

CT 18-10
Tax Type: Cigarette Tax
Tax Issue: Possession of Unstamped Cigarettes

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

JOHN DOE AND ABC, INC.,

Taxpayers

No. XXXX
Account ID XXXX

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Daniel Edelstein, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Doug Ibendahl, Esq. on behalf of *JOHN DOE* and *ABC, INC.*

SYNOPSIS:

On January 27, 2015, *JOHN SMITH* and *JOHN JONES*, Department of Revenue (“Department”) Criminal Investigation Division special agents seized 258 packs of tobacco products believed by them to be little cigars from the premises of *ABC, INC.*, a business owned by *JOHN DOE* located in *ANYWHERE*, Illinois. The packages did not have Illinois tax stamps affixed to them and therefore were determined by the Department’s special agents to be possessed in violation of the Tobacco Products Tax Act of 1995, 35 ILCS 143/10-1 *et seq.* (“Tobacco Act”). The Department seeks

forfeiture of the tobacco products, believed by the Department to be little cigars, and seeks to impose civil penalties pursuant to the Cigarette Tax Act as incorporated by reference into the Tobacco Act. A hearing on this matter was conducted on May 16, 2016 and June 22, 2016. During the hearing, counsel for *JOHN DOE* and *ABC, INC.* (the “Taxpayers”) asked that the forfeiture and penalties be abated because the Department possessed insufficient evidence to prove that the tobacco products possessed by the Taxpayers were little cigars required to have tax stamps pursuant to the Tobacco Act. For the following reasons, it is recommended that this matter be resolved in favor of the Taxpayers.

FINDINGS OF FACT:

1. On January 27, 2015, Special Agent *JOHN SMITH* and Special Agent *JOHN JONES*, Special Agents for the Department’s Criminal Investigation Division, found 258 packs of unstamped tobacco products believed by them to be little cigars at *ABC, INC.*, a retailer of tobacco products located in *ANYWHERE*, Illinois. Department Exhibit (“Ex.”) 1.
2. *ABC, INC.* is owned by *JOHN DOE* who is a resident of Illinois. *Id.*
3. The tobacco products discovered by the Department’s Special Agents did not have Illinois tax stamps affixed to them. *Id.* The Department has seized the packs of unstamped tobacco products, believed to be little cigars discovered by the Department’s agents. *Id.*
4. Neither *ABC, INC.* nor *JOHN DOE* is a licensed distributor or stamping distributor of little cigars. *Id.*

CONCLUSIONS OF LAW:

Section 10-27 of the Tobacco Act provides, in part, as follows:

Retailers; purchase and possession of little cigars.

(a) Retailers are prohibited from possessing unstamped packages of little cigars containing 20 or 25 little cigars at locations where retailers make sales of little cigars to consumers or users. Retailers that are also stamping distributors are prohibited from possessing unstamped little cigars at locations where those retailers make sales of packages of little cigars containing 20 or 25 little cigars to consumers or users. Retailers that are not stamping distributors shall purchase stamped packages of little cigars containing 20 or 25 little cigars for resale only from stamping distributors, distributors, or wholesalers. Retailers who are not stamping distributors may not purchase or possess unstamped packages of little cigars containing 20 or 25 little cigars. A retailer must be a stamping distributor to make tax exempt sales of packages of little cigars containing 20 or 25 little cigars for use outside of this State. A retailer who is a stamping distributor making sales of stamped packages of little cigars for use outside of this State may file a claim for credit for such sales with the Department on forms and in the manner provided by the Department.

35 **ILCS** 143/10-27(a)

Section 10-45 of the Tobacco Act incorporates by reference various provisions of the Cigarette Tax Act (“CTA”) (35 **ILCS** 130/1 *et seq.*), including sections 18a, 18b, and 18c. Section 10-45 includes the following: “References in the incorporated Sections to sales of cigarettes mean sales of little cigars in packages of 20 or 25 little cigars.” 35 **ILCS** 143/10-45.

Section 18a of the CTA states that if it is determined, after a hearing that the original packages of “cigarettes” (“cigarettes” being defined to include little cigars pursuant to section 10-45 of the Tobacco Act) seized were not tax stamped at the time of seizure, then an order must be entered declaring the original packages confiscated and

forfeited to the State. 35 ILCS 130/18a. The Taxpayers in the present case did not dispute the fact that the packages did not have Illinois tax stamps.

In addition, sections 18b and 18c of the CTA contain civil penalty provisions, which provide as follows:

Sec. 18b. Possession of more than 100 original packages of contraband cigarettes; penalty. With the exception of licensed distributors and transporters, as defined in Section 9c of this Act, possessing unstamped original packages of cigarettes, and licensed distributors possessing original packages of cigarettes that bear a tax stamp of another state or taxing jurisdiction, anyone possessing contraband cigarettes contained in original packages is liable to pay, to the Department for deposit in the Tax Compliance and Administration Fund, a penalty of \$25 for each such package of cigarettes in excess of 100 packages, unless reasonable cause can be established by the person upon whom the penalty is imposed. This penalty is in addition to the taxes imposed by this Act. Reasonable cause shall be determined in each situation in accordance with rules adopted by the Department. The provisions of the Uniform Penalty and Interest Act do not apply to this Section.

Sec. 18c. Possession of not less than 10 and not more than 100 original packages of contraband cigarettes; penalty. With the exception of licensed distributors and transporters, as defined in Section 9c of this Act, possessing unstamped original packages of cigarettes, and licensed distributors possessing original packages of cigarettes that bear a tax stamp of another state or taxing jurisdiction, anyone possessing not less than 10 and not more than 100 packages of contraband cigarettes contained in original packages is liable to pay to the Department, for deposit into the Tax Compliance and Administration Fund, a penalty of \$10 for each such package of cigarettes, unless reasonable cause can be established by the person upon whom the penalty is imposed. Reasonable cause shall be determined in each situation in accordance with rules adopted by the Department. The provisions of the Uniform Penalty and Interest Act do not apply to this Section. 35 ILCS 130/18b, 18c.

Under section 18c, the penalty applicable to the Taxpayers for the first 100 packs of tobacco products if, as the Department contends, they contain little cigars, is \$900.¹

Under section 18b, the penalty for the remaining 158 packs, if properly classified as little

¹ There is no penalty for the first 10 packs. The penalty for the remaining 90 packs is \$10 each for a total penalty of \$900 for the first 100 packs. 35 ILCS 130/18c

cigars, is \$3,950 (158 packs at \$25 each for a total of \$3,950). The total penalty amount for possession of 258 packs of unstamped little cigars is \$4,850.

Section 10-5 of the Tobacco Act, 35 **ILCS** 143/10-5 defines the term “little cigar” as follows:

“Little cigar” means and includes any roll, made wholly or in part of tobacco, where such roll has an integrated cellulose acetate filter and weighs less than 4 pounds per thousand and the wrapper or cover of which is made in whole or in part of tobacco.”

The characterization of tobacco products as “little cigars” is important because if a person possesses packages of twenty or twenty five “Little cigar[s]” in Illinois, which “do not bear a required tax stamp” (35 **ILCS** 143/10-5, “Contraband little cigar”), and such person is not a stamping distributor, distributor, or wholesaler (*see id.* at section 10-27(a)), such packages are forfeited to the Department, and the person is liable for penalties based on the number of packages. *See* 35 **ILCS** 130/18a-c; *id.* at 143/10-45, second paragraph.

The Taxpayers contend that the Department has presented insufficient evidence to establish that the tobacco products confiscated from the Taxpayers constituted little cigars the possession of which, if not properly stamped, constitutes an offense punishable by the confiscation of the little cigars and the imposition of penalties prescribed by section 18b and 18c of the Cigarette Tax Act, as outlined above. During the hearing in this matter, the Department produced the tobacco products confiscated from the Taxpayers along with records establishing a chain of custody of this evidence verifying that this evidence is what the Department purports it to be. Department Ex. 2, 3.

As noted above, the Tobacco Act defines a “little cigar” as any roll that is made in whole or in part of tobacco and has an integrated cellulose acetate filter, weights less than

4 pounds per thousand, and has a wrapper or case that is made in whole or in part of tobacco. 35 ILCS 143/10-5. To establish that the tobacco products confiscated from the Taxpayer fall within the category of “little cigars” as defined by the Tobacco Act, the Department offered the testimony of Special Agent *JOHN SMITH* who stated that the packages confiscated did not bear the designation “HW” and therefore were determined to meet the weight requirements for classification as little cigars enumerated in section 10-5 of the Tobacco Act, 35 ILCS 143/10-5. Tr. pp. 29, 37-42.

As pointed out by the Taxpayers in their brief:

The Department had the initial burden to establish at least some evidence essential to prove that the seized products were “little cigars” as defined by the Act and, if so proven, that the tax liability and penalties are warranted.

The Act defines a “little cigar” as any roll that is made in whole or in part of tobacco and has an integrated cellulose acetate filter, weighs less than 4 pounds per thousand, and has a wrapper cover that also is made in whole or in part of tobacco. 35 ILCS 143/10-5. [Emphasis added.]

Here, upon the close of its case-in-chief, the Department has failed to present any evidence whatsoever to support its naked contention that the seized tobacco products were “little cigars” as defined in the Act. The Department offered only the testimony of a single witness, Agent *SMITH*, who testified regarding the absence of the designation “HW” on the packaging of the confiscated tobacco products. However, the Department did not even attempt to introduce any evidence into the record establishing the existence of any mention whatsoever of the term “HW” in any Illinois statute, or any Department circular or bulletin.

The term “HW” is in fact not mentioned or referenced in any Illinois statute, or in any Department circular or bulletin. “HW” is not a legally defined term and at most it is a marketing or sales designation which certain manufacturers print on their products entirely at their own discretion and by their own choosing.

But even more importantly, and the fact which renders a fatal blow to the Department’s case, no evidence was introduced regarding the weight of the confiscated tobacco products. These facts remain undisputed, and without establishing the products’ weight and proof that such tests were properly conducted, the Department has clearly

failed to meet its burden of even establishing that the products it confiscated are “little cigars.”

In summary, the Department failed to present any evidence whatsoever establishing that the confiscated tobacco products weighed “less than 4 pounds per thousand” so as to be classified as “little cigars” and thus subject to the subject statute’s tax stamp requirement.

Based upon the foregoing reasoning, I find that the evidence adduced at the hearing in this case failed to establish that the tobacco products possessed by the Taxpayers, at issue in this case, met the weight classification necessary to fall within the category of “little cigars” as defined in the Tobacco Act.

Section 143/10-45 of the Tobacco Act assesses the penalties imposed pursuant to sections 18b and 18c of the CTA upon “anyone possessing” unstamped “little cigars.” While the evidence submitted by the Department during the hearing in the instant case established that the Taxpayers possessed various tobacco products, it failed to establish that these tobacco products were “little cigars” necessary for the application of the punitive provisions of the CTA noted above.

Moreover, the Department has not presented evidence that *JOHN DOE* individually acted as a retailer or wholesaler. The Tobacco Act prohibits only retailers and wholesalers from possessing unstamped little cigars. 35 ILCS 143/10-27(a); 35 ILCS 143/28. Because the Department has presented no evidence that *JOHN DOE* individually acted as a retailer or wholesaler, no penalties can be imposed upon him personally.

Based upon the record before me, I recommend that the confiscation of the tobacco products at issue be rescinded, that, with the exception of any confiscated tobacco products the possession of which would violate the law, confiscated tobacco products be returned to the Taxpayer, and that no penalties provided in section 18b and 18c of the CTA, 130 ILCS 18b and 18c be assessed against the Taxpayers.

Enter: September 13, 2016

**Ted Sherrod
Administrative Law Judge**