



## ARIZONA LUXURY TAX RULING LTR 15-1

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Governor

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### **ISSUE:**

This ruling addresses various transfers of untaxed tobacco products between manufacturers, importers, and distributors.

### **BACKGROUND:**

Effective July 24, 2014, Laws 2014, chapter 160 (“HB 2674”) introduced numerous changes to Arizona laws governing state tobacco tax. *Arizona Luxury Tax Procedure* LTP 14-1 provides the procedure by which, under the new law, a taxpayer who is a licensed tobacco distributor may request a waiver of the general prohibition against transferring unstamped cigarettes to another licensed tobacco distributor.

This ruling addresses the various forms of transfers of unstamped cigarettes and other untaxed tobacco products between licensed and unlicensed parties (*i.e.*, manufacturers, importers, and distributors).

### **RELEVANT LAW:**

#### Provisions applicable to both cigarettes and OTP:

A.R.S. § 42-3001(11) defines a “distributor” as “any person who manufactures, produces, ships, transports or imports into this state or in any manner acquires or possesses for the purpose of making the *first sale*” any unstamped cigarettes or untaxed OTP (emphasis added). A “first sale,” as defined under A.R.S. § 42-3001(13), is “the initial sale or distribution in intrastate commerce or the initial use or consumption of cigarettes or other tobacco products.”

A.R.S. § 42-3201(A) requires a distributor “acquiring or possessing” cigarettes or OTP “for the purpose of making the initial sale or distribution” in Arizona to obtain a distributor’s license from the Department.

A.R.S. § 42-3009 provides that Arizona tobacco taxes cannot be imposed on any article or substance sold in interstate commerce and that the federal Constitution prohibits the state from taxing.

A.R.S. § 42-3201(D) states that a person cannot hold, store, or transport unstamped cigarettes or untaxed OTP for sale or distribution in Arizona in any vehicle, except under either of the following two circumstances:

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1. The vehicle is owned, operated, or contracted by a person with a valid Arizona distributor's license and is transporting unstamped cigarettes or untaxed OTP from one of the licensee's places of business listed on its license application to another.
2. The vehicle is transporting unstamped cigarettes or untaxed OTP to a licensed distributor "as part of a lawful sale" or "in interstate commerce to a person lawfully operating as a manufacturer, distributor or retailer of cigarettes or other tobacco products."

A.R.S. § 42-3201.02(B) reiterates that a vehicle may, however, transport cigarettes or OTP (whether taxed or untaxed) in a lawful delivery if the vehicle is owned, operated, or contracted by a person holding a valid Arizona distributor's license.

A.R.S. § 42-3202(B) provides the general restriction that a licensed distributor cannot sell, distribute, or transfer cigarettes or OTP to another licensed distributor without payment of tax at the time of sale, distribution, or transfer.

A.R.S. § 42-3202.02(A)(3) provides that Arizona tobacco taxes do not apply to cigarettes or OTP that are "non-taxed-paid" under subtitle E, chapter 52 of the Internal Revenue Code and that are under Internal Revenue bond or customs control. This exclusion applies to:

1. cigarettes or OTP furnished by the manufacturer for use or consumption by employees or for experimental purposes;
2. cigarettes or OTP: (a) transferred by the manufacturer or an export warehouse proprietor to the bonded premises of another manufacturer or export warehouse proprietor, (b) removed by a manufacturer or export warehouse proprietor for shipment to a foreign country or U.S. possession, or (c) removed for use by the federal government;
3. cigarettes or OTP imported or brought into the U.S. and released from customs custody for delivery to the proprietor of an export warehouse or to a manufacturer; and
4. certain cigarettes or OTP previously exported and returned, as described in 26 U.S.C. § 5704(d).

26 U.S.C. 5704.

Tobacco taxes also do not apply to cigarettes or OTP sold by a manufacturer to an Arizona-licensed tobacco distributor, pursuant to A.R.S. § 42-3202.02(A)(7).

A.R.S. § 42-3201.02(A) provides that no retailer may acquire or possess unstamped cigarettes or untaxed OTP unless it holds a tobacco distributor's license. A.R.S. § 42-3212(B) requires a distributor to issue an invoice or equivalent documentation for each sale, purchase, or consignment of cigarettes or OTP to a retailer that includes the distributor's license number.

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#### Provisions applicable specifically to cigarettes:

A.R.S. § 42-3001(6) defines a “cigarette distributor” as a “distributor” of unstamped cigarettes who is required to hold a distributor’s license. It *excludes* any retailer or person holding a permit as a cigarette manufacturer, export warehouse proprietor, or importer under 26 U.S.C. § 5712 if the permit holder sells or distributes cigarettes in Arizona only to licensed cigarette distributors or to another person holding a federal permit under 26 U.S.C. § 5712 as either an export warehouse proprietor or manufacturer. A “cigarette manufacturer” is a “distributor who manufactures, fabricates, assembles, processes or labels a finished cigarette, including a distributor who uses or makes available for use a tobacco product rolling vending machine in the manufacture, fabrication, assembly[,] or processing of tobacco products,” pursuant to A.R.S. § 42-3001(8).

A.R.S. § 42-3201(F) requires any individual who acquires or possesses unstamped cigarettes in Arizona for sale, barter, exchange, or for any purpose in addition to or other than that individual’s own use or consumption to obtain a distributor’s license.

A.R.S. § 42-3201.01(A) provides that a cigarette manufacturer can only sell or distribute cigarettes to a person located or doing business in Arizona if the person is a licensed cigarette distributor or importer or if the cigarette manufacturer sells stamped cigarettes upon which Arizona tobacco taxes have been paid.

A.R.S. § 42-3201.01(D) provides that a cigarette distributor can only obtain cigarettes from a licensed cigarette manufacturer, cigarette importer, or cigarette distributor.

A.R.S. § 42-3205(A) provides that the only persons that may possess unstamped cigarettes within the state are those shipping or transporting unstamped cigarettes pursuant to A.R.S. § 42-3205(B), licensed cigarette manufacturers, licensed cigarette importers, or licensed cigarette distributors receiving unstamped cigarette packages directly from a licensed cigarette manufacturer or cigarette importer.

Payment of tax on cigarettes is evidenced by Arizona tax stamps affixed to the cigarette packs, pursuant to A.R.S. § 42-3202(A)(1). A.R.S. §§ 42-3202(B) and 42-3203(C) provide the general restriction that cigarettes cannot be sold, distributed, or transferred unless tax has been paid on them, as evidenced by Arizona tax stamps at the time of sale, distribution, or transfer. A.R.S. § 42-3203(G) provides that a distributor can only stamp cigarettes that it has directly received from a licensed cigarette distributor, licensed cigarette manufacturer, or licensed cigarette importer.

Pursuant to A.R.S. § 42-3203(D), a licensed distributor can submit a written waiver request to sell, distribute, or transfer unstamped cigarettes to another licensed distributor. The Department provides a procedure for submitting and granting such requests in LTP 14-1.

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Pursuant to A.R.S. § 42-3203(E), cigarettes that are exempt from tax under 26 U.S.C. 5701 and distributed according to federal regulations are not subject to Arizona tobacco tax and do not require Arizona tax stamps. This provision essentially reinforces the general exclusion of federal non-tax-paid tobacco products found at A.R.S. § 42-3202.02(A)(3).

A.R.S. § 42-3211(A) requires each cigarette distributor to file a monthly report in the form and manner specified by statute. Cigarette manufacturers and importers file a separate monthly report with the information required under A.R.S. § 42-3211(B).

#### Provisions applicable specifically to OTP:

Payment of tax on OTP is evidenced by return properly filed in the manner, method, and time prescribed by A.R.S. § 42-3208, as provided in A.R.S. § 3202(A). A.R.S. § 42-3208(A) requires every distributor of OTP to pay tobacco taxes on all OTP except for those products deemed contraband in A.R.S. § 42-3208(F).

#### **RULINGS:**

Ruling 1. *Distributors subject to provisions of A.R.S. Title 42, Chapter 3:* A distributor of either cigarettes or OTP is, pursuant to A.R.S. § 42-3001(11) and (13), limited to a person who either ships, transports, or imports into Arizona or acquires or possesses for intrastate sale, distribution, use, or consumption any unstamped cigarettes or untaxed OTP. Consequently, statutes licensing tobacco distributors in A.R.S. Tit. 42, Ch. 3 are limited to those who engage in such activities with unstamped cigarettes or untaxed OTP. If a business does not handle any unstamped cigarettes or untaxed OTP, it is not subject to those particular provisions limited in applicability to distributors.

Ruling 2. *Statutory references to licensed cigarette manufacturers and licensed cigarette importers:* If a cigarette manufacturer or cigarette importer does not engage in intrastate distribution other than lawful distribution of its own products requiring it to obtain a tobacco distributor's license, the Department does not issue a separate license to do business as a cigarette manufacturer or cigarette importer in this state. As such, any reference to a "licensed cigarette manufacturer" or "licensed cigarette importer" in state statute means a manufacturer or importer who has received approval to engage in business by the federal Alcohol and Tobacco Tax and Trade Bureau ("TTB"), pursuant to 26 U.S.C. 5712 and 27 C.F.R. parts 40 and 41. A cigarette manufacturer or cigarette importer that carries on the distribution of tobacco products beyond those activities falling within the scope of its manufacturing or importing business, however, must still be licensed as a distributor.

Ruling 3. *Cigarette manufacturers distributing cigarettes into Arizona:* Cigarette manufacturers holding a TTB permit under 26 U.S.C. 5712 are not distributors that can obtain a tobacco distributor's license under A.R.S. § 42-3201, pursuant to A.R.S. § 42-3001(11), provided they do not engage in distribution beyond activities falling within the scope of their manufacturing business. They may convey cigarettes that they have

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manufactured to licensed tobacco distributors without first paying Arizona tobacco taxes, pursuant to A.R.S. §§ 42-3201(D) and 42-3202.02(A)(7).

Activities falling outside the scope of an entity's manufacturing business include, but are not limited to, the entity's replenishment of a retailer's inventory of cigarettes manufactured by the entity (*i.e.*, replacing expired or unsaleable stock) and the entity's distribution of cigarettes that it does not itself manufacture. A cigarette manufacturer that also manufactures OTP must comply with Ruling 4 below.

Ruling 4. *OTP manufacturers distributing untaxed OTP into Arizona:* Despite the general prohibition of transfer of untaxed OTP between licensed distributors, pursuant to A.R.S. §§ 42-3201(D) and 42-3202.02(A)(7), an OTP manufacturer may convey OTP that it has manufactured to another licensed tobacco distributor without first paying Arizona tobacco taxes. This exception does not apply to any OTP distributed by an OTP manufacturer that did not manufacture the OTP itself; the manufacturer must remit Arizona tobacco taxes on such products before transfer to any other party.

Ruling 5. *Unlicensed out-of-state distributors prohibited from distributing cigarettes to in-state tobacco distributors:* Pursuant to A.R.S. § 42-3201.01(D), a cigarette distributor can only purchase cigarettes from a distributor who holds a current tobacco distributor's license issued under A.R.S. § 42-3201 or a manufacturer or importer authorized by TTB to engage in business. A cigarette distributor cannot obtain cigarettes for sale or distribution in this state unless it is itself a licensed distributor, pursuant A.R.S. § 42-3201.01(C)). This ruling does not prohibit transfers of cigarettes pursuant to A.R.S. §§ 42-3202.02(A)(3), 42-3203(E), 42-3205(B), or other specific circumstances under which such transfers are allowed under state or federal law.

Ruling 6. *Unlicensed out-of-state distributors distributing OTP to in-state tobacco distributors:* There is no general restriction prohibiting an unlicensed out-of-state OTP distributor to distribute OTP to an in-state tobacco distributor. Nevertheless, the in-state tobacco distributor must hold a distributor's license under A.R.S. § 42-3201 to receive untaxed OTP. This ruling does not prohibit transfers of OTP pursuant to A.R.S. § 42-3202.02(A)(3) or other specific circumstances under which such transfers are allowed under state or federal law.

Ruling 7. *Transfers of cigarettes by Arizona-licensed cigarette distributors:* Licensed tobacco distributors are allowed to transfer unstamped cigarettes without obtaining a waiver from the Department under any of the following conditions:

- a. The transfer is to a distributor, manufacturer, importer located outside the state, pursuant to A.R.S. §§ 42-3009 and 42-3201(D).
- b. The distributor is making the transfer between its places of business that are listed with the Department under its license application, pursuant to A.R.S. § 42-3201(D).
- c. The transfer is made pursuant to an exemption found under A.R.S. § 42-3202.02.

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- d. The transfer is being made for a reason other than for the purpose of making the first sale (*i.e.*, the initial sale or distribution in intrastate commerce).

In all other circumstances, a licensed cigarette distributor must obtain a waiver from the Department before it can transfer unstamped cigarettes, pursuant to A.R.S. §§ 42-3202(B).

Ruling 8. *Transfers of OTP by Arizona-licensed OTP distributors.* Licensed tobacco distributors are allowed to transfer untaxed OTP under any of the following conditions:

- a. The transfer is to a distributor, manufacturer, or importer located outside the state, pursuant to A.R.S. §§ 42-3009 and 42-3201(D).
- b. The distributor is making the transfer between its places of business that are listed with the Department under its license application, pursuant to A.R.S. § 42-3201(D).
- c. The transfer is made pursuant to an exemption found under A.R.S. § 42-3202.02.
- d. The transfer is being made for a reason other than for the purpose of making the first sale (*i.e.*, the initial sale or distribution in intrastate commerce).

A licensed tobacco distributor is not allowed to transfer untaxed OTP under any other circumstance.

David Raber, Director

Signed: January 23, 2015

### Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to Department personnel. A tax procedure is a written statement issued by the Department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.