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Governor

FINANCE AND ADMINISTRATION CABINET
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WILLIAM M. LANDRUM III
Secretary

DANIEL P. BORK
Commissioner

In the matter of:

██████████, INC.

Contact: ██████████ PLLC

FINAL RULING NO. 2016-32
September 16, 2016

Cigarette and Other Tobacco Products Tax Assessments
for the Audit Period
July 1, 2009 through May 31, 2013

FINAL RULING

The Kentucky Department of Revenue ("DOR") currently has outstanding Cigarette Excise and Other Tobacco Products Tax assessments against ██████████, Inc. ("██████████") totaling \$██████████ (plus applicable interest and penalties) for audit periods of July 1, 2009 through May 31, 2013. A breakdown of the assessments are shown in the chart below:

Tax Period	Tax	Interest	Penalty/Fees	Totals
07/01/2009-06/30/2011	\$█	\$█	\$█	\$█
07/01/2011-05/31/2013	\$█	\$█	\$█	\$█
07/01/2009-06/30/2011	\$█	\$█	\$█	\$█
07/01/2009-06/30/2011	\$█	\$█	\$█	\$█
07/01/2011-05/31/2013	\$█	\$█	\$█	\$█
TOTAL	\$█	\$█	\$█	\$█

However, billing records, bills of lading and other documentation examined during the audit revealed many discrepancies in inventory levels from what was reported monthly to DOR for the applicable reporting periods. Specifically, the beginning balance of cigarettes on hand for the 2011 through 2013 audit period, invoices found onsite during the audit were not reported on the originally filed form 73A420 or the amended filed form 73A420 for the previous audit period of July 1, 2009 through June 30, 2011 as required per Kentucky Regulation 103 KAR 41:030. For this reason, inventory was increased to reflect the unreported invoices found during the audit. The Department correctly determined the beginning balance on hand as outlined in the reporting requirements per 103 KAR 41:030 and KRS 138.190.

Furthermore, the sale of untax-paid cigarettes to out of state wholesalers is a clear violation of KRS 138.195(12) which directs that “no person licensed under this section except nonresident wholesalers shall either sell to or purchase from any other such licensee untax-paid cigarettes.” As a licensed resident wholesaler, ██████████ was not allowed to sell untax-paid cigarettes under any circumstances. Kentucky Regulations 103 KAR 41:030 and 41:100 provide guidance on how a KY resident wholesaler is to handle the stamping of cigarettes that are destined for sale into other states.

Kentucky Regulation 103 KAR 41:030, Section 2(1)(c) requires the wholesaler to submit a monthly report accounting for the total inventory of cigarettes purchased and stamped with Kentucky or other state stamps. Section 2(2) addresses transactions where a Kentucky wholesaler sells cigarettes into out of state jurisdictions which do not require the affixing of cigarette stamps as proof of tax paid (██████████). In these transactions, the wholesaler must submit to DOR copies of reports to out of state jurisdictions with proof of the other state tax paid. For the audit periods in question, ██████████ was not licensed to stamp for any out of state jurisdictions even though it claimed to be selling into other jurisdictions such as ██████████ which has stamping requirements. Furthermore, the company provided no proof that it paid the tax on any product it claims to have shipped into out of state jurisdictions without stamp requirements.

Absent any proof or even authorization to remit cigarette excise tax to out of state tax jurisdictions, the Kentucky tax is imposed on the sale of cigarettes within the state of Kentucky. KRS 138.130 (6) defines “sales” as “any transfer for a consideration, exchange, barter, gift, offer for sale, advertising for sale, soliciting an order for cigarettes or tobacco products, and distribution in any manner or by any means whatsoever.”

The OTP audit assessment for the sale to ██████████ was made in accordance to KRS 138.140(4) & (5). ██████████ was a licensed Kentucky subjobber as defined under KRS 138.130(12) which states in part as “any person who purchases cigarettes, other tobacco products, or snuff from a wholesaler licensed under KRS 138.195 on which the tax imposed by KRS 138.140 has been paid”. By definition, ██████████ could not receive

untax-paid product. Therefore, the Kentucky licensed wholesaler is responsible for the tax imposed by KRS 138.140.

The Department asserts the cigarette shipments from ██████████ received by ██████████ were unstamped product thus taxable under KRS 138.146. ██████████ is a manufacturer of cigarettes and other tobacco products as defined under KRS 138.130(2). ██████████ does not now hold nor did it hold a non-resident wholesaler's license for the periods at issue in this case. Since ██████████ directly sold cigarettes it manufactured without the requisite license to pay the tax and affix the cigarette tax evidence, it is the Department of Revenue's position that the tax has not been paid. According to the provisions of KRS 138.146, the tax is due when a Kentucky licensed wholesaler takes possession within this state.

To further the Department's stance, DOR notified ██████████ in an email dated ██████████, 2010 at ██████████ AM of the Department's position on out of state shipments of cigarettes regarding the applicable excise tax. The email stated the following:

██████████ would still be obligated to pay the excise tax to the appropriate taxing authority on cigarettes shipped to another state; in this case the state of ██████████. Also, it is advisable to contact the state of ██████████ to determine any applicable licensing and tax laws which may affect ██████████. Per KRS 138.146(1) the tax imposed by KRS 138.130 to 138.205 shall be due when any licensed wholesaler or unclassified acquirer takes possession within this state of untax-paid cigarettes. Accordingly, if no excise tax is paid to the state of ██████████, then the excise tax is due immediately to Kentucky.

The Department assessed interest and penalties in accordance with KRS 131.183(1)(a), and KRS 131.180(2).

KRS 131.183(1)(a) states:

All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate.

KRS 131.180(2) states:

Any taxpayer who fails to withhold or collect any tax as required by law, fails to pay the tax computed due on a return or report on or before the due date prescribed for it or the due date as extended by the department or, excluding underpayments determined pursuant to subsections (2) and (3) of KRS 141.990, fails to have timely paid at least seventy-five percent (75%) of the

tax determined due by the department shall, unless it is shown to the satisfaction of the department that the failure is due to reasonable cause, pay a penalty equal to two percent (2%) of the tax not withheld, collected, or timely paid for each thirty (30) days or fraction thereof that the withholding, collection, or payment is late. The total penalty levied pursuant to this subsection shall not exceed twenty percent (20%) of the tax not timely withheld, collected, or paid; however, the penalty shall not be less than ten dollars (\$10).

██████████ requested a waiver of penalties citing KRS 131.081(6), KRS 131.175 and 103 KAR 1:040, Section (1)(9)(11) & (14).

KRS 131.081(6) states:

If any taxpayer's failure to submit a timely return or payment to the department is due to the taxpayer's reasonable reliance on written advice from the department, the taxpayer shall be relieved of any penalty or interest with respect thereto, provided the taxpayer requested the advice in writing from the department and the specific facts and circumstances of the activity or transaction were fully described in the taxpayer's request, the department did not subsequently rescind or modify the advice in writing, and there were no subsequent changes in applicable laws or regulations or a final decision of a court which rendered the department's earlier written advice no longer valid. Since, the Department clarified the written advice on August 31, 2010 (as cited earlier), Burley is not entitled to a waiver a penalty and interest per KRS 131.081(6).

KRS 131.175 provides the Commissioner the authority to waive penalty when reasonable cause is shown to the satisfaction of the Department. ██████████ has not shown to the Department of Revenue's satisfaction that failure to file or pay timely was due to reasonable cause as outlined in 103 KAR 1:040.

Therefore, the outstanding Cigarette Tax and Other Tobacco Product assessments totaling \$██████████ (plus applicable interest and penalties) are deemed legitimate liabilities of ██████████, Inc. due to the Commonwealth of Kentucky.

This letter is the final ruling of the Department of Revenue.

APPEAL

For purposes of this final ruling, the terminology “Kentucky Board of Tax Appeals” and “Board” represent both the current Kentucky Board of Tax Appeals, as well as, the Kentucky Claims Commission that was established by Executive Order on August 8, 2016 and is expected to replace the current Kentucky Board of Tax Appeals on October 1, 2016.

You may appeal this final ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this final ruling, your petition of appeal must be filed at the principal office of the Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601-3714, within thirty (30) days from the date of this final ruling. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;
3. Contain the petitioner's or appellant's position as to the law and facts; and
4. Include a copy of this final ruling with each copy of the petition of appeal.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 3 of 802 KAR 1:010:

1. An individual may represent himself in any proceedings before the Board where his individual tax liability is at issue or he may obtain an attorney to represent him in those proceedings;
2. An individual who is not an attorney may not represent any other individual or legal entity in any proceedings before the Board;
3. In accordance with Supreme Court Rule 3.020, if the appealing party is a corporation, trust, estate, partnership, joint venture, LLC, or any other artificial legal entity, the entity must be represented by an attorney on all matters before the Board, including the filing of the petition of appeal. If the petition of appeal is filed by a non-attorney representative for the legal entity, the appeal will be dismissed by the Board; and
4. An attorney who is not licensed to practice in Kentucky may practice before the Board only if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,

DEPARTMENT OF REVENUE

A handwritten signature in black ink that reads "Doug Howell". The signature is written in a cursive, flowing style.

Attorney Manager
Office of Legal Services for Revenue

CERTIFIED MAIL
RETURN RECEIPT REQUESTED