

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
SMOKE OUTLET, INC.

) OTA Case No. 22029618
) CDTFA Case ID 2-463-558
)
)
)
)

OPINION

Representing the Parties:

For Appellant: Sadie Saleh, President

For Respondent: Sunny Paley, Tax Counsel III
Stephen Smith, Tax Counsel IV

For Office of Tax Appeals: Casey Green, Tax Counsel III

T. STANLEY, Administrative Law Judge: Pursuant to California Code of Regulations, title 18, (Regulation) sections 30103(b)(1) and 35057(k), Smoke Outlet, Inc. (appellant) appeals a December 2, 2021 Decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's appeal of a Notice of Decision (NOD) issued on June 21, 2021. The NOD upheld the violations of Business and Professions Code (B&PC) sections 22974 and 22974.3(b) asserted in CDTFA's citation to appellant,¹ but reduced the 20-day license suspension to five days since it was appellant's first seizure.²

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Sara A. Hosey held an oral hearing for this matter in Cerritos, California, on

¹ In the citation, CDTFA also asserted a violation of B&PC section 22980.2(a) (unlicensed sales of cigarettes and tobacco products by an unlicensed distributor). However, CDTFA treated this violation as a distributor violation, creating a distributor's license account (administration-only) for appellant, and imposed a Warning Notice as the penalty for this violation. CDTFA then administratively closed the distributor's license account on September 9, 2021. Appellant did not appeal the Warning Notice, so the violation of section 22980.2(a) is not part of this appeal.

² On August 18, 2020, CDTFA issued a separate Decision regarding the tobacco products seizure, finding that 271 seized items were to be returned to appellant, but otherwise finding the remaining items were forfeited. Appellant did not appeal CDTFA's Decision regarding the seizure. Thus, whether additional seized products should be returned to appellant is not part of this appeal.

March 23, 2023. At the conclusion of the hearing, the parties submitted the matter, and OTA closed the record.

ISSUE

Has appellant established that the five-day license suspension should be further reduced to a zero-day suspension?

FACTUAL FINDINGS

1. Appellant, a corporation, operates a smoke shop in Modesto, California. Appellant holds a seller's permit and has held a Cigarette and Tobacco Products Retailer License since July 19, 2019. Appellant's president held a Cigarette and Tobacco Products Retailer License at the same location since December 2015.
2. CDTFA first inspected appellant's business location on October 9, 2019, and found appellant to be in violation of B&PC sections 22974 (failure to provide 12 months of purchase invoices) and 22974.3(b) (possession of untaxed products).
3. CDTFA seized 877 tobacco products which it considered to be untaxed. CDTFA estimated the retail value of those 877 tobacco products at \$14,480.
4. CDTFA subsequently issued a Notice of Violation to appellant on December 17, 2020, imposing a 20-day license suspension for the violations, which appellant timely appealed.
5. CDTFA issued the NOD on June 21, 2021, upholding the violations but reducing the 20-day license suspension to a 5-day suspension, since it was appellant's first seizure. Appellant timely appealed to CDTFA.
6. On December 2, 2021, CDTFA issued the Decision at issue, which denied appellant's appeal of the NOD.
7. This timely appeal followed.
8. During the briefing process with OTA, appellant provided additional invoices, and to date, there are 588 items remaining that are not supported by a valid invoice.

DISCUSSION

The California Cigarette and Tobacco Products Licensing Act of 2003 (the Act) requires retailers of cigarettes or tobacco products to obtain a license and comply with requirements under the Cigarette and Tobacco Products Tax Law. (Stats. 2009, ch. 890 (Assem. Bill No. 71).) A

retailer is a person who engages in the sale of cigarettes or tobacco products³ directly to the public from a retail location in this state. (B&PC, § 22971(q).) A retailer must retain purchase invoices that meet the requirements set forth in B&PC section 22978.4 for all cigarettes or tobacco products the retailer purchased for a period of four years. (B&PC, § 22974.) The records must be kept at the retail location for at least one year after the purchase and must be made available upon request during normal business hours for review, inspection, and copying by CDTFA. (*Ibid.*) Any retailer found in violation of these requirements or any person who fails, refuses, or neglects to retain or make available invoices for inspection and copying shall be subject to penalties pursuant to B&PC section 22981. (*Ibid.*)

B&PC section 22974.3(b) provides that the possession by a retailer or other person of untaxed tobacco products on which tax is due but has not been paid is a violation of the Act. It is presumed that tax has not been paid to CDTFA on all tobacco products in the possession of a retailer or of any other person until the contrary is established by proof of payment to CDTFA. (B&PC, § 22974.3(b).) A retailer may also establish proof of payment with a purchase invoice as described in B&PC section 22978.4, showing that the retailer or other person, as applicable, paid the tax-included purchase price to a licensed distributor, wholesaler, manufacturer, or importer. (*Ibid.*) B&PC section 22974.3(b) states that the burden of proving that tax has been paid is on the person in possession thereof, and that upon discovery by CDTFA that a retailer or any other person possesses, stores, owns, or has made a retail sale of tobacco products on which tax is due but has not been paid to CDTFA, CDTFA is authorized to seize such tobacco products, which are deemed forfeited. (See also Cal. Code Regs., tit. 18, § 4703(b)(1)(D), (b)(2).)⁴

B&PC section 22974.7(a) provides that in addition to any other civil or criminal penalty provided by law, when CDTFA finds that a retailer has violated any provision of the Act, in the case of a first offense, CDTFA may revoke or suspend the retailer's license. Regulation section 4603(a)(1) provides that a first offense of B&PC section 22974 will result in the issuance of a Warning Notice. Regulation section 4603(d)(3) provides that a violation of B&PC

³ "Tobacco products" includes, but is not limited to, a product containing, made, or derived from tobacco or nicotine that is intended for human consumption, but does not include cigarettes. (Revenue and Taxation Code, § 30121.)

⁴ Possession of untaxed tobacco products on which tax is due but has not been paid is a misdemeanor punishable by a fine not to exceed \$5,000 and/or imprisonment not exceeding one year in a county jail. (B&PC, §§ 22974.3(b), 22981.)

section 22974.3(b) involving a first offense for a seizure of tobacco products that is equivalent to the wholesale cost of 20 packages of cigarettes or more will result in a 20-day license suspension. Regulation section 4603(e) provides that in cases involving multiple violations, as here, the violation punishable by the most severe penalty will be used for purposes of determining the penalty assessed.

A reduction in the length of a suspension period may be warranted if mitigating circumstances are present, including, but not limited to: (1) how recently the licensee purchased the business or began operations and acquired its inventory of cigarettes and/or tobacco products, (2) the amount of cigarettes without tax stamps and with counterfeit tax stamps in relation to the size of the licensee's overall inventory, (3) the size of the licensee's cigarette and/or tobacco products business, (4) the retail value of any cigarettes or tobacco products seized, and (5) the absence of prior seizures. (Cal. Code Regs., tit. 18, §§ 4603(f), 4606.) If any suspension period is reduced, the redetermined period of suspension must be 0 days, 5 days, 10 days, or 20 days. (Cal. Code Regs., tit. 18, § 4603(f).) A licensee has the burden of proving the grounds for the reduction of penalties. (Cal. Code Regs., tit. 18, § 35057(d).)

Appellant contends that the five-day license suspension is unwarranted, as this was its first offense, and that the seized tobacco products were purchased tax-paid. Appellant also argues that the suspension will cause significant financial hardship to the business and to the family of the president. Appellant further asserts that it has suffered financial losses because CDTFA seized products that expired before they were returned, appellant was not compensated for seized products, and appellant suffered numerous closures related to COVID-19. Appellant claims that it has provided valid invoices for all of the seized tobacco products except 221 puff pods and 27 naked disposables. Appellant claims that the puff pods and naked disposables were not for sale, but instead were given to its customers as samples and were clearly marked as samples. Finally, appellant asserts that CDTFA seized products that were supported by purchase invoices, which CDTFA claims it did not seize.

Appellant does not claim that it had purchase invoices for all of its tobacco products inventory at the retail location at the time of the inspection. Rather, appellant admits that its president had to travel home to obtain some invoices and offered to email additional invoices to the inspector. The failure to keep records on location for at least a year is a violation of B&PC section 22974.

As for the violation of B&PC section 22974.3(b), appellant has not shown that tax was paid on 588 tobacco products. The burden of proving that tax has been paid is on appellant, as appellant was the person in possession of the products, and appellant has failed to carry its burden. (See B&PC § 22974.3(b).) Despite appellant's contention that invoices were provided to support all but 221 puff pods and 27 naked disposables, appellant did not submit additional invoices beyond those listed in CDTFA's seizure report. Likewise, appellant did not provide evidence, such as pre- and post-inspection inventories, showing that CDTFA seized other tobacco products that were supported by invoices. Appellant's claim that the 221 puff pods and 27 naked disposables were not for resale (i.e., samples and display only) is not supported by any evidence of such. Furthermore, even if OTA were to accept this assertion as true, appellant's "use or consumption" of the 221 puff pods and 27 naked disposables as samples would constitute a distribution of untaxed tobacco products.⁵ Appellant failed to establish that fewer than 588 other tobacco products remain unsupported, nor that the value of those products is less than \$14,480.⁶

Pursuant to Regulation section 4603(d)(3), the amount of products not proven to be tax-paid exceeds the minimum legal threshold of the wholesale cost of 20 packages of cigarettes, thus warranting a license suspension. (Cal. Code Regs., tit. 18, §§ 4603(f), 4606.) Although appellant's license was issued shortly before the inspection, appellant's president operated the same business as a sole proprietor prior to incorporating in 2019. Moreover, the mitigating factor of appellant's first offense was accounted for in the suspension reduction from 20 days to 5 days. Therefore, appellant was in violation of B&PC section 22974.3(b), and CDTFA has considered the available mitigating factors to reduce the 20-day license suspension to a 5-day license suspension. Accordingly, appellant has not met its burden of proof to establish that a lesser suspension is warranted.

Regarding appellant's contention that the suspension will cause it financial hardship, financial hardship is not one of the mitigating factors. (Cal. Code Regs., tit. 18, §§ 4603(f),

⁵ Appellant would either be required to report and pay usetax on the samples or present an invoice from a distributor showing that it had paid tax on the purchase of the samples.

⁶ CDTFA notes that its Investigations Bureau valued the retail cost for the 877 seized tobacco products at \$14,480. On appeal, CDTFA reduced the number of unsubstantiated tobacco products from 877 to 588, which would also reduce the retail cost for unsubstantiated tobacco products. A proportionate retail cost for the remaining tobacco products would exceed \$9,000, which itself far exceeds the retail cost of 20 packages of cigarettes (represented by CDTFA to be \$113 and undisputed by appellant).

4606.) As relevant here, there is no basis in the law that would allow OTA to grant equitable relief. Thus, OTA must reject appellant’s argument.


Based on the foregoing, OTA finds that appellant violated B&PC sections 22974 and 22974.3(b), and the five-day license suspension is warranted.

HOLDING

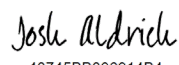
Appellant has not established that the five-day license suspension should be further reduced to a zero-day suspension.


DISPOSITION

CDTFA’s action upholding the five-day license suspension imposed on appellant is sustained.

DocuSigned by:

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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:

48745BB806914B4
Josh Aldrich
Administrative Law Judge

DocuSigned by:

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Sara A. Hosey
Administrative Law Judge

Date Issued: 5/19/2023