



TAX BULLETIN 08-13
Virginia Department of Taxation
December 11, 2008

CIGARETTE TAX

INCREASED COMPLIANCE EFFORTS

In Virginia Tax Bulletin 07-3 (March 15, 2007), the Department of Taxation (TAX) announced increased compliance efforts for the enforcement of the cigarette tax and put in place some temporary rules regarding the application of penalties. This Tax Bulletin supersedes Virginia Tax Bulletin 07-3, effective December 1, 2008, and provides additional information and modifies the rules regarding the assessment of cigarette tax penalties and the procedures for appealing these penalties.

The Virginia cigarette tax is currently imposed at the rate of 30 cents per pack of 20 cigarettes and the payment of the tax is evidenced by affixing a Virginia Cigarette Revenue Stamp. Stamping agents must affix the stamps within one business day of receipt of any unstamped cigarettes. Unless exempt by law, all packs of cigarettes must be stamped by a licensed stamping agent prior to shipping the product to wholesale or retail dealers in Virginia.

Stamping Exemptions

A stamping agent may sell cigarettes without the Virginia revenue stamp affixed if:

1. The cigarettes are sold to a cigarette dealer in another state;
2. The cigarettes are purchased exclusively for resale in the other state; and
3. The cigarettes sold into the other state are at the time of sale stamped with the other state's cigarette stamp by the Virginia wholesale dealer.

A stamping agent may also sell cigarettes without the Virginia revenue stamp affixed if:

1. The cigarettes are being sold to the United States or an instrumentality of the United States for purposes of resale to or for the use or consumption by members of the armed services;

2. The cigarettes are being sold to the Veterans Canteen Service of the Veterans Administration for resale to or for the use or consumption by veterans of the armed services who are hospitalized or domiciled in Veterans Administration homes and hospitals, or
3. The cigarettes are being sold and delivered to ships regularly engaged in foreign commerce or coastwise shipping between points in this Commonwealth and points outside of this Commonwealth for resale to or for use or consumption upon such ship or in foreign commerce.

Penalties Applicable to Licensed Stamping Agents

Any stamping agent who fails to properly affix the required stamps to any cigarettes is subject to a maximum penalty of \$250 per pack if the amount of unstamped cigarettes is 100 packs or less. If the amount of unstamped cigarettes exceeds 100 packs the stamping agent is subject to a maximum penalty of \$500 per pack. Where willful intent to defraud the Commonwealth of the cigarette tax is found, the stamping agent is subject to a maximum penalty of \$2,500 per pack. If the number of unstamped packs exceeds (i) 30 packs or 5% of the cigarettes in the stamping agent's place of business, whichever is greater, or (ii) more than 500 packs, such possession shall be prima facie evidence of intent to defraud. *Va. Code* § 58.1-1013. As set forth below, in limited circumstances, TAX may assess less than the maximum penalty provided under *Va. Code* § 58.1-1013 to licensed stamping agents in the amounts set forth in the Cigarette Tax Penalty Assessments schedule below. In addition to the penalties imposed, the stamping agent is liable for the cigarette excise tax on all unstamped cigarettes.

If a stamping agent believes that he has delivered unstamped cigarettes to a customer, he has a duty to immediately notify his customer of the situation and take action to remove any unstamped cigarettes from sale by the customer. The stamping agent must also notify TAX of the situation by emailing the Tobacco Unit at tobacco@tax.virginia.gov and providing the name and address of each customer who may have been shipped unstamped cigarettes and the steps taken by the stamping agent to correct the error. Additionally, the stamping agent must remit any unpaid cigarette tax to TAX.

Penalties Applicable to Persons Other than Stamping Agents

Any person who is not a stamping agent who sells, purchases, transports, receives or possesses less than 3,000 packs of unstamped cigarettes for the purpose of evading taxes is subject to a maximum penalty not to exceed \$500 per pack. Any person who is not a stamping agent who sells, purchases, transports, receives or possesses 3,000 packs or more of unstamped cigarettes for the purpose of evading taxes is subject to a penalty not to exceed \$2,500 per pack. If a person who (i) has not been issued a permit to affix revenue stamps by TAX or (ii) is not a retail dealer who has lawfully purchased cigarettes from such permit holder has in his possession within the Commonwealth

more than 30 packs of unstamped cigarettes, such possession is presumed to be for the purpose of evading taxes. *Va. Code* § 58.1-1017. Any person subject to the penalty imposed by this section is also liable for the cigarette excise tax on all unstamped cigarettes.

Cigarette retailers and wholesalers who are not stamping agents must carefully inspect every pack of cigarettes at the time of delivery or receipt to ensure that every pack of cigarettes has been stamped with the Virginia Revenue Stamp. In the event that unstamped cigarettes are discovered, the dealer should immediately segregate the unstamped cigarettes and post a notice on the cigarettes stating that they are unstamped and not for sale. Additionally, the dealer should immediately telephone or e-mail its supplier to notify the supplier of the situation and arrange for the return of the unstamped cigarettes to the supplier. Stamping agents and dealers are strongly encouraged to revisit their quality control procedures so that unstamped cigarettes are neither shipped nor received into inventory.

TAX has created a system of graduated penalties for use in situations where the amount of unstamped cigarettes held by a retailer or wholesaler, who is not a stamping agent, is less than 3,000 packs. While penalties will be imposed in most instances as listed in the following chart, TAX reserves the right to depart from the penalties listed below when required by circumstances and to impose the maximum penalty allowed under the law. An example of circumstances where TAX may depart from the penalties listed below is where there are recurring assessments. For purposes of this graduated system of penalties, each retail or wholesale location will be treated separately when determining the amount of unstamped cigarettes held by a retailer or wholesaler and the penalty amount involved.

CIGARETTE TAX PENALTY ASSESSMENTS

| # PACKS | PENALTY PER PACK |
|----------------|-----------------------------|
| 1-30 | Warning Letter |
| 31-100 | \$50 |
| 101-250 | \$100 |
| 251-2,999 | \$250 |

The monetary penalties listed above apply to every unstamped pack of cigarettes held by a retailer or wholesaler who is not a stamping agent, not just the number of packs of unstamped cigarettes in excess of 30 packs.

A retail dealer can avoid the penalties listed above by proving to TAX that the unstamped cigarettes were lawfully purchased from a licensed Virginia Stamping Agent. In order to prove that the cigarettes were purchased lawfully, the retailer must provide a copy of the invoice from the stamping agent and physical proof that the unstamped cigarettes were purchased from that stamping agent. The following are examples of physical proof:

1. A signed affidavit from the stamping agent stating the stamping agent sold the unstamped product in question to the retailer;
2. Distinctive numbering, lettering, marking, labeling, bar codes or other features reflecting that the cigarettes were sold by the stamping agent; or
3. Physical observation by a TAX auditor that:
 - a. The unstamped cigarettes are segregated from other inventory;
 - b. The unstamped cigarettes are clearly posted as being unstamped and not for sale; and
 - c. The dealer is able to document that the stamping agent has been contacted by the dealer concerning the unstamped packs no more than 15 days prior to the date of physical inspection by the auditor.

By signing an affidavit, the stamping agent acknowledges that it sold the unstamped product in question to the retailer and that it may be liable for the penalty imposed pursuant to Va. Code § 58.1-1013. In the event that the retailer can provide proof that the cigarettes were purchased from a licensed Virginia Stamping Agent, TAX will refrain from assessing the penalty imposed under Va. Code § 58.1-1017 on the retailer. In these cases, TAX will assess upon the stamping agent the penalty imposed under Va. Code § 58.1-1013. This penalty will typically not exceed the penalty that would have been assessed to the retailer under Va. Code § 58.1-1017 under the Cigarette Tax Penalty Assessments schedule above.

The reduced penalties set forth in the Cigarette Tax Penalty Assessments schedule are intended to address situations where the failure to stamp the cigarettes was unintentional, such as cases of employee or machine error. In such cases, TAX will typically not make further reductions in penalties on appeal or pursuant to an offer in compromise, unless exceptional circumstances are present.

Appeals

Any person assessed with cigarette tax or penalties may apply for relief to the Tax Commissioner by filing a complete appeal within ninety days from the date of the assessment. More information regarding the filing of administrative appeals may be found in the Administrative Appeal Guidelines for Tax Assessments Issued by the

Virginia Department of Taxation, Public Document 06-140, (November 29, 2006). The Administrative Appeals Guidelines can be found in TAX's Policy Library at www.policylibrary.tax.virginia.gov/OTP/policy.nsf.

A third party may always provide information, testimony, or documentary evidence on behalf of a taxpayer who has been assessed cigarette tax or penalties. However, a properly executed Power of Attorney is needed in order for a third party to file an administrative appeal on behalf of a taxpayer. The Power of Attorney must be signed and dated by both the taxpayer and the taxpayer's representative and must accompany the administrative appeal. Form PAR 101, Power of Attorney and Declaration of Representative can be found on TAX's website, www.tax.virginia.gov. Any other Power of Attorney form containing the same information will also be accepted by TAX. The authority given by the Power of Attorney does not include the power to receive refund checks, the power to substitute another representative, the authority to execute a request for a tax return or the power to sign certain returns, or a consent to disclose tax information unless specifically indicated on the form by the taxpayer.

An appeal may be brought by the person assessed with cigarette tax or penalties if the person believes that TAX has incorrectly assessed the cigarette tax or penalties. Taxpayers seeking to have cigarette tax or penalties abated based on claims that machine error or employee error resulted in unstamped cigarettes being possessed or sold should file an offer in compromise as discussed below.

Offers in Compromise

Any person assessed with cigarette tax or penalties may choose to make an offer in compromise to settle for less than the full amount. Under *Va. Code* § 58.1-105, TAX may accept an offer in compromise if the taxpayer can show that there is reasonable cause for reducing or waiving the penalty or can show doubtful liability or collectibility for reducing or waiving the tax and interest. While penalties may be reduced or waived entirely with good cause, taxes and interest may not be waived unless it can be shown that the tax liability is doubtful, or that it is doubtful that the bill can be collected. TAX will generally not consider machine error or employee error as good cause for waiving or reducing penalties below the amount of the reduced penalties set forth in the Cigarette Tax Penalty Assessments schedule above.

To request an offer in compromise, the person assessed should write to the Tax Commissioner describing the type of tax involved, taxable period, date and amount of the bill, and include a detailed explanation, along with supporting documentation, of the reasons why the tax, penalty or interest should be reduced or waived. A check for the amount of the offer should be included with the letter. The check will be applied to the account. The deposit of the check does not indicate the acceptance or denial of the offer. An explanation of when and how payment will be made should be provided if no payment is made with the offer submission. If the offer is made because the person

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assessed is unable to pay the bill, a signed Financial Information Statement must be included. This form is available from TAX's website, www.tax.virginia.gov. The proposal will be considered based on the available information. If the Tax Commissioner accepts the offer, any amounts waived will be removed from the bill. If the offer is not accepted, the balance of the bill must be paid.

All appeals and any offer in compromise based upon a claim of doubtful liability, along with supporting documentation, should be mailed to:

Appeals and Rulings
P.O. Box 27203
Richmond, VA 23261-7203

All other offers in compromise, along with supporting documentation, should be mailed to:

Tax Commissioner
Department of Taxation
P.O. Box 2475
Richmond, Virginia 23218-2475

If you have any questions please contact the Tobacco Tax Unit at (804) 371-0730.