

STATE OF RHODE ISLAND

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

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

IN THE MATTER OF

Taxpayer.

:
: **Case Nos.: 20-T-002; 21-T-021;**
: **21-T-225; 22-T-021; 24-T-036**
: **SC 20-02; -03; 021; SC 21-053; -054;**
: **SC 23-011; -012; -084**
: **cigarette and other tobacco products**
: **breach of stipulation**

DECISION

I. INTRODUCTION

The above-entitled matter came for hearing pursuant to five (5) notices of hearing sent to the above-captioned taxpayer (“Taxpayer”) by Division of Taxation (“Division”) in response to requests for hearing by the Taxpayer, and that have been consolidated for hearing.

More specifically, an Order to Show Cause, Notice of Pre-Hearing Conference and Appointment of Hearing Officer was issued on January 27, 2020 in relation to SC 20-02 (OTP) and SC 20-03 (cigarette) (“2020 Notice”).¹ More specifically, an Order to Show Cause, Notice of Pre-Hearing Conference and Appointment of Hearing Officer was issued on January 26, 2021 in relation to SC 20-021 (refusal to allow inspection) (“January 2021 Notice”).² More specifically, an Order to Show Cause, Notice of Pre-Hearing Conference and Appointment of Hearing Officer was issued on May 4, 2021 in relation to SC 21-054 (OTP) and SC 21-053 (cigarette) (“May 2021 Notice”).³ More specifically, an Order to Show Cause, Notice of Pre-Hearing Conference and Appointment of Hearing Officer was issued on March 1, 2023 in relation to SC 23-011 (OTP) and

¹ The undersigned has assigned this matter case number 20-T-002.

² The undersigned has assigned this matter case number 21-T-021.

³ The undersigned has assigned this matter case number 21-T-225.

SC 23-012 (cigarette) (“2023 Notice”).⁴ More specifically, an Order to Show Cause, Notice of Administrative Hearing and Appointment of Hearing Officer was issued on August 15, 2024 in relation to SC 23-084 (OTP) (“2024 Notice”).⁵

The Taxpayer holds a cigarette dealer’s license (“License”) pursuant to R.I. Gen. Laws § 44-20-1 *et seq.* A hearing was held on October 1, 2024. The parties were represented by counsel. The record was held open until October 11, 2024 for submission of further evidence by the Taxpayer. The Taxpayer declined to submit further evidence, and on October 18, 2024, the parties agreed to rest 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 280-RICR-20-00-2 *Administrative Hearing Procedures*.

III. ISSUE

Whether the Taxpayer owes the cigarette and/or other tobacco products tax and penalties assessed by the Division, and whether the Taxpayer breached a settlement stipulation, and if so, what sanctions, if any, should be imposed.

IV. MATERIAL FACTS AND TESTIMONY

For ease, the Division’s investigators’ testimony is summarized by each inspection.

SC 20-002, 20-003 2020 Notice

Tax Investigator, testified on behalf of the Division. He testified he conducted a nonrandom tobacco compliance inspection of the Taxpayer on October 24, 2019. He testified that prior to the 2019 inspection, the Taxpayer’s manager told him the Taxpayer purchased other tobacco products (“OTP”) from Alhamrah Corporation which is not a

⁴ The undersigned has assigned this matter case number 22-T-021.

⁵ The undersigned has assigned this matter case number 24-T-036.

Rhode Island distributor. He testified that in order to purchase tobacco from an out-of-state distributor, the cigarette dealer must submit an OTP-4 form and invoices to the Division showing tax has been paid on the out-of-state purchased OTP. He testified that in June and July 2019, he reviewed the Taxpayer's OTP-4 filings which seemed low for the store. He testified he reached out to [redacted] but was unable to obtain their records of the Taxpayer's purchases, but tobacco inspectors in Pennsylvania were able to subpoena the Taxpayer's invoices of purchases from [redacted]. He testified he confirmed with [redacted] their invoices had six (6) digit numbers, and the Taxpayer's OTP-4 forms had some six (6) digit numbers but also four (4) digit invoice numbers for [redacted]. He testified a Division attorney also confirmed with [redacted] that it would not have four (4) digit invoice numbers.

[redacted] testified that he used the Taxpayer's invoices from [redacted] to conduct the inspection on October 24, 2019. He testified that he determined the Taxpayer would make separate orders of a few hundred dollars and of a few thousand dollars but only file an OTP-4 form for the smaller order. He testified he found untaxed rolling papers and hemp cigarettes that are statutorily defined as cigarettes. He testified the Taxpayer was given a chance to submit invoices after the inspection to show if any of the tax had been paid but no invoices were submitted. Division's Exhibits Six (6) and Seven (7) (notice of license revocation and Notice of Deficiency Determination for OTP both dated December 13, 2019); Eight (8) (cigarette compliance report); Nine (9) (seizure report); Ten (10) (report of excise tax OTP dated December 4, 2019); 11 and 12 (notice of license revocation and Notice of Deficiency Determination both dated December 13, 2019 for the cigarettes); 13 (OTP compliance report); 14 (report of excise tax cigarette dated December 4, 2019); and 16 (2020 Notice).

On cross-examination, testified that he did not know the Taxpayer had separate stores; however, invoices are location specific so the products should be at the store location on the invoice. He testified he conducted the inspection with two (2) other investigators, and they identified themselves and conducted the inspection and asked for invoices which the Taxpayer did not have. He testified he relied on the invoices during the inspection. He testified he did not find any secret hiding places that day, and he may have opened boxes, but he does not remember. He testified that if the product was on the invoices, but no OTP-4 form had been filed for that product, they seized the product. He testified they seized products that were on display, and he believes they were there for a few hours.

SC 21-053, SC 21-054 May 2021 Notice

testified that he conducted an inspection on January 27, 2021 which was not random as the Central Falls police had informed the Division that they were going to execute a search warrant that day after making several marijuana buys at the Taxpayer. He testified he and another inspector showed up at 8:00 a.m. that day, and they saw the Taxpayer's owner and wife arriving by car to open up the business. He testified the police secured the business. He testified he inspected the owner and his wife's vehicle and found untaxed rolling paper and OTP in the trunk and OTP in the back seat for which there were no invoices. He testified they also inspected the store so there were two (2) two seizure reports, one for the vehicle inspection and one for the store inspection. He testified the Taxpayer did not produce invoices for the seized products. Division's Exhibits 24 and 25 (notice of license revocation and Notice of Deficiency Determination both dated March 25, 2021); 26 (compliance report); 27 (seizure report); 28 (audit report); 29 (notice of license revocation dated March 25, 2021); 30 (Notices of Deficiency

Determination dated March 25, 2021 for cigarettes and OTP); 31 (compliance report); 32 (seizure report); 33 (audit report); and 35 (May 2021 Notice).

On cross-examination, testified he did not remember how they were able to get into the car and whether it was unlocked or if the police had the key. He testified that in his compliance reports, he uses the term search and inspection because they are the same. He testified the statute authorizes inspections of cars, and when conducting an inspection, one views what is in a room and that one can open a box; otherwise, the contents of a box cannot be verified. On redirect, he testified that if there are secret hides, the statute allows those to be searched.

SC 23-011, SC 23-012 2023 Notice

Tax Investigator, testified on behalf of the Division. He testified that he conducted a random inspection on January 26, 2023 of the Taxpayer. He testified there was a clerk on duty, and they asked for the invoices. He testified they seized unstamped leaf wraps and OTP and provided a seizure report the clerk signed. He testified the Taxpayer had an opportunity to provide invoices to show proof of payment of tax but did not. Division's Exhibit 36 (notice of license revocation dated February 9, 2023, notice of assessment, compliance report, seizure report, audit report and workpapers). On cross-examination, he testified he conducted the inspection with two (2) other investigators, and they were there an hour or an hour and 45 minutes. He testified the police were not there, and he did not recall opening any sealed boxes. He testified they reviewed the products and invoices. He testified that they could open drawers, and there were no closed areas, and they went into the basement but there were no items there.

SC 23-084 2024 Notice

testified on behalf of the Division. He testified that he conducted a random inspection with another inspector on November 9, 2023 of the Taxpayer. He testified they

identified themselves to the clerk and explained what they were doing and requested invoices. He testified they reviewed the cigarettes which were fine. He testified they found a box of Game Blue Cigarillos in the basement. He testified the Taxpayer was given an opportunity to provide invoices and subsequently the Taxpayer provided an OTP-4 form and invoice for Game Blue Cigarillos. He testified he discussed said invoice with Salzillo. On cross-examination, he testified they were in the store for about 45 minutes to an hour. He testified the box was located in the cellar. He testified he may have opened a box and if a box is sealed, they can open it to confirm what is inside.

testified on behalf of the Division. He testified that about five (5) days after this inspection, _____ told him about the Taxpayer's invoice from a tobacco company which was not a licensed distributor. He testified that he found the 800 telephone number for the company and spoke to a representative and followed up with an email about the information that he sought. He testified that he was informed the company had a different type of invoice number from the number on the invoice the Taxpayer submitted, and the company never ships overnight as indicated on the Taxpayer's submitted invoice. He testified he was told the Taxpayer made an order on November 9, 2023 for Game Blue Cigarillos but it was never shipped. He testified the company provided him with a copy of the order. He testified that he made a supplemental report about what he found about the Taxpayer's invoice. He testified the Taxpayer signed the OTP-4 form for said invoice indicating that the information on the form was truthful but that based on his investigation, the invoice was fraudulent and was filed as an attempt to mislead the Division.

On cross-examination, _____ testified the invoice was fraudulent and that he spoke to someone named _____ at the company who was a customer service representative. Division's Exhibit 37 (notice of license revocation, notice of assessment, compliance report, submitted invoice, OTP-4 form, Division and tobacco company emails with company indicating the

submitted invoice was not its invoice and the Taxpayer never had any product shipped to it, seizure report, audit report and workpapers, Taxpayer's disciplinary history print-out).

Principal Tax Auditor, testified that he is familiar with the Taxpayer. He testified the Taxpayer has held a cigarette dealer's license and a permit to make sales at retail since 2017. He testified that it is not a licensed tobacco distributor. He testified the Division is statutorily authorized to conduct tobacco inspections and to seize contraband without a warrant. He testified the various assessments issued to the Taxpayer have not been paid nor has the Taxpayer ceased from selling tobacco after the issuance of notices of license revocation as the Taxpayer requested hearings for the matters. He testified that statutory interest has accrued.

The Auditor testified for the October, 2019 inspection, the Division issued a license of revocation notice and deficiency notices for OTP and cigarettes. He testified the Division assessed tax and penalties (a) and (b) under the statute for the seized OTP and cigarettes. He testified the statutory tax for OTP was applied, and penalty (a) was five (5) times the retail value as this was a first offence in 24 months, and penalty (b) was assessed at one (1) time the tax due as the first offense. He testified that as the cigarettes were seized at the same time, that seizure was also considered a first offense in 24 months. He testified the Division assessed a tax and penalties (a) and (b) under the statute for the seized cigarettes. He testified the statutory tax for cigarettes was applied, and penalty (a) was five (5) times the retail value as this was a first offence in 24 months, and penalty (b) was assessed at \$1,000 as the greater amount as provided by statute. Division's Exhibits Six (6) and 11 (revocations); Seven (7) and 12 (deficiencies); Eight (8) and 13 (compliance reports); Nine (9) (seizure report); and 10 (OTP and cigarette excise tax report).

The Auditor testified the Division attempted to inspect the Taxpayer on December 13, 2019, and the Taxpayer refused to allow the inspectors entry. He testified an assessment for this

violation was issued based on penalty (b) under the statute. He testified the Taxpayer entered into a Stipulation of Settlement of Dismissal (“Stipulation”) on June 25, 2021 in relation to the January 2021 Notice issued on the Taxpayer’s refusal of inspection. He testified the penalty amount was reduced in the Stipulation and was to be paid by the Taxpayer by July 15, 2021. He testified the Taxpayer did not pay the settlement amount, and the Stipulation provides that in case of a default the full amount of the assessment is to be paid. He testified this was the Taxpayer’s second offense in 24 months. Division’s Exhibits 17 and 18 (notice of license revocation and Notice of Deficiency Determination both dated October 20, 2020); 19 (compliance report); 20 (report of excise tax); 22 (January 2021 Notice); and 23 (Stipulation).

The Auditor testified the January 27, 2021 inspection was the Taxpayer’s third offence within 24 months. The Auditor testified for this inspection, the Division issued a license of revocation and deficiency notices for OTP and cigarettes. He testified the Division assessed tax and penalties (a) and (b) under the statute for the seized OTP. He testified the statutory tax for OTP was applied and penalty (a) was 15 times the retail value as this was a third offence in 24 months, and penalty (b) was assessed at three (3) times the tax due as the third offense. He testified that for the seized cigarettes, the statutory tax for cigarettes was applied and penalty (a) was 15 times the retail value as this was a third offence in 24 months, and penalty (b) was assessed at three (3) times the tax due as the third offense. Division’s Exhibits 24 and 29 (revocations); 25 and 30 (OTP and cigarette assessments); 26 and 31 (compliance reports); 27 and 32 (seizure reports); and 28 and 33 (audit reports).

The Auditor testified the January 26, 2023 inspection was the Taxpayer’s third offence within 24 months but was its overall fifth offense. The Auditor testified for this inspection, the Division issued a license of revocation notice and deficiency notices for OTP and cigarettes. He

testified the Division assessed the tax and penalties (a) and (b) under the statute for the seized OTP and cigarettes. He testified the statutory tax for OTP was applied, and penalty (a) was 16 times the retail value as this was a third offence in 24 months with a factor of five (5) used for each offence and one (1) aggravating factor, and penalty (b) was assessed at five (5) times the tax due as the fifth offense. He testified for the seized cigarettes, the statutory tax for cigarettes was applied, and penalty (a) was 16 times the retail value as this was a third offence in 24 months with a factor of five (5) for each offense and one (1) aggravating factor, and penalty (b) was assessed at five (5) times the tax due as the fifth offense. Division's Exhibit 36 (revocations, OTP and cigarette assessments, compliance and seizure and audit reports).

The Auditor testified the November 9, 2023 inspection was the Taxpayer's third offence within 24 months but its overall sixth offense. The Auditor testified for this inspection, the Division issued a license of revocation notice and deficiency notice for OTP. He testified the Division assessed tax and penalties (a) and (b) under the statute for the seized OTP. He testified the statutory tax for OTP was applied and penalty (a) was 17 times the retail value as this was a third offence in 24 months so a factor of five (5) for each offense with two (2) aggravating factors and penalty (b) was assessed at five (5) times the tax due as was the sixth offense. Division's Exhibit 37 (revocation, OTP assessment, compliance and seizure and audit reports).

On cross-examination, the Auditor testified that he is familiar with the tobacco tax statutes, and the tax statute provides authority for inspections. When asked about the packet seized in Division's Exhibit 27, he testified the box would say how many leaves inside so do not have to open the packet, and he does not know if it was opened.

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 must 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 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. *Defenders of Animals v. Dept. of Environmental Management*, 553 A.2d 541 (R.I. 1989). 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 § 44-20-12⁶ imposes a tax on cigarettes sold. R.I. Gen. Laws § 44-20-13.2⁷ imposes tax on “other tobacco products.” Inspections of cigarette dealers are allowed by R.I. Gen.

⁶ 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.

⁷ R.I. Gen. Laws § 44-20-13.2 provides in part as follows:

Tax imposed on other tobacco products, smokeless tobacco, cigars, and pipe tobacco products. (a) A tax is imposed on all other tobacco products, smokeless tobacco, cigars, and pipe tobacco products sold, or held for sale in the state by any person, the payment of the tax to be accomplished according to a mechanism established by the administrator, division of taxation, department of revenue. The tax imposed by this section shall be as follows:

(1) At the rate of eighty percent (80%) of the wholesale cost of other tobacco products, cigars, pipe tobacco products, and smokeless tobacco other than snuff.

(2) Notwithstanding the eighty percent (80%) rate in subsection (a) above, in the case of cigars, the tax shall not exceed fifty cents (\$.50) for each cigar.

Laws § 44-20-40.1.⁸ R.I. Gen. Laws § 44-20-51.1⁹ provides for administrative penalties for the violation of the tax laws. In addition, R.I. Gen. Laws § 44-20-8¹⁰ provides for the suspension or revocation of a cigarette dealer's license.

(b) Any dealer having in his or her possession any other tobacco products with respect to the storage or use of which a tax is imposed by this section shall, within five (5) days after coming into possession of the other tobacco products in this state, file a return with the tax administrator in a form prescribed by the tax administrator. The return shall be accompanied by a payment of the amount of the tax shown on the form to be due. Records required under this section shall be preserved on the premises described in the relevant license in such a manner as to ensure permanency and accessibility for inspection at reasonable hours by authorized personnel of the administrator.

⁸ R.I. Gen. Laws § 44-20-40.1 which provides as follows:

Inspections. (a) The administrator or his or her duly authorized agent shall have authority to enter and inspect, without a warrant during normal business hours, and with a warrant during nonbusiness hours, the facilities and records of any manufacturer, importer, distributor, or dealer.

(b) In any case where the administrator or his or her duly authorized agent, or any police officer of this state, has knowledge or reasonable grounds to believe that any vehicle is transporting cigarettes or other tobacco products in violation of this chapter, the administrator, such agent, or such police officer, is authorized to stop such vehicle and to inspect the same for contraband cigarettes or other tobacco products.

⁹ R.I. Gen. Laws § 44-20-51.1 provides as follows:

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.

¹⁰ R.I. Gen. Laws § 44-20-8 provides in part as follows:

Suspension or revocation of license. The tax administrator may suspend or revoke any license under this chapter for failure of the licensee to comply with any provision of this chapter or with any provision of any other law or ordinance relative to the sale or purchase of cigarettes or other tobacco products. The tax administrator may also suspend or revoke any license for failure of the licensee to comply with any provision of chapter 19 of title 44 and chapter 13 of title 6, and, for the purpose of determining whether the licensee is complying with any provision of chapter 13 of title 6, the tax administrator and his or her authorized agents are empowered, in addition to authority conferred by § 44-20-40, to examine the books, papers, and records of any licensee. *** Any person aggrieved by the suspension or revocation may apply to the administrator for a hearing as provided in § 44-20-47, and may further appeal to the district court as provided in § 44-20-48.

C. Breach of Stipulation and Sanction

In response to the January 2021 Notice, the Taxpayer entered into the Stipulation and agreed to pay a reduced amount of the total amount of the assessment. However, the Taxpayer agreed to pay the full amount of the assessment if it defaulted on the Stipulation.

Paragraph 16 of the Stipulation's terms provides as follows:

DEFAULT. Failure of Taxpayer to abide by any of the requirements of this Stipulation shall be a default under the Stipulation. In the event Taxpayer defaults under the Stipulation, Taxpayer agrees that the entire amount due pursuant to the Deficiency Notice, as set forth herein, shall be immediately due, final, and payable. Upon breach by Taxpayer, the Tax Division may invoke any further remedies under Rhode law that it deems appropriate.

Pursuant to paragraph 16 of the Stipulation, the Taxpayer agreed that any default by the Taxpayer of the Stipulation would result in the original assessed amount being owed immediately. The evidence was the Taxpayer did not make the payment due under the Stipulation which the Taxpayer did not dispute. Therefore, the Taxpayer shall pay the full amount owed for the assessment for its refusal to allow inspection issued on October 29, 2020 and as set forth in the Stipulation. Division's Exhibits 18 (assessment); 22 (January 2021 Notice); and 23 (Stipulation).

D. The Seized Products – Whether Tax is Owed

Prior to hearing, the Taxpayer moved to suppress items seized by the Division that are the subject of this matter and to which the Division objected. By order dated August 26, 2024, the undersigned denied the motion. Said order is incorporated by reference. During the hearing, the Taxpayer continued to argue the Division conducted searches that required warrants.

The fourth amendment of the United States Constitution¹¹ protects against searches and seizures without a warrant. However, the United States Supreme Court has found there are

¹¹ The fourth amendment to the United States Constitution provides as follows:

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable

exceptions to this requirement. The Court has held that any expectation of privacy in commercial premises is less than a similar expectation in an individual's home. *New York v. Burger*, 482 U.S. 691 (1987). Furthermore, certain "closely regulated" industries have such a history of government oversight that no reasonable expectation of privacy could exist for a proprietor. Essentially, administrative inspections without court orders are often necessary to further an important state regulatory scheme. As the Court found, "[i]f an inspection is to be effective and serve as a credible deterrent, unannounced, even frequent, inspections are essential." *Id.* at 710 (citation omitted). *Burger* established three (3) criteria needed for warrantless inspections of pervasively regulated businesses. Relying on *Burger*, the Rhode Island Supreme Court in *Keeney v. Vinagro*, 656 A.2d 973, 975 (R.I. 1995) found that a warrantless search of a pervasively regulated business is reasonable if the following three (3) criteria are met:

- 1) "a 'substantial' government interest that informs the regulatory scheme pursuant to which the inspection is made."
- 2) "the warrantless inspections must be necessary to further the regulatory scheme."
- 3) "the statute's inspection program, in terms of the certainty and regularity of its application," must provide "a constitutionally adequate substitute for a warrant." *Keeney*, at 975. See also *Burger*, 482 U.S. at 702-03.

Keeney relied on *Burger* in finding how and when administrative inspections may be made which were adopted by Rhode Island in *Keeney*.

All entities involved in the sale of tobacco products are required to be licensed by the Division. The Division has regulatory authority over the enforcement and administration of

cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Article I, Section Six (6) of the Rhode Island Constitution provides as follows:

§ 6. Search and seizure. The right of the people to be secure in their persons, papers and possessions, against unreasonable searches and seizures, shall not be violated; and no warrant shall issue, but on complaint in writing, upon probable cause, supported by oath or affirmation, and describing as nearly as may be, the place to be searched and the persons or things to be seized.

tobacco taxes. Records of tobacco sales and purchases must be kept and be available for inspection. Those records may be inspected by the Division and must be kept on premises for such inspection. Dealer licensees are required to keep records of the “sale, purchase, transfer, consignment, or receipt of cigarettes.” R.I. Gen. Laws § 44-20-40. The Division ensures compliance by licensees via inspections and noncompliant licensees are subject to administrative penalties and the suspension or revocation of dealer licenses. The tobacco taxing statute ensures that dealer licensees maintain records of the sale and purchase of cigarettes which ensures records are kept about payment of statutorily required tax for tobacco products. R.I. Gen. Laws § 44-20-8, R.I. Gen. Laws § 40-20-13.2, R.I. Gen. Laws § 44-20-40, and R.I. Gen. Laws § 44-20-40.1 all authorize inspections of tobacco licensees. R.I. Gen. Laws § 44-20-12.2 and R.I. Gen. Laws § 44-20-15 authorize tax inspectors and law enforcement at the direction of the Division to seize contraband tobacco products without a warrant. R.I. Gen. Laws § 44-20-43 and R.I. Gen. Laws § 44-20-45 authorize criminal penalties for violations of the taxing statute.

1. **Applicability of *Burger* and *Keeney* - Closely Regulated Business**

Burger found that a warrantless inspection even in the context of a pervasively regulated business, will only be deemed reasonable if the three (3) criteria in that case are met. *Id.* at 701. Thus, the first question to be asked before applying the three (3) criteria is whether the sale of tobacco is a closely regulated industry. *Burger* found that automobile junkyards were a closely regulated industry because the regulatory scheme required junkyard owners to obtain licenses, keep books recording purchases and sales of automobiles and parts, make the books and automobiles available for inspection, and junkyard owners could be subject to criminal penalties, license revocation, and civil fines for failure to comply. *Burger* at 704-5. *Burger* also found other states impose such conditions on junkyard operators. Like junkyard operators, cigarette dealers

must obtain licenses, keep records of sales and purchases, keep records on premises for inspection and are subject to license revocation, administrative penalties, and criminal penalties for violations.

The tobacco industry in other states with similar tobacco taxing statutes have been found to be closely regulated businesses subject to warrantless administrative inspections. *U.S. v. Mansour*, 252 F.Supp.3d 182 (Dt. Ct. W.D. N.Y. 2017) found that New York state cigarette retailers are pervasively regulated and upheld a warrantless inspection. That court found that all cigarette dealers must be licensed and risk suspension or revocation of license for possessing and selling unstamped cigarettes. The court also noted that 47 states require tax stamps on cigarettes and New York pre-collects that tax (like Rhode Island) so inspections were a method to block the sale in New York of out of state cigarettes with lower excise taxes. *U.S. v. Hamad*, 6 F.Supp.3d 852 (Dt. Ct. N.D. IL, E.D. 2013) also found tobacco retailers to be closely regulated in Cook County, Illinois and upheld a warrantless inspection for the same kind of tax stamp regulatory scheme. *People v. Beydoun*, 770 N.W.2d 54 (Mich.App. 2009) applied a *Burger* like test for a pervasively regulated industry finding that tobacco products were extensively regulated in Michigan. Like Rhode Island, Michigan had licensing, stamping, and record keeping requirements as well as a statutory provision allowing the seizure of tobacco as contraband during an inspection.

Anyone applying for dealer's license is aware that he is she is subject to "close government supervision." *Burger* 482 U.S. 700. An applicant for a dealer license would be aware of the licensing requirement as well as the conditions of the license to only buy from licensed distributors, to maintain and keep records, and be subject to inspections. Indeed, these statutory requirements demonstrate that the sale of tobacco is a closely regulated business or a pervasively regulated business. It is clear from a review of the tax statutes and *Burger* that the sale of tobacco is a closely regulated business in Rhode Island. Therefore, the three (3) criteria from *Keeney* apply.

a. “a ‘substantial’ government interest that informs the regulatory scheme pursuant to which the inspection is made.”

The original tobacco taxing statute was enacted in 1939. P.L. 1939, ch. 663, § 1 (etc.). As evidenced by the statutory licensing, records, and tax requirements and authority given to the Division in the cigarette and the OTP tax statute, R.I. Gen. Laws § 44-20-1 *et seq.*, and regulations promulgated pursuant to said statute, there is a strong public interest in the administration and enforcement and collection of the proper payment of tobacco taxes. Indeed, dealers are required to buy cigarettes from licensed distributors which ensures the cigarette tax is prepaid. R.I. Gen. Laws § 44-20-12; R.I. Gen. Laws § 44-20-8.2. Thus, there is a strong government interest that informs the regulatory scheme pursuant to which inspections can be made.

b. “the warrantless inspections must be necessary to further the regulatory scheme.”

If a warrant was required for every inspection related to the tobacco industry, the regulatory scheme would be severely frustrated. If store owners had advance notice of inspections, they would be able to remove any untaxed tobacco products defeating the purpose of an inspection. The purpose of the inspection is to ensure the proper collection and payment of taxes. *Mansour*; and *Hamad*. It is for those reasons that *Keeney* adopted *Burger* regarding warrantless inspections for closely regulated businesses. *Burger* found that for regulatory inspections to be effective and serve as a deterrent, unannounced, even frequent, inspections are essential. That is the purpose of the statutory tax inspections.

c. “the statute's inspection program, in terms of the certainty and regularity of its application,” must provide “a constitutionally adequate substitute for a warrant.”

Under the third prong, the regulatory scheme must advise the tobacco licensee that an inspection¹² is being made by law and has been properly defined in scope. Any licensed dealer is aware that under the statute they are subject to inspections without a warrant during business hours. The statutory scheme provides clear notice to tobacco licensees that “facilities and records” are subject to inspections during business hours and contraband goods may be seized.

2. Administrative Inspections

The Taxpayer argued that because tobacco was seized, the Division conducted a search rather than an inspection. However, the statute authorizes the seizure of any cigarettes found in violation of this section. In other words, the Division is authorized to inspect licensees’ records for compliance. Indeed, those records are to be kept on premises for the ease of inspection. If during the inspection, the Division finds cigarettes or OTP not in compliance with the statute – e.g. no tax stamp, no records supporting payment of taxes – they can be seized as part of the inspection. The Taxpayer may want to call that a search, but it is an inspection as authorized by the taxing statute. The inspector reviews the products and the records and then is authorized to seize products not in compliance as demonstrated by the record review.

In addition, the Division testified that during the January 27, 2021 inspection, the Taxpayer’s owner and his wife’s car was inspected by Division inspectors. This inspection was conducted after the police concluded its investigation. Such an inspection is provided for by R.I. Gen. Laws § 44-20-40.1(b) which allows for an inspection of a vehicle when there are reasonable grounds to believe it is transporting tobacco products and to inspect it for any contraband cigarettes

¹² It is noted that *Burger* uses the term search. The Taxpayer tried to differentiate between an inspection and a search by calling the inspection a seizure, but the statutory scheme provides for inspections and seizure of contraband goods.

or OTP. Here, the vehicle was owned by the Taxpayer's owner and his wife and was driven by them to the premises at the time the Division was there to conduct an inspection.

In *Benson v. Department of Environmental Management*, 2022 RI Super LEXIS 38 (Superior Court), the Superior Court upheld the inspection, seizure, and disposal of a fisherman's summer flounder catch as he did not hold the proper license for such fishing. In reviewing the administrative appeal, the Superior Court applied the *Burger* test adopted by *Keeney*. The Court found that commercial fishing was a closely regulated business as like the tobacco industry and the junkyard in *Burger*, it is subject to licensing requirements, inspections, and licensees face license suspension or revocation for violation of the regulatory scheme. The court found that the three (3) criteria applied and upheld the warrantless inspection and seizure of the catch.

Pursuant to R.I. Gen. Laws § 44-20-12.2¹³ and R.I. Gen. Laws § 44-20-15,¹⁴ the Division is authorized to seize contraband cigarettes and OTP if during an inspection of products and

¹³ R.I. Gen. Laws § 44-20-12.2 provides in part as follows:

Prohibited acts — Penalty. (a) No person or other legal entity shall sell or distribute in the state; acquire, hold, own, possess, or transport for sale or distribution in this state; or import, or cause to be imported, into the state for sale or distribution in this state; nor shall tax stamps be affixed to any cigarette package:

(d) Any cigarettes found in violation of this section shall be declared to be contraband goods and may be seized by the tax administrator, or his or her agents, or by any sheriff, or his or her deputy, or any police officer, without a warrant. The tax administrator may promulgate rules and regulations for the destruction of contraband goods pursuant to this section, including the administrator's right to allow the true holder of the trademark rights in a cigarette brand to inspect contraband cigarettes prior to their destruction.

¹⁴ R.I. Gen. Laws § 44-20-15 provides in part as follows:

Confiscation of contraband cigarettes, other tobacco products, and other property. (a) All cigarettes and other tobacco products that are held for sale or distribution within the borders of this state in violation of the requirements of this chapter are declared to be contraband goods and may be seized by the tax administrator or his or her agents, or employees, or by any sheriff, or his or her deputy, or any police officer when directed by the tax administrator to do so, without a warrant. All contraband goods seized by the state under this chapter shall be destroyed.

(b) All fixtures, equipment, and all other materials and personal property on the premises of any distributor or dealer who, with the intent to defraud the state, fails to keep or make any record, return, report, or inventory; keeps or makes any false or fraudulent record, return, report, or inventory required by this chapter; refuses to pay any tax imposed by this chapter; or attempts in any manner to evade or defeat the requirements of this chapter shall be forfeited to the state.

records, they are found to be noncompliant. See also 280-RICR-20-15-1 *Cigarette Tax* (“Cigarette Regulation”) and 280-RICR-20-15-2 *Other Tobacco Products* (“OTP Regulation”).¹⁵ As the

¹⁵ The Cigarette Regulation provides in part as follows:

1.19 Inspections

A. The Tax Administrator and his or her agents is authorized under R.I. Gen. Laws § 44-20-40.1 to conduct unannounced inspections to insure compliance with all provisions of R.I. Gen. Laws Chapter 44-20. Accordingly, the Tax Administrator and his or her agents shall be permitted to inspect the Place of Business of any person selling any and all tobacco products within the State. Inspections of Licensed Distributors or Dealers shall be conducted during normal business hours without a warrant and without prior notice.

B. The Tax Administrator and his or her duly authorized agents shall be permitted to inspect he books, papers, reports and records of any Manufacturer, Importer, Distributor, or Dealer in this state for the purpose of determining whether taxes imposed by R.I. Gen. Laws Chapter 44-20 have been fully paid, and may investigate the stock of cigarettes and other tobacco products in or upon the Place of Business for the purpose of determining whether the provisions of R.I. Gen. Laws Chapter 44-20 are being obeyed.

C. Failure to allow such inspection(s) of the Place of Business and/or records may result in civil penalties and/or suspension or revocation of a Cigarette Dealer’s or Distributor’s License.

1.20 Seizures

All cigarettes and/or other tobacco products which are possessed, stored, retained, or otherwise brought into the state in contradiction to R.I. Gen. Laws § 44-20-13.2 and these Regulations shall be considered untaxed contraband by the Tax Administrator and his or her agents. The cigarettes and/or other tobacco products may be seized by the Tax Administrator or his or her agents or employees or by any sheriff or his or her deputy or any police officer when directed by the Tax Administrator to do so, without a warrant.

1.21 Billings and Penalties

1.22 Seizure and Destruction of Unstamped Cigarettes

Any cigarettes found at any place in this state without stamps affixed as required R.I. Gen. Laws Chapter 44-20 are declared to be contraband goods and may be seized by the Tax Administrator, his or her agents, or employees, or by any deputy sheriff, or police officer when directed by the Tax Administrator to do so, without a warrant. Any cigarettes seized under the provisions of R.I. Gen. Laws Chapter 44-20 shall be destroyed. The seizure and/or destruction of any cigarettes under the provisions of this R.I. Gen. Laws § 44-20-37 does not relieve any person from a fine or other penalty for violation of R.I. Gen. Laws Chapter 44-20.

The OTP Regulation provides in part as follows:

2.9 Inspections

A. The Tax Administrator and his or her agents are authorized under R.I. Gen. Laws § 44-20-40.1 to conduct unannounced inspections to insure compliance with all provisions of R.I. Gen. Laws Chapter 44-20. Accordingly, the Tax Administrator and his or her agents shall be permitted to inspect the Place of Business of any Person selling any tobacco products within the State. Inspections of licensed Distributors or Dealers shall be conducted during normal business hours without a warrant and without prior notice.

B. The Tax Administrator and his or her duly authorize agents shall be permitted to inspect the books, papers, reports, and records of any Manufacturer, Importer, Distributor, or Dealer in this state for the purpose of determining whether taxes imposed by R.I. Gen. Laws Chapter 44-20 have been fully paid, and may investigate the stock of cigarettes and Other Tobacco Products in or upon the Place of Business for the purpose of determining whether the provisions of R.I. Gen. Laws Chapter 44-20 are being obeyed.

C. Failure to allow such inspection(s) of the Place of Business and/or records may result in civil penalties and/or suspension or revocation of a Cigarette Dealer’s or Distributor’s License.

purpose of the statute is to ensure tax compliance, it would be inconsistent with the purpose of the statute to allow taxpayers to continue to sell products that are considered contraband. The statute authorizes the seizure and destruction of contraband goods. If cigarettes are seized without tax stamps, they can be destroyed. If a taxpayer is unable to provide proof either by invoice or at hearing that OTP tax was paid, the contraband is to be destroyed. Section 2.12 of OTP Regulation. The statute authorizes the seizure of contraband goods to ensure that tax is being properly paid. The fact that goods were seized during a statutory administrative inspection of the Taxpayer's commercial property does not turn the inspection into a criminal warrantless search.

As discussed in *Benson*, if a Department of Environmental Management ("DEM") administrative inspection of a fishing vessels finds fish caught without the proper permit, said fish are seized by the inspectors and sold. Thus, if the licensee contests the finding that it caught fish without a proper license and prevails at hearing, the licensee would conceivably be able to obtain the return of the price for which the fish was sold. However, it would defeat the purpose of the

2.10 Seizures

Other Tobacco Products which are possessed, stored, retained, or otherwise brought into the State in contradiction to R.I. Gen. Laws § 44-20-13.2 and this Regulation shall be considered untaxed contraband by the Tax Administrator and his or her agents. The Other Tobacco Products may be seized by the Tax Administrator or his or her agents or employees or by any sheriff or his or her deputy or any police officer when directed by the Tax Administrator to do so, without a warrant.

2.11 Billings and Penalties

A. In the event that contraband Other Tobacco Products are seized, the Tax Administrator shall issue a Notice of Deficiency Determination for the amount of tax due but unpaid on the seized items. The Tax Administrator may impose civil penalties for failure to pay tax on any Notice of Deficiency that results from a seizure of contraband Other Tobacco Products. The civil penalty shall be in the amount of five (5) times the tax due but unpaid, as calculated by the Tax Administrator and his or her agents.

B. In addition to the civil penalties listed above, the Tax Administrator, in his or her sole discretion, may suspend or revoke a cigarette Dealer's or Distributor's license for any violation of these Regulations.

2.12 Destruction of Other Tobacco Products

In the event that the taxpayer is unable or unwilling to provide valid records/invoices to evidence tax paid on the seized contraband, the contraband shall be destroyed in any manner deemed appropriate by the Tax Administrator pursuant to R.I. Gen. Laws § 44-20-15(b). If a Dealer contests a Notice of Deficiency Determination within thirty (30) days, no seized Other Tobacco Products will be destroyed while the matter is pending hearing. All seized contraband may be stored at any facility or location the Tax Administrator deems appropriate.

DEM inspection to allow an inspected fishing vessel to keep and sell fish that had been caught in contravention of the fishing regulations.

The same is true here. Tobacco is a closely regulated business and under the statute administrative inspections are authorized. Indeed, the statute details the type of records to be kept. Failure to keep proper records can lead to a finding that the appropriate taxes were not paid. Rather than allow a business to continue with what has been found to be the nonpayment of taxes, the Division is authorized to seize those goods. If the business can demonstrate after the seizure by invoice or at hearing, that such goods were not contraband and the proper taxes were paid, the goods can be returned. If not, they are destroyed.

The tax statute provides that inspections are to be made during business hours. The Taxpayer did not argue that any of the inspections were not made during business hours.

In this matter, the Taxpayer was engaged in an activity – sale of tobacco and other tobacco products - for which there is a substantial governmental interest (*supra*) and for which it needed permission to operate from the Division and for which warrantless and regulatory inspections as a closely regulated business are provided for by applicable statutes.¹⁶ The Division did not need a warrant to conduct inspections of a licensed dealer in its premises during business hours.

There was no showing by the Taxpayer that the Division inspectors did anything during any of the inspections but review records, products, and seize products deemed to be noncompliant with tax statutes.¹⁷ Therefore, the Division conducted inspections as authorized by statute and seized tobacco products as authorized by law.

¹⁶ It is noted that a determination of unconstitutionality of a statute is a not an issue that is properly before an administrative agency. *Easton's Point Association et al v. Coastal Resources Management Council et al.*, 522 A.2d 199 (R.I. 1987). However, the Taxpayer did not argue that the taxing statutes were unconstitutional. Rather the Taxpayer argued the inspection did not comport with the requirements for a search. As detailed in this decision, the inspection complied with the Division's statutory authority as provided for in *Burger* and *Keeney*.

¹⁷ At hearing, the Taxpayer for the first time stated there were surveillance videos of the inspections. At the Taxpayer's request the record was left open for the videos to be submitted; however, no videos were submitted.

E. Whether the Taxpayer Owes the Tax Assessments on Seized Products

The testimony was the applicable statutory tax for OTP, cigarettes, and cigars was applied to the seized OTP, cigarettes, and cigars (etc.) products. The Taxpayer did not challenge the calculation of the taxes owed. The Taxpayer did not provide any evidence that it paid tax on any of the seized tobacco products. Thus, the Taxpayer owes the applicable tobacco taxes for the seized tobacco products.

F. What Sanctions Should be Imposed for the Various Seizures

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. The statute further provides that for a second or subsequent offense in a 24 month period, a penalty of not more than 25 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 when imposing penalties (a) and (b). The Division seeks monetary penalties for the seized OTP and cigarettes pursuant to R.I. Gen. Laws § 44-20-51.1(a) and (b).

2. The Taxpayer’s Violations

There were five (5) different inspections at issue in this hearing. The Division presented testimony that the two (2) 2023 inspections resulted in the Taxpayer’s overall fifth and sixth offenses. This is because there was a violation on May 4, 2022 that resulted in a settled assessment.

According to the Division's print-out of the Taxpayer's violation history, this 2022 matter did not go to hearing and resulted in an assessment with the suspension pending. Division's Exhibit 37. The Taxpayer did not dispute that there was a 2022 violation.

SC 20-002, 20-003 2020 Notice - Date of Violation: October 24, 2019

This offense was the Taxpayer's first offense. The Division imposed penalty (a) with a factor of five (5). The Division's testimony showed that a factor of five (5) is used by the Division for each offense. The statute allows for penalty (a) to be up to ten (10) times the retail value of the tobacco product for a first offense. Penalty (b) was assessed as one (1) time the tax due as this was the first offense and it was greater than \$1,000, and the greater amount is mandated by statute. The Division considered mitigating or aggravating factors such as history, severity, and intent in determining the penalties. Therefore, the Division properly imposed the penalties for this violation.

SC 20-021 January 2021 Notice - Date of Violation: December 13, 2019,

This offense was the Taxpayer's second offense within 24 months. Its sanction was addressed above as the Taxpayer breached the Stipulation that settled this matter.

SC 21-053, SC 21-054 May 2021 Notice - Date of Violation: January 27, 2021

This offense was the Taxpayer's third offense in 24 months. The Division imposed penalty (a) with a factor of 15. The statute allows for penalty (a) to be up to 25 times the retail value of the tobacco product for a second or subsequent offense within 24 months. The Division's testimony showed that a factor of five (5) is used by the Division for each offense so as this was the third offense within 24 months, a factor of 15 was used for the penalty (a). Penalty (b) was assessed as three (3) times the tax due as this was the third offense and it was greater than \$1,000 which is mandated by statute. The Division considered mitigating or aggravating factors such as

history, severity, and intent in determining the penalties. Here, the penalties were increased due to it being the Taxpayer's third offense in 24 months for penalty (a) and its third offense for penalty (b). Therefore, the Division properly imposed the penalties for this violation.

SC 23-011, SC 23-012 2023 Notice - Date of Violation: January 26, 2023

The evidence was that this was the Taxpayer's third offense in 24 months. This includes the January 27, 2021 violation and the March, 2022 violation (settled; not in hearing). However, this was the Taxpayer's overall fifth offense as there were two (2) violations in 2019, one (1) violation in 2021, and one (1) violation in 2022.

The Division imposed penalty (a) with a factor of 16. The statute allows for penalty (a) to be up to 25 times the retail value of the tobacco product for a second or subsequent offense within 24 months. The Division's testimony showed that a factor of five (5) is used by the Division for each offense so as this was the third offense within 24 months, a factor of 15 was used for the penalty (a) as well as an additional factor of one (1) for the aggravating factor of not having invoices for cigarettes and OTP. Penalty (b) was assessed at the maximum five (5) times the tax due as this was the fifth offense and it was greater than the \$1,000 which is mandated by statute. The Division considered mitigating or aggravating factors such as history, severity, and intent in determining the penalties. Here, the penalties were increased due to it being the Taxpayer's third offense in 24 months for penalty (a) and its overall fifth offense for penalty (b). Therefore, the Division properly imposed the penalties for this violation.

SC 23-084 2024 Notice - Date of Violation: November 9, 2023

The evidence was that this was the Taxpayer's third offense in 24 months. This includes the March, 2022 violation (settled; not in hearing) and January 26, 2023 violation. However, this

was the Taxpayer's overall sixth offense as there were two (2) violations in 2019, one (1) violation in 2021, one (1) violation in 2022, and one (1) violation in 2023.

The Division imposed penalty (a) with a factor of 17. The statute allows for penalty (a) to be up to 25 times the retail value of the tobacco product for a second or subsequent offense within 24 months. The Division's testimony showed that a factor of five (5) is used by the Division for each offense so as this was the third offense within 24 months, a factor of 15 was used for the penalty (a) as well as an additional factor of two (2) for the aggravating factors of not having invoices for cigarettes and OTP and filing a false document. Penalty (b) was assessed at the maximum of five (5) times the tax due as this was the sixth offense and it was greater than \$1,000 which mandated by statute. The Division considered the mitigating or aggravating factors such as history, severity, and intent in determining the penalty. Here, the penalties were increased due to it being the Taxpayer's third offense in 24 months for penalty (a) and its sixth offense for penalty (b). Therefore, the Division properly imposed the penalties for this violation.

3. Whether Dealer's License Should be Revoked

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.¹⁸

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

¹⁸ *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.

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).

Nevertheless, based solely on the three violations before the Court, the Court could find the 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.

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 the sanction 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.

The Taxpayer's first offense was a very egregious offense in that the tax owed alone was \$118,421.65 for OTP. Two months after the October, 2019 inspection that resulted in the discovery of a large amount of untaxed tobacco products, the Division attempted to inspect the Taxpayer again. At this time, the Taxpayer refused to allow the inspectors in to inspect despite the statute governing the sale of tobacco under which the Taxpayer is licensed as a cigarette dealer clearly allows such regulatory inspections without a warrant. The only conclusion that can be made from the Taxpayer's refusal two (2) months after the first inspection was that rather than no longer engaging in tax avoidance schemes, the Taxpayer was continuing to engage in such schemes and did not want the Division to conduct an inspection and find more untaxed tobacco products. Such refusal flies in the face of a cigarette dealer's statutory requirements obligations and is very serious since inspections ensure cigarette dealers' compliance with their tax obligations.

Over a year after the 2021 refusal to inspect, the Division conducted another inspection because the police informed it, they would be executing a search warrant. Again, the Division found untaxed tobacco products. In early 2023, another inspection of the Taxpayer found untaxed products. Finally, in late 2023, another inspection found a box of untaxed OTP. The third, fifth,

and sixth offenses that are part of this hearing had tax owed that was much lower than the first offense. Nonetheless, the Taxpayer repeatedly continued to fail to comply with the tax statutes.

As always, the Taxpayer was given a chance to provide invoices to show that tax had been paid on seized products. In 2019, 2021, and early 2023, the Taxpayer was unable to provide such invoices. However, in late 2023, the Taxpayer provided an invoice, but it was fraudulent. The Division contacted the out of state tobacco company which by written correspondence indicated the Taxpayer never bought any product from them, and in fact the Taxpayer had filed an order for the product that was seized after the product was seized but that product was never shipped. The company also confirmed that its invoices did not look like the invoice submitted by the Taxpayer.¹⁹

The Taxpayer already engaged in a systematic process to avoid tax as evidenced by the testimony about the Taxpayer invoices. There was testimony the Taxpayer would make two (2) orders, a large and small order and use the small order to submit its OTP-4 forms. Thus, the Taxpayer tried to avoid scrutiny by paying some taxes on OTP but not all of the taxes owed based on its orders. Not only did the Taxpayer not pay the tax owed, but the Taxpayer took steps to obfuscate it was not paying tax on all of its tobacco orders.

This is the Taxpayer's sixth offense within five (5) years and these offenses demonstrate a high volume amount of contraband product (first offense) and a repeated and systematic circumvention of the tobacco taxing statute. An egregious type of violation (e.g. systematic high

¹⁹ It is noted that during the hearing, the Taxpayer objected to some testimony on the grounds of hearsay. Hearsay is allowed in administrative hearings pursuant to R.I. Gen. Laws § 42-35-10 "when necessary to ascertain facts not reasonably susceptible of proof under those rules, evidence not admissible under those rules may be submitted (except where precluded by statute) if it is of a type commonly relied upon by reasonably prudent men in the conduct of their affairs." See *DePasquale v. Harrington*, 599 A.2d 314, 316-317 (R.I. 1991).

In this matter, all testimony about the seizures and tax calculations were testified to by the inspectors and the auditor involved in the inspection and calculations. In terms of the fake invoice, the inspector testified to speaking to the company and received a copy of the company's real invoices that was compared to the one submitted by the Taxpayer. There are no grounds to reject that testimony. The inspector credibly testified as to the steps he took to determine the validity of the invoice and received documentation by email from the company regarding its invoices.

volume circumvention of the tax statutes) could result in revocation after the first or second offense. Here, the Taxpayer has been engaged in a pattern of circumventing tax statutes over several years. Instead of coming into compliance after the first offense, the Taxpayer refused to allow the Division to conduct an inspection only two (2) months later. The Division's subsequent inspections continued to find ongoing violations culminating in the Taxpayer falsifying an invoice.

The submission of a false document in 2023 to cover up the nonpayment of tax by the Taxpayer to the Division is so egregious that in of itself supports the revocation of the cigarette dealer's license. This was not a situation where a taxpayer accidentally submitted the wrong documentation or where a taxpayer was sloppy in its recordkeeping. Instead, the Taxpayer took deliberate steps to place an order with a tobacco company for the product the Division had already seized to fake an invoice. The submission of this false document showed the Taxpayer has no regard and no interest in maintaining accurate records as required by law. Rather, it felt justified to falsify a document to try to only pay tax rather than also be sanctioned by the Division for its violation.²⁰ The statute is clear regarding the payment of tax and what is expected of cigarette dealers. The retention and maintenance of purchase records by a cigarette dealer is fundamental to the Division's statutory mandate to ensure compliance with the taxing statute. *Supra*. Such a fraudulent action cannot be tolerated by tobacco licensees.

The Taxpayer's submission of the false invoice, its egregious first violation, the subsequent violations, and its refusal to allow inspection demonstrated the Taxpayer has no regard for its

²⁰ Indeed, there was evidence that the Taxpayer previously submitted falsified invoices in 2019 when the Division reviewed the submitted invoices and then obtained the actual invoices from the company itself. The Taxpayer submitted a report explaining the discrepancies in real invoices, and the Taxpayer's submitted invoices in relation to the October 24, 2019 inspection. Division's Exhibit 13. The Division did not include this as an aggravating factor in penalty (a). The Division did not provide the alleged falsified invoices as an exhibit. The real invoices were contained in Division's Exhibit Ten (10). It certainly seems the 2024 false invoice was not the first time the Taxpayer submitted such documentation to the Division. Nonetheless, the finding in this decision is the sole submission of the 2023 faked document is enough to revoke a cigarette license.

statutory obligations as a cigarette dealer. The type and pattern of behavior since 2019 shows the Taxpayer systematically, continuously, and repeatedly tries to avoid paying taxes. Such behavior justifies the revocation of the cigarette dealer's license.

4. Interest

As testified at hearing, the imposition of interest after the nonpayment of an assessment by its due date is authorized by R.I. Gen. Laws § 44-1-7.²¹

VI. FINDINGS OF FACT

1. OTP and cigarette and tobacco for which no tax was paid were seized from the Taxpayer on October 24, 2019, January 27, 2021, January 26, 2023, and November 9, 2023.

2. On December 13, 2019, the Taxpayer refused to allow the Division's inspectors to inspect its premises.

3. As a result of the four (4) seizures and the refusal to inspect, the Division issued the 2020 Notice, the January 2021 and, the May 2021 Notice, the 2023 Notice, and the 2024 Notice.

4. The Taxpayer entered into a Stipulation to resolve the refusal to inspect matter. The Taxpayer did not pay the amount due under the Stipulation by the due date and has not paid the amount due under the Stipulation.

5. The Notices were consolidated for hearing.

6. Prior to hearing, the Taxpayer moved to suppress items seized. By order dated, August 26, 2024, the motion was denied.

²¹ 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.

7. A hearing was held on October 1, 2024 with the record closing and the parties resting on the record on October 18, 2024.

8. 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 280-RICR-20-00-2 *Administrative Hearing Procedures*.

2. The Taxpayer owes the assessed other tobacco products and cigarette tax and penalties and any accrued interest.

3. The Taxpayer breached the Stipulation and owes the full assessment as provided for in the Stipulation and the Notice of Assessment.

4. The Taxpayer's cigarette dealer's license shall be revoked.

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, R.I. Gen. Laws § 44-20-13.2, and R.I. Gen. Laws § 44-20-51.1, the taxes and penalties were properly assessed on the Taxpayer's OTP and cigarettes seizures as set forth above. Pursuant to R.I. Gen. Laws § 44-1-7, the Taxpayer owes any accrued interest on said assessments.

Pursuant to R.I. Gen. Laws § 44-20-1 *et seq.*, the Taxpayer breached the Stipulation and owes the full assessment as provided for in the Stipulation and said Notice of Assessment

Pursuant to R.I. Gen. Laws § 44-20-8, the Taxpayer's cigarette dealer's license shall be revoked effective on the 31st day after the execution of this decision.

The taxes and penalties and any interest owed by the Taxpayer and the Stipulation assessment shall be due to the Division by the 31st day after the execution of this decision.

Date: December 9, 2024

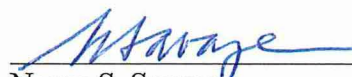

Catherine R. Warren
Hearing Officer

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: 12/17/24


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 19th day 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 John Beretta, Esquire, Division of Taxation, One Capitol Hill, Providence, RI 02908.

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