STATE OF RHODE ISLAND

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2024-30

STATE OF RHODE ISLAND
DEPARTMENT OF REVENUE
DIVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908

IN THE MATTER OF:	:	**SC 22-085; 22-T-108**
	:	**cigarette tax**
Taxpayer.	:	

DECISION

I. INTRODUCTION

The above-entitled matter came for hearing pursuant to an Order to Show Cause, Notice of Pre-Hearing Conference, and Appointment of Hearing Officer ("Order to Show Cause") issued on December 1, 2022 to the above-captioned taxpayer ("Taxpayer") by the Division of Taxation ("Division") in response to a request for hearing. A hearing was held on November 21, 2024. The parties were represented by counsel, and they rested on the record.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-20-1 *et seq.*, and the 280-RICR-20-00-2 *Administrative Hearing Procedures* ("Hearing Regulation").

III. ISSUE

Whether the Taxpayer owes cigarette tax and if so, should sanctions be imposed.

IV. MATERIAL FACTS

The Taxpayer stipulated to the 2022 cigarette seizure and agreed that for the purpose of this hearing, the products seized fell under the cigarette statute, and it owed tax on the seized products.

Principal Tax Auditor, testified on behalf of the Division. He testified the Taxpayer's 2022 violation is the Taxpayer's fourth offense. He testified it had been counted as a fifth violation, but the 2018 incidence was not a violation. On cross-examination, he testified that when the Taxpayer was inspected in 2022, it had not had a violation since 2014, and the Taxpayer has had no violations since the 2022 inspection. He testified the Taxpayer's cigarette dealer's license has never been suspended, and it paid the previous assessments. He testified that of the three (3) prior violations, two (2) were for the Cumberland store and one (1) was for the Pawtucket store. He testified the 2022 seizure was from the Pawtucket store and the prior Pawtucket seizure was from 2013. He testified that both stores are under the same corporate ID; however, each store has their own cigarette dealer's license and sales permit. Division's Exhibits Four (4) (notice of suspension); Five (5) (assessment); Six (6) (compliance report); Seven (7) (seizure report); and Eight (8) (audit report).

testified on behalf of the Taxpayer. He testified he is a principal of the Taxpayer which has two (2) locations, and he operates the Pawtucket location, and his partner operates the Cumberland location. He testified that he agreed that in 2022, he had a product called high tea herbal wrap on his premises that was seized. He testified he received said product from Core Mark distributor. He testified that it was a pre-book order which are random new products from the distributor to put on display and are automatically added to orders. He testified he paid for the order and did not pay the tax, but it was not something he chose to order but rather it was a promotional product from the distributor. Taxpayer's Exhibit One (1) (Core Mark invoice showing the four (4) herbal tea products seized by the Division). He testified the Division inspectors seized the product on October 13, 2022. He testified that after the seizure, he called Core Mark to discuss the seized product and spoke with them, and the distributor then issued a

letter indicating that stores should not sell the high tea products. Taxpayer's Exhibit Two (2) (letter dated October 20, 2022 from instructing stores not to sell said products since the Division believes they are taxable; though, the distributor does not agree with that statutory analysis).[1]

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.,* 637 A.2d 1047 (R.I. 1994). If a statute is clear and unambiguous, "the Court Omust interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Oliveira v. Lombardi*, 794 A.2d 453, 457 (R.I. 2002) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. DEM*, 553 A.2d 541 (R.I. 1989) (internal citation omitted). In cases where a statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998).

B. Relevant Statutes

R.I. Gen. Laws § 44-20-12 imposes a tax on cigarettes sold and R.I. Gen. Laws § 44-20-51 provides for administrative penalties for the violation of the tax laws.[2]

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[1] The Division believes the seized products are rolling papers. Division's Exhibits Six (6) and Eight (8).

[2] R.I. Gen. Laws § 44-20-12 provides as follows:

> Tax imposed on cigarettes sold. A tax is imposed on all cigarettes sold or held for sale in the state. The payment of the tax to be evidenced by stamps, which may be affixed only by licensed distributors to the packages containing such cigarettes. Any cigarettes on which the proper amount of tax provided for in this chapter has been paid, payment being evidenced by the stamp, is not subject to a further tax under this chapter. The tax is at the rate of two hundred twelve and one-half (212.5) mills for each cigarette.

R.I. Gen. Laws § 44-20-51.1 provides as follows:

C. Arguments

The Division requested that the tax and penalties assessment be upheld and sought a 40 day suspension of the Taxpayer's cigarette dealer's license for the Pawtucket store because this is the Taxpayer's fourth offense.

The Taxpayer argued that said product actually does not fall under the statutory definition of cigarette but would leave that determination for another day. It argued the product was bought from a distributor, and there have been no violations by the Taxpayer in ten (10) years so that a reasonable penalty in addition to the tax should be imposed, but a suspension is not merited.

D. Whether Tax is Owed on the Cigarettes

It was undisputed that on October 13, 2022, the Division seized cigarettes from the Taxpayer for which no Rhode Island tax had been paid. *Supra.* R.I. Gen. Laws § 44-20-12 provides that tax is imposed on cigarettes, so the Division assessed tax on the seized cigarettes. There was no showing the Division improperly calculated the tax owed pursuant to the applicable statute, and the Taxpayer agreed tax was owed on the seized products. Thus, the Taxpayer owes the assessed tax.

Civil penalties. (a) Whoever omits, neglects, or refuses to comply with any duty imposed upon him/her by this chapter, or to do, or cause to be done, any of the things required by this chapter, or does anything prohibited by this chapter, shall, in addition to any other penalty provided in this chapter, be liable as follows:

(1) For a first offense in a twenty-four-month (24) period, a penalty of not more than ten (10) times the retail value of the cigarettes and/or other tobacco products involved; and

(2) For a second or subsequent offense in a twenty-four-month (24) period, a penalty of not more than twenty-five (25) times the retail value of the cigarettes and/or other tobacco products involved.

(b) Whoever fails to pay any tax imposed by this chapter at the time prescribed by law or regulations, shall, in addition to any other penalty provided in this chapter, be liable for a penalty of one thousand dollars ($1,000) or not more than five (5) times the tax due but unpaid, whichever is greater.

(c) When determining the amount of a penalty sought or imposed under this section, evidence of mitigating or aggravating factors, including history, severity, and intent, shall be considered.

E. What Sanctions Should be Imposed

1. Penalties (a) and (b)

R.I. Gen. Laws § 44-20-51.1(a) provides that for a first offense in a 24 month period, a penalty of not more than ten (10) times the retail value of the cigarettes and/or other tobacco products involved "shall" be imposed. R.I. Gen. Laws § 44-20-51.1(b) provides that a penalty of not more than five (5) times the tax due or $1,000 whichever is greater shall be imposed. Penalty (b) does not reset the clock for violations within a 24 month period as does penalty (a). R.I. Gen. Laws § 44-20-51.1(c) provides that when determining the penalty to be imposed, mitigating and aggravating factors such as history, severity, and intent shall be considered.

The Division seeks monetary penalties for the nonpayment of tax on the seized cigarettes pursuant to R.I. Gen. Laws § 44-20-51.1. According to the audit report, penalty (a) used a factor of six (6) times the retail value representing a factor of five (5) for a first offense and a factor of one (1) for the aggravating factor of not having invoices at the time of inspection. The audit report indicated that penalty (b) was calculated as $1,000 as the greater amount as provided by statute.

The penalties imposed are in line with the statutory penalties for a first offense for penalty (a) in the last 24 months and for penalty (b). As a consequence, the Taxpayer's violation justified the penalties imposed in the Division's notice of assessment for the seized cigarettes.

The imposition of interest after the nonpayment of a deficiency by its due date is authorized by R.I. Gen. Laws § 44-1-7.[3]

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[3] R.I. Gen. Laws § 44-1-7 provides in part as follows:

> Interest on delinquent payments. (a) Whenever the full amount of any state tax or any portion or deficiency, as finally determined by the tax administrator, has not been paid on the date when it is due and payable, whether the time has been extended or not, there shall be added as part of the tax or portion or deficiency interest at the rate as determined in accordance with subsection (b) of this section, notwithstanding any general or specific statute to the contrary.

2. Whether Dealer's License Should be Suspended

Along with the monetary penalties that "shall" be imposed under the statute, R.I. Gen. Laws § 44-20-8 provides the suspension or revocation of a cigarette dealer's license "may" be imposed. R.I. Gen. Laws § 44-20-51.1(c) provides that when determining the administrative penalty to be imposed, mitigating and aggravating factors including severity, history, and intent shall be considered. The suspension and revocation statute does not contain the same kind of mitigating and aggravating factors as those found in the administrative penalty statute. *Supra.* It also does not provide a look back of two (2) years when determining first or subsequent offences. Instead, it provides that a license may be suspended or revoked for failure to comply with that chapter or with any other law or ordinance relative to the sale or purchase of cigarettes or other tobacco products and for failure to comply with R.I. Gen. Laws § 44-19-1 *et seq.* or R.I. Gen. Laws § 6-13-1 *et seq.* Nonetheless, in considering whether a licensee's violations merit either a suspension or a revocation in addition to the mandatory monetary penalties, an agency does not have unbridled discretion but rather must determine the appropriate penalty in light of the relevant facts. Not all violations merit a revocation and not all violations merit a suspension of the same amount of time.

In *Chernov Enterprises, Inc. v. Sarkas*, 284 A.2d 61 (R.I. 1971), the Supreme Court construed a license renewal statute that did not provide specific statutory violations as grounds for denial but rather provided the license renewal could be denied for "cause." In that situation, the Court found that in "establishing cause as the controlling standard, the Legislature obviously did not intend to confer upon the licensing authority a limitless control or to permit the exercise of an unbridled discretion." *Chernov* at 287. The Court found that such administrative action needed to be based on legally competent evidence, and a review of such an action would only be "to ascertain

whether the action being reviewed was so arbitrary or capricious as to constitute an abuse of discretion, whether there was any legal evidence to support it, and whether the licensing proceeding was otherwise affected by an error of law." *Id.* at 288. In other words, the Court would decide whether there was legally competent evidence to support the denial of a renewal application or whether the action was so arbitrary or capricious that it would be an abuse of discretion. The Superior Court has discussed the same kind of considerations for determining whether a suspension or revocation of a license is an appropriate sanction for a licensee's violations.

Under *Rocha vs. Public Utilities Commission*, 694 A.2d 722 (R.I. 1997), a court cannot substitute its judgment for what should be an appropriate sanction but instead the Court will determine if there was legally competent evidence to support an agency's decision. Thus, in *Rocha*, the Court upheld the revocation of license as there was legally competent evidence to support the finding of the violation that was a basis for revocation under the statute.

A Superior Court decision, *Jake and Ella's Inc. v. Department of Business Regulation*, 2002 WL977812 (R.I. Super.), discussed *Rocha*'s holding that as long as there is an evidentiary basis for an agency's finding, a court cannot overturn a sanction because it disagrees with the sanction. However, the Court discussed how in general hearing officers must apply concepts of proportionality to sanctions. The Court found that "[t]here are times when the sanction imposed by an agency, while permitted by law, is so arbitrary and extreme that it constitutes a clear abuse of discretion" so that under the arbitrary and capricious standard contained in R.I. Gen. Laws § 42-35-15 of the Administrative Procedures Act ("APA"), the Court can reverse the lower court's decision. *Jake* at 5. The Court found there are two (2) components to administrative decision: 1) a determination of the merits of the case; and 2) determination of the sanction and while the former is mainly factual, the latter not only involves ascertainment of factual circumstances but the

application of administrative judgment and discretion. The Court indicated that factors to be considered in weighing the severity of a violation should include the number and frequency of the violations, the real and/or potential danger to the public posed by the violation(s), history of any prior violations and sanctions, and other relevant facts to determining an appropriate sanction.

In 2014, the Superior Court in reviewing a Department of Health's licensee's sanction on appeal cited to the factors considered in *Jake* for sanctions and discussed whether it had been properly applied by an agency director. *Blais v. Department of Health*, 2014 WL 7368789 (R.I.Super.). A more recent Superior Court case, *John Hope Settlement House, Inc. v. DCYF et al.*, 2017 WL 2021402 (R.I.Super.), also discussed *Rocha* and the applicability of *Jake* when determining administrative penalties for a licensee and what should be considered. In that case, the Superior Court discussed what would be the appropriate sanction by the Department of Children, Youth, and Families on a day care licensee for three (3) violations. The Court found there was not enough information in the record to make a determination about sanctions as the Court could not tell if the violations were intermittent technical violations or a "pattern of inability to comply with substantive Department policies." *John Hope* at 6. The Court remanded the matter so the record could be supplemented so the Court could make a determination on sanctions.[4]

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[4] *John Hope* at 6 found as follows:

> Finally, the Center contends that despite the three violations found, the Hearing Officer erred by affirming DCYF's penalty—the revocation of its day care license. Specifically, John Hope argues that these three violations do not merit the "death sentence" that revocation would bring.. . . To that end, the Center points to *Jake & Ella's* . . .. In *Jake & Ella's*, the Superior Court vacated the revocation of a liquor license because "the sanction imposed [was] excessive and disproportionate as a matter of law." *Id.* at *5. There, the Court held that "implementation of that sanction [revocation] under the facts of this case was clearly an abuse of discretion, ignoring concepts of proportionality that hearing officers should be expected to apply." *Id.* at *6.
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> On the other hand, the Court is mindful of *Rocha v. State Pub. Utils. Comm'n*, 694 A.2d 722 (R.I. 1997), heavily cited to in *Jake & Ella's*, which stated that "[t]he Superior Court is limited in its review of an agency decision to examining the record to determine whether it contains some or any legal evidence therein to support the finding made by the division." *Rocha*, 694 A.2d at 727. This Court cannot "merely disagree[] with the sanction decided upon by the division and reverse[] the division's decision." Id at 726 (internal citations omitted).
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> Nevertheless, based solely on the three violations before the Court, the Court could find the

For an administrative appeal, the Division is not subject to the APA. When its decisions are appealed, its appeals are *de novo* to District Court. See R.I. Gen. Laws § 44-20-48. Thus, on appeal, the court would not be deciding whether a sanction was arbitrary and capricious, but rather the court, if it found violations after a *de novo* hearing, would determine the appropriate sanction. The suspension and revocation statute provides the statutory grounds for such an action but not every violation will merit a suspension of the same length of time or a revocation. There are several factors to be considered - even if they are not specifically delineated in the suspension and revocation statute - to assure that a sanction that is imposed is not disproportionate. The imposition of a suspension or revocation is not subject to unbridled discretion. Such a determination includes consideration of relevant facts to the licensee and its violations. Therefore, in determining the appropriate sanction for the Taxpayer's violations, it is relevant to consider the Taxpayer's disciplinary history, the seriousness of violations, the type of violations, and the effect on the public among the relevant factors to be considered.

In 2013, the Taxpayer was assessed for a cigarette seizure and paid and served no suspension. Again in 2013, a seizure led to an assessment for cigarettes and other tobacco products ("OTP") with an assessment of for the cigarettes and for the OTP. The Taxpayer paid the full amount for the cigarette and OTP assessments and served no

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revocation to be "so arbitrary and extreme that it constitutes a clear abuse of discretion" in the vein of *Jake & Ella's*, 2002 WL 977812 at *5. This Court lacks a sufficiently-developed record to make such a conclusion. Of the three violations, two were technical and only one potentially could have threatened the safety and welfare of the children in John Hope's care. ***

If the Department's revocation was based on the cumulative effect of the violations which led to the several probationary periods, the nature of John Hope's previous violations is unclear from the record. While the record hints at technical violations, see R. Ex. 9, there may be more substantive violations that were not mentioned. Whether the decision of the Department to revoke the license was arbitrary, capricious, or an abuse of discretion depends on whether John Hope has committed intermittent technical violations of DCYF regulations or has shown a pattern of inability to comply with substantive Department policies. The record here lacks the information needed for the Court to make such a determination.

suspension. In 2014, there was an assessment of for OTP, and the Taxpayer paid the full amount and served no suspension. While the Division records indicated there may have been a violation in 2018, the testimony was the 2018 incidence was not a violation. Division's Exhibit Eight (8) (disciplinary record). The tax owed for the 2022 violation was with penalty (a) being (six (6) times the retail value of) and penalty (b) was as the greater amount (compared to five (5) times the tax owed)). Division's Exhibits Five (5) and Eight (8). The testimony also indicated the 2022 violation was the second violation for the Pawtucket store but the overall fourth offense for the Taxpayer rather than the individual license holder. However, there were no violations between 2014 and 2022.

The only evidence regarding the prior violations is the date and type of violation, e.g. whether cigarette or OTP, and the total assessed amount and the settled amount as well as if a suspension was imposed in addition to the mandatory monetary penalties. Thus, it is not known if the cigarette violations were due to purposely purchasing out of state lower taxed cigarettes for resale or erroneously taking delivery of an untaxed cigarette product. It is not known if the Taxpayer had all OTP records but never filed the required OTP-4 tax form or if the Taxpayer not only did not pay the OTP tax but failed to keep purchase records, etc. What is known is that none of the three (3) prior violations within two (2) years merited a suspension.

The evidence for the 2022 violation was the Taxpayer did not order the seized product. Rather the product was included in the distributor's delivery as a promotional product. As soon as the product was seized, the Taxpayer contacted the distributor regarding the issue of the taxability of the product. While the Taxpayer may not have had the invoice on premises as required (thus an aggravating factor for the monetary penalty), it did provide the invoice showing it received the product from a distributor. The Taxpayer did not buy the product from an unlicensed distributor

and try to hide it and not declare it to the Division. The Taxpayer did not buy out of state lower taxed cigarettes and sell them in an attempt to evade the cigarette tax and make a profit.

The evidence was eight (8) years after the last prior violation, a new product was delivered to the Taxpayer by a distributor and as soon as it was seized, the Taxpayer called the distributor. Indeed, the distributor believes the product is not taxable. The distributor's letter states that it disagrees with the Division over the taxability of the product.

Unlike in *In the Matter of Taxpayer*, 2024 WL 47298216 (R.I. Div. Tax), there was no evidence the purchase of this product was part of pattern of willful noncompliance by the Taxpayer over several years as there had been no violations for eight (8) years, and the product was a pre-book order. Nor did the evidence demonstrate the Taxpayer failed to institute corrective measures after prior violations. The evidence did not demonstrate the Taxpayer failed to maintain records in that the Taxpayer had its invoice for the product at issue. The evidence did not demonstrate a repetitive pattern of noncompliance when there were no violations for eight (8) years.[5] Rather the evidence was the Taxpayer received the product from a licensed distributor which thought the product was not taxable, and the Taxpayer contacted the distributor right after the seizure.

The Division asserted that a 40 day suspension should be imposed as this is the Taxpayer's fourth offense. If a pattern of noncompliance had been shown, some kind of suspension could be merited. If this was an egregious type of violation involving a scheme to deliberately evade taxation, a suspension could have been merited. But a 40 day suspension is disproportionate to the violation at issue. Indeed, this violation is more like a technical violation as opposed to a pattern of inability to comply with statutory requirements.

[5] In that decision, those factors were present to support the imposition of a 30 day suspension, and that taxpayer had prior violations including a recent violation and had a prior suspension that showed such a pattern of behavior and had also obstructed the inspection at issue.

Based on the foregoing, no suspension is warranted in addition to the mandatory monetary penalties as calculated above.

VI. FINDINGS OF FACT

1. Cigarettes for which no tax was paid were seized by the Division from the Taxpayer on October 13, 2022.

2. An Order to Show Cause was issued on December 1, 2022.

3. A hearing on this matter was held on November 21, 2024 with the parties both represented by counsel who rested on the record.

4. The facts contained in Section IV and V are reincorporated by reference herein.

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-20-1 *et seq.*, and the Hearing Regulation.

2. The Taxpayer violated R.I. Gen. Laws § 44-20-12 on October 13, 2022.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows:

Pursuant to R.I. Gen. Laws § 44-20-1 *et seq.*, R.I. Gen. Laws § 44-20-12, and R.I. Gen. Laws § 44-20-51.1, the Taxpayer owes the tax and penalties assessed by the Division as set forth in the notice of assessment contained in Division's Exhibit Five (5). Additionally, the Taxpayer owes the accrued interest pursuant to R.I. Gen. Laws § 44-1-7. Payment shall be made by the 31st day from the date of execution of this decision.

Date: December 17, 2024

Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

✓ ADOPT
_____ REJECT
_____ MODIFY

Dated: 12/23/24

Neena S. Savage
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 44-20-48 Appeal to district court.

Any person aggrieved by any decision of the tax administrator under the provisions of this chapter may appeal the decision within thirty (30) days thereafter to the sixth (6th) division of the district court. The appellant shall at the time of taking an appeal file with the court a bond of recognizance to the state, with surety to prosecute the appeal to effect and to comply with the orders and decrees of the court in the premises. These appeals are preferred cases, to be heard, unless cause appears to the contrary, in priority to other cases. The court may grant relief as may be equitable. If the court determines that the appeal was taken without probable cause, the court may tax double or triple costs, as the case demands; and, upon all those appeals, which may be denied, costs may be taxed against the appellant at the discretion of the court. In no case shall costs be taxed against the state, its officers, or agents. A party aggrieved by a final order of the court may seek review of the order in the supreme court by writ of certiorari in accordance with the procedures contained in § 42-35-16.

CERTIFICATION

I hereby certify that on the 23rd day of December, 2024 a copy of the above Decision and Notice of Appellate Rights was sent by first class mail, postage prepaid and by electronic delivery to the Taxpayer's attorney's address on record with the Division and by electronic delivery to Matthew Williamson, Esquire, Department of Revenue, Division of Taxation, One Capitol Hill, Providence, RI 02908.

Gail Belasco