

Letter of Findings: 05-20210141
Cigarette Tax
For the Years 2018 through 2020

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department disagreed with mid-level Cigarette Distributor that it presented evidence sufficient to warrant abating the Department's assessment of additional cigarette tax; Cigarette Distributor failed to present verifiable, contemporary records which would have justified such an adjustment.

ISSUE

I. Cigarette Tax - Imposition.

Authority: IC § 6-7-1-1; IC § 6-7-1-17; IC § 6-7-1-19; IC § 6-8.1-5-4; [IC 6-8.1-5-1](#); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 8.1-1-1](#) Tobacco Tax Software and Services, tobtax.avior.tax

Taxpayer argues that the Department's assessment of additional cigarette tax is overstated because it can now provide documentation establishing that a number of the audit entries were erroneous resulting in an inflated amount of cigarettes sold during the audit period.

STATEMENT OF FACTS

Taxpayer is an Indiana mid-level tobacco and cigarette distributor. Taxpayer purchases these products from out-of-state vendors and then resells the cigarettes and tobacco products to its own Indiana retail business and to unrelated retailers. Taxpayer sells to in-state down-stream retailers.

During the time in which the cigarettes were in Taxpayer's possession, Taxpayer purportedly bought and applied an Indiana tax stamp to each individual cigarette package. These stamps were purchased and paid for by the Taxpayer. Taxpayer's purchase of the stamps was considered an "advance payment" collected for "convenience [sake] with the cost of the tax eventually added to the price paid by the ultimate consumer."

The Indiana Department of Revenue conducted an audit review of Taxpayer's tax returns, business records, bank records, and inventory records. The Department reviewed Taxpayer's monthly CIG-M ("Monthly Return for Cigarette Distributors") reports.

The audit reviewed a selected sample of invoices documenting cigarette sales to retail outlets. The audit also reviewed other documents and found shortcomings in both Taxpayer's monthly returns and its own hand-written inventory records.

The audit report stated that Taxpayer "failed to report the brand details on their cigarette ending inventory." In addition, the audit found that Taxpayer failed to reconcile monthly "tax paid" sales. The audit report explained that Taxpayer "failed to carry forward the prior month ending inventory as the beginning inventory for the next month." For example, Taxpayer may have reported that it had possessed 100 cases of cigarettes at end-of-day December 31, 2021 but did not report that same number as the January 1 starting number.

The audit reviewed the inventory and purchase records to "confirm the correct amount of cigarettes subject to tax." The Department calculated the amount of cigarettes subject to tax (amount stamped) not necessarily the

sales amount. In Taxpayer's case, the calculation started with the beginning number of unstamped cigarettes, adding that number to the number of unstamped purchases, and then subtracting the unstamped ending inventory. This calculation resulted in the number of cigarettes subject to tax. In turn, the audit's calculation resulted in the \$90,000 assessment of additional cigarette tax. That assessment reflects the inventory corrections and unstamped purchase adjustments.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Cigarette Tax - Imposition.

DISCUSSION

This protest is about whether a distributor accurately accounted for the number of cigarettes which passed through Taxpayer's facility. The Department found Taxpayer failed to account for all the cigarettes which it bought and sold. Taxpayer argues that it can now provide an accurate accounting.

A. Burden of Proof.

As a threshold issue, it is the Taxpayer's responsibility to establish that cigarette tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In making its case, a taxpayer is required to provide documentation explaining and supporting his or her argument that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

B. Statement of Law - Cigarette Tax.

A distributor, such as Taxpayer may find itself in a position of owing additional cigarette tax. IC § 6-7-1-1 provides in part:

It is the intent and purpose of this chapter to levy a tax on all cigarettes sold, used, consumed, handled, or distributed within this state, and to collect the tax from the *person who first sells, uses, consumes, handles, or distributes the cigarettes*. It is further the intent and purpose of this chapter that whenever any cigarettes are given for advertising or any purpose whatsoever, they shall be taxed in the same manner as if they were sold, used, consumed, handled, or distributed in this state. Notwithstanding any other provisions contained in this chapter, the liability for the excise taxes imposed by this chapter shall be conclusively presumed to be on the retail purchaser or ultimate consumer, pre-collected for convenience and facility only. When such taxes are paid by any other person, *such payment shall be considered as an advance payment* and shall be added to the price of the cigarettes and recovered from the ultimate consumer or user. (*Emphasis added*).

The Department's regulation, [45 IAC 8.1-1-1](#) restates the principle.

The cigarette tax imposed by [IC 6-7-1](#) is collected from the person or company who first sells, uses, consumes, handles, or distributes cigarettes within Indiana. The *tax must be initially collected by the person or company engaged in the business of selling or purchasing cigarettes in Indiana as a distributor*. (*Emphasis added*).

As a licensed Indiana distributor, Taxpayer is acting as and has the responsibility of an Indiana agent. IC § 6-7-1-17(a) provides in relevant part:

Distributors who hold certificates and retailers shall be agents of the state in the collection of the taxes imposed by this chapter and the amount of the tax levied, assessed, and imposed by this chapter on cigarettes sold, exchanged, bartered, furnished, given away, or otherwise disposed of by distributors or to retailers. Distributors who hold certificates *shall be agents of the department* to affix the required stamps (Emphasis added).

As a licensed Indiana distributor and as Indiana's agent, Taxpayer is required to prepare, maintain, and make available records documenting the purchase and sale of cigarettes. IC § 6-7-1-19(a) in part provides:

Every distributor of cigarettes shall keep and preserve for three (3) years records and invoices, showing the purchase and sale of all cigarettes. Such distributors shall also keep separate invoices, and records of stamps purchased. All the aforementioned records, invoices, and stocks of cigarettes and unused stamps on hand shall be open to inspection by the department at all reasonable times.

The Department here refers to Indiana's own general record keeping requirement found at IC § 6-8.1-5-4(a).

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts and canceled checks.

C. The Department's Audit.

During the years under audit, the audit report found that the taxpayer had distributed approximately 3,900,000 more cigarettes than originally reported. That number is a result of two types of inventory adjustments and certain unstamped purchase adjustments. The first inventory adjustment was the result of reconciling each month's beginning unstamped inventory with the previous month's ending unstamped inventory. (Note these are instructions printed on the CIG-IS supporting schedule.) The second inventory adjustment stemmed from the fact that the beginning unstamped inventory and the ending unstamped inventory of the audit period did not match the physical inventories counted by the auditors in either the current or prior audit.

In December 2018, the [T]axpayer reported a beginning inventory of 4,887,200 sticks (cigarettes) that did not match the ending physical count from the prior audit of 7,626,000. An adjustment to the cigarette beginning inventory was made to match the prior audit cigarette ending inventory.

. . . .

In July 2019, the [T]axpayer reported beginning inventory of 5,418,600 sticks that did not match the ending inventory sticks figure of 7,638,200 for June 2019. An adjustment to the cigarette beginning inventory was made to match the prior audit cigarette ending inventory.

The Department's audit found other errors. For example:

Upon reviewing the September 2019 purchases, the auditors found that the [T]axpayer misreported their untaxed purchases for 12,000 sticks on [vendor] invoice no. 42745. The [T]axpayer reported 540,000 sticks but the invoice showed 528,000 sticks. An adjustment was made to the Cigarette Untaxed Purchases for September 2019 for (12,000) sticks.

In another portion of the audit report, the report stated:

During the review of the July 2020 ending inventory count, the auditors discovered that the [T]axpayer overstated the cigarette ending inventory amount. The error occurred because the [T]axpayer included Indiana stamped cigarettes on hand as part of their cigarette ending inventory. For a resident distributor, the inventory should only include unstamped cigarettes and other state cigarettes as inventory on . . . the CIG-M return. An adjustment of 341,840 sticks was made to correct the July 2020 cigarette ending inventory.

The Department's audit also took note of "variances" between Taxpayer's inventory of unused cigarette stamps and the amount of cigarette tax due. As a result, "Monthly reported overage/shortage amounts were netted with the stick and stamp audit adjustments within each audit period, resulting in a net shortage for the audit period."

D. Taxpayer's Response to the Audit Report Findings.

Taxpayer points out that its previous audit - covering through November 2018 - resulted in "zero findings."

Taxpayer explains that variances marked by apparent discrepancies between monthly "ending" inventory and the next month's "beginning" inventory are all attributable to "an error made by Avior a third-party tax reporting service" and Taxpayer was "not aware of [this error] at the time this audit began."

Taxpayer explains further Avior's error:

[Avior's error] started a chain causing the other findings in this as each month was reviewed and reconciled individually instead of examining a defined audit period as a whole, as had been done in all previous audit.

According to Taxpayer, Avior's error was not corrected until July 20, 2020, and with Avior's initial error "it was never going to be possible to have an accurate counting of what the entire picture looked like for this audit period."

Taxpayer's representative concludes that he has "re-examined all of the business transactions and inventory/sales figures for this entire audit period as a whole and I believe that it can be proven that the tax liability resulting from this audit is in error."

For clarity's sake and not as an authoritative reference, publicly available information describes Avior as providing "a line of tax automation products that streamline and simplify all aspects of tobacco and vapor products taxes lifecycle – compute, report, collect – of tobacco taxes for U.S. jurisdictions". Tobacco Tax Software and Services, tobtax.avior.tax (Last visited January 12, 2022).

Taxpayer argues that the error (or errors) committed by Avior dominoed forward and that the error (or errors) was/were compounded month-by-month. Taxpayer explains that it now can provide the actual beginning inventory and the final inventory for the audit period and that the difference between those two amounts represents a reliable accounting for the cigarettes it processed during the December 2018 to July 2020 audit period. However, that is not the procedure required of Taxpayer. Indiana does not determine tax liability in the manner suggested by Taxpayer. The Department is required to conduct an actual physical count that then can be reconciled to beginning inventory amounts, cigarette purchases, returned inventory, and inventory adjustments.

In addition, Taxpayer has not followed through on its own proposal. Taxpayer has not provided the Avior beginning inventory count and has not provided the Avior closing inventory. Even if those numbers were available, it is not known whether that number somehow corresponds to what was reported on the original returns. If it does not correspond, Taxpayer has not provided any explanation that would account for discrepancies.

The Department is unable to agree that Taxpayer has met its burden of establishing that the assessment was "wrong". Without hard and verifiable information, the Department is unable to sustain Taxpayer and set aside the original assessment.

FINDING

Taxpayer's protest is respectfully denied.

March 1, 2022

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An [html](#) version of this document.