

REDACTED DECISION – DOCKET NUMBER 12-366 X-M

**A.M. “FENWAY” POLLACK, CHIEF ADMINISTRATIVE LAW JUDGE - SUBMITTED
FOR DECISION on DECEMBER 31, 2013
ISSUED ON AUGUST 18, 2014**

BEFORE THE WEST VIRGINIA OFFICE OF TAX APPEALS

SYNOPSIS

PUBLIC HEALTH

**IMPLEMENTATION AND ENFORCEMENT OF TOBACCO MASTER
SETTLEMENT AGREEMENT**

The agreement between West Virginia and certain major tobacco companies is referred to as the “Tobacco Master Settlement Agreement” and implementation of this agreement is codified in West Virginia Code Section 16-9B-1 *et seq.* Enforcement of the agreement is codified in West Virginia Code Section 16-9D-1 *et seq.*

PUBLIC HEALTH

**ENFORCEMENT OF STATUTES IMPLEMENTING TOBACCO MASTER
SETTLEMENT AGREEMENT
DEFINITIONS**

In Article 9D, the West Virginia Legislature has given the Tax Commissioner enforcement duties under the agreement. *See* W. Va. Code Ann. §16-9D-2(c) (West 2014) (“Commissioner” means the duly appointed head of the agency responsible for collection of the excise tax on cigarettes”).

PUBLIC HEALTH

**ENFORCEMENT OF STATUTES IMPLEMENTING TOBACCO MASTER
SETTLEMENT AGREEMENT
CERTIFICATIONS; DIRECTORY; TAX STAMPS**

“*Directory of cigarettes approved for stamping and sale.* – The commissioner shall develop and publish on the tax division's website a directory listing all tobacco product manufacturers that have provided current and accurate certifications conforming to the requirements of subsection (a) of this section and all brand families that are listed in the certifications, except as provided in subdivisions (1) and (2) of this subsection.” W. Va. Code Ann. §16-9D-3(b) (West 2014).

PUBLIC HEALTH

ENFORCEMENT OF STATUTES IMPLEMENTING TOBACCO MASTER SETTLEMENT AGREEMENT

CERTIFICATIONS; DIRECTORY; TAX STAMPS

“The tax commissioner shall update the directory as necessary in order to correct mistakes and to add or remove a tobacco product manufacturer or brand family.” W. Va. Code Ann. §16-9D-3(B)(3) (West 2014).

PUBLIC HEALTH

ENFORCEMENT OF STATUTES IMPLEMENTING TOBACCO MASTER SETTLEMENT AGREEMENT

CERTIFICATIONS; DIRECTORY; TAX STAMPS

“Prohibition against stamping or sale of cigarettes not on the directory. -- It is unlawful for any person: (1) To affix a stamp to a package or other container of cigarettes of a tobacco product manufacturer or brand family not included in the directory; or (2) To sell, offer, or possess for sale in this state, cigarettes of a tobacco product manufacturer or brand family not included in the directory” W. Va. Code Ann. §16-9D-3(c)(1)&(2) (West 2014).

PUBLIC HEALTH

ENFORCEMENT OF STATUTES IMPLEMENTING TOBACCO MASTER SETTLEMENT AGREEMENT

PENALTIES AND OTHER REMEDIES

“Revocation of business registration certificate and civil money penalty. -- In addition to or in lieu of any other civil or criminal remedy provided by law, upon a determination that a distributor, stamping agent or any other person has violated subsection (c), section three of this article, or any rule adopted pursuant thereto, the commissioner may revoke or suspend the business registration certificate of the distributor, stamping agent or other person in the manner provided by article twelve, chapter eleven of this code. Each stamp affixed and each sale or offer to sell cigarettes in violation of subsection (c), section three of this article constitutes a separate violation. The commissioner may also impose a civil penalty in an amount not to exceed the greater of five hundred percent of the retail value of the cigarettes or five thousand dollars upon a determination of violation of subsection (c), section three of this article or any rules adopted pursuant thereto.” W. Va. Code Ann. §16-9D-8(a) (West 2014).

WEST VIRGINIA OFFICE OF TAX APPEALS

CONCLUSION OF LAW

West Virginia Code Section 16-9D-8(a) affords the Tax Commissioner discretion as to both, what action to take upon the sale of de-listed cigarettes and as to the amount of penalty upon such sales.

WEST VIRGINIA OFFICE OF TAX APPEALS

CONCLUSION OF LAW

By failing to exercise discretion as to the amount of the money penalty in this matter, the Tax Commissioner abused his discretion.

**WEST VIRGINIA OFFICE OF TAX APPEALS
CONCLUSION OF LAW**

In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. See W. Va. Code Ann. §11-10A-10(e) (West 2010); W. Va. Code. R. §§121-1-63.1 and 69.2 (2003).

**WEST VIRGINIA OFFICE OF TAX APPEALS
CONCLUSION OF LAW**

The Petitioner has met its burden of showing that the money penalty issued against it by the Tax Commissioner was erroneous, unlawful, void, or otherwise invalid.

FINAL DECISION

On August 3, 2012, the Auditing Division of the West Virginia State Tax Commissioner's Office (hereafter Tax Commissioner or Respondent) issued an audit notice of assessment against Petitioner (hereafter Petitioner). This assessment was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 16, Article 9D *et seq.*, of the West Virginia Code. The assessment was for the sale of cigarettes not listed in the directory of approved brands or manufacturers during the period from June 30, 2009, through May 31, 2012. The assessment was for additions to tax (a money penalty) in the amount of \$_____. Written notice of this assessment was served on the Petitioner, as required by law.

On October 3, 2012, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. See W. Va. Code Ann. §§11-10A-8(1); 11-10A-9 (West 2010). An evidentiary hearing was held on August 27, 2013. Thereafter, the parties filed legal briefs. At the conclusion of the briefing schedule this matter became ripe for decision.

FINDINGS OF FACT

1. The Petitioner is an out of state corporation that provides inventory to convenience stores, including some in West Virginia. Included in the inventory it provides are tobacco products.

2. In 1998, the state of West Virginia was one of the states that entered into a settlement agreement with various tobacco manufacturers, as the result of previously filed national litigation. This agreement is commonly referred to as the “master settlement agreement.”

3. In 2003, the West Virginia Legislature drafted Article 9D of Chapter 16 of the state code, which codified certain violations and penalties regarding the agreement. One of the provisions of Article 9D was a prohibition on selling cigarettes that were not listed in a directory of approved brands. Article 9D also created money penalties for selling unapproved brands.

4. Article 9D gave the Tax Commissioner enforcement duties.

5. In 2012, an auditor with the West Virginia State Tax Department reviewed the Petitioner’s books and records regarding cigarette sales and discovered that it had sold cigarettes that were no longer listed in the directory of approved brands. Specifically, during the period of June to September of 2009 the Petitioner sold 12,210 packs of Brand A cigarettes and twenty packs of Brand B cigarettes when those brands were not on the approved list.

6. During the period when the de-listed cigarettes were sold the Petitioner was undergoing management/staffing issues. The Petitioner attributes the selling of the de-listed brands to these issues.

7. This is the third audit of this Petitioner that revealed the sale of de-listed cigarettes.

8. The money penalty amount that forms this assessment constitutes the number of packs sold that were not on the approved list, times the state minimum pricing, times seven percent, to obtain the retail price, times five hundred percent.

DISCUSSION

Despite the fact that this matter involves the tobacco master settlement agreement, the West Virginia Legislature has clearly given the Tax Commissioner enforcement authority and the Petitioner does not quibble about this point. *See* W. Va. Code Ann. §16-9D-1 *et seq* (West 2014). In fact, this matter hinges on only one complaint by the Petitioner, namely, that the penalty/fine that was assessed is too high, and that the Tax Commissioner abused his discretion in levying such a penalty. The Tax Commissioner, for his part, argues that the Petitioner should have known better than to sell brands that were not on the list, because twice before it has been assessed a money penalty for selling non-approved brands. The Tax Commissioner also points out that he could have revoked the Petitioner's business registration certificate, but chose not to.

The Tax Commissioner's ability to assess a money penalty for the sale of de-listed brands is codified in West Virginia Code Section 16-9D-8:

Revocation of business registration certificate and civil money penalty. -- In addition to or in lieu of any other civil or criminal remedy provided by law, upon a determination that a distributor, stamping agent or any other person has violated subsection (c), section three of this article, or any rule adopted pursuant thereto, the commissioner may revoke or suspend the business registration certificate of the distributor, stamping agent or other person in the manner provided by article twelve, chapter eleven of this code. Each stamp affixed and each sale or offer to sell cigarettes in violation of subsection (c), section three of this article constitutes a separate violation. The commissioner may also impose a civil penalty in an amount not to exceed the greater of five hundred percent of the retail value of the cigarettes or five thousand dollars upon a determination of violation of subsection (c), section three of this article or any rules adopted pursuant thereto.

W. Va. Code Ann. §16-9D-8(a) (West 2014). In their post-hearing briefs the parties argue back and forth as to whether the Tax Commissioner abused his discretion under the facts of this case. As one would expect, the Petitioner argues that the Tax Commissioner failed to take into account any factors that would mitigate the issuance of a maximum penalty. The Tax Commissioner contrasts Section 8(a) with West Virginia Code Section 11-10-19¹. Due to the fact that Section 11-10-19 only allows the Tax Commissioner to issue a penalty upon a finding of a willful failure to pay or evade a tax, while Section 8(a) contains no willfulness requirement for assessing a penalty for selling de-listed cigarettes, the Tax Commissioner argues that the penalty in this case was proper. We find this argument to be unpersuasive. The Tax Commissioner's suggestion that he has no choice but to assess a penalty upon the sale of a de-listed brand is belied by the Legislatures use of the word "may" in Section 8(a). See Rosen v. Rosen, 222 W. Va. 402, 664 S.E.2d 743 (2008) (An elementary principle of statutory construction is that the word "may" is inherently permissive in nature and connotes discretion). West Virginia Code Section 16-9D-8(a) is clear and unambiguous, and by its plain language the Tax Commissioner can do four things upon discovering the sale of de-listed cigarettes, he or she can 1) revoke the sellers business registration certificate, 2) assess them a money penalty, 3) revoke and assess a penalty, 4) or do nothing. Additionally, if the Tax Commissioner assesses a money penalty, he or she has discretion as to the amount of the penalty.

¹ Any person required to collect, account for and pay over any tax administered under this article, who willfully fails truthfully to account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a money penalty equal to the total amount evaded, or not collected, or not accounted for and paid over. W. Va. Code Ann. §11-10-19 (West 2010).

In this matter, we must rule for the Petitioner. The Tax Commissioner did abuse his discretion when he assessed the penalty in this matter, but not because, as the Petitioner argues, he ignored certain mitigating factors. The evidence in this matter shows that the Tax Commissioner exercised no discretion at all in issuing the penalty. In fact, the Tax Commissioner's only witness testified that there is **never** any discretion exercised when issuing penalties such as this.

JUDGE POLLACK: . . . Now, is it your understanding that you have no discretion, that you have to do 500 percent?

MR. JOHNSON: Yes. My auditors have no discretion. I mean they have the ability to come to me. I have the ability to go to my director and get anything --- to request something less. It's never happened. I mean we --- in my recollection, they've all been 500 percent that we've done. And these are rare. There's not that many of them.

Transcript at p. 65. Mr. Johnson's testimony seems to suggest that while the Tax Commissioner routinely assesses the maximum penalty in cases such as this, there is the remote possibility that in certain circumstances, there is at least room for discussion about a lesser penalty. Unfortunately, later in his testimony, Mr. Johnson states something more troubling, namely, that the Tax Department computers have been programed to always assess the maximum penalty.

JUDGE POLLACK: Okay. But when you say it's at 500 percent, is it your understanding that --- don't even bother going up the food chain because the answer is going to be no?

MR. JOHNSON: I've never gone up the food chain for any ---. I've never heard a good explanation to go up the food chain. **Our audit program is locked in at 500 percent.** I mean I don't ---. Like I said, these were rare. I don't recall any reason to ask for a reduced rate.

Transcript at p. 67 (emphasis added). No matter what the situation, employees who think they have to assess the maximum penalty, or a computer program² that will not allow a lesser penalty, the evidence in this matter clearly shows that the Tax Commissioner never exercises the discretion afforded him by the Legislature, when it drafted West Virginia Code Section 16-9D-8.³ The end result is Section 8(a) having been, for all intents and purposes, rewritten by the Tax Commissioner to now read: “The commissioner may also impose a civil penalty in an amount ~~not to exceed~~ **equal to** the greater of five hundred percent of the retail value of the cigarettes or five thousand dollars.”

The Petitioner wants this Tribunal to rule that the Tax Commissioner abused his discretion by ignoring certain mitigating factors regarding the amount of the penalty in this matter. We cannot rule as such, because the Tax Commissioner never considered any factors regarding the amount of the penalty. However, this failure was, in and of itself, an abuse of discretion. *See e.g. Brunson v. Pierce Cnty.*, 149 Wash. App. 855, 205 P.3d 963 (2009) (Failure to exercise discretion is an abuse of discretion).

After this decision was completed we sent it to the parties with directions that they, in accordance with Section 73 of Title 121, Series 1 of the Code of State Rules, consult and attempt to arrive at a corrected penalty amount.⁴ The parties were unable to agree on a revised penalty amount. The Petitioner argues for a penalty equating to the retail price of the delisted cigarettes

² If the computers will in fact not allow a lesser penalty, the record does not show who, at the Tax Department, directed that they be programmed as such.

³ We recognize that the Legislature has given the Tax Commissioner discretion in two areas, what to do upon discovery of the sale of de-listed brands and how much of a penalty to assess. As a result, the Tax Commissioner’s argument that he could have revoked the Petitioner’s business registration certificate is not relevant to a discussion regarding the exercising of discretion as to the proper amount of penalty.

⁴ “Where the office of tax appeals has filed or stated its opinion determining the issues in a case, it may withhold entry of its decision for the purpose of permitting the parties to submit computations pursuant to the office of tax appeals determination of the issues, showing the correct amount of the liability or overpayment to be entered as the decision.” W. Va. Code R. §121-1-73.1.1 (2003).

sold, times 25%, which would reduce the Tax Commissioner's penalty by approximately \$_____. The Tax Commissioner argues that the penalty should remain at the maximum allowed under West Virginia Code Section 16-9D-8(a) *supra* which is the retail price times 500%. The Tax Commissioner makes this argument based upon the fact that this is the third time the Petitioner has sold cigarettes that were not on the approved list.⁵

We have no interest in micromanaging the functions of the Tax Department. However, in this matter the Petitioner argued that the Tax Commissioner had abused the discretion given to him in Section 8(a) and the evidence showed that to be true. We do agree with the Tax Commissioner that a larger penalty is warranted in this matter, precisely because this is not the first time the Petitioner has been audited and been found to have sold delisted brands. We just disagree with the Tax Commissioner's contention that this Petitioner deserves the maximum penalty. Common sense tells us that the maximum penalty should be reserved for the worst offenders, for example, a seller who deliberately sells delisted brands or who engages in some criminal activity in connection with cigarette sales. We believe that a 25% reduction in the penalty in this matter is appropriate, or put another way, a fine representing the price of the non-approved packs that were sold times 375%.

⁵ The Tax Commissioner also complains that this decision is inconsistent with a recently issued decision in which we upheld the maximum penalty for a first time violator. However, in that matter, the Petitioner, by counsel, argued that there should be no penalty whatsoever because the Tax Commissioner failed to properly notify it of the brand's removal from the approved list. Therefore, we did not have any evidence before us regarding the Tax Commissioner's exercise of discretion or lack thereof.

CONCLUSIONS OF LAW

1. The agreement between West Virginia and certain major tobacco companies is referred to as the “Tobacco Master Settlement Agreement” and implementation of this agreement is codified in West Virginia Code Section 16-9B-1 *et seq.* Enforcement of the agreement is codified in West Virginia Code Section 16-9D-1 *et seq.*

2. In Article 9D, the West Virginia Legislature has given the Tax Commissioner enforcement duties under the agreement. *See* W. Va. Code Ann. §16-9D-2(c) (West 2014) (“Commissioner” means the duly appointed head of the agency responsible for collection of the excise tax on cigarettes”).

3. “*Directory of cigarettes approved for stamping and sale.* – The commissioner shall develop and publish on the tax division's website a directory listing all tobacco product manufacturers that have provided current and accurate certifications conforming to the requirements of subsection (a) of this section and all brand families that are listed in the certifications, except as provided in subdivisions (1) and (2) of this subsection.” W. Va. Code Ann. §16-9D-3(b) (West 2014).

4. “The tax commissioner shall update the directory as necessary in order to correct mistakes and to add or remove a tobacco product manufacturer or brand family.” W. Va. Code Ann. §16-9D-3(b)(3) (West 2014).

5. “*Prohibition against stamping or sale of cigarettes not on the directory.* -- It is unlawful for any person: (1) To affix a stamp to a package or other container of cigarettes of a tobacco product manufacturer or brand family not included in the directory; or (2) To sell, offer, or possess for sale in this state, cigarettes of a tobacco product manufacturer or brand family not included in the directory” W. Va. Code Ann. §16-9D-3(c)(1)&(2) (West 2014).

6. *“Revocation of business registration certificate and civil money penalty.* -- In addition to or in lieu of any other civil or criminal remedy provided by law, upon a determination that a distributor, stamping agent or any other person has violated subsection (c), section three of this article, or any rule adopted pursuant thereto, the commissioner may revoke or suspend the business registration certificate of the distributor, stamping agent or other person in the manner provided by article twelve, chapter eleven of this code. Each stamp affixed and each sale or offer to sell cigarettes in violation of subsection (c), section three of this article constitutes a separate violation. The commissioner may also impose a civil penalty in an amount not to exceed the greater of five hundred percent of the retail value of the cigarettes or five thousand dollars upon a determination of violation of subsection (c), section three of this article or any rules adopted pursuant thereto.” W. Va. Code Ann. §16-9D-8(a) (West 2014).

7. West Virginia Code Section 16-9D-8(a) affords the Tax Commissioner discretion as to both, what action to take upon the sale of de-listed cigarettes and as to the amount of penalty upon such sales.

8. By failing to exercise discretion as to the amount of the money penalty in this matter, the Tax Commissioner abused his discretion.

9. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. §11-10A-10(e) (West 2010); W. Va. Code. R. §§121-1-63.1 and 69.2 (2003).

10. The Petitioner has met its burden of showing that the money penalty issued against it by the Tax Commissioner was erroneous, unlawful, void, or otherwise invalid.

DISPOSITION

Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the money penalty assessment issued against the Petitioner on August 3, 2012, for additions to tax in the amount of \$_____ is hereby **MODIFIED** to now be in the amount of \$_____.

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
A. M. "Fenway" Pollack
Chief Administrative Law Judge

Date Entered