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## ARIZONA LUXURY TAX RULING LTR 04-2

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### **ISSUE:**

Imposition of Arizona luxury privilege tax on molasses tobacco.

### **APPLICABLE LAW:**

Arizona Revised Statutes ("A.R.S.") § 42-3002 provides that the area of luxury taxation is preempted by the state.

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

A.R.S. § 42-3052(6) imposes luxury privilege tax at a rate of two cents per ounce or major fraction of an ounce on "smoking tobacco, snuff, fine cut chewing tobacco, cut and granulated tobacco, shorts and refuse of fine cut chewing tobacco, and refuse, scraps, clippings, cuttings and sweepings of tobacco, excluding tobacco powder or tobacco products used exclusively for agricultural or horticultural purposes and unfit for human consumption."

A.R.S. § 42-3052(7) imposes luxury privilege tax at a rate of one-half cent per ounce or major fraction of an ounce on "all cavendish, plug or twist tobacco."

A.R.S. § 42-3152(A) provides that luxury privilege tax and all related increases, interest, and penalties are a personal debt of the taxpayer to this state from the time they are due and payable.

A.R.S. § 42-3202 provides that a distributor may not offer for sale any tobacco, cigarettes, or cigars upon which luxury tax is imposed to any person within Arizona unless the tax has been paid.

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A.R.S. § 42-3251(2) imposes a tobacco tax for health care of 4.5 cents per ounce or major fraction of an ounce on “smoking tobacco, snuff, fine cut chewing tobacco, cut and granulated tobacco, shorts and refuse of fine cut chewing tobacco, and refuse, scraps, clippings, cuttings and sweepings of tobacco, excluding tobacco powder or tobacco products used exclusively for agricultural or horticultural purposes and unfit for human consumption.”

A.R.S. § 42-3251(3) imposes the tobacco tax for health care at a rate of 1.1 cents per ounce or fractional part of an ounce on “all cavendish, plug or twist tobacco.”

A.R.S. § 42-3251.01 imposes a second tobacco tax for health care of one and one-half times the tax collected under A.R.S. § 42-3251 for deposit in the tobacco products tax fund.

A.R.S. § 42-3302 imposes an Indian reservation tobacco tax on “cigarettes, cigars, smoking tobacco, plug tobacco, snuff and other forms of tobacco” purchased on a reservation.

### **DISCUSSION:**

Under A.R.S. § 42-3051, Arizona imposes luxury privilege tax on the privilege of selling certain luxury items to customers for consumption, including all forms of tobacco. As provided in A.R.S. § 42-3002, luxury taxation is a power held by the state exclusive of counties, cities, towns, and other local taxing authorities. It is in addition to and separate from the transaction privilege tax. Analogous to a vendor’s liability for transaction privilege tax, the legal obligation for luxury privilege tax imposed on tobacco products rests upon the distributor, pursuant to A.R.S. §§ 42-3152(A) and 42-3202.<sup>1</sup>

Tobacco products other than cigars and cigarettes are divided into two groups with two different luxury privilege tax rates as provided in A.R.S. § 42-3052(6)-(7). Other taxes are also imposed in the luxury taxation statutes: two tobacco taxes for health care are imposed under A.R.S. § 42-3251 and § 42-3251.01 respectively, and another tax for tobacco products purchased on Indian reservations is imposed under A.R.S. § 42-3302. The latter three taxes use or refer to the same groupings of tobacco products to impose their respective tax rates as those devised under A.R.S. § 42-3052.

Molasses tobacco is a blend of tobacco leaves and other additives, including molasses extracted from sugarcane, honey, and fruit derivatives. Molasses tobacco may be smoked in a special water pipe called a *hookah*, *nargile*, *shisha*, or *hubble-bubble* and can be combined with fruit pulp before consumption. Typically, the tobacco is placed in a bowl that is attached to the shaft of the water pipe with a heating element (*e.g.*, charcoal) placed

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<sup>1</sup> See also *Watkins Cigarette Serv., Inc. v. Ariz. Tax Comm’n*, 526 P.2d 708, 710 (Ariz. 1974).

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above it. The heating element burns the tobacco and smoke travels down the central shaft into a sealed glass basin that is partially filled with water. One or more smokers then inhale the smoke through hoses that extend from the shaft.

This ruling explains the appropriate luxury privilege tax rates for molasses tobacco. It also addresses the question of whether molasses tobacco purchased or consumed in Arizona is taxed on the entire weight of the product or solely on tobacco content.

Although the tobacco products in the “first group”—those listed in A.R.S. § 42-3052(6) (see “Applicable Law” section above)—are produced using greatly varying methods,<sup>2</sup> they are predominantly composed of tobacco leaves. *Casing*, a mixture of a variety of ingredients such as sweeteners, humectants, and aromatic substances, is often applied to tobacco leaves before cutting to enhance aroma and allow the tobacco to retain moisture and flexibility.<sup>3</sup> Casing is distinct from *flavor*, which is a perfume (e.g., essential oil, resin, plant extract) added to tobacco after cutting to produce a specific taste or mask deficiencies in natural tobacco flavor.<sup>4</sup> While casing and flavor are used to treat the leaves for the A.R.S. § 42-3052(6) tobacco products, they do not constitute a large proportion of the composition and weight of the final products.

The tobacco products in the “second group”—those listed in A.R.S. § 42-3052(7) (see “Applicable Law” section above)—are composed of tobacco that has been exposed to varying degrees of heat, humidity, and pressure before being shaped into different forms for final consumption.<sup>5</sup> Unlike the products listed in A.R.S. § 42-3052(6), water, flavor, and casing such as honey or molasses constitute a large part of the final composition and weight of cavendish, plug, and twist tobacco. Plug or “firm moist” tobacco is a type of chewing tobacco consisting of tobacco leaves that are combined with large amounts of casing, pressed into cakes, and cut before packing.<sup>6</sup>

Molasses tobacco consists of tobacco leaves combined with plentiful amounts of flavoring material and casing, such that the latter two categories of ingredients compose most of the composition and weight of the final product. The product is compressed and cut into blocks for sale to consumers. Molasses tobacco thus falls into the second group of tobacco products (e.g., those taxed by A.R.S. § 42-3052(7) at one-half cent per ounce or fractional part of an ounce) because it is plug tobacco for the purpose of imposing Arizona luxury privilege tax.

Luxury privilege tax is calculated based on the entire weight of tobacco products listed in both A.R.S. § 42-3052(6) and A.R.S. § 42-3052(7). There is no statutory or administrative

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<sup>2</sup> TOBACCO ENCYCLOPEDIA 414-19, 432-38 (Ernst Voges ed., 1984).

<sup>3</sup> *Id.* at 65, 411.

<sup>4</sup> *Id.* at 411-12.

<sup>5</sup> *Id.* at 66, 247, 338.

<sup>6</sup> *Id.* at 247, 435-38.

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provision permitting the tax to be imposed only on the proportion of a tobacco product that consists of tobacco leaves.

### **RULING:**

Molasses tobacco is a tobacco product that is plug tobacco for the purpose of Arizona luxury taxation. It is thus subject to Arizona luxury privilege tax at the rates imposed by A.R.S. §§ 42-3052(7) and 42-3251(A)(3), with the tobacco tax for health care imposed under A.R.S. §42-3251.01 to equal one and one-half times the tax rate prescribed by A.R.S. § 42-3251(A)(3). If purchased on an Indian reservation, molasses tobacco is subject to tax at the rate prescribed by A.R.S. §§ 42-3251 and 42-3251.01 depending upon the special provisions described under A.R.S. § 42-3302(C) when a particular Indian tribe imposes a luxury, sales, transaction privilege, or similar tax on the tobacco.

The luxury privilege tax liability is calculated using the entire weight of the product and not merely the portion of the product consisting of tobacco leaves.

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.