leaving ten stamps unaccounted for. The result is the appearance of "over stamping."

*Result:* The Department is not obligated to refund or redeem stamps for Distributor unless Distributor provides proof that: (a) the conditions provided in A.A.C. R15-3-314 have been met to show that the ten stamps were used on cigarettes exported from Arizona; (b) the stamps are affixed to articles upon which stamps were not required; (c) the stamps are affixed to cigarette packages that are unfit for sale due to breakage or spoilage; or (d) the stamps are unused. Over stamping caused by Distributor's mistakes in the handling, usage, or recordkeeping of the stamps will not oblige the Department to issue a refund.

#### Example 2:

*Facts:* After conducting an audit of Distributor's cigarette inventory, the Department finds that Distributor stamped 150 packages of 20 ("20-packs") but used only 100 20-pack stamps and stamped 150 packages of 25 ("25-packs") but used 170 25-pack stamps. The Department issues an assessment for fifty 20-packs, but Distributor claims that the additional twenty 25-pack stamps used "must have" been affixed to twenty 20-packs and that the assessment should thus be reduced by the cost of the twenty stamps. Distributor offers no additional proof.

*Result:* The Department will not refund or redeem stamps because Distributor cannot show that any of the conditions of A.R.S. §42-3008 or §42-3209 are met as listed in Example 1 above. The Department will not offset the assessment by the amount paid for the twenty 25-pack stamps Distributor "must have" used on 20-packs without additional proof.

#### Example 3:

*Facts:* In January, Distributor has 100 stamps at the beginning of the month but receives 130 packages to stamp. Distributor fails to purchase additional stamps during the month and has a stamp inventory of zero at the end of January. Distributor buys 130 stamps during February but receives only 100 packages to stamp. At the end of February, Distributor once again reports having no stamps left in its inventory.

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*Result:* An overstepping and an understamping that occur in adjacent months cannot be offset against each other. Here, the Department will not allow the overstepping by Distributor in February to offset its understamping in January.

Gale Garriott, Deputy Director  
for J. Elliott Hibbs, Director

Signed: March 3, 2004

### Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to Department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.