

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

|                                 |   |                          |
|---------------------------------|---|--------------------------|
| In the Matter of the Protest of | ) |                          |
|                                 | ) | DOCKET NO. 1-233-268-736 |
| <b>[Redacted]</b>               | ) |                          |
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| ,                               | ) |                          |
|                                 | ) |                          |
| Petitioner.                     | ) | DECISION                 |
|                                 | ) |                          |

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This is a tobacco products tax case.

On June 22, 2015, the staff of the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to **[Redacted]** (taxpayer) proposing income taxes, penalty, and interest for period January 1, 2014 through March 31, 2015 (Audit Period), in the total amount of \$7,260.

**BACKGROUND**

The taxpayer operates a retail store in **[Redacted]**, Idaho, that sells a variety of products, including pipes and pipe tobacco, cigars, vaping products, beer, wine, and other “gentleman’s wares.” The taxpayer purchases tobacco products and accessories from a variety of wholesalers in and out of Idaho.

On March 2, 2015, the Bureau sent a letter to the taxpayer regarding a supplier invoice which was not reported on the taxpayer’s tobacco tax return. On March 12, 2015, the taxpayer provided the Bureau with a return which included the previously unreported invoice. On April 23, 2015, the Bureau informed the taxpayer that it was conducting an audit of the period January 1, 2014 through March 31, 2015, and it required additional information. During a meeting to discuss the audit, the taxpayer, by and through its agent and owner, **[Redacted]**,

explained that he had been calculating his Idaho tobacco tax liability by first deducting any Federal Excise Tax (FET) itemized on his supplier invoices.

The Bureau requested and received invoices from all suppliers of tobacco products during the Audit Period. A review of these invoices revealed that the taxpayer had failed to report all of his wholesale tobacco purchases during the Audit Period (unreported invoices). The invoices also showed that, on reported purchases, the taxpayer had not been paying Idaho tobacco tax on the entire wholesale price (underreported invoices). Instead, the taxpayer had been deducting FET from the wholesale price when it was separately stated on the invoice, as well as deducting FET based on his own calculations when it was not separately stated on the invoice.

The Bureau issued a NODD on June 22, 2015. The deficiency amount included the invoices not reported by the taxpayer on a Form 1350 and the difference between the taxpayer's reported purchase price and the wholesale sales price listed on the invoice. The NODD also included a five percent (5%) negligence penalty, plus interest, totaling \$7,260.

The taxpayer filed a timely protest on August 21, 2015, and participated in an informal hearing on January 19, 2016. In his submissions and at the informal hearing, the taxpayer clarified the extent of his protest: the taxpayer does not protest any deficiency related to unreported invoices, nor does he protest any underreported invoices which did not separately state FET (i.e., invoices where the taxpayer himself deducted an amount equivalent to the FET before calculating the Idaho tobacco tax).

Therefore, the taxpayer's protest is limited to the deficiency amount stemming from three suppliers' invoices which separately stated FET. The taxpayer asserts that when FET is separately stated on a supplier invoice, then FET should not be included in the "wholesale price" for purposes of Idaho tobacco tax calculation. The taxpayer also protests the penalty charged by the Commission.

## ANALYSIS

Idaho law places a tax on the sale, use, consumption, handling, or distribution of all tobacco products. Idaho Code §§ 63-2552, -2552A.<sup>1</sup> The tax amount is calculated as forty percent (40%) of the wholesale sales price of such tobacco products. I.C. §§ 63-2552, -2552A. The tax is imposed at the time a distributor “brings, or causes to be brought, into this state from without the state tobacco products for sale.” *Id.*

The term “distributor” is broadly defined. It includes “any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from without the state any tobacco products for sale.” I.C. § 63-2551(3). Thus, for purposes of the Idaho Tobacco Products Tax Act, even a retailer can fit within the definition of “distributor,” if that retailer is causing tobacco products for sale to be brought into Idaho. Here, the taxpayer is clearly causing tobacco products for sale to be brought into Idaho; the taxpayer falls within the meaning of “distributor” under I.C. § 63-2551(3).

As stated above, the tax is calculated as forty percent (40%) of the “wholesale sales price” of the tobacco products. The meaning of “wholesale sales price” is at the heart of this matter as the taxpayer argues that any amount listed on his suppliers’ invoices as “federal excise tax” or “FET” should not be included within the meaning of that term. “[W]holesale sales price” is defined as “*the established price for which a manufacturer or any person sells a tobacco product to a distributor that is not a related person as defined in section 267 of the Internal Revenue Code, exclusive of any discount or other reduction.*” I.C. § 63-2551(7). In essence, the tax is based on the established price of the sale of a tobacco product.

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<sup>1</sup> The term “tobacco products” is defined broadly to mean “any cigars, cheroots, stogies, smoking tobacco (including granulated, plug, cut, crimp cut, ready rubbed and any other kinds and forms of tobacco suitable for smoking in a pipe or cigarette), chewing tobacco (including cavendish, twist, plug, scrap and any other kinds and forms of tobacco suitable for chewing) and snuff, however prepared; and shall include any other articles or products made of tobacco except cigarettes.” Idaho Code § 63-2551(1).

In this case, a review of the invoices in question shows that the Bureau correctly calculated the wholesale sales price to include the amounts listed separately as “federal excise tax” or “FET” on the pertinent invoices. The taxpayer is incorrect that the FET charge should be carved out of the wholesale sales price as a separate charge from the price of the tobacco product.

First, the plain meaning of the term “wholesale sales price” indicates that any separately-stated FET charges are to be included when calculating the tax amount. As stated above, the wholesale sales price means “the established price” for which a person sells “a tobacco product.” I.C. § 63-2551(7). There is no ambiguity in this statute. To “establish” means “to make or form; to bring about or into existence.” *Black’s Law Dictionary* 586 (2004 8<sup>th</sup> ed.). “Price” means the “amount of money or other consideration asked for or given in exchange for something else; the cost at which something is bought or sold.” *Black’s* at 1226. The established price, therefore, for a tobacco product, is the total amount that the taxpayer’s suppliers have set or made as the amount of money for the cost of the tobacco product.

In this case, the invoices at issue reflect charges for various tax products and their related shipping or freight costs. The statute imposes a tax on the established price for the tobacco products. There is no tax to be imposed on shipping charges. There is no tax to be imposed on insurance costs. In short, there is no tax to be imposed on non-tobacco products. Under the statute, I.C. § 63-2551(7), there is no tax being imposed on anything other than the fixed price for the tobacco products that the taxpayer purchased. The FET charge is part of the amount of money given in exchange for the tobacco product; and that amount is set or made by the taxpayer’s suppliers. The FET charges are included in the established price for the tobacco products.

Second, the taxpayer is also incorrect to conclude that the FET charge should be deleted from the wholesale sales price because the taxpayer *is not actually being charged or paying the FET*. The taxpayer is fundamentally mistaken when he states that the FET amount listed in the invoices is a separate tax from the federal level on the taxpayer. Rather, the FET in question is a tax on tobacco products imposed by the federal government, *see* 26 U.S.C. § 5701, the liability for which falls on manufacturers and importers of tobacco products (not on retailers like the taxpayer). *See also*, 26 U.S.C. § 5703. Moreover, the FET is paid via a federal tobacco products tax return, not via invoices to suppliers. *See* 26 U.S.C. § 5703(b).

The taxpayer's payment of the equivalent amount of his suppliers' FET does not equate to the taxpayer paying the FET himself. In this case, any FET was paid by the taxpayer's suppliers; and it was paid to the federal government. The invoices in this case are not federal tax returns whereby this taxpayer is transmitting an FET payment to any federal agency to satisfy the taxpayer's federal tax obligation. The taxpayer is not paying the actual FET imposed on the particular tax products. In summary, the FET amounts should not be deducted from the calculation of wholesale sales price.

The only reasonable conclusion to be reached for the separately stated FET charges in the invoices is that the taxpayer's suppliers are merely *explaining* the breakdown of the established price for the tobacco products. At most, it could be said that the taxpayer's supplier is "passing on" its cost to the taxpayer. But again, the taxpayer is not actually paying the FET. The taxpayer's argument fails for these reasons.

In its protest, the taxpayer makes two additional arguments related to what it calls "double taxation." First, the taxpayer asserts that being required to pay an FET charge *and* the Idaho tobacco products tax is an improper "double tax." As set forth above, however, the taxpayer is not actually paying the FET. He is apparently being charged the *equivalent* amount

of the FET in the invoices in question. But there is no actual double taxation by the State of Idaho. There is only one tax at issue here.

The taxpayer argues, additionally, that the very arrangement of the Idaho Tobacco Products Tax that calculates the tax *to include* the amount of another tax is improper. In this way, the taxpayer argues, Idaho bases its tax calculation in part on the amount of another tax, and therefore is charging a “tax on a tax” (e.g., 40% of the FET charged.) This argument fails, too. The Tobacco Products Tax Act merely charges a tax on the “established price” for which a person sells a tobacco product. The amount of money asked for or given in exchange for the tobacco products in this case clearly includes the amount denominated by the suppliers as “FET.” This is the price of the taxpayer’s purchased tobacco products within the meaning of I.C. § 63-2551(7). The cost at which the tobacco products are being sold by the suppliers clearly includes the separately stated FET charges. *See, Black’s Law Dictionary* 1226 (2004 8<sup>th</sup> ed.) The tax calculation is not based on another tax.

Moreover, there is no general blanket prohibition against so-called “double taxation.” As the Idaho Supreme Court explained, “the Fourteenth Amendment [to the U.S. Constitution] does not prohibit double taxation.” *Idaho State Tax Comm’n v. Stang*, 135 Idaho 800, 803, 25 P.3d 113, 116 (2001) (*quoting Cream of Wheat Co. v. Grand Forks County*, 253 U.S. 325, 330, 40 S.Ct. 558, 560, 64 L.Ed. 931, 934 (1920).) In *Stang*, the Idaho Supreme Court examined whether Idaho could tax income that another state had already taxed. Following U.S. Supreme Court case law, it held that the mere fact that another state had taxed the receipt of income did not deny Idaho the right to tax something done within its borders, too. *See, id.*, 135 Idaho at 103-104.

In *Stang*, the Idaho Supreme Court also examined case law on the issue whether the federal government could tax both the income of a corporation and the amounts distributed to the

corporation's stockholders from those profits. *Stang*, 135 Idaho at 103 (citing *Hellmich v. Hellman*, 276 U.S. 233 (1928)). The federal government can impose income taxes both upon the profits of a corporation and upon those same profits when they were distributed to the stockholders, the United States Supreme Court concluded, “[w]hen, as here, Congress has clearly expressed its intention, . . . even though double taxation results.” *Hellmich*, 276 U.S. at 238 (quoted in *Stang*, 135 Idaho at 803).

Thus, a state may tax income already taxed by another state, and the federal government can impose tax both on the income of a corporation and on the distributions on the same income. It stands to reason that, even if the taxpayer here were being made to pay the FET—which it is not—the State of Idaho could constitutionally include the amount of another tax in its calculations for the tobacco products tax.

It is true that the Idaho Constitution does forbid the “duplicate taxation of property for the same purpose during the same year.” Idaho Const. art. VII, § 5. However, this prohibition is narrowly defined. “There is no double taxation when two separate and distinct privileges are being taxed even though the subject matter to which each separate transaction pertains may be identical.” *Boise Bowling Ctr. v. State*, 93 Idaho 367, 461 P.2d 262 (1969); see also, *Humbird Lumber Co. v. Kootenai Cty.*, 10 Idaho 490, 79 P. 396, 398 (1904) (“The prohibition contained in that section against duplicate taxation was undoubtedly directed against the taxing of the same property twice during the same year for the same purpose, *while other like and similar property is taxed only once during the same period for the same purpose.*”). As shown above, Idaho is not imposing double taxation. There is no unconstitutional duplicate taxation here.

Finally, the taxpayer protests the imposition of the negligence penalty under I.C. § 63-3046(a), which provides that, “[i]f any part of any deficiency is due to negligence or disregard of rules but without intent to defraud, five percent (5%) of the total amount of the deficiency (in

addition to such deficiency) shall be assessed.” I.C. § 63-3046(a). The Commission has reviewed the file and has found the imposition of the negligence penalty to be appropriate in this case.

THEREFORE, the Notice of Deficiency Determination dated June 22, 2015, and directed to **[Redacted]**, is hereby APPROVED and MADE FINAL, as follows:

|            |                |                    |                 |
|------------|----------------|--------------------|-----------------|
| <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u>    | <u>TOTAL</u>    |
| \$6,713    | \$342          | \$288.68           | \$7,343.68      |
|            |                | LESS PAID          | (\$6,798.20)    |
|            |                | <b>BALANCE DUE</b> | <b>\$545.48</b> |

Interest is calculated through October 28, 2016.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer’s right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2016.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2016, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

**[Redacted]**

Receipt No.

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