

05-0375
Audit
Signed 11/21/2005

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)		
	)	ORDER	
Petitioner,)		
	)	Appeal No.	05-0375
v.)		
	)	Account No.	#####
AUDITING DIVISION OF THE	)	Audit Period:	6/1/03 – 3/31/04
UTAH STATE TAX COMMISSION,	)	Tax Type:	Cigarette Tax &
	)		Sale and Use Tax
Respondent.	)	Presiding:	Chapman

Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER
For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
RESPONDENT REPRESENTATIVE 2, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5 on November 3, 2005.

At issue is the assessment of cigarette tax and sales and use tax to the Petitioner, as imposed by Auditing Division (“Division”) in a Statutory Notice – Cigarette Stamp, dated March 9, 2005. The Division’s assessment imposed tax on the Petitioner’s purchase of ##### cartons (or ##### packs) of cigarettes over a 10-month period from COMPANY, an Internet retailer who shipped the cigarettes from STATE to the Petitioner. The Division claims that the Petitioner failed not only to pay the Utah cigarette tax and the sale and use tax due on these cigarettes, but that he also failed to file cigarette tax returns. The Division assessed a cigarette tax of 69.5 cents per pack of cigarettes and a use tax of 6.5% of the purchase price of each carton, based on the sales tax rate of CITY, Utah, where the cigarettes were delivered. The Division also assessed the Petitioner a \$\$\$\$ penalty for failure to file ##### cigarette tax returns during the audit period. In addition, the Division assessed

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a 10% negligence penalty for failing to remit the use tax due on the purchases. Lastly, interest on both taxes was assessed.

The Petitioner admits that he purchased the cigarettes at issue and states that he purchased them for himself and for friends who did not have credit cards with which to purchase the cigarettes themselves. The Petitioner purports that he was not in the business of selling cigarettes, a fact that the Division does not contest at the Initial Hearing. In fact, the Division states in a pre-hearing brief that the “audit was assessed on the presumption of personal consumption.”

The Petitioner also states that he believed the purchases were “legal” because the United State Post Office delivered the cigarettes and because the Internet site from which he purchased them claimed to be a legal retailer. Furthermore, because all of the packs contained a state cigarette stamp (in this case, a STATE stamp), the Petitioner believed the purchase satisfied all taxation requirements. He further states that he never would have purchased the cigarettes had he known that his actions violated Utah law. Lastly, because the STATE cigarette tax has already been paid on the cigarettes, the Petitioner asks if the requirement to obtain a Utah stamp and pay the Utah tax would be double taxation.

The Division explains that all sales of cigarettes across state lines are reported to the Tax Commission in accordance with federal law known as the Jenkins Act. The Division further explains that for the past two or three years, Internet sellers have started complying with the terms of the Jenkins Act and providing information to the Tax Commission concerning their sales of cigarettes into Utah. The Division explains that it learned of the Petitioner’s purchase from the information that COMPANY provided in accordance with this act. The Division also contends that any purchaser of cigarettes that are taxable in Utah is required to file a Utah cigarette tax return (Tax Commission Form TC-720) and that, if such return is not filed, a penalty for failure to file the return may be assessed. The Division has assessed the Petitioner a \$\$\$\$ penalty, in accordance with Utah Code Ann. §59-1-401, for not filing ##### monthly returns during the audit

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period. The Division also contends that a 10% negligence penalty is appropriate for not paying the use tax as due and that interest may be charged on both of the taxes imposed by the assessment. For these reasons, the Division requests that the Commission sustain the assessments.

The Division proffers that the cigarette tax and sales and use tax requirements have been in place for many years and that the Utah individual income tax return includes a line on which an individual is instructed to include the use tax due on out-of-state purchases on which Utah sales and use tax has not been paid. Furthermore, the Division explains that the Commission issued a public statement in August 2005 to inform the general public that cigarette purchases such as those at issue are and have been subject to Utah cigarette tax and sales and use tax.

APPLICABLE LAW

Cigarette Tax Applicable Law. UCA §59-14-204(1), (2) provides that a tax is levied upon the sale, use, storage, or distribution of cigarettes in Utah at the rate of “3.475 cents on each cigarette.” Subsection 59-14-204(3) provides that the tax shall be paid by any person who is “the manufacturer, jobber, distributor, wholesaler, retailer, user, or consumer.”

Utah Admin. Rule R865-20T-2(A) (“Rule 2”) provides that “[i]f the tax is due as a result of use, storage, or consumption of imported cigarettes, the tax may be paid by affixing stamps or by filing a return prescribed by the Tax Commission.” Section (A)(2) of Rule 2 also provides that returns are due on a monthly basis.

The Utah Cigarette and Tobacco Tax and Licensing Act provides for the imposition of penalties, as set forth in UCA §59-1-401, and interest, as set forth in UCA §59-1-402, in three circumstances, as follows: (1) UCA §59-14-303(6) authorizes the assessment of both penalties and interest when the tobacco products tax has not been paid; (2) UCA §59-14-403 authorizes the assessment of penalties, but not interest, when a “person dealing in taxable cigarettes” does not mail or deliver a duplicate invoice of all purchase, if

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requested by the commission; and (3) UCA §59-14-407(4)(b) authorizes the assessment of penalties, but not interest, when a “manufacturer, distributor, wholesaler, or retail dealer” required to submit a quarterly report under that section fails to do so.

Sale and Use Tax Applicable Law. UCA §59-12-103(1)(a) provides that “[a] tax is imposed on the purchaser as provided in this part for amounts paid or charged for . . . retail sales of tangible personal property made within the state[.]”

For sales subject to taxation under Section 59-12-103, UCA §59-12-107(1)(d) provides that a person shall pay a use tax, as follows:

A person shall pay a use tax imposed by this chapter on a transaction described in Subsection 59-12-103(1) if:

- (i) the seller did not collect a tax imposed by this chapter on the transaction; and
- (ii) the person:
 - (A) stores the tangible personal property in the state;
 - (B) uses the tangible personal property in the state; or
 - (C) consumes the tangible personal property in the state.

Utah Admin. Rule R865-21U-6 (“Rule 6”) provides for the payment of use tax as follows, in pertinent part:

A. Purchasers of tangible personal property - the storage, use, or other consumption of which is subject to tax - must account for the tax liability by paying the tax:

.....
2. directly to the Tax Commission if the retailer from whom the property was purchased does not hold a certificate of registration. Under these circumstances, one of the following procedures must be followed:

- (a) if the purchases are made by a business required by Section 59-12-106 to hold or obtain a sales tax license or a use tax certificate of registration, the tax is paid on a sales and use tax return;
- (b) if the purchases are made by any person as defined in Utah Code Ann. Section 59-12-102, who has no sales tax collection responsibility, and if the annual taxes due may be reasonably expected to exceed \$400, such person must apply for registration as a consumer and pay the tax using a quarterly use tax return; or
- (c) if the purchases are made by an individual who has no sales tax collection responsibility and the annual use tax liability is less than \$400, the tax is

remitted using the individual income tax return filed each year. The tax is computed by using the rates provided in the income tax instructions for the address of the consumer as shown on the individual income tax form. . . .

UCA§59-12-107(10)(c) provides that “[e]ach person who fails to pay any tax to the state or any amount of tax required to be paid to the state . . . within the time required by this chapter . . . shall pay, in addition to the tax, penalties and interest as provided in Section 59-12-110.” UCA§59-12-110(4) provides that

- (a) Subject to the provisions of Subsection (4)(b), the commission may impose on a deficiency under this section:
 - (i) a penalty as provided in Section 59-1-401; and
 - (ii) interest as provided in Section 59-1-402.
- (b) The commission may impose a penalty and interest on the entire deficiency if any part of the deficiency is due to:
 - (i) negligence;
 -

Individual Income Tax Applicable Law. UCA §59-10-539(1) provides for the imposition of penalty and interest, pertinent parts as follow:

-
- (2) If any part of any deficiency in tax imposed by this chapter, as defined by Section 59-10-523, is due to negligence or intentional disregard of rules, but without intent to defraud, a penalty shall be assessed, collected, and paid as provided in Section 59-1-401 in the same manner as if it were an underpayment.
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- (8) In addition to the penalties added by this section, there shall be added to the tax due interest payable at the rate and in the manner prescribed in Section 59-1-402 for underpayments.

UCA §59-10-537 provides for the payment of interest as prescribed in Section 59-1-402 if any amount of income tax is not paid on before the last date prescribed in the Individual Income Tax Act for payment.

UCA §59-10-514 provides that, in most instances, an individual income tax return shall be filed “on or before the 15th day of the fourth month following the last day of the taxpayer's taxable year[.]”

General Penalty and Interest Applicable Law. UCA §59-1-401(1) provides that the “penalty for failure to file a tax return within the time prescribed by law including extensions is the greater of \$20 or 10% of the unpaid tax due on the return.”

UCA §59-1-401(5)(a)(i) provides that “if any underpayment of tax is due to negligence, the penalty is 10% of the underpayment.”

UCA §59-1-402(5) provides that “[i]nterest on any underpayment, deficiency, or delinquency of any tax or fee administered by the tax commission shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.”

Furthermore, in those situations where penalty and interest have been properly imposed, the Tax Commission is granted the authority to waive, reduce, or compromise penalties and interest upon a showing of reasonable cause. Utah Code Ann. §59-1-401(10).

DISCUSSION

The Petitioner purchased cigarettes from an Internet site that did not collect and remit Utah cigarette tax or Utah sales and use tax. The Division’s assessment imposes both taxes on the Petitioner’s purchases that occurred during a 10-month period, June 1, 2003 and March 31, 2004. The Division imposed the Utah cigarette tax of 4.375 cents per cigarette (69.5 cents per 20-cigarette pack), a \$\$\$\$ penalty for the failure to file each of ##### cigarette tax return that became due during the audit period, and interest on the unpaid cigarette tax. The Division also imposed Utah use tax, a 10% negligence penalty concerning the nonpayment of the use tax, and interest on the unpaid use tax. Although the Petitioner claims to have purchased some of the cigarettes for his friends, he also claims that he is not a cigarette dealer or in the business of selling cigarettes. The Division confirms that it considers the Petitioner to have purchased the cigarettes for personal use.

Cigarette Tax. Section 59-14-204 imposes a Utah cigarette tax of 3.475 cents per cigarette

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upon any user or consumer of cigarettes. The testimony and evidence proffered shows that, during the audit period, the Petitioner purchased and consumed (or used) ##### packs of cigarettes, each pack containing ##### cigarettes, on which Utah cigarette tax was not paid. In accordance with Section 59-14-204, the Petitioner is required to pay a cigarette tax of 69.5 cents per 20-cigarette pack. For this reason, the Commission sustains the Division's assessment of cigarette tax in the amount of \$\$\$\$\$.

The Petitioner states that the cigarettes at issue all had a STATE cigarette stamp affixed to the packs and inquires whether the requirement of a Utah stamp, as well, would result in double taxation. The answer is no. Multiple jurisdictions may impose their individual taxes without the result deemed double taxation. For example, both a federal government and a state government may tax the same income. Furthermore, many states apply sales tax to the same sales transaction. Furthermore, Utah law does not provide for a credit against Utah cigarettes taxes due for cigarette taxes already paid to another jurisdiction.

Penalty for Not Filing Cigarette Tax Returns. Utah Admin. Rule R865-20T-2 provides that if the cigarette tax is due as a result of use, storage, or consumption of imported cigarettes, the tax may be paid by affixing stamps or by filing a return on a monthly basis. Because the cigarette tax was due and the Petitioner did not affix the required Utah cigarette stamps, he was required, under the rule, to file a monthly return and pay the tax. The Petitioner did not file any of the nine monthly returns that became due during the audit period in a timely fashion, so the Division assessed a \$\$\$\$\$ penalty for each of the ##### violations in accordance with Section 59-1-401(1)(a).

Section 59-1-401(1)(a) provides only the amount of the penalty for failure to file a tax return within the prescribed time. Accordingly, this statute alone is inadequate to justify the imposition of a penalty under these circumstances. A statute that **imposes** the penalty must also exist.¹ No statute exists that imposes

¹ See *Jensen v. State Tax Comm.n*, 835 P.2d 965 (Utah 1992), in which the Utah Supreme Court determined that the Tax Commission cannot rely on a general provision in 59-1-401 to penalize a taxpayer, but must instead find some basis

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the Section 59-1-401(1)(a) penalty upon a user or consumer who fails to file a cigarette tax return, as required under Rule 2, within the prescribed time. Accordingly, the Commission overturns the nine penalties for failure to file a cigarette tax return within the prescribed time.

Interest on Cigarette Tax. The Division also assessed interest from the date each cigarette tax return was due on the basis of Section 59-1-402(5). Section 59-1-402(5) provides that “[i]nterest on any underpayment, deficiency, or delinquency of any tax or fee administered by the tax commission shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.”

As with the penalty discussed above, there exists no statute in the Cigarette and Tobacco Tax and Licensing Act that imposes interest on unpaid cigarette taxes. However, the Commission believes that the “shall be computed” language of the general statute, Section 59-1-402(5), is sufficient not only to provide the basis for how to calculate interest, but also to impose interest for any violation that occurs in tax chapters not excluded in Subsection 59-1-402(7). Because the Cigarette and Tobacco Tax and Licensing Act is not excluded in Subsection 402(7), the general statute, Section 59-1-402(5) applies to all violations of the Cigarette and Tobacco Tax and Licensing Act that result in tax being due, including the Petitioner’s failure to pay the cigarette taxes that were due. Accordingly, the Commission sustains the Division’s imposition of interest on the unpaid cigarette taxes.

Use Tax. The Petitioner purchased cigarettes that were delivered to him from an out-of-state retailer. These transactions are considered Utah retail sales of tangible personal property and, in accordance with Section 59-12-103(1)(a), are subject to Utah sales and use tax. In addition, the retailer from whom the Petitioner purchased the cigarettes did not collect and remit Utah sales and use tax to Utah on the transactions. Section 59-12-107(1)(d) provides that, under these circumstances, the purchaser (the Petitioner) shall pay the

in the tax chapter.

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Utah use tax that is due. The Division assessed the Petitioner use tax based on 6.5% of the purchase price, claiming that 6.5% is the tax rate for the Petitioner's CITY, Utah address. The Petitioner did not challenge that his home address is in CITY, Utah or that the sales tax rate for CITY is 6.5%. For these reasons, the Commission finds that the Petitioner is required to pay use tax in the amount imposed by the Division in its assessment.

Pursuant to Utah Admin. Rule R865-21U-6(A)(2)(c), the Division contends that the Petitioner should have paid the use tax he owed by claiming and paying the liability on his individual income tax returns for the 2003 and 2004 income tax years. By assessing the use tax, the Division asserts that the Petitioner did not pay the required use tax when he filed his income tax returns for these years, which were due on April 15, 2004 for the 2003 income tax year and April 15, 2005 for the 2004 tax year. The Division imposed its assessment on March 9, 2005. Accordingly, that portion of the Division's use tax assessment relating to 2004 purchases was imposed prior to its becoming delinquent, because the use tax on the Petitioner's 2004 purchases would not have due until April 15, 2005, the date his 2004 individual income tax return was due. However, as of the date of the hearing, the entire amount of use tax was due. Although the Division proffered no income tax returns to show that the Petitioner failed to claim and pay the use tax that it imposed, the Petitioner, who has the burden of proof, did not assert that he had already paid the use tax. In fact, he claims not to have known it was due or how it should have been paid. Accordingly, the Commission sustains the Division's assessment of use tax.

10% Negligence Penalty for Failing to Pay Use Tax. In Sections 59-10-107(10)(c) and 59-12-110(4), the Utah Sales and Use Tax Act provides that deficiencies under that act, which includes deficiencies of use tax, may be subject to penalties as provided in Section 59-1-401, including negligence penalties. Furthermore, Section 59-10-539(2) provides that if a deficiency in tax imposed under the Individual Income Tax Act is due to negligence, a penalty may be assessed as provided in Section 59-1-401. UCA §59-1-

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401(5)(a)(i) provides that “if any underpayment of tax is due to negligence, the penalty is 10% of the underpayment.” From these authorities, the Commission finds that the Division may impose a negligence penalty of 10% if the Petitioner’s actions that resulted in the nonpayment of the use tax are deemed negligent.

The Division’s Statutory Notice indicates that the Division imposed a 10% negligence penalty on the unpaid use tax “because a reasonable attempt to remit the tax due was not made.” The Petitioner claims that he did not pay the tax because he did not know it was due, first because he thought Internet sales were nontaxable and second, because he thought he was purchasing the cigarettes from an (X) whose sales were tax-exempt.

In *Hales Sand & Gravel v. Audit Division*, 842 P.2d 887 (Utah 1992), the Utah Supreme Court set forth the conditions under which the Tax Commission may impose a negligence penalty. The Court stated that the “negligence penalty is appropriate when the taxpayer has failed to pay taxes and a reasonable investigation into the applicable rules and statutes would have revealed that the taxes were due.” Furthermore, the Court stated that the “taxpayer can escape the penalty if he or she can show that he or she based the nonpayment of taxes on a legitimate, good faith interpretation of an arguable point of law.”

In this case, the Commission does not find the Petitioner’s defense to be a legitimate, good faith interpretation of an arguable point of law and believes that a reasonable investigation into the applicable law would have shown him that his purchases were subject to use tax. Accordingly, the Commission finds that the Division correctly determined that the Petitioner’s actions were negligent.

Nevertheless, the Commission may waive a penalty, including a negligence penalty, for reasonable cause shown. The Petitioner stated, in what appeared to be an earnest manner, that he did not know the transactions to be taxable and was unaware that Internet transactions were could result in use tax. Furthermore, all purchases at issue occurred prior to the Commission’s August 2005 public announcement informing the public that it had access to its Internet cigarette purchases and, as provided by law, would be

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assessing tax on them. For these reasons, the Commission finds sufficient reasonable cause to waive the negligence penalty.

Interest on Use Tax. The Division imposed interest on the unpaid use tax, calculating the interest based on the time that has elapsed since each of the ##### cigarette tax returns, as discussed earlier, was due. Such an imposition of interest is incorrect. The use tax due under these circumstances is reported and paid on the Petitioner's income tax returns, not cigarette tax returns. Section 59-10-537 imposes interest, as prescribed in Section 59-1-402, if tax due on an income tax return is not paid before the last date prescribed in the Individual Income Tax Act for payment. Section 59-10-514 provides that, in most instances, an individual income tax return shall be filed "on or before the 15th day of the fourth month following the last day of the taxpayer's taxable year[.]" Section 59-1-402(5) provides that interest "shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received."

Accordingly, any use tax due on purchases made in 2003 would not have been due until the due date of the 2003 income tax return, April 15, 2004 and, on purchases made in 2004, not until the due date of the 2004 return, April 15, 2005. The Petitioner has not shown that he received an extension to file either of these income tax returns. Accordingly, the Commission finds that interest is due on the use tax associated with the Petitioner's 2003 cigarette purchases and should be calculated from the April 15, 2004 due date of the 2003 income tax return. Similarly, the Commission finds that interest is due on the use tax associated with the Petitioner's 2004 cigarette purchases and should be calculated from the April 15, 2005 due date of the 2004 income tax return.

Conclusion. In summary, the Commission: 1) sustains the Division's assessment of cigarette tax; 2) overturns and, thus, abates the Division's assessment of ##### penalties, each in the amount of \$\$\$\$\$, for failure to file cigarette tax returns in a timely manner; 3) sustains the Division's assessment of interest on the unpaid cigarette tax; 4) sustains the Division's assessment of use tax; 5) approves the Division's assessment

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of a 10% negligence penalty for failure to report and pay use tax, but waives the penalty due to reasonable cause shown; and 6) finds that interest is due on the unpaid use tax, but in an amount different from that which the Division imposed. The Commission finds that the interest due on the unpaid use tax should be calculated from April 15, 2004 for 2003 purchases and from April 15, 2005 on 2004 purchases.

DECISION AND ORDER

Based upon the foregoing, the Commission sustains the cigarette tax and the use tax that the Division imposed, as well as the interest charge associated with the cigarette tax. The Commission overturns and, thus, abates the ##### penalties that the Division imposed for failure to file cigarette returns. Furthermore, the Commission waives, for reasonable cause shown, the 10% negligence penalty for failure to pay use tax. Lastly, the Commission finds that the Division improperly calculated the interest due on the use tax and orders the Division to revise its use tax interest assessment as set forth in this Order. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2005.

Kerry R. Chapman
Administrative Law Judge

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BY ORDER OF THE UTAH STATE TAX COMMISSION:

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2005.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

Notice: If a Formal Hearing is not requested as discussed above, failure to pay the balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty.

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