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ARIZONA LUXURY TAX RULING LTR 17-3

(This ruling supersedes and rescinds Arizona Luxury Tax Ruling LTR 94-1)

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ISSUE:

Tax treatment of sales of tobacco products, including sales to consumers that occur on tribal lands within the State of Arizona.¹

APPLICABLE LAW:

25 Code of Federal Regulations (“C.F.R.”) § 286.3 establishes the criteria for Indian ownership and Indian economic enterprises.

Arizona Revised Statutes (“A.R.S.”) 42-2003(B)(5)(e) provides that, pursuant to statute and a written agreement between the Department and tribe, the Department may disclose confidential information to an agency, official, or organization of an Indian tribal government with tax regulation and enforcement, law enforcement, or drug enforcement responsibilities, provided that they grant substantially similar privileges to the Department for the type of information being sought.

A.R.S. Title 42, Chapter 3 (A.R.S. § 42-3001 *et seq.*) contains all statutes pertaining to the imposition of Arizona tobacco taxes.

A.R.S. § 42-3003(B) provides the Department, its agents, and representatives with police power and the “powers and authority of appraisal, valuation, assessment, correction, computation, estimation, supervision, direction, investigation, inspection, collection and enforcement” vested in the Department by any state law relating to tax and public revenue and applicable to administering Arizona tobacco taxes.

¹ In this ruling, all references to transactions that occur “on-reservation” or “on tribal lands” should be construed to include lands considered part of “Indian country,” which includes reservation land, dependent Indian communities and lands set aside for members of these communities, and Indian allotments.

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A.R.S. § 42-3006(A) provides that the Department shall prepare and have on hand official adhesive stamps according to the classifications in A.R.S. § 42-3052 of luxuries upon which a tax is imposed by this chapter and for which the Department either collects payment or prepayment of the tax through the purchase of such stamps or requires the affixation of stamps to indicate the tax-exempt nature of the luxuries.

A.R.S. §§ 42-3010 and 42-3405 provide the general recordkeeping requirements for distributors of tobacco products.

A.R.S. § 42-3051 provides for the levy of taxes 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 provides the general luxury privilege tax rates for the various classifications of tobacco products.

A.R.S. § 42-3251 provides for the levy and collection of the first Tobacco Tax for Health Care, and includes the tax rates for the different categories of tobacco products subject to the tax.

A.R.S. § 42-3251.01 provides for the levy and collection of the second Tobacco Tax for Health Care at a rate of one and one-half times the tax rates imposed under the first Tobacco Tax for Health Care.

A.R.S. § 42-3251.02 provides for the levy and collection of the third healthcare fund-related tobacco tax, the Tobacco Tax for the Smoke-Free Arizona Fund. The tax rate is one tenth of one cent on each cigarette.

A.R.S. § 42-3302 provides for the levy and precollection of the state’s Indian Reservation Tobacco Tax (“IRTT”), as well as a rate adjustment if an Indian tribe “imposes a luxury, sales, transaction privilege or similar tax” on tobacco products. The tax rate for the tax is equal to the combined rates for the two Tobacco Taxes for Health Care imposed under A.R.S. §§ 42-3251 and 42-3251.01.

A.R.S. § 42-3303 provides that the IRTT is conclusively presumed to be a direct tax on the consumer and is precollected and remitted to the Department by the distributor for purposes of convenience. The taxes that are precollected by the distributor are considered an advance payment and are to be added to the price of the tobacco products subject to the tax. For purposes of precollection, the distributor must obtain and affix revenue stamps from the Department.

A.R.S. § 42-3303.01(A) provides that from and after December 31, 2014, for cigarettes purchased on an Indian reservation by an enrolled member of the governing tribe:

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1. Where the tribe does not levy an excise tax on tobacco products or exempts its enrolled members from the tax, a distributor must affix tax-exempt stamps that are distinguishable from any other tax stamp required by A.R.S. Tit. 42, Ch. 3.
2. Where the tribe levies an excise tax on tobacco products and does not exempt its members from the tax, a distributor must purchase and affix tax stamps pursuant to A.R.S. Tit. 42, Ch. 3, Art. 11 that are distinguishable from any other tax or tax-exempt stamp required.

A.R.S. § 42-3308(A) provides that the Department may collect and administer any tribal excise tax on tobacco products imposed by an Indian tribe through an intergovernmental agreement or contract with the tribe to provide a uniform or coordinated method of administration of the IRTT and tribal excise tax.

A.R.S. § 42-3371 provides for the levy and collection of the Tobacco Tax for Early Childhood Development and Health ("First Things First Tax"), and includes the tax rates for the different categories of tobacco products subject to the tax.

A.R.S. § 42-3406(A) provides that, with limited exception, a distributor requesting a rebate of taxes paid on tobacco products must establish entitlement to the rebate by obtaining a report executed by the retailer that purchased the tobacco products on which the distributor paid taxes.

A.R.S. § 42-3453 provides the general presumption that,

until the contrary is established, it is presumed that cigarettes that are sold, distributed, used or consumed by a person in this state, but not placed in packages or containers on which official tax stamps are affixed, are intended for first sale by the person and are subject to the taxes imposed by this chapter.

A.R.S. § 42-3455(C) provides that only licensed cigarette distributors may purchase, obtain or affix cigarette stamps and may not sell or provide stamps to any other cigarette distributor or person.

A.R.S. § 42-3456(A) provides that all cigarettes on which tax is imposed by the state must be placed in packages or containers on which an official stamp has been affixed.

A.R.S. §§ 42-3462 and 42-3501 provide the monthly filing requirements for licensed tobacco distributors.

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DISCUSSION:

This ruling provides an overview of Arizona tobacco taxes as applied to cigarettes and other tobacco products (“OTP”), including the tax treatment of cigarette sales on Indian reservations within Arizona, and provides guidance on the procedures that tobacco distributors must follow to comply with statutory and regulatory requirements.

GENERAL INFORMATION RELATING TO ARIZONA TOBACCO TAXES

In considering the taxation of tobacco products sold in the state, apart from a vendor or purchaser’s Arizona transaction privilege or use tax liability arising from such sales or purchases, there are four categories of “tobacco taxes” found in A.R.S. Title 42, Chapter 3 that may apply to a particular tobacco product. These categories are: the *luxury privilege tax*; the *Healthcare Fund-related tobacco taxes*, which encompasses three separate taxes; the *Tobacco Tax for Early Childhood Development and Health* (“First Things First Tax”); and the *Indian Reservation Tobacco Tax* (“IRTT”).

General Luxury Privilege Tax

The general luxury privilege tax is levied by the state on all tobacco products.² The specific classifications of tobacco products that are subject to tax and their respective rates are all statutorily provided for as follows:

- Cigarettes: \$0.009 per cigarette;
- Smoking tobacco, snuff, fine cut chewing tobacco, and other tobacco products consisting of 50 percent or more tobacco: \$0.02 per ounce or major fraction of an ounce;
- Cavendish, plug, or twist tobacco, and other tobacco products consisting of less than 50 percent tobacco: \$0.005 per ounce or fractional part of an ounce;
- Small cigars (*i.e.*, cigars weighing no more than 3 pounds per 1,000 cigars): \$0.04 per 20 cigars; and
- Cigars made of tobacco or any tobacco substitute other than small cigars:
 - If manufactured to retail at \$0.05 apiece or less: \$0.02 per 3 cigars;
 - If manufactured to retail at more than \$0.05 apiece: \$0.02 per cigar.³

² A.R.S. § 42-3051.

³ A.R.S. § 42-3052. The Department’s 50-percent demarcation for OTP, based on the stated classifications in A.R.S. § 42-3052(6) and (7), is discussed in *Arizona Luxury Tax Ruling* LTR 04-2 (Mar. 3, 2004).

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The responsible parties for paying and remitting the tax are distributors selling cigarettes to in-state retailers (including those located on tribal lands within the state) and distributors receiving untaxed OTP in this state.

Healthcare Fund-Related Tobacco Taxes

In 1994, the electorate approved Proposition 200, which added the first Tobacco Tax for Health Care, levied on all tobacco products.⁴ In 2002, voters passed Proposition 303, which imposed the second Tobacco Tax for Health Care, levied on all tobacco products at a rate of one and one-half times the rates prescribed for the first Tobacco Tax for Health Care.⁵

In the 2006 general election, voters approved Proposition 201, which established the third Tobacco Tax for Health Care, also known as the Tobacco Tax for the Smoke-Free Arizona Fund. The tax funds the enforcement of a general ban on smoking in all public places and places of employment within Arizona, and is levied at a rate of one-tenth of one cent on each cigarette sold.⁶

All three Tobacco Taxes for Health Care apply to the same tobacco products and same taxpayers as for the general luxury privilege tax, as described above.

Tobacco Tax for Early Childhood Development and Health (First Things First Tax)

Also in 2006, voters approved Proposition 203, which provides dedicated funding for early childhood development and health programs and establishes a statewide structure to coordinate early childhood development and health programs. The First Things First Tax is derived through a separate tax on tobacco products to be deposited in the Early Childhood Development and Education Fund.⁷

The First Things First Tax applies to the same tobacco products and same taxpayers as for the general luxury privilege tax, as described above.

Indian Reservation Tobacco Tax (IRTT)

Established as part of 1994's Proposition 200, the IRTT applies to tobacco purchases made by nontribal members on reservation land.⁸ The IRTT constitutes a direct tax on the nontribal consumer but, for the purpose of convenience and facility, is precollected and

⁴ A.R.S. § 42-3251.

⁵ A.R.S. § 42-3251.01.

⁶ A.R.S. § 42-3251.02.

⁷ A.R.S. § 42-3371.

⁸ A.R.S. § 42-3302.

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remitted to the Department by the distributor.⁹ The tax is to be added to the price of tobacco products and is to be recovered from purchasers. The rate is equal to the sum of the two Tobacco Taxes for Health Care,¹⁰ which is currently \$1.00 for a pack of 20 cigarettes. There is a rate adjustment for purchases that occur on reservation lands where the governing tribe imposes an independent tax on tobacco. If a tribe imposes its own tax on tobacco at a rate that is less than the state tax rate, the IRTT is levied at a rate equal to the difference between the state tax rate and the tribal tax rate. If a tribe imposes its own tax on tobacco at a rate that is equal to or greater than the state tax rate, then the IRTT rate is zero.

State statute exempts from IRTT cigarettes and other tobacco products: 1) on which the two Tobacco Taxes for Health Care have been paid; 2) that are exempt from the federal excise tax on tobacco products; or 3) sold by an Indian tribe, or by a federally licensed Indian Trader, on an Indian reservation to Indians who are enrolled members of the Indian tribe for whose benefit the Indian reservation was established.

Revenue from the IRTT is deposited in the Tobacco Products Tax Fund and the Tobacco Tax and Health Care Fund.¹¹

GENERAL ISSUES AFFECTING TAXATION ON INDIAN RESERVATIONS:

The State of Arizona includes the lands of 22 federally-recognized Indian tribes within its borders.¹² Businesses on reservations may be owned either by the tribe for which the reservation was established or by enrolled members of that tribe, but may alternately be owned by non-Indians or Indians who are not enrolled members of that tribe.

Jurisprudence Regarding State Taxation of On-Reservation Activities

Supplementing state statutes, federal and state case law informs the Department's understanding of taxation and regulation of on-reservation activities. Several opinions are of particular importance in understanding the Department's administration of tobacco taxes on reservation land:

⁹ A.R.S. § 42-3303.

¹⁰ A.R.S. §§ 42-3251 and 42-3251.01.

¹¹ A.R.S. § 42-3302(B).

¹² See, e.g., 81 Fed. Reg. 26826 (May 4, 2016). This count includes tribal land of the Zuni Tribe of the Zuni Reservation, New Mexico, that falls within Arizona. The federal Bureau of Indian Affairs ("BIA") publishes its most updated list of tribal entities recognized and eligible for funding and services from the BIA by virtue of their status as Indian tribes.

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- In *McClanahan v. State Tax Commission of Arizona*,¹³ the Court held that state income tax could not be levied against Navajo Indians living on their reservation, when the income arose wholly from reservation sources.
- In *Moe v. Confederated Salish & Kootenai Tribes*,¹⁴ the Court held that Montana could not impose personal property taxes on member-owned, on-reservation property; licensing fees for member-owned, on-reservation businesses; or cigarette sales tax on sales by Indians to Indians on reservation land. The Court further held that insofar as the state imposes a tax on non-Indians for cigarettes sold to them by Indian smoke shops, it is a minimal burden to require the smoke shop to add the tax to the sales price to prevent non-Indians' avoidance of the payment of a lawful tax.
- In *Washington v. Confederated Tribes of Colville Indian Reservation*,¹⁵ the Court held that Washington State had the power to impose tobacco and sales taxes on on-reservation purchases by anyone who is not an enrolled member of the governing tribe. As such, the state could require tribal smoke shops to affix the state's cigarette tax stamps to packs sold to nonmembers, as these are "minimal burdens" to aid in enforcing and collecting the tax. The state could also impose record keeping requirements on tribal smoke shops for both exempt and nonexempt sales as a means of preventing fraudulent transactions.
- In *White Mountain Apache Tribe v. Bracker*,¹⁶ the Court held that Arizona could not levy its motor carrier license tax and use fuel tax on a non-Indian logging business that felled tribal-owned timber on reservation land. The Court found that, where the state asserts authority over the conduct of non-Indians for on-reservation activity, a balancing test of state, federal, and tribal interests must be used to determine whether the state's exercise of its authority would violate federal law.
- In *Department of Taxation and Finance of New York v. Milhelm Attea & Bros.*,¹⁷ the Court held that New York's regulations imposing a quota on the number of tax-exempt cigarettes a wholesaler may sell for resale on tribal land; imposing related recordkeeping requirements; and requiring that wholesalers only sell untaxed cigarettes to retailers that have obtained a valid exemption certificate did not create excessive burdens on Indian traders. The Court also held that Indian traders are not wholly immune from state regulation that is "reasonably necessary" to the state's collection and assessment of lawful tax.

¹³ 411 U.S. 164 (1973).

¹⁴ 425 U.S. 463 (1976).

¹⁵ 447 U.S. 134 (1980).

¹⁶ 448 U.S. 136 (1980).

¹⁷ 512 U.S. 61 (1994).

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- In *State ex rel., Arizona Dept. of Revenue v. Dillon*,¹⁸ the Court held that an Indian who engaged in on-reservation tobacco sales was not exempt from state luxury tax as he was not an enrolled member of that reservation's tribe; federal law did not preempt the application of the state's luxury tax to cigarette sales of an Indian trader to non-Indian customers; and the imposition of the tax did not infringe on the sovereignty of the tribe.

INTERGOVERNMENTAL AGREEMENTS WITH TRIBES

Based on its authority to enter into intergovernmental agreements with tribes, the Department is able to jointly administer and collect tribal tobacco taxes on behalf of the tribal authorities. Such agreements provide tribes with greater capability to administer and enforce their existing or future tax laws and support the Department's efforts to account for the state's entire tobacco market, both on and off of reservation land.

RULING:

TAX STAMPS AND CIGARETTE SALES

When affixed to cigarette packs, tax stamps constitute official indicia that Arizona tobacco taxes due have been paid on the cigarettes.¹⁹ Generally, before selling, distributing, or transferring cigarettes to any other person in this state, a distributor must affix one of the Arizona tax stamps to any unstamped cigarette packs unless otherwise authorized by the Department. Based on statutory requirements, the Department issues four categories of tax stamps, with each category denoted by a different stamp color.

The four categories of tax stamps are: the general tobacco tax stamp (*blue*), the IRTT stamp (*red*), the tribal tobacco tax stamp (*yellow*), and the tribal tax-free stamp (*green*). In the following subsections, terms are used in the following manner:

- *Tribal retailer*: A retail business that is owned and operated either by a tribe on whose reservation the retail sales at issue are being made or an enrolled member of that tribe. For a business to be considered owned and operated by a tribe, it must conform, at a minimum, to the criteria for Indian ownership and Indian economic enterprises provided under 25 C.F.R. § 286.3 and guidance issued by the United States Bureau of Indian Affairs, which generally require a business entity to: (1) be at least 51 percent owned by one or more individuals qualifying as Indians; (2) have one or more of the Indian owners involved in the daily business management of the

¹⁸ 170 Ariz. 560 (1991).

¹⁹ A.R.S. § 42-3456.

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enterprise; and (3) have the majority of the enterprise's earnings accrue to such persons.

- *Nontribal retailer.* A retail business that is neither owned and operated by the tribe on whose reservations the retail sales at issue are being made nor owned and operated by an enrolled member of that tribe. Examples of nontribal retailers are a non-Indian retailer or an Indian retailer owned and operated by a member of a tribe other than that on whose reservation the retailer is conducting its business.
- *Tribal consumer.* A purchaser of tobacco products who is an enrolled member of the tribe on whose reservation the retail sale to the consumer is made.
- *Nontribal consumer.* A purchaser of tobacco products who is not an enrolled member of the tribe on whose reservation the retail sale to the purchaser is made. Examples of nontribal consumers are a non-Indian purchaser or an Indian purchaser who is not an enrolled member of the tribe on whose reservation the retail sale is made.

A cigarette distributor must consider four factors when determining the proper tax stamp to affix to a particular cigarette pack:

1. The location where the pack is to be sold at retail (*i.e.*, off-reservation or on-reservation),
2. The status of the vendor who will sell the pack at retail (*i.e.*, tribal retailer or nontribal retailer),
3. The status of the purchaser to whom the vendor sells the pack (*i.e.*, tribal consumer or nontribal consumer), and
4. Whether the tribe on whose reservation the product is sold imposes an independent tobacco tax on tribal consumers.

Blue Stamps

A distributor affixes blue stamps to cigarette packs to pay the general luxury privilege tax, the three Healthcare Fund-related tobacco taxes, and the First Things First Tax. Consequently, for a pack of 20 cigarettes, the following amounts of tobacco taxes are being paid:

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General luxury privilege tax	\$0.18
+ § 42-3251 Tobacco Tax for Health Care	\$0.40
+ § 42-3251.01 Tobacco Tax for Health Care	\$0.60
+ § 42-3251.02 Smoke-Free AZ Tax	\$0.02
+ First Things First Tax	\$0.80
TOTAL	\$2.00

In any sale of blue-stamped cigarettes, the full amount of generally-applicable state taxes (\$2.00/pack of 20 cigarettes) is paid by the distributor on a cigarette pack when the distributor affixes a blue stamp to it. The economic burden of the tax may be passed down the distributor chain (*i.e.*, from distributor to retailer to final purchaser).

For this reason, a distributor should never sell blue-stamped cigarettes to tribal retailers. Additionally, an on-reservation nontribal retailer should never sell blue-stamped product to an enrolled member of the tribe on whose reservation the retail sale is being made.

Consequently, distributors may sell cigarette packs bearing blue stamps to the following types of retailers, for the following transactions:

- Any off-reservation retailer for any type of retail sale.
- Any on-reservation, nontribal retailer for retail sales to nontribal consumers.

Red Stamps

A distributor obtains and affixes red stamps to precollect the state's IRTT before selling or transferring the stamped packs to on-reservation tribal retailers. The economic burden of the IRTT will ultimately be on purchasers other than enrolled members of the tribe on whose reservation the final retail sales occur (*i.e.*, non-Indians and Indians who are not enrolled members of the tribe on whose reservation the retail sales occur).

The operation of the IRTT is consistent with the United States Supreme Court's rulings summarized above. The tax collection and recordkeeping duties associated with the IRTT constitute "minimal burdens" on tribal retailers that work to prevent or minimize an artificial competitive advantage gained by arbitraging the difference between a nonexistent or lower tribal tobacco tax and the state tobacco taxes that would be applicable, were the same purchase to occur off-reservation. Because the tax is on the consumer, precollected as an advance payment by the distributor, and is *not* passed on to the tribal retailer, it does not impermissibly pass an economic burden on to a tribal entity or enrolled member.

Distributors may sell cigarette packs bearing red stamps to the following types of retailers, for the following transactions:

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- Any on-reservation, tribal retailer for sales to nontribal consumers (*i.e.*, consumers who are either non-Indians or Indians who are not enrolled members of the tribe on whose reservation the retail sales are occurring).

No red-stamped packs may be held at or transferred to retail sales locations located off-reservation.

Any tobacco tax levied by the governing tribe on cigarettes sold in such transactions may offset any applicable IRTT; depending on the rate of tribal tax, the IRTT may be offset partially or in its entirety.

Examples of the IRTT due, as affected by tribal tobacco tax, are as follows:

Example 1 (no tribal tax): Assume a tribe levies no tobacco tax. If a distributor sells a red-stamped pack of 20 cigarettes to a tribal retailer who operates on a reservation of this tribe and the retailer sells the pack to a nontribal consumer, the distributor will have ultimately precollected and remitted the full \$1.00 of the IRTT and would not be due a rebate:

Indian Reservation Tobacco Tax	\$1.00
– Tribal tobacco tax offset	<u>(\$0.00)</u>
TOTAL IRTT DUE:	\$1.00

Example 2 (tribal tax offset, tribal tax rate is less than IRTT rate): Assume a tribe levies a tobacco tax that equals \$0.60 for a pack of 20 cigarettes. If a distributor sells a red-stamped pack of 20 cigarettes to a tribal retailer who operates on a reservation of this tribe and the retailer sells the pack to a nontribal consumer, the distributor will ultimately be responsible for precollecting and remitting \$0.40 of the IRTT and may be due a \$0.60 rebate of the IRTT it prepaid, depending on whether the tribal tax is administered by the Department (see “Rebates of IRTT” discussion below):

Indian Reservation Tobacco Tax	\$1.00
– Tribal tobacco tax offset	<u>(\$0.60)</u>
TOTAL IRTT DUE:	\$0.40

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Example 3 (tribal tax offset, tribal tax rate equals IRTT rate): Assume a tribe levies a tobacco tax that equals \$1.00 for a pack of 20 cigarettes. If a distributor sells a red-stamped pack of 20 cigarettes to a tribal retailer who operates on a reservation of this tribe and the retailer sells the pack to a nontribal consumer, the distributor will ultimately not be responsible for precollecting and remitting the IRTT and may be due a \$1.00 rebate of the tax it prepaid, depending on whether the tribal tax is administered by the Department (see “Rebates of IRTT” discussion below):

Indian Reservation Tobacco Tax	\$1.00
– Tribal tobacco tax offset	(\$1.00)
TOTAL IRTT DUE:	<u>\$0.00</u>

Example 4 (tribal tax offset, tribal tax rate is greater than IRTT rate): Assume a tribe levies a tobacco tax that equals \$1.29 for a pack of 20 cigarettes. If a distributor sells a red-stamped pack of 20 cigarettes to a tribal retailer who operates on a reservation of this tribe and the retailer sells the pack to a nontribal consumer, the distributor will ultimately not be responsible for precollecting and remitting the IRTT and may be due a \$1.00 rebate of the tax it prepaid, depending on whether the tribal tax is administered by the Department (see “Rebates of IRTT” discussion below):

Indian Reservation Tobacco Tax	\$1.00
– Tribal tobacco tax offset (\$1.29 ≈ \$1.00)	(\$1.00)
TOTAL IRTT DUE:	<u>\$0.00</u>

Rebates of IRTT:

Because the IRTT is precollected and paid by a distributor as an advance payment for the consumer, a distributor may be due a rebate of the IRTT paid on red-stamped cigarettes: (a) that are sold to a reservation with an independent tribal tobacco tax and (b) for which any amount of IRTT due is recovered directly from the consumer, pursuant to A.R.S. § 42-3303(A)(3).

From a timing perspective, payment of IRTT as offset by any tribal tax by the true taxpayer—the condition precedent for a rebate to the distributor—occurs at the time of the final sale of the cigarettes by a retailer to the consumer. Moreover, whether a sale is properly a red-stamped sale (IRT, offset by tribal tobacco tax) or a yellow- or green-stamped sale (tribal tobacco tax, if levied) depends on the identity of the final purchaser as a tribal or nontribal consumer, which remains unknown until the final retail sale occurs. For these reasons, distributors are required to provide adequate documentation that the on-reservation retail sales subject to the rebate request were made to the proper consumers.

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To establish entitlement to a rebate, licensed distributors are required to obtain and submit a report executed by the retailer that purchased the tobacco products upon which the rebate request is based ("Retailer Report"). With limited exception, a properly completed Retailer Report must accompany any request for a rebate of IRTT. In the event a retailer is uncooperative or has gone out of business, a licensed distributor may request authorization to submit proof other than the required Retailer Report to establish its entitlement to a rebate of IRTT.²⁰

Any rebate due to a distributor is reduced by the amount of any tribal tobacco tax that the Department administers and remits to a tribe pursuant to an intergovernmental agreement. To the extent that a distributor sells cigarettes to a tribe with a tobacco tax program administered by the Department, tribal tax would partially or completely eliminate any rebate otherwise due to the distributor.

Green Stamps

A distributor affixes green stamps to cigarette packs that are to be sold tax-free on reservation land. Distributors can sell cigarette packs bearing green stamps to the following types of retailers, for the following transactions:

- Any on-reservation retailer (tribal or nontribal) for sales to consumers who are enrolled members of the tribe on whose reservation the retail sales are occurring, *if* the tribe either does not levy a tobacco tax or levies a tobacco tax from which its own members *are* exempt.

No state tax is paid on such transactions.

Distributors cannot sell or transfer green-stamped cigarettes to retail business locations located either off-reservation or on a reservation whose tribe does not exempt its own enrolled members from tribal tobacco tax.

Yellow Stamps

Yellow stamps are used to indicate the levy of *tribal* tobacco tax on cigarettes to which they are affixed. Distributors obtain yellow stamps free of charge from the Department and can sell cigarette packs bearing yellow stamps to the following types of retailers, for the following transactions:

²⁰ A.R.S. § 42-3406.

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- Any on-reservation retailer (tribal or nontribal) for sales to consumers who are enrolled members of the tribe on whose reservation the retail sales are occurring, *if* the tribe levies a tobacco tax from which its own members are *not* exempt.

No state tax is levied on such transactions. As with red- and green-stamped cigarettes, no yellow-stamped packs may be held at or transferred to retail sales locations located off of reservation land.

Reporting and Remitting Tribal Tobacco Taxes Through Yellow Stamps:

The Department notifies distributors of the tribes for which the Department administers and collects tribal tobacco taxes. For such tribes, distributors are required to report and remit tribal tobacco taxes to the Department as part of their monthly filings; reporting and remittance will be deemed to be timely if made on the 20th of the month immediately following the month in which a distributor sells yellow-stamped cigarettes to retail locations operating on a reservation of one of these tribes. The Department may assess applicable penalties and interest for failure to timely file and pay tribal tobacco taxes for these tribes.

Pursuant to a written agreement with a tribe, the Department may share distributors' sales data from monthly reports with the tribe for additional action by their taxing authorities, despite the fact that the Department does not itself administer the tribe's tax programs.²¹

OTHER TOBACCO PRODUCTS (OTP)

While many of the same principles of taxation for on-reservation sales of cigarettes apply to OTP, in practice, OTP is treated differently for two reasons:

- OTP is not stamped prior to sale or transfer by the distributor, so as to designate or limit the final sale of the products according to taxes levied.
- Distributors must pay tobacco taxes on OTP on the 20th of the month following the month in which they *received* the product, rather than the month in which they sold or transferred the product as with cigarettes.

Consequently, distributors remit all state tobacco taxes normally levied on off-reservation sales (*i.e.*, the taxes collected through blue stamps for cigarettes) on *all* OTP received in the previous month, with refunds or rebates being due to them based on subsequent sales and transfers. Eligibility for a rebate of IRTT must be established by the distributor through substantiating documentation.

²¹ A.R.S § 42-2003(B)(5)(e).

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RETAILER ALLOCATIONS OF TAX-FREE TOBACCO PRODUCTS

In 1994, the Department established a mechanism to determine the permitted quantity of green-stamped cigarettes and tax-free OTP that may be sold by distributors to retailers located on reservation land for use by enrolled tribal members. The Department determined the initial quota and retailer allocations by multiplying the U.S. Bureau of Indian Affairs census figure of the Arizona portion for each reservation by the per capita annual consumption of cigarettes derived from the 1993 consumption figures published by the Arizona Department of Health Services' Office of Chronic Disease Epidemiology.

The retailer allocation percentages, which the Department makes available to licensed tobacco distributors, reflect the ratios of member and nonmember tobacco sales for each registered retailer. The Department periodically revises the allocations based on additional information provided by retailers and actual sales figures reported by licensed tobacco distributors.

A distributor making sales of cigarettes and other tobacco products to registered retailers is required to maintain sufficient documentation in support of all tax-free sales. Such documentation must be preserved for at least four years from the date of the transaction at the distributor's place of business and be made available for inspection by the Department.²² The distributor may establish a tax-free sale by marking the invoice or receipt with the quantity of tobacco products delivered, the price of the tobacco products without regard to the exemption, and the price paid by the purchaser for the tobacco products. All sales to registered retailers must show the percentage of each type of sale (*i.e.* exempt and non-exempt) through a clear computation directly on the invoice.

To ensure proper administration of state and tribal tobacco tax, prevent fraudulent activity and avoid impermissible state taxation of exempt transactions, licensed tobacco distributors may only sell tobacco products to on-reservation retailers that have registered and received a retailer identification number from the Department. There is no fee to obtain a retailer identification number. Retailers may register with the Department through Arizona Luxury Tax Online, available at <https://luxury.aztaxes.gov>.

Grant Nülle, Deputy Director

Signed: December 18, 2017

²² A.R.S. § 42-3405.

ARIZONA LUXURY TAX RULING

LTR 17-3

(This ruling supersedes and rescinds
Arizona Luxury Tax Ruling LTR 94-1)
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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.