

Cite as Det. No. 98-040, 17 WTD 260 (1998)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 98-040
	)	
...	)	Registration No. ...
	)	Cigarette Tax Assessment # ...
	)	

[1] RULE 186; RCW 82.24.040: CIGARETTE TAX -- EXEMPTION -- INTERSTATE SALE -- DOCUMENTATION. Sales of unstamped cigarettes to an out-of-state customer are not exempt from cigarette tax where testimony indicates that the unstamped cigarettes were delivered to a Washington address for local pick-up by the customer.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A cigarette wholesaler protests the assessment of additional cigarette taxes assessed in an audit report.<sup>1</sup>

FACTS:

Okimoto, A.L.J. – [Taxpayer] is a cigarette distributor based in [Homebase] Washington. Taxpayer's books and records recording Taxpayer's sales subject to cigarette tax were examined by the Miscellaneous Tax Section of the Special Programs Division (Miscellaneous Tax) of the Department of Revenue (Department) for the period January 1, 1991 through June 30, 1994. As a result of that examination, Cigarette Tax Assessment #. . . was issued on January 30, 1996 in the amount of \$. . . including tax and interest. Taxpayer asked for and was granted an extension to file its petition until April 4, 1996. By mutual agreement the audit assessment was put on administrative hold to allow Taxpayer additional time to procure records seized by the U.S. Customs Service on . . . , 1993. In addition, the Department agreed to waive interest pending the release of Taxpayer's records for the period beginning April 16, 1996 through April 17, 1997. Additional extensions and a partial waiver of interest were granted through September 2, 1997.

---

<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

After expiration of these extensions, Taxpayer filed a petition with the Department's Appeals Division (Appeals) protesting the tax assessment and it remains due.

### Schedule 3: Out of State Sales Delivered in Washington

In this schedule, Miscellaneous Tax assessed cigarette tax on sales of unstamped cigarettes made to [Vendor], a California company. Miscellaneous Tax described the reason for the assessment in the "Auditor's Detail of Differences and Instruction to Taxpayer" portion of the audit report as follows:

The shipments of cigarette sold to out-of-state vendors were verified and being done in accordance with WAC 458-20-193, except for shipments to [Vendor]. The destination for sales to [Vendor] was [Freight Company], located in [Terminal] Washington. The shipping documents provided, indicated that the deliveries took place in the state of Washington. Schedule 3, lists these sales where the deliveries took place in Washington. RCW 82.24.250 (copy inclosed) does not allow any person other than (1) a licensed wholesaler in its own vehicle, or (2) a person who has given notice to the department in advance of the commencement of transportation to transport or cause to be transported cigarettes not having the stamps affixed to the packages or containers, upon the public highways, roads or streets of this state. (Emphasis added.)

Miscellaneous Tax contends that cigarette sales to [Vendor] are not exempt for several reasons. First, Taxpayer has failed to produce documents that the cigarettes were delivered to a purchaser outside the state of Washington. In fact, Miscellaneous Tax states that the information it examined indicated that the cigarettes were picked up by [Vendor] or its agent in [Terminal], Washington. Second, Miscellaneous Tax states that Taxpayer has failed to document that [Vendor] was a licensed dealer in Washington or any other state. Miscellaneous Tax contends that either one of these defects nullifies the exemption.

Taxpayer asserts, however, that it had the appropriate documentation to substantiate interstate delivery at one time, but that its records were seized by the U.S. Customs Service. Taxpayer states that [Vendor] was being investigated for illegally importing into Canada cigarettes purchased from Taxpayer. Taxpayer states that its attorney has attempted to obtain the required records from the U.S. Customs Service and has not succeeded in obtaining the type of documentation required.

Taxpayer asserts that Miscellaneous Tax reviewed and accepted its other interstate sales and that sales to [Vendor] were handled and documented in the exact same manner. Taxpayer argues that if Miscellaneous Tax accepted cigarette sales made to other out-of-state purchasers as valid interstate sales, it should accept the ones to [Vendor], as well.

Taxpayer explained during the hearing that the cigarettes sold to [Vendor] were transported from [Homebase], Washington to [Terminal], Washington by [Freight Company]. In [Terminal], the

cigarettes were delivered to [Vendor] or its agent. Taxpayer testified during the hearing that Taxpayer's delivery responsibilities terminated in [Terminal], Washington and that after delivery, [Vendor] transported the unstamped cigarettes outside the state via its own trucks or a common carrier. Taxpayer states that although the cigarettes were originally destined for Oregon, the cigarettes were apparently diverted away from that destination and into Canada.

Taxpayer argues that the critical fact is that the cigarettes were delivered and consumed outside the state of Washington, and that it really doesn't matter whether the cigarettes were delivered into Oregon or Canada. Taxpayer further states that it can produce undeniable testimony that the cigarettes left the state and were not consumed in Washington.

#### ISSUE:

Are sales of unstamped cigarettes to an out-of-state customer exempt from cigarette tax where testimony indicates that the unstamped cigarettes were delivered to a [Terminal], Washington address for local pick-up by the customer and all documentation of the transaction was seized by federal authorities?

#### DISCUSSION:

The cigarette tax is imposed by RCW 82.24.020(1)<sup>2</sup> upon the sale, use, consumption, handling, possession or distribution of all cigarettes at the rate of tax specified in the statute. "Possession" means both physical possession by the purchaser and constructive possession when being transported. RCW 82.24.020(4).

Furthermore, it is the legislative intent to levy a tax on cigarettes handled or possessed within this state and to collect the tax from the person who first handles or possesses (either physically or constructively) the articles taxed. RCW 82.24.080<sup>3</sup>, WAC 458-20-186.

In this case, Taxpayer is clearly the first person to handle or possess the cigarettes within the state of Washington. Taxpayer had physical possession of the cigarettes at [Homebase] and constructive possession during their transportation to [Terminal]. Therefore, unless Taxpayer's possession is exempt, it is subject to the tax.

RCW 82.24.040<sup>4</sup> allows a limited exception to the prohibition of possessing unstamped cigarettes. It states in pertinent part:

No wholesaler in this state may possess within this state unstamped cigarettes except that:

---

<sup>2</sup> Although RCW 82.24.020 was amended in 1993 and 1994 the changes do not affect the outcome in this case.

<sup>3</sup> Although RCW 82.24.080 was amended in 1993 and 1995, the changes also do not affect the outcome in this case.

<sup>4</sup> Although RCW 82.24.040 was amended in 1995, the changes do not alter the outcome of this case.

. . .

(2) Any wholesaler in the state who is licensed under Washington state law and who furnishes a surety bond in a sum satisfactory to the department, shall be permitted to set aside, without affixing the stamps required by this chapter, such part of his stock as may be necessary for the conduct of his business in making sales to persons in another state or foreign country, to instrumentality's of the federal government, or to the established governing bodies of any Indian tribe, recognized as such by the United States Department of the Interior. Such unstamped stock shall be kept separate and apart from stamped stock.

RCW 82.24.040(3) further states:

(3) Every wholesaler licensed under Washington state law shall, at the time of shipping or delivering any of the articles taxed herein to a point outside of this state, or to a federal instrumentality, or to an Indian tribal organization, make a true duplicate invoice of the same which shall show full and complete details of the sale or delivery, whether or not stamps were affixed thereto, and shall transmit such true duplicate invoice to the main office of the department, at Olympia, not later than the fifteenth day of the following calendar month, and for failure to comply with the requirements of this section the department may revoke the permission granted to the taxpayer to maintain a stock of goods to which the stamps required by this chapter have not been affixed. The department may also revoke this permission to maintain a stock of unstamped goods for sale to a specific Indian tribal organization when it appears that sales of unstamped cigarettes to persons who are not enrolled members of a recognized Indian tribe are taking place, or have taken place, within the exterior boundaries of the reservation occupied by that tribe.

Since Miscellaneous Tax has not raised the issue, we presume that Taxpayer has posted the required bond and properly segregated its unstamped stock. The remaining issue is whether Taxpayer's sales of unstamped cigarettes were made to proper persons and properly documented. Rule 186<sup>5</sup> implements RCW 82.24.040 and states:

(3) EXEMPTIONS. The cigarette tax does not apply upon cigarettes sold to persons licensed as cigarette distributors in other states when, as a condition of the sale, the seller either delivers the cigarettes to such a buyer at a point outside this state, or delivers the same to a common carrier with the shipment consigned by the seller to such a buyer at a location outside this state. Any person engaged in making sales to licensed distributors in other states or making export sales (see WAC 458-20-193A and 458-20-193C). . . ;.

---

<sup>5</sup> Rule 186 was amended in 1994. We have cited the version in affect during the audit period.

Such unstamped stock must be kept separate and apart from any stamped stock. (Emphasis added.)

In order to qualify for the interstate exemption the unstamped cigarettes must both be sold to a licensed cigarette distributor in another state and “. . . as a condition of the sale, the seller either delivers the cigarettes to such a buyer at a point outside this state, or delivers the same to a common carrier with the shipment consigned by the seller to such a buyer at a location outside this state.” In this instance, Taxpayer has presented no documentation that [Vendor] is a validly licensed dealer in another state, nor has it provided documentation that the unstamped cigarettes were delivered to [Vendor] at a point outside the state or delivered to a common carrier with the shipment consigned to [Vendor] at a location outside this state. On the contrary, Taxpayer’s testimony indicates that the unstamped cigarettes were shipped to [Terminal] and picked up locally by [Vendor] or its designee. This is an entirely local transaction and fully subject to tax. WAC 458-20-193. Although it is unfortunate that Taxpayer’s sales and shipping documents were seized by federal authorities, that seizure does not relieve Taxpayer of its documentation responsibilities. This is especially true when it appears as though Taxpayer’s possession and sale of cigarettes failed to qualify for the exemption under either Rule 186 or Rule 193. Therefore, based on Taxpayer’s lack of documentation of delivery terms or dealership licenses, we are unable to grant Taxpayer’s petition.

Subsequent to the hearing, Taxpayer submitted sample documentation of reported interstate sales made during November of 1993 as being representative of the type of interstate documentation seized by the U.S. Customs Office. The sample documentation illustrates two different delivery methods made to three out-of-state customers. One set of invoices listed an out-of-state purchaser and was supported by Taxpayer’s UPS shipping log showing an out-of-state destination. This is clearly acceptable interstate documentation. The second and third set of invoices also showed an out-of-state customer. The shipping documentation, however, clearly shows that delivery was made via [Freight Company] and consigned to the out-of-state customer in [Terminal], Washington. This appears to be a local delivery fully subject to Washington’s cigarette tax. Taxpayer argues, however, that because this type of interstate documentation was allegedly accepted by Miscellaneous Tax for other transactions during the audit period (evidenced by their absence from the tax assessment) that the Department must now accept this documentation as valid for [Vendor] sales as well.

We disagree. First, there is no evidence that documentation for November of 1993 interstate sales was ever examined or accepted by Miscellaneous Tax. We take administrative notice that it is standard audit procedure to examine documentation on a test or “spot check” basis. Many reporting errors are simply missed or overlooked. Second, even if this documentation was examined and accepted initially by Miscellaneous Tax, this does not preclude the Department from applying the correct standards under Rule 186 and Rule 193 for other transactions. Finally, we note that Taxpayer has not provided any documentation to substantiate its interstate deduction for [Vendor] sales even though the documentation is required by RCW 82.24.090. For the above reasons, Taxpayer’s petition is denied.

DECISION AND DISPOSITION:

Taxpayer's petition is denied. This case is remanded to the Miscellaneous Tax Section for collection.

Dated this 26th day of March 1998.