STAR IMPORTERS & WHOLESALERS 2043 MOUNTAIN INDUSTRIAL BLVD. TUCKER, GA 30084-6308,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. MISC. 13-420
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Star Importers & Wholesalers ("Taxpayer") for State and County tobacco tax for January 2007 through July 2012 and September 2009 through July 2012, respectively. A hearing was conducted on January 23, 2014. The Taxpayer's representatives, Douglas Thompson, Baxter Thompson, and Warren Matthews, and the Taxpayer's president, Amin Hudda, attended the hearing. Assistant Counsel David Avery represented the Department.

The Taxpayer is headquartered in Tucker, Georgia. It sells a variety of non-cigarette tobacco products to customers in various states. It is undisputed that the Taxpayer sold non-cigarette tobacco products to customers in Alabama during the periods in issue, and also that the Taxpayer delivered some of those products into Alabama in its own trucks. The issue is whether the Taxpayer is liable for the tobacco sales tax levied at Code of Ala. 1975, §40-25-2(a) on its sales to its Alabama customers. The above statute levies a privilege or license tax on "every person, firm, corporation. . ." that sells, stores, receives, or distributes cigarettes and non-cigarette tobacco products in Alabama.

The Revenue Department mailed a letter to the Taxpayer on November 14, 2008 that stated in part – "It has come to the State of Alabama Department of Revenue's attention that you are distributing and delivering tobacco products in Alabama. Revenue

Rules 810-7-1-.08(7) and 810-7-1-.09(7) requires a monthly report to be filed with the Alabama Department of Revenue." See, Department Ex. 1. The Department also attached to the letter an application for an Alabama tobacco stamping permit and accompanying agreement.

The Department mailed another copy of the above letter to the Taxpayer on December 29, 2008. That letter was stamped "Second Notice." See again, Department Ex. 1. The Taxpayer did not respond to either letter. It also did not file monthly tobacco tax reports with the Department during the periods in issue.

On June 29, 2009, the Department requested information from the Taxpayer regarding sales it had made to a certain company in Alabama from April 2006 through March 2009. The letter stated in part – "The requested information is not being used to investigate or determine tax liabilities owed by Star Importers & Wholesalers." Department Ex. 3. It is not in evidence if the Taxpayer eventually submitted the requested records to the Department.

In 2010, two Revenue Department examiners observed one of the Taxpayer's trucks delivering non-cigarette tobacco products to a customer in Jefferson County, Alabama. One of the examiners testified at the January 23 hearing that the "stake out" resulted from information received by the Department "through the grapevine" from an unnamed source indicating that the Taxpayer was delivering tobacco products to customers in Alabama in its own trucks. (T. 108). The examiner also testified that he had been informed by someone with the Department, perhaps Sandy Donaldson, manager of the Department's other tobacco products section, that the Department had been told by someone with the

Taxpayer that the Taxpayer was not making deliveries into Alabama.

> Q. It's my understanding about your understanding --- you were told by somebody in the Department who was told by somebody else in the Department that when they contacted the taxpayer or somebody at the taxpayer's office, they said they weren't making deliveries in Alabama?
>
> A. Correct.
>
> Q. Do you have any idea who that somebody talked to at the taxpayer?
>
> A. I believe they talked to Sandy Donaldson. We can –
>
> Q. Is that with the taxpayer?
>
> A. Oh, with the – you're talking about with the Department who talked to them in the tobacco tax section?
>
> Q. Who was that person at Star –
>
> A. Oh, they talked to –
>
> Q. -- who made the statement? Do you have any clue?
>
> A. I'm not sure.
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> Mr. R. Thompson: Your Honor, we move to strike that as triple hearsay.
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> ALJ Thompson: Well, I'll consider all that when I do my order.

(T. 147 – 149).

The Department subsequently audited the Taxpayer for tobacco tax. The parties agreed that the Taxpayer would mail the Department all of its invoices concerning its sales of non-cigarette tobacco products to Alabama customers during the periods in issue. The Taxpayer provided those records, and the examiners used the records to compute and assess the disputed tax in issue. The Department also assessed the Taxpayer for the 50 percent fraud penalty at Code of Ala. 1975, §40-2A-11(d).

Section 40-25-2(a) levies a tax on "every person, firm, corporation, club, or association, within the State of Alabama, who sells or stores or receives for the purpose of distribution . . . within the State of Alabama. . . ." any cigarettes or other tobacco products. The Department contends that the Taxpayer is a tobacco wholesaler, and is thus liable for the §40-25-2(a) tax because it sold non-cigarette tobacco products to customers in Alabama for resale during the periods in issue.

The Taxpayer argues that the scope of the §40-25-2(a) levy is narrowed by §40-25-2(f), which provides that the tobacco tax must be collected by "every wholesaler, distributor, jobber, or retail dealer (who) shall add the tax levied herein to the price of the tobacco products sold." It argues that it is not a tobacco "wholesaler," as argued by the Department, because it does not fit the tobacco tax definition of that term. Specifically, the Taxpayer cites §40-25-1(1), which defines "Wholesale Dealer and Jobber" to include "[p]ersons, firms, or corporations who sell at wholesale only, . . . to licensed retail dealers for the purpose of resale only." The Taxpayer's president testified repeatedly at the January 23 hearing that he only sold to Alabama customers that resold the products to wholesalers, and that he never sold to licensed retail dealers in Alabama. The Taxpayer thus contends that because it was not selling to licensed retail dealers in Alabama, it was not a wholesaler liable for the §40-25-2(a) tax.

The Department argues that the Taxpayer is a wholesaler, and at the January 23 hearing identified two of the Taxpayer's Alabama customers that the Department claimed had resold the Taxpayer's products at retail. The Department also asserts that the §40-25-2(a) levy applies to any person or entity selling tobacco products in Alabama, and is thus

broader than the §40-25-2(f) phrase "wholesaler, distributor, jobber, or retail dealer."

I agree that the §40-25-2(a) levy, as enacted in 1935, was by its language intended to broadly apply to any person or entity that sold, received, and/or distributed tobacco products in Alabama. The use of the words "wholesaler, distributor, jobber, or retail dealer" in §40-25-2(f) was not intended to narrow the scope of the levy. Rather, it was the Legislature's attempt to generally identify those persons, firms, corporations, etc. that sell tobacco products in Alabama, and that are thus subject to the §40-25-2(a) levy. But even if the Taxpayer is correct that the levy applies to only wholesalers, distributors, jobbers, and retail dealers, the Taxpayer was still subject to the tax during the periods in issue.

The evidence is inconclusive as to whether the Taxpayer was a "wholesaler" that sold to licensed retail dealers for resale during the periods in issue. It is clear, however, that the Taxpayer was a "distributor" during the subject periods, and thus liable for the §40-25-2(a) tax on its sales in Alabama.

"Distributor" is not defined by Alabama's tobacco tax statutes, Code of Ala. 1975, §40-25-1, et seq. In such cases, a word's commonly understood meaning must be applied. *Custer v. Homeside Lending, Inc.*, 858 so.2d 233 (Ala. 2003). The American Heritage Dictionary, Fourth College Ed., at page 412, defines "distributor," as follows – "One that markets or sells merchandise, esp. a wholesaler." The term "distributor" is thus broader than the term "wholesaler." The Taxpayer undisputedly sold tobacco products, i.e., merchandise, to Alabama customers during the periods in issue. The Taxpayer was

thus a distributor for purposes of the §40-25-2(a) tobacco tax levy.[1]

Alabaman's tobacco tax laws, §40-25-1, et seq., clearly specify that a distributor is subject to the §40-25-2(a) levy. The §40-25-2(a) levy applies to every "person, firm corporation. . ." etc. in Alabama, and thus clearly applies to any distributor that markets or sells tobacco products in Alabama. As indicated, §40-25-2(f) also requires a distributor, among others, to add the tobacco tax to the price of its tobacco products and then collect and remit the tax to the Department. Finally, §40-25-4.1 specifies that the only persons or businesses authorized to purchase tobacco stamps are "wholesalers and distributors."[2]

Concerning the amount of tax assessed, the Taxpayer argues that some of the sales included in the Department audit were closed outside of Alabama, and thus not subject to Alabama tax. It also contends that most if not all of its Alabama customers subsequently reported and paid the tobacco tax due to the Department during the periods in issue. In support of the above claims, the Taxpayer submitted with its reply brief a

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[1] The Taxpayer asserts on page 19 of its reply brief that "the Taxpayer is not itself a definitional wholesaler or distributor under Alabama law." That assertion that the Taxpayer is not a "definitional . . . distributor under Alabama law" is unsupported because the tobacco tax law at §40-25-1, et seq. does not define "distributor." As discussed, the Taxpayer is a distributor under the generally accepted meaning of the word.

[2] Alabama law provides that the tobacco tax levied at §40-25-2(a) shall be paid through the use of tobacco stamps, see §40-25-2(f) – "The tax herein levied shall be paid to the state through the use of stamps," and §40-25-4 – "The license tax imposed by this article shall be paid by affixing stamps" to the various tobacco products.

Section 40-25-2(g) provides, however, that in lieu of using stamps, the Department "may require a monthly report without use of a stamp to report the amount of taxes due. Pursuant to that statute, the Department promulgated Reg. 810-7-1-.08 in 1989. That regulation requires taxpayers that sell non-cigarette tobacco products in Alabama to report and pay the tax due using monthly reports.

statement from Magic City Distribution, Inc., which is located in Birmingham, Alabama. The statement indicates that "[a]ll tobacco products purchased by Magic City Distribution, Inc. from (the Taxpayer) were picked up from (the Taxpayer's) warehouse (in Georgia) by Magic City Distribution, Inc." The statement further indicates that Magic City paid tobacco tax on the products to the State using Alabama Permit No. 738T. See, Exhibit A attached to Taxpayer's reply brief. The statement is dated March 3, 2014, but does not identify the period covered by the statement.

The above statement raises a larger issue. The Department computed the tax due based on the Taxpayer's invoices issued to its Alabama-based customers. It is not in evidence, however, where those sales occurred. The Department concedes that if the sales occurred, i.e., the products were delivered, outside of Alabama, then the Taxpayer would not be liable for Alabama tax on the products. It also concedes that it observed the Taxpayer deliver products to an Alabama customer on only one occasion.

A final assessment is prima facie correct on appeal, and the burden is on a taxpayer to prove it is incorrect. Code of Ala. 1975, §40-2A-7(b)(5)c.3. The burden is thus on the Taxpayer to show (1) that the sales to its Alabama customers during the periods in issue were closed outside of Alabama, and thus not subject to Alabama tax, and/or (2) that its Alabama customers subsequently paid the Alabama tax due on those products.

The Taxpayer is allowed until July 11, 2014 to provide the above proof/information to the Administrative Law Division. The proof/information will then be submitted to the Department for review. I understand the difficulties the Taxpayer faces in obtaining the above information because, as indicated by the Taxpayer, some of its customers during

the periods in issue have closed, and others may not provide the Taxpayer with the information. Perhaps the Taxpayer's invoices might show if the products were delivered to the customer in Alabama or picked up by the customer in Georgia. In any case, the Department should contact Magic City Distribution and confirm that Magic City picked up the products purchased from the Taxpayer at the Taxpayer's warehouse in Georgia during the periods in issue. Appropriate action will be taken after the Taxpayer and the Department respond.

The Department argues that the 50 percent fraud penalty applies because (1) the Taxpayer was notified by the two Department letters in late 2008 that it was liable for Alabama tobacco tax, yet the Taxpayer thereafter never filed Alabama tobacco tax returns and paid the tax due, and (2) someone with the Taxpayer told the Department that the Taxpayer was not delivering tobacco products into Alabama, yet a Taxpayer truck was observed doing so in 2010.

The burden is on the Department to prove fraud by presenting evidence that the Taxpayer willfully intended to evade a known duty to collect and remit Alabama tobacco tax during the periods in issue. Section 40-2A-11(d); *Wade v. CIR*, 185 F.3d 876 (1999); *Zaveri v. State of Alabama*, Docket S. 12-185 (Admin. Law Div. 2/20/2013). The Department has failed to carry that burden in this case.

To begin, the Taxpayer's president denied at the January 23 hearing that he had ever seen the two Department letters sent in late 2008. And there is otherwise no evidence that the Department notified the Taxpayer that it was subject to the Alabama tobacco tax on its sales to its Alabama customers until the Department began auditing the

Taxpayer in 2011.[3] The president also testified that it was and is his belief that his Alabama customers were liable for and required to report and remit all Alabama tax due, and that they in fact did so. Without credible evidence that the Taxpayer's president had actually received notice that the Taxpayer was subject to Alabama's tobacco tax, I cannot find that the Taxpayer knowingly failed to file returns and remit the tax due with the intent to evade tax.

The Department's claim that a Taxpayer employee knowingly misinformed the Department that the Taxpayer was not making deliveries into Alabama is also insufficient to support a fraud penalty.

One of the examiners that audited the Taxpayer testified that someone in the tobacco tax section told him that some unidentified person with the Taxpayer had told someone in the tobacco tax section that the Taxpayer was not making deliveries into Alabama. The above testimony is hearsay evidence, which would be inadmissible in circuit court. But while the circuit court rules of evidence generally apply in proceedings before the Administrative Law Division, the Division is authorized to allow otherwise inadmissible evidence "if relevant or of the type commonly relied upon by prudent persons." Code of Ala. 1975, §40-2A-9(f). Hearsay evidence thus may be allowed in some instances, but the

[3] As discussed, the Department requested information from the Taxpayer in 2009, but the letter specified that the information was not being used to investigate or determine the Taxpayer's Alabama tax liablity. That letter also did not otherwise inform the Taxpayer that it was liable for Alabama tax on its sales to Alabama customers.

double or triple hearsay testimony of the examiner is beyond the pale.[4]

To begin, the examiner was not sure exactly who told him that someone with the Taxpayer had told someone in the tobacco tax section that the Taxpayer did not make deliveries into Alabama. And it is not clear that the someone that made the statement to the examiner was the actual Department employee that had talked to the unidentified person with the Taxpayer. A statement can easily be miscommunicated or lost in translation in such cases, which confirms why hearsay evidence is frowned upon to begin with.

The unidentified Department employee that talked with the unidentified person with the Taxpayer also may not have clearly communicated the question, or the person with the Taxpayer may have misunderstood the question. It is also not known if the unidentified person with the Taxpayer even knew whether the Taxpayer was making deliveries into Alabama. When asked if the Taxpayer was delivering products into Alabama, the person with the Taxpayer could have responded, "not that I know of," and the Department employee could have assumed that answer to mean that the Taxpayer was not making deliveries into Alabama.

Under the circumstances, there is no clear and convincing evidence that the Taxpayer knowingly failed to report and remit the tobacco tax due to the Department with the intent to evade tax. The fraud penalty is thus inapplicable.

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[4] This finding is not meant to reflect on the examiner. I agree with the Department that from past experience, the examiners that audited the Taxpayer are among the Department's best.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered April 21, 2014.

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BILL THOMPSON
Chief Administrative Law Judge

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