

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA
THIRD JUDICIAL DISTRICT AT ANCHORAGE

PETE’S TOBACCO SHOP, LLC & PETE’S)	
TOBACCO SHOP TOO, LLC,)	
)	
Appellants,)	
)	
vs.)	
)	
STATE OF ALASKA, DEPARTMENT OF)	
REVENUE,)	
)	
Appellee.)	
)	Case No. 3AN-14-08044CI

ORDER AFFIRMING THE OFFICE OF ADMINISTRATIVE HEARINGS DECISION
DATED MAY 9, 2014.

Pete’s Tobacco Shop, LLC and Pete’s Tobacco Shop Too, LLC [collectively Pete’s] appeals the Office of Administrative Hearings [OAH] Decision dated May 9, 2014.¹

Pete’s formerly operated two tobacco shops, one in Anchorage and one in Wasilla. Neither shop sold cigarettes. The shops sold briar smoking pipes, accessories, pipe tobacco, and cigars. Pete’s purchased all pipe tobacco from People’s True Taste,

¹ Pete’s also appeals OAH’s Order Granting Partial Summary Adjudication dated June 20, 2012, which was incorporated in the May 9 Decision.

Inc. [PTT] and purchased cigars from, *inter alia*, Fuente & Newman and its partner J.C. Newman Cigar Company [collectively Fuente & Newman].²

The Alaska Department of Revenue [the Department] audited Pete's after Pete's filed excise tax returns excluding the cost of packaging in the wholesale price paid for tobacco products. The audit resulted in decisions from the Department affirming its initial taxation. Pete's then appealed the decisions to OAH. The resulting OAH Decision affirming the Department is on appeal.

Three issues are on appeal. First, whether the cost of packaging may be deducted from the wholesale price of tobacco when calculating the Alaska tobacco products excise tax. Pete's also argues PTT and Fuente & Newman were not manufacturers for the purpose of the excise tax. The court addresses PTT and Fuente & Newman separately.

The Court assumes jurisdiction under AS 22.10.020, 43.05.480, and 44.62.560-.570.

STANDARD OF REVIEW

The Court will not overturn a factual finding unless it cannot conscientiously find a reasonable mind might accept the evidence as adequate to support the finding.³ Questions which implicate special agency expertise will not be overturned if facts

² The parties agree J.C. Newman Cigar Company manufactured some of the cigars it sold to Pete's. The only Cigars in contention are the cigars from the Fuente Plant in the Dominican Republic sold by Fuente & Newman and its partner J.C. Newman Cigar Company to Pete's.

³ *May v. State, Commercial Fisheries Entry Comm'n*, 175 P.3d 1121, 1216 (Alaska 2007).

support the agency's conclusion and it has a reasonable basis in law.⁴ The Court reviews questions of law not involving agency expertise *de novo*.⁵ When reviewing mixed questions of law and fact, the court reviews factual questions under the clearly erroneous standard and legal questions using independent judgment.⁶

LAW AND ANALYSIS

An excise tax is levied on tobacco products at the rate of 75 percent of the wholesale price of tobacco under enumerated conditions.⁷ Tobacco products include cigars, pipe tobacco, and other items made of tobacco or tobacco substitutes not included in the definition of a cigarette.⁸ Wholesale price means the established price for which a manufacturer sells a tobacco product to a distributor or the price, as determined by the department, for which tobacco products of comparable retail price are sold to distributors in the ordinary course of trade.⁹

The court interprets statutes according to reason, practicality, and common sense, taking into account the plain meaning and purpose of the law as well as the

⁴ *State, Dep't of Admin. v. Bachner Co.*, 167 P.3d 58, 61 (Alaska 2007).

⁵ *Simpson v. State, Commercial Fisheries Entry Comm'n*, 101 P.3d 605, 609 (Alaska 2004).

⁶ *Paula E. v. State, Dep't of Health & Soc. Servs., Office of Children's Servs.*, 276 P.3d 422, 430 (Alaska 2012) (citing *Ben M. v. State, Dep't of Health & Soc. Servs., Office of Children's Servs.*, 204 P.3d 1013, 1018 (Alaska 2009)).

⁷ AS 43.50.300.

⁸ AS 43.50.390(4).

⁹ AS 43.50.390(5).

intent of the drafters.¹⁰ A fundamental principle of statutory interpretation is a statute means what its language reasonably conveys to others.¹¹ The court decides questions of statutory interpretation on a sliding scale: “[T]he plainer the language of the statute, the more convincing contrary legislative history must be.”¹²

The Office of Administrative Hearings correctly determined People’s True Taste is a manufacturer.

All facts in this section are taken from the parties’ Appellate Rule 201(b)(8) statement.

PTT purchased tobacco from Alliance, Ltd. [Alliance]. Alliance typically sold tobacco to PTT in 220-pound packages. PTT broke this package down and divided the tobacco into five-pound bags. PTT labeled those bags, boxed them for shipment, and sold them to companies such as Pete’s. PTT sold their bags of tobacco at a higher price per pound than Alliance.

PTT is a manufacturer of tobacco products according to its federal permit. PTT asserts this label and permit only applied to roll your own cigarette tobacco, which PTT has not sold since 2009. At the hearing, PTT did not hold itself out to be a manufacturer.

¹⁰ *Marathon Oil Co. v. State, Dep’t of Nat. Res.*, 254 P.3d 1078, 1082 (Alaska 2011) (*Native Village of Elim v. State*, 990 P.2d 1, 5 (Alaska 1999)).

¹¹ *N. Slope Borough v. Sohio Petroleum Corp.*, 585 P.2d 534, 540 (Alaska 1978).

¹² *Marathon Oil* at 1082 (citing *Alaskans For Efficient Gov’t, Inc. v. Knowles*, 91 P.3d 273, 275 (Alaska 2004)).

The parties do not dispute the facts. The only dispute is whether the limited actions of repackaging, labeling, shipping, and selling tobacco for higher price per pound makes PTT a manufacturer. OAH concluded PTT is a manufacturer because the bulk tobacco PTT purchases from Alliance is not suitable for the needs of retail sellers.

Interpreting AS 43.50.300 is a question of law the court will review *de novo*. AS 43.50.390¹³ does not define manufacturer, but defines distributor as a person who 1) brings, or causes to be brought, a tobacco product into the state from outside the state for sale; 2) makes, manufactures, or fabricates a tobacco product in the state for sale in the state; or 3) ships or transports a tobacco product to a retailer in the state for sale by the retailer. The Department has not promulgated any regulations defining manufacturer. After extensive research, the court could not find any legislative history to assist in determining how the legislature sought to define manufacturer.

To determine the reasonable, practicable, and common sense definition of manufacturer, the court looks to lay and non-binding legal definitions. AS 43.50.170(6) defines a manufacturer of cigarettes as a person who makes, fashions, or produces cigarettes for sale to distributors or other persons. Black's defines manufacturer as a "person or entity engaged in producing or assembling new products."¹⁴ Washington State defines a tobacco manufacturer as a person who manufactures and sells tobacco

¹³ Definitions.

¹⁴ MANUFACTURER, Black's Law Dictionary (10th ed. 2014).

products.¹⁵ Google defines a manufacturer as “a person or company that makes goods for sale”¹⁶ and Merriam-Webster defines manufacturer as “a company that makes a product.”¹⁷ Wikipedia defines manufacturing as “a range of human activity. . . most commonly applied to industrial production, in which raw materials are transformed into finished. . . finished goods may be used for manufacturing other, more complex products. . .”¹⁸

The legal and lay definitions of manufacturer all define manufacturing broadly. AS 43.50.170(6) defines those who merely fashion cigarettes as manufacturers. Black’s definition is so broad it includes assembling of new products. Google and Meriam-Webster both broadly define manufacturer as a company or person who makes a product for sale. The lay definitions allow the court to determine what AS 43.50.300 reasonably conveys to others. From these definitions, the court agrees with OAH—a company who takes large packages of tobacco and repackages, labels, and resells the tobacco is a manufacturer of retail tobacco under a reasonable definition of manufacture. PTT received a product and transformed the product into a new finished good it was able to sell to retailers.

¹⁵ RCW 82.26.010 (2010).

¹⁶ Define:manufacturer - Google Search, Google.com, <https://goo.gl/xtmoua> (last visited Aug 16, 2016).

¹⁷ Manufacturer, Merriam-Webster, <http://www.merriam-webster.com/dictionary/manufacturer> (last visited Aug 16, 2016).

¹⁸ Manufacturing, Wikipedia.org, <https://en.wikipedia.org/wiki/Manufacturing> (last visited Aug 16, 2016).

OAH did not err when it decided PTT is a manufacturer.

Pete's did not meet its burden to show the Office of Administrative Hearings erred in determining Fuente & Newman's purchase of cigars from A. Fuente & Company was not in the ordinary course of business.

The court must determine whether Fuente & Newman's purchase of cigars from Fuente & Company was in the ordinary course of business, also called as an arms-length transaction. Pete's has the burden to show OAH erred.¹⁹

Pete's purchased Arturo Fuente cigars from Fuente & Newman. Arturo Fuente cigars are assembled at the Fuente plant in the Dominican Republic. The Fuente plant sells the cigars to another Fuente entity in the Dominican Republic who then sells the cigars to A. Fuente & Company, an importer. Fuente & Newman purchases the cigars from A. Fuente & Company and sells them to businesses such as Pete's. A. Fuente & Company charges more for the cigars than it pays and makes limited sales to companies other than Fuente & Newman. Fuente & Newman is separate from A. Fuente & Company and the Fuente plant. Pete's, and other retailers, do not have the option to purchase cigars from any other entity in the chain besides Fuente & Newman.

Wholesale price means the price, as determined by the department, for which tobacco products of comparable retail price are sold to distributors in the ordinary course of trade.²⁰

¹⁹ See *Tesoro Corp. v. State, Dep't of Revenue*, 312 P.3d 830, 838 (Alaska 2013) (burden on taxpayer); see also *Kenai Peninsula Borough v. Arndt*, 958 P.2d 1101, 1103 (Alaska 1998) (burden is on the taxpayer).

Whether Fuente & Newman's purchase of their cigars from Fuente & Company was in the ordinary course of business is a mixed question of fact and law. The court reviews factual questions under the clearly erroneous standard and legal questions using a reasonable basis in law standard when the legal question involved an agency's special expertise.²¹ OAH's decision affirmed the Department's determination an arms-length transaction did not occur. The Department has special expertise to determine transaction types for tax purposes.

The only witness at the OAH hearing was Shira Martin. At the Hearing, Martin was unable to provide the following information: 1) direct information about the makeup of the partnership; 2) the amount the Dominican Republic manufacturer charged other distributors in the US for their cigars; or 3) how much Fuente & Newman pays for its cigars. She was able to provide some information as to a holding company which owns interest in both companies.

Based on the testimony, OAH determined the businesses have interlocking ownership and directorates. OAH also concluded the owners of the Fuente family of businesses had an ownership interest in Fuente & Newman.

Pete's argues OAH did not have substantial evidence to decide Fuente & Newman's purchase of cigars was not an arms-length transaction. However, the burden to show an arms-length transaction falls on Pete's. Pete's has provided no evidence to

²⁰ AS 43.50.390(5)(B).

²¹ *Bachner Co.* at 61; *Paula E.* at 430.

this court or OAH to show an arms-length transaction exists. The court will not overturn OAH's determination when Pete's has not shown an evidentiary error nor argued a specific legal error in OAH's determination.

The court cannot find clear error in OAH's factual findings nor can the court say the Department and OAH's determination an arms-length transaction did not occur was not reasonably based in law.

OAH did not err when it decided Fuente & Newman is a manufacturer.

The State Department of Revenue properly applied the excise tax to packaging materials.

Pete's alleges OAH erred then it determined the Department correctly included the cost of packaging when calculating the wholesale price of tobacco purchased from PTT. This issue is legal: may the cost of packaging be deducted from the wholesale price of tobacco products when calculating Alaska's tobacco excise tax. The court reviews this question *de novo*.

AS 43.50.390 provides an enumerated list of items constituting a tobacco product including any article or product made of tobacco or a tobacco substitute, but not including a cigarette. . .²² The statute also defines the wholesale price as the established price for which a manufacturer sells a tobacco product to a distributor.²³ The court did not find any legislative history to guide its analysis.

²² AS 43.50.390(4)(h).

²³ AS 43.50.390(5).

Pete's cites a variety of non-controlling authorities including 21 USC 321(rr)(IV), 27 CFR § 44.11, various state statutes and regulations, and a World Health Organization Article, all of which explicitly recognize the existence of packaging separate from the tobacco product or invalidate taxation schemes where the taxing body taxed and recognized packaging. These are inapposite to Alaska's statute because AS 43.50.390 does not explicitly acknowledge the existence of packaging as a separate entity from the tobacco product. The department argues the court should instead look to the Revised Code of Washington 82.26.010(19)(a) for guidance, which is similar to AS 43.50.300.

RCW 82.26.010 is silent as to packaging, but Washington courts have determined packaging and other value from the manufacturer are included in the taxed value. In *U.S. Tobacco Sales & Mktg. Co. Inc. v. Washington State Dep't of Revenue*, the Court of Appeals of Washington, Division 2 held:

The statute imposes the tax upon the value of a manufacturer's products, measured at the time the manufacturer sells the products. This price will reflect the quality, quantity, packaging, and trademark value of the products as provided by the manufacturer. At a minimum, this price must include the costs and profits associated with manufacturing and sales, because those functions are mandated by the statutory definition of "manufacturer."²⁴

Washington defines manufacturer as a person who manufactures and sells tobacco products;²⁵ Alaska does not have a statutory definition of manufacturer. Washington

²⁴ 128 Wash. App. 426, 430, 115 P.3d 1080, 1081-82 (2005).

²⁵ RCW 82.26.010(11).

taxes the taxable sales price of tobacco products by the manufacturer;²⁶ Alaska taxes the wholesale price.²⁷ These differences are not determinative. Pete’s agrees the Alaska excise tax should be levied on the wholesale price charged by the manufacturer; this is functionally the same as the taxable sale price by the manufacturer. The court has also already determined the Alaska definition of manufacturer, although not statutory, is broad.

The court agrees with OAH and finds the established price the manufacturer sells the product to the distributor includes all extra work completed by the manufacturer. This includes packaging, marketing, and other components of value. If the legislature wished to exclude packaging or other components of value from the wholesale price, the legislature could have done so explicitly. The parties have identified numerous other jurisdictions where the legislature explicitly separated the value of tobacco products from other non-tobacco components. The court has no reason to assume the legislature here would not have done the same had that been their intent.

The language “established price” persuades the court the legislature sought to make this an easily computable number. Pete’s argument would force the court to seek a non-established price and instead litigate an abstract price based on the assertions of the parties and non-parties.

²⁶ RCW 82.26.020 (a)-(b).

²⁷ AS 43.50.300.

OAH did not err when it decided The State Department of Revenue properly applied the excise tax to packaging materials.

A hearing is unnecessary.

Pete's requested a hearing on this matter. Pete's did not dispute any of the facts from OAH's decision—and the Department did not dispute any of the facts in Pete's brief. No factual contentions exist and a hearing is not necessary.

Pete's primary request for a hearing is to determine the cost of packaging. This is irrelevant because the court determined the cost of packing is included in the wholesale price of the tobacco products.

CONCLUSION

The *Commissioner's Decision* is **affirmed**.

DATED at Anchorage, Alaska this 19th day of August, 2015.

Signed _____
Paul E. Olson
Superior Court Judge

[This document has been modified to conform to the technical standards for publication.]