

# **CIGARETTE TAX GUIDELINES AND RULES** **RELATED TO ENFORCEMENT**

**August 13, 2010**

Effective July 1, 2010, House Bill 820 and Senate Bill 476 (2010 *Acts of Assembly*, Chapters 35 and 471) reduce the penalties related to unstamped cigarettes. Stamping agents who fail to properly affix Virginia revenue stamps will be required to pay a penalty of \$2.50 per pack, up to \$500, for the first violation by a legal entity within a 36 month period, \$5 per pack, up to \$1,000, for the second violation by the legal entity within a 36 month period, and \$10 per pack, up to \$50,000, for the third or subsequent violation by the legal entity within a 36 month period. The stamping agent will be required to pay a civil penalty of \$25 per pack, up to \$250,000, where willful intent exists to defraud the Commonwealth. Persons other than stamping agents who sell, purchase, transport, receive, or possess unstamped cigarettes, except as otherwise provided by law, will also be subject to the same civil penalties.

These guidelines and rules ("Guidelines") are issued by the Department of Taxation ("TAX") to provide guidance to taxpayers regarding the penalties for possession of unstamped cigarettes. These guidelines are exempt from the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 *et seq.*). To the extent that there is a conflict between the existing Cigarette Tax Regulations (23 *Virginia Administrative Code* (VAC) 10-240-10 *et seq.*) and these Guidelines, these Guidelines supersede the regulations. TAX has worked with stamping agents and retailers to develop these Guidelines. These Guidelines supersede Virginia Tax Bulletins 08-13 and 07-3 effective July 1, 2010. As necessary, additional Guidelines will be published and posted on TAX's website, [www.tax.virginia.gov](http://www.tax.virginia.gov).

## **Background**

In Virginia Tax Bulletin 08-13 (November 15, 2008), TAX announced modifications to the rules regarding the assessment of cigarette tax penalties and the procedures for appealing these penalties. Virginia Tax Bulletin 08-13 superseded Virginia Tax Bulletin 07-3 (March 15, 2007), in which TAX announced increased compliance efforts for the enforcement of the cigarette tax and put in place some temporary rules regarding the application of penalties. The Virginia cigarette tax is currently imposed at the rate of 30 cents per pack of 20 cigarettes and the payment of the tax is evidenced by affixing a Virginia Cigarette Revenue Stamp.

## **Time Frame for Stamping Cigarettes**

Prior to July 1, 2010, stamping agents were required to affix the stamps within one business day of receipt of any unstamped cigarettes. Effective July 1, 2010, House Bill 874 (2010 *Acts of Assembly*, Chapters 701) provides that stamping agents must affix Virginia revenue stamps representing the proper cigarette tax to any unstamped cigarettes prior to shipping to other wholesale dealers or retail outlets in Virginia. (Source: *Va. Code* § 58.1-1003)

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### **Stamping Exemptions**

A stamping agent may sell cigarettes without the Virginia revenue stamp affixed if:

1. The cigarettes are sold to a cigarette dealer in another state;
2. The cigarettes are purchased exclusively for resale in the other state; and
3. The cigarettes sold into the other state are at the time of sale stamped with the other state's cigarette stamp by the Virginia wholesale dealer.

A stamping agent may also sell cigarettes without the Virginia revenue stamp affixed if:

1. The cigarettes are being sold to the United States or an instrumentality of the United States for purposes of resale to or for the use or consumption by members of the armed services;
2. The cigarettes are being sold to the Veterans Canteen Service of the Veterans Administration for resale to or for the use or consumption by veterans of the armed services who are hospitalized or domiciled in Veterans Administration homes and hospitals, or
3. The cigarettes are being sold and delivered to ships regularly engaged in foreign commerce or coastwise shipping between points in this Commonwealth and points outside of this Commonwealth for resale to or for use or consumption upon such ship or in foreign commerce.

### **Penalties Applicable to Licensed Stamping Agents for Unstamped Cigarettes**

Effective July 1, 2010, any stamping agent who fails to properly affix the required stamps to any cigarettes is subject to a penalty of \$2.50 per pack, up to \$500, for the first violation by a legal entity within a 36 month period, \$5 per pack, up to \$1,000, for the second violation by the legal entity within a 36 month period, and \$10 per pack, up to \$50,000, for the third or subsequent violation by the legal entity within a 36 month period. In addition to the penalties imposed, the stamping agent is liable for the cigarette excise tax on all unstamped cigarettes. For inspections where the number of unstamped cigarette packs does not exceed 30 packs, TAX may issue a warning letter to the stamping agent instead of assessing the penalty. Even if TAX does not impose a monetary penalty, such inspections will still be used for the purposes of determining the number of violations made within a 36 month period by a legal entity. (Source: *Va. Code* § 58.1-1013)

Where willful intent to defraud the Commonwealth of the cigarette tax is found, a penalty of \$25 per pack, up to \$250,000, may be imposed. If a stamping agent has an amount of unstamped cigarettes (i) more than 30 packs or 5% of the cigarettes in their place of business, whichever is greater, or (ii) more than 500 packs, such possession shall be prima facie evidence of intent to defraud. If such unstamped cigarettes are in the stamping agent's possession pursuant to the authority provided by *Va. Code* § 58.1-1003, such possession will not be prima facie evidence of intent to defraud. *Va. Code*

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§ 58.1-1003, requires stamping agents to affix Virginia revenue stamps only prior to shipping to other wholesale dealers or retail outlets. Notwithstanding these threshold limits, any person who commits a voluntary, conscious, and intentional act to defraud the Commonwealth is subject to the increased penalty. (Source: *Va. Code* § 58.1-1013)

For the purposes of determining the number of violations made within a 36 month period, a stamping agent that has undergone a corporate or similar reorganization will be considered the same legal entity, even if it results in the use of a new tax registration number or Federal Employer Identification Number (FEIN). A legal entity that purchases the assets of an existing business through a bona fide sale will not be liable for prior violations by such business. It is the burden of the stamping agent to show that it is a new legal entity for the purposes of determining the number of violations.

If a stamping agent believes that he has delivered unstamped cigarettes to a customer, he has a duty to immediately notify his customer of the situation and take action to remove any unstamped cigarettes from sale by the customer. The stamping agent must also notify TAX of the situation by emailing the Tobacco Unit at [TobaccoUnit@tax.virginia.gov](mailto:TobaccoUnit@tax.virginia.gov) and providing the name and address of each customer who may have been shipped unstamped cigarettes and the steps taken by the stamping agent to correct the error.

### **Penalties Applicable to Persons Other than Stamping Agents for Unstamped Cigarettes**

Effective July 1, 2010, any person who is not a stamping agent who sells, purchases, transports, receives or possesses unstamped cigarettes is subject to a penalty of \$2.50 per pack, up to \$500, for the first violation by a legal entity within a 36 month period, \$5 per pack, up to \$1,000, for the second violation by the legal entity within a 36 month period, and \$10 per pack, up to \$50,000, for the third or subsequent violation by the legal entity within a 36 month period. Any person subject to the penalty imposed by this section is also liable for the cigarette excise tax on all unstamped cigarettes. This penalty applies to both retailers and individuals purchasing cigarettes from exempt entities as well as stamping agents. For inspections where the number of unstamped cigarette packs does not exceed 30 packs, TAX may issue a warning letter to the legal entity instead of assessing the penalty. Even if TAX does not impose a monetary penalty, such inspections will still be used for the purposes of determining the number of violations made within a 36 month period by a legal entity. (Source: *Va. Code* § 58.1-1017)

Where willful intent to defraud the Commonwealth of the cigarette tax is found, a penalty of \$25 per pack, up to \$250,000, may be imposed. If a person who (i) has not been issued a permit to affix revenue stamps by TAX or (ii) is not a retail dealer who has lawfully purchased cigarettes from such permit holder has in his possession within the Commonwealth more than 30 packs of unstamped cigarettes, such possession is

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presumed to be for the purpose of evading taxes. Notwithstanding these threshold limits, any person who commits a voluntary, conscious, and intentional act to defraud the Commonwealth is subject to the increased penalty. (Source: *Va. Code* § 58.1-1017)

For the purposes of determining the number of violations made within a 36 month period, a business that has undergone a corporate or similar reorganization will be considered the same legal entity, even if it results in the use of a new tax registration number or Federal Employer Identification Number (FEIN). A legal entity that purchases the assets of an existing business through a bona fide sale will not be liable for prior violations by such business. It is the burden of the business to show that it is a new legal entity for the purposes of determining the number of violations.

Cigarette retailers and wholesalers who are not stamping agents must carefully inspect every pack of cigarettes at the time of delivery or receipt to ensure that every pack of cigarettes has been stamped with the Virginia Revenue Stamp. In the event that unstamped cigarettes are discovered, the dealer should immediately segregate the unstamped cigarettes and post a notice on the cigarettes stating that they are unstamped and not for sale. Additionally, the dealer should immediately telephone or e-mail its supplier to notify the supplier of the situation and arrange for the return of the unstamped cigarettes to the supplier. Stamping agents and dealers are strongly encouraged to revisit their quality control procedures so that unstamped cigarettes are neither shipped nor received into inventory.

### **Avoidance of Penalties for Unstamped Cigarettes by Retailers**

A retail dealer may avoid the penalties for purchasing, receiving, or possessing unstamped cigarettes by proving to TAX that the unstamped cigarettes were lawfully purchased from a licensed Virginia Stamping Agent. In order to prove that the cigarettes were purchased lawfully, the retailer must provide a copy of the invoice from the stamping agent and physical proof that the unstamped cigarettes were purchased from that stamping agent. The following are examples of physical proof:

1. A signed affidavit from the stamping agent stating the stamping agent sold the unstamped product in question to the retailer;
2. Distinctive numbering, lettering, marking, labeling, bar codes or other features reflecting that the cigarettes were sold by the stamping agent; or
3. Physical observation by a TAX auditor that:
  - a. The unstamped cigarettes are segregated from other inventory;
  - b. The unstamped cigarettes are clearly posted as being unstamped and not for sale; and

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- c. The dealer is able to document that the stamping agent has been contacted by the dealer concerning the unstamped packs no more than 15 days prior to the date of physical inspection by the auditor.

### **Affidavit Process**

In the event that a retail dealer wishes to use an affidavit signed by his stamping agent to prove that any unstamped cigarettes were purchased lawfully in order to avoid the penalties, the retail dealer must request the affidavit from the stamping agent and notify TAX that he has done so by emailing the Tobacco Unit at [TobaccoUnit@tax.virginia.gov](mailto:TobaccoUnit@tax.virginia.gov) within 14 days of the inspection. The stamping agent will then have an additional 14 days to provide a signed affidavit stating that he sold the unstamped product in question to the retailer. If the retail dealer does not request the affidavit from the stamping agent or notify TAX that he has done so within 14 days, TAX will issue an assessment to the retail dealer for the penalty imposed under *Va. Code* § 58.1-1017. Additionally, if a signed affidavit is not provided to TAX within 28 days of the inspection, TAX will issue an assessment to the retail dealer for the penalty imposed under *Va. Code* § 58.1-1017.

By signing an affidavit, the stamping agent acknowledges that he sold the unstamped product in question to the retailer and that he may be liable for the penalty imposed pursuant to *Va. Code* § 58.1-1013. In the event that the retailer can provide proof that the cigarettes were purchased from a licensed Virginia Stamping Agent, TAX will refrain from assessing the penalty imposed under *Va. Code* § 58.1-1017 on the retailer. In these cases, TAX will assess upon the stamping agent the penalty imposed under *Va. Code* § 58.1-1013, which equal the penalties imposed pursuant to *Va. Code* § 58.1-1013. TAX will typically not make further reductions in penalties on appeal or pursuant to an offer in compromise, unless exceptional circumstances are present. Each assessment of penalties through the affidavit process would be considered a violation by the stamping agent under *Va. Code* § 58.1-1013 for the purposes of determining the number of violations by a legal entity within a 36 month period.

### **Penalties for Contraband Cigarettes**

Under *Va. Code* § 3.2-4206, the Attorney General is required to post a directory (the "Directory") of the tobacco product manufacturers that have provided current certifications conforming to state law. The removal of a manufacturer or brand family from the website is deemed to provide notice to purchasers that the cigarettes may no longer be sold in the Commonwealth. The Directory can be found on the Office of the Attorney General's website, [www.oag.state.va.us](http://www.oag.state.va.us).

Any person who i) affixes a Virginia revenue stamp to a package or other container of cigarettes of a tobacco product manufacturer or brand family not included in the Directory, or ii) sells, offers, possesses for sale, ships, distributes, or imports for personal consumption cigarettes of a tobacco product manufacturer or brand family not included in the Directory in the Commonwealth is subject to a maximum penalty not to

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exceed the greater of 500% of the retail value of the cigarettes sold or \$5,000, for each violation. (Source: *Va. Code* §§ 3.2-4207 and 3.2-4212)

A person purchasing cigarettes for resale is in compliance with the law if the cigarettes were included in the Directory at the time of purchase, are otherwise lawfully stamped, and sold within 14 days of the date when the cigarettes were removed from the Directory. In addition, a retailer who lawfully purchases such cigarettes is not in violation of the law if the cigarettes are sold or delivered within 14 days after receipt from the wholesaler. However, any manufacturer, wholesaler, or retailer offering the cigarettes for sale during the safe harbor period must notify any purchasers of the cigarettes at the time of delivery that such cigarettes have been removed from the Directory. (Source: *Va. Code* § 3.2-4207)

All purchasers of cigarettes, both wholesalers and retailers, are required to monitor the Directory on an ongoing basis. While it is the responsibility of both wholesalers and retailers to ensure that purchasers are notified when cigarettes are removed from the Directory, the wholesaler's responsibility to notify the retailer when cigarettes are removed from the Directory does not diminish the retailer's responsibility for verifying that the cigarettes are listed in the Directory.

Where the possession or sale of contraband cigarettes was not knowing or intentional, TAX will generally assess less than the maximum penalty provided under *Va. Code* § 3.2-4212 and instead assess the *lesser* of 500% of the retail value of the cigarettes sold or \$5,000. If the retail value of the cigarettes is unavailable, TAX will use the average market value of the cigarettes at the time of the violation. However, TAX reserves the right to depart from the reduced penalties when required by circumstances. In addition to the penalties imposed, all contraband cigarettes are subject to confiscation and forfeiture.

As the reduced penalties set forth are intended to address situations where the possession or sale of the contraband cigarettes was unintentional, TAX will typically not make further reductions in penalties on appeal or pursuant to an offer in compromise, unless exceptional circumstances are present.

### **Appeals**

Any person may appeal issues related to the cigarette tax to TAX using the administrative appeals process administered by TAX under *Va. Code* § 58.1-1820 *et seq.* and 23 VAC 10-20-165.

A third party may always provide information, testimony, or documentary evidence on behalf of a taxpayer who has been assessed cigarette tax or penalties. However, a properly executed Power of Attorney is needed in order for a third party to file an administrative appeal on behalf of a taxpayer. The Power of Attorney must be signed and dated by both the taxpayer and the taxpayer's representative and must accompany

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the administrative appeal. Form PAR 101, Power of Attorney and Declaration of Representative can be found on TAX's website, [www.tax.virginia.gov](http://www.tax.virginia.gov). Any other Power of Attorney form containing the same information will also be accepted by TAX.

An appeal may be brought by the person assessed with cigarette tax or penalties if the person believes that TAX has incorrectly assessed the cigarette tax or penalties. Taxpayers seeking to have cigarette tax or penalties abated based on claims reasonable cause, doubtful liability, or doubtful collectibility should file an offer in compromise as discussed below.

### **Offers in Compromise**

Any person assessed with cigarette tax or penalties may choose to make an offer in compromise to settle for less than the full amount. Under *Va. Code* § 58.1-105, TAX may accept an offer in compromise if the taxpayer can show that there is reasonable cause for reducing or waiving the penalty or can show doubtful liability or collectibility for reducing or waiving the tax and interest. While penalties may be reduced or waived entirely with good cause, taxes and interest may not be waived unless it can be shown that the tax liability is doubtful, or that it is doubtful that the bill can be collected. TAX will generally not consider machine error or employee error as good cause for waiving or reducing penalties.

To request an offer in compromise, the person assessed should write to the Tax Commissioner describing the type of tax involved, taxable period, date and amount of the bill, and include a detailed explanation, along with supporting documentation, of the reasons why the tax, penalty or interest should be reduced or waived. A check for the amount of the offer should be included with the letter. The check will be applied to the account. The deposit of the check does not indicate the acceptance or denial of the offer. An explanation of when and how payment will be made should be provided if no payment is made with the offer submission. If the offer is made because the person assessed is unable to pay the bill, a signed Financial Information Statement must be included. This form can be found with the Taxpayer Bill of Rights, which is available on TAX's website at <http://www.tax.virginia.gov>. The proposal will be considered based on the available information. If the Tax Commissioner accepts the offer, any amounts waived will be removed from the bill. If the offer is not accepted, the balance of the bill must be paid.

All appeals and any offer in compromise based upon a claim of doubtful liability, along with supporting documentation, should be mailed to:

**Appeals and Rulings**  
**P.O. Box 27203**  
**Richmond, VA 23261-7203**

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All other offers in compromise, along with supporting documentation, should be mailed to:

**Tax Commissioner**  
**Department of Taxation**  
**P.O. Box 2475**  
**Richmond, Virginia 23218-2475**

**Additional Information**

These Guidelines and rules are available on-line in the Tax Policy Library section of TAX's website, located at [www.tax.virginia.gov](http://www.tax.virginia.gov). If you have any questions, please contact the Tobacco Tax Unit at (804) 371-0730.

**Approved:**



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Craig M. Burns  
Acting Tax Commissioner