

**BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO**

**IN THE MATTER OF THE PROTEST OF
SANTA FE CIGAR CO.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0092660288**

No. 14-28

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on June 9, 2014, before Brian VanDenzen, Esq., Hearing Officer, in Santa Fe. Mr. James Day, former owner of Santa Fe Cigar, Co. (“Taxpayer”) appeared *pro se*, although Attorney Ralph Scheuer did not file a withdrawal of representation listing a new contact address for Taxpayer and therefore remained attorney of record. Staff Attorney Elena Romero Morgan appeared representing the State of New Mexico, Taxation and Revenue Department (“Department”). Protest Auditor Andrick Tsabetsaye and Auditor Steve Duran appeared as witnesses for the Department. Department Exhibits A-C were admitted into the record, as described more thoroughly in the Administrative Protest Hearing Exhibit Log. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On November 30, 2010, the Department assessed Taxpayer for \$136,587.61 in tobacco products tax, \$0.00 in penalty, and \$23,367.78 in interest for a then total assessment of \$159,955.39 for the reporting periods between May 31, 2006, and December 31, 2009. [Letter id. no. L0092660288].

2. On December 29, 2010, Taxpayer requested an extension of time in which to file a protest.
3. On January 10, 2011, the Department granted Taxpayer an extension in which to file a protest, until February 28, 2011.
4. On February 28, 2011, Taxpayer protested the Department's assessment.
5. On March 11, 2011, the Department acknowledged receipt of Taxpayer's protest.
6. On January 3, 2014, the Department requested a hearing in this matter with the Hearings Bureau.
7. On January 6, 2014, the Hearings Bureau sent Notice of Administrative Hearing, scheduling this matter for a hearing on June 9, 2014.
8. On November 14, 2005, the Department selected Taxpayer for an audit. That audit encompassed the period of January 1, 2003 through April 30, 2006. This audit was completed on July 14, 2006 (hereinafter referred to as the July 14, 2006 audit). [Department Ex. A].
9. In the July 14, 2006, audit, the auditors looked both at Taxpayer's compliance under the Tobacco Products Tax and under the Cigarette Excise Tax. [Department Ex. A].
10. For Tobacco Products Tax, in the July 14, 2006 audit, the auditors concluded that Taxpayer was in compliance with its Tobacco Products Tax obligations.[Department Ex. A].
11. Despite being in compliance with its Tobacco Products Tax obligations in the July 14, 2006 audit, the auditors noted that since one of the three vendors they reviewed, Phillips & King, was registered with the Department, Phillips & King was the first purchaser and liable for the Tobacco Products Tax, not Taxpayer. The auditors noted that Taxpayer was paying the appropriate tax on purchases from General Cigar and Altadis USA. [Department Ex. A].

12. In the July 14, 2006, audit, the auditors concluded the section on the Tobacco Products Tax in bold print, stating that “[s]ince General Tobacco and Altadis USA are not registered distributors, [Taxpayer] is considered the ‘first purchaser’ and, therefore, responsible for the tobacco tax.” [Department Ex. A].

13. For Cigarette Excise Tax, in the July 14, 2006, audit, the auditors concluded that Taxpayer was in compliance and no exceptions were found.[Department Ex. A].

14. In speaking with the Department’s auditors and as a result of seeing no exceptions noted in the July 16, 2006, audit narrative, Mr. Day concluded that Taxpayer no longer needed to file or pay Tobacco Products Tax.

15. Taxpayer dropped its Tobacco Products Tax registration with the Department and did not report or pay Tobacco Products Tax beginning in the May 1, 2006, reporting period. [Department Ex. B].

16. After the July 16, 2006 audit, Taxpayer claimed a refund for the payment of Tobacco Products Tax during the audit period.

17. The Department took no action on Taxpayer’s claim for refund and Taxpayer neither filed a protest or commenced a civil action against the Department for that inaction.

18. Taxpayer made no substantial changes to its business practices after completion of the Department’s July 14, 2006 audit.

19. On February 24, 2010, the Department selected Taxpayer for an audit from May 1, 2006 through December 31, 2009. Department auditor Steve Duran conducted this audit. The Department completed the audit on August 4, 2010 (hereinafter referred to August 4, 2010 audit). [Department Ex. B].

20. The August 4, 2010 audit determined that Taxpayer was purchasing tobacco products from purchasers not registered with the Department, and therefore Taxpayer was the first purchaser of the tobacco products in New Mexico and liable for payment of Tobacco Products Tax. [Department Ex. B].

21. Steve Duran recommended that no penalty be imposed against Taxpayer because Taxpayer showed during the audit that it was purchasing tobacco products from some of the same suppliers during the August 4, 2010 audit period as during the previous July 16, 2006 audit where the Department found no exceptions. [Department Ex. B].

22. As a result of the August 4, 2010 audit, the Department issued its November 30, 2010 assessment to Taxpayer without imposing a penalty.

23. As of the date of hearing, Taxpayer owed \$136,587.61 in Tobacco Products Tax and \$38,605.71 in interest for a total outstanding liability of \$175,193.36. [Department Ex. C].

DISCUSSION

There are three main issues at protest in this matter. The first issue is whether Taxpayer was liable for the assessed Tobacco Products Tax. The second issue is whether Taxpayer is entitled to the abatement of the assessment either because of the written information contained in the Department's July 14, 2006 audit narrative or because of alleged verbal assurances of the Department auditors that Taxpayer was no longer required to pay and file Tobacco Products Tax returns. The final issue is whether Taxpayer may apply its previously claimed refund against the assessed tax liability.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessment of tax issued in this case is presumed correct. Unless otherwise specified, for the purposes of the Tax Administration Act,

“tax” is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department’s assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep’t of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). Taxpayer has the burden to overcome the assessment. *See Archuleta v. O’Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 431. However, once a taxpayer rebuts the presumption of correctness, the burden shifts to the Department to show the correctness of the assessed tax. *See MPC Ltd. v. N.M. Taxation & Revenue Dep’t*, 2003 NMCA 21, ¶13, 133 N.M. 217.

Tobacco Products Tax

Under the Tobacco Products Tax, New Mexico imposes an excise tax of 25% of the value of tobacco products on tobacco products manufactured or acquired in New Mexico. *See* NMSA 1978, § 7-12A-3 (A) (2009). The Tobacco Products Tax is imposed upon the first purchaser of the tobacco product. *See* § 7-12A-3 (C). For the purposes of the Tobacco Products Tax Act, the first purchaser is “a person engaging in business in New Mexico who manufactures tobacco products or who purchases or receives on consignment tobacco products from any person outside of New Mexico, which tobacco products are to be distributed in New Mexico in the ordinary course of business.” NMSA 1978, § 7-12A-2 (D) (2009). Under NMSA 1978, Section 7-12A-7 (1986), sellers of tobacco products in New Mexico are required to register with the Department.

In this case, Taxpayer purchased and sold tobacco products in New Mexico. Taxpayer bought tobacco products from out-of-state vendors not registered in New Mexico, vendors that had not previously paid the Tobacco Products Tax for the purchased tobacco products. Consequently, Taxpayer was the first purchaser and subject to Tobacco Products Tax under Section 7-12A-3.

Taxpayer found it unfair that he could be found liable for Tobacco Products Tax in the August 4, 2010 audit since his business practices did not change from the July 16, 2006 audit to the August 4, 2010 audit (an argument that will be addressed in greater detail below). While Taxpayer believed the July 16, 2006 audit had established he was not liable for Tobacco Products Tax, that July 16, 2006 audit narrative clearly articulated that he was in fact liable for Tobacco Products Tax from two of the three vendors mentioned in the audit, General Cigar and Altadis USA. Taxpayer further over read the auditors' conclusion in the audit narrative that Taxpayer was in compliance with its Tobacco Products Tax obligations. What that means is that the auditors did not find any additional outstanding tax liability beyond what Taxpayer had already paid, which included payment of Tobacco Products Tax. Being in compliance with one's tax obligations is far different than stating that the tax is inapplicable. It follows then that even if Taxpayer's business practice remained identical, that Taxpayer would continue to be liable for the Tobacco Products Tax for tobacco products purchased from General Cigar and Altadis USA, both of which were noted as taxable in the July 16, 2006 audit narrative.

Taxpayer's Fairness Argument.

Taxpayer argued that the assessment of Tobacco Products Tax in this matter should be abated because its business practices remained the same as found in the July 16, 2006 audit. Taxpayer argued that it only stopped reporting and paying Tobacco Products Tax after the Department's July 16, 2006 audit indicated that Taxpayer had no taxable exceptions and after Department employees directed Taxpayer to stop reporting and paying Tobacco Products Tax. Taxpayer's argument essentially constitutes an argument for estoppel and equitable relief.

NMSA 7-1-60 (1993) establishes statutory estoppel in certain circumstances. In pertinent part, under Section 7-1-60, the Department is estopped from acting when a taxpayer's actions

were “in accordance with any regulation effective during the time the asserted liability for tax arose or in accordance with any ruling addressed to the party personally and in writing by the secretary...”

Taxpayer’s argument also amounts to a claim for equitable estoppel. Equitable estoppel does not appear to be a possible remedy in an administrative protest hearing before the Department. *See AA Oilfield Service v. New Mexico State Corporation Commission*, 1994-NMSC-085, ¶18, 118 N.M. 273 (equitable remedies are not part of the “quasi-judicial” powers of administrative agencies). Even if it is available in this context, courts are reluctant to apply the doctrine of equitable estoppel against the state in cases involving the assessment and collection of taxes. *See Taxation & Revenue Dep’t v. Bien Mur Indian Mkt. Ctr., Inc.*, 1989-NMSC-015, ¶9, 108 N.M. 22. In such cases, estoppel applies only pursuant to statute or when “right and justice demand it.” *Bien Mur Indian Market*, ¶9. Oral statements not reduced to writing are generally not grounds to grant equitable estoppel. *See Kilmer v. Goodwin*, 2004-NMCA-122, ¶28, 136 N.M. 440. Estoppel cannot lie against the state when the act sought would be contrary to the requirements expressed by statute. *See Rainaldi v. Public Employees Retirement Board*, 1993-NMSC-028, ¶18-19, 115 N.M. 650.

Under *Kilmer*, ¶26 (internal citations omitted), in order for a taxpayer to establish an equitable estoppel claim against the Department, a taxpayer must show that

- (1) the government knew the facts;
- (2) the government intended its conduct to be acted upon or so acted that plaintiffs had the right to believe it was so intended;
- (3) plaintiffs must have been ignorant of the true facts;
- and (4) plaintiffs reasonably relied on the government's conduct to their injury.

The claimant must also show “affirmative misconduct on the part of the government.” *id.*, ¶27 (internal citations omitted).

Neither statutory estoppel under Section 7-1-60 or equitable estoppel under the case law grant Taxpayer any relief in this circumstance. Taxpayer had a written document from the July 16, 2006 audit narrative that made clear in bold print that Taxpayer was the first purchaser subject to New Mexico's Tobacco Products Tax: "Since General Tobacco and Altadis USA are not registered distributors, [Taxpayer] is considered the 'first' purchaser and, therefore, responsible for tobacco tax." It is difficult to read this clear statement in the audit narrative in a manner that would support Taxpayer's assertion that it was no longer required to file or pay Tobacco Products Tax after the July 16, 2006 audit. Respectfully, the language of the audit narrative is opposite of Taxpayer's beliefs about the July 16, 2006 audit conclusion. As such, it was not reasonable for Taxpayer to rely on the audit narrative to conclude that it could drop its registration with the Department and stop reporting and paying Tobacco Products Tax. Since Taxpayer's actions were not in reasonable reliance of a written statement that Taxpayer was not liable for Tobacco Products Tax, statutory estoppel under Section 7-1-60 and equitable estoppel under *Kilmer*, ¶26, do not apply.

Taxpayer argues that during and shortly after the audit, the Department auditors verbally directed Mr. Day to stop reporting and paying Tobacco Products Tax. The evidence is unclear exactly what the Department auditors told Mr. Day during the audit or shortly thereafter, especially because the audit narrative itself written by the same auditors makes clear that Taxpayer was liable for Tobacco Products Tax, contradicting the alleged oral statements. However, Mr. Day apparently relied on the statements of the auditors to claim a refund, to drop Taxpayer's state registration for the sale of tobacco products, and to stop filing and paying of Tobacco Products Tax.

Again, oral statements not reduced to writing are generally not grounds to grant equitable estoppel. *See Kilmer*, ¶2. This seems particularly true in an instance where the Department auditors directed a written statement to Taxpayer that contradicts their apparent oral statements

to Taxpayer. At the very least, given the conflicting written statement and oral directions from the Department auditors, Taxpayer could not reasonably rely on the Department's auditors oral statements under the last prong of the equitable estoppel analysis in *Kilmer*, ¶26. Under New Mexico's self-reporting tax system, "every person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *Tiffany Construction Co. v. Bureau of Revenue*, 1976-NMCA-127, ¶5, 90 N.M. 16. In light of this contradiction between the auditors' written audit narrative and the same auditors' apparent oral statements, Taxpayer had an obligation to independently verify whether it was appropriate to drop its registration with the Department, stop reporting, and stop paying Tobacco Products Tax. There is no evidence that Taxpayer took any action to consult with a tax professional to clarify Taxpayer's Tobacco Products Tax obligations. There are no estoppel grounds to abate the assessment based on the Department auditors' oral statements to Taxpayer.

However, in recognition of the confusion that stemmed from the July 16, 2006 audit, the Department did not assess Taxpayer a 20% civil negligence penalty.

Claim for Refund.

In Taxpayer's protest letter, Taxpayer asked that its outstanding claim for refund stemming from the July 16, 2006 audit offset any liability under the assessment. However, at the hearing, Taxpayer presented little evidence related to the claim for refund other than that after the July 16, 2006 audit, Taxpayer claimed a refund, never received a refund from the Department, and never filed a protest or civil action to contest the Department's inaction on the claim for refund. There is no evidence establishing a timeline on the claim for refund or the Department's failure to act to grant or deny the claim.

NMSA 1978, Section 7-1-26 (F) (2013) establishes that a taxpayer under an audit for multiple periods may offset the overpayment of one period against the underpayment of tax in another period of the audit. However, Section 7-1-26 (F) is addressing multiple reporting periods within one audit, not multiple audits that covered different reporting periods. Since Taxpayer's assessed tax liability came from a different audit with a different audit period than the July 16, 2006 audit covered, Taxpayer's claim related to the July 16, 2006 audit has no ability under Section 7-1-26 (F) to offset the assessed liability. Moreover, since Taxpayer took no action to protest or file a civil action against the Department's inaction on the claim for refund, and the statute of limitations on a claim for refund related to the July 16, 2006 audit has long since expired, the Department also has no ability to consider Taxpayer's refund claim or apply it to the assessed outstanding tax liability. *See Kilmer*, ¶19-24.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the assessment. Jurisdiction lies over the parties and the subject matter of this protest.

B. As the first purchaser of tobacco products in New Mexico, Taxpayer was liable for the payment of Tobacco Products Tax under Section 7-12A-3.

C. Taxpayer is not entitled to statutory estoppel under Section 7-1-60 because the written audit narrative addressed to Taxpayer indicated that Taxpayer was subject to Tobacco Products Tax.

D. Taxpayer is not entitled to equitable estoppel under *Kilmer v. Goodwin*, 2004-NMCA-122, ¶26, 136 N.M. 440 because it was not reasonable to rely on the alleged oral statements of the Department auditors given that the written audit narrative prepared by those auditors and addressed to Taxpayer indicated that Taxpayer was subject to Tobacco Products Tax.

E. Since the two separate audits encompassed two separate reporting periods, since Taxpayer did not establish it timely confronted the Department's inaction on Taxpayer's claim for refund, and since the statute of limitations on Taxpayer's claim for refund has long since expired, the Department is without authority under Section 7-1-26 to consider Taxpayer's claim for refund.

For the foregoing reasons, Taxpayer's protest **IS DENIED**. As of the date of hearing, Taxpayer owed \$136,587.61 in Tobacco Products Tax and \$38,605.71 in interest for a total outstanding liability of \$175,193.36. Interest continues to accrue until the tax principal is satisfied.

DATED: July 7, 2014.

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