JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2010-06-29-11 / NON-PRECEDENTIAL**
ID: **P-09-130-K / P-09-173-K**
DATE: **JUNE 29, 2010**
DISPOSITION: **DENIED**
TAX TYPE: **TOBACCO**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

COMPANY ("Company") is represented by MEMBER ("Member"), whom appears pro se (collectively referred to as "Protestants"). The Compliance Division of the Oklahoma Tax Commission ("Division") is represented by OTC ATTORNEY, Acting General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

The Division performed an audit of the Company's tobacco tax reports for the periods inclusive of August, 2006 through April, 2009. As a result of the audit, the Division by letters dated June 8, 2009, June 23, 2009 and June 24, 2009, proposed the assessments of tobacco taxes, interest and penalties against the Company in the total aggregate amount of $2,340,165.07.[1] The three (3) proposed assessments were timely protested by letter dated August 7, 2009. A hearing was requested in the letter of protest.

On August 3, 2009, the Division caused to be issued three (3) proposed assessments of tobacco taxes, interest and penalties against the Member of the Company in the same amounts as proposed against the Company, as corrected. The Member timely protested the three (3) proposed assessments by letter dated September 25, 2009. A hearing was requested in the letter of protest.

On September 11, 2009 and October 13, 2009, the Company's protest and Member's protest; respectively, were referred to the Office of the Administrative Law Judges for further proceeding consistent with the Uniform Tax Procedure Code[2] and the Rules of Practice and Procedure before the Oklahoma Tax Commission[3]. The protests were docketed as Case Nos. P-09-130-K and P-09-173-K and assigned to ALJ, Administrative Law Judge.[4]

Pre-hearing conferences were scheduled in each case by *Prehearing Conference Notices* issued September 3, 2009 and October 19, 2009.[5] Pursuant to the conference in Case No. P-09-130-K, a *Prehearing Conference Order and Notice of Hearing* was issued setting forth the procedure by which the protest would be submitted for decision. The *Order* also scheduled a hearing to be held before the undersigned on February 23, 2010.

---

[1] The letter of June 8, 2009, contains a mathematical error. The amount shown is the corrected amount.

[2] 68 O.S. 2001, § 201 et seq.

[3] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[4] *OAC*, 710:1-5-22(b).

[5] *OAC*, 710:1-5-28.

The Member neither appeared at the pre-hearing conference nor responded to the *Notice* issued in his case.

On November 4, 2009, the Division filed a *Motion to Consolidate Cases* in Case No. P-09-173-K. By letter issued November 5, 2009, the Member was notified that he could file a response to the *Motion* on or before November 19, 2009. No response to the *Motion* was received, and by *Order Granting Motion for Consolidation and Amending Scheduling Order* the protests of the Company and Member were consolidated for purposes of further proceedings. The *Scheduling Order* issued in Case No. P-09-130-K was amended to extend the date for the exchange of witness lists and documents; and in all other respects the procedure was retained, including the hearing date.

The hearing was held as scheduled on February 23, 2010. The Member did not appear at the hearing. The transcript of the hearing held on August 10, 2009 and records pertaining to Case No. FD-09-003-K[6] were upon motion incorporated and admitted into evidence in these cases. MANAGER, Revenue Unit Manager of the Alcohol and Tobacco Section of the Division testified with respect to the Division's records and the reasons for the assessments. Exhibits E through Q were identified, offered and admitted into evidence. Exhibits A through D were admitted by official notice.[7] The record was held open for the Division to submit the original of the Affidavit of WITNESS, Vice-President of WHOLESALE CO., which was submitted in response to and accepted by the Division as complying with the subpoena issued in these cases on February 17, 2010. On February 24, 2010, the record was closed and the protests to the proposed tobacco products tax assessments were submitted for decision.[8]

FINDINGS OF FACT

Upon review of the file and records, including the recording of the hearing held on February 23, 2010, the exhibits and records received into evidence and the pleadings of the Division, the undersigned finds:

1. The Member registered the Company as a domestic limited liability company on August 17, 2005. The Member listed himself as the resident agent of the Company. Exhibit A.[9]

2. The Company was issued an Unstamped Tobacco License effective September 1, 2006. Exhibit E.

3. Amended Articles of Organization of an Oklahoma Limited Liability Company were filed by the Member on May 3, 2006. The Member executed the Amended Articles as manager of

[6] In re: Application for an Order of Forfeiture and Destruction of Other Tobacco Products Seized from COMPANY, ANYTOWN, Oklahoma. This case involved the confiscation of non-compliant other tobacco products with an estimated retail of $209,612.45 during two (2) compliance checks at the Company's business location.

[7] *OAC*, 710:1-5-36.

[8] *OAC*, 710:1-5-39(a).

[9] Articles of Organization of an Oklahoma Limited Liability Company, SOS Form 0073-11/99).

the Company. The Amended Articles were filed to show PRESIDENT was a fifty-one percent (51%) shareholder and President of the Company. Exhibit B.

4. The 2006 Annual Certificate Limited Liability Companies was filed on behalf of the Company by the Member on May 31, 2006. The Annual Certificate reflects the Company was active as of the date of filing. Exhibit C.

5. The 2007 and 2008 Annual Certificate Limited Liability Companies were filed on behalf of the Company by the Member on September 18, 2008. The Annual Certificates indicate the Company was not active as of the date of filing. Exhibit D.

6. The Company was the subject of three (3) compliance checks. Other tobacco products were confiscated during each of these compliance checks because the Company could not produce purchase invoices for the product. The Member of the Company was the contact person during the first and second compliance checks. During these checks, the Member was advised that all tobacco products for which the Company could not produce an invoice would be confiscated. At the second compliance check, the Member listed the Company's distributors of other tobacco products as DISTRIBUTOR 1, DISTRIBUTOR 2 and DISTRIBUTOR 3, even though the Company was also purchasing tobacco products from WHOLESALE CO. See, Exhibits A and B; and Tr. 19, 24, 26 and 29-30, Case No. FD-09-003-K; and Exhibits G and P.

7. The Division receives monthly reports from the State of Kansas which show sales of cigarettes and other tobacco products by Kansas' distributors to Oklahoma companies. These reports indicated that the Company was purchasing other tobacco products from WHOLESALE CO. With this information, the Division compared the Company's Oklahoma Tobacco Tax Reports and determined that the other tobacco products purchased by the Company from WHOLESALE CO. were not included on the Company's Oklahoma Tobacco Tax Reports. Testimony of MANAGER. See, Tr. 4-5, and 14-17, Case No. FD-09-003-K.

8. In response to a subpoena duces tecum, WHOLESALE CO. produced copies of its sales invoices to the Company for the period inclusive of August, 2006 through April, 2009. Testimony of MANAGER; Exhibits F and G. All sales of tobacco products to the Company were performed in the State of Kansas, paid for in Kansas and delivered at WHOLESALE CO.'S dock in Kansas. Exhibit P. The sales invoices reflect that the Company purchased a total of approximately $3,795,366.00 worth of other tobacco products from WHOLESALE CO. Exhibit G.

9. On June 8, 2009; June 23, 2009 and June 24, 2009, the Division caused to be issued against the Company proposed assessments of tobacco excise taxes, interest and penalties for the period of August, 2006 through April, 2009, in the total aggregate amount of $2,340,165.07[10], inclusive of taxes in the amount of $2,068,818.80, interest in the amount of $64,464.39[11] and

[10] The Division concedes that the proposed assessment issued June 8, 2009 contained a mathematical error in the calculation of the total tax, interest and penalty assessed. Testimony of MANAGER. See, Exhibits H and L. The corrected amount is enumerated.

[11] Interest was accrued through August 15, 2009 with respect to the June 8, 2009 proposed assessment and September 1, 2009, with respect to the other proposed assessments.

penalties in the amount of $206,881.88. Attached to the assessment letters were work papers showing WHOLESALE CO.'S sales invoice number and date, the type and dollar amount of product sold and the excise tax due on the purchase. Exhibits H through J.

10. The three (3) proposed assessments issued against the Company were timely protested by letter dated August 7, 2009. Exhibit K.

11. On August 3, 2009, the Division caused to be issued three (3) proposed assessments of tobacco taxes, interest and penalties against the Member of the Company in the amounts proposed against the Company, as corrected. The proposed assessments included a copy of the work papers. Exhibits L through N.

12. The Member timely protested the three (3) proposed assessments by letter dated September 25, 2009. Exhibit O.

13. The Company's charter was terminated May 12, 2008, for failure to file the 2007 annual certificate and reinstated September 18, 2008, upon the filing of the annual certificate.[12]

14. The Company's other tobacco tax reports were filed by the Member. The other tobacco tax reports reported other purchases of other tobacco products from other distributors. Testimony of MANAGER.

15. The Affidavit indicates that the Member set up the account with WHOLESALE CO. as the representative of the Company. Exhibit P. WHOLESALE CO.'S invoices show the other tobacco products were sold to the Company and the Member. Exhibit G.

ISSUE AND CONTENTIONS

Two issues are presented for decision. The first issue is whether Protestants sustained their burden of proving the proposed assessments are incorrect. The second issue is whether the Member can be held liable for the amounts assessed.

Protestants contend that the assessments are based on incorrect information and accuse them of making purchases they did not make. Protestants further contend that the assessments are based upon incorrect calculations and faulty math.

The Division contends that Protestants have failed to prove the proposed assessments are incorrect and in what respect. In support of this contention, the Division argues that Protestants challenge the correctness of the assessments, but have not provided any verifiable facts or documentation to show the assessments are erroneous. The Division further contends that the evidence shows Protestants purchased other tobacco products during the audit period and failed to report and remit taxes with respect to these purchases. Additionally, the Division contends that the Member should be found personally liable for the assessed amounts because his acts or omissions were not made in good faith or involved intentional misconduct or a knowing violation of law. In

[12] Oklahoma Secretary of State's website, https://www.sooneraccess.state.ok.us. See, *OAC*, 710:1-5-36.

support of this contention, the Division argues that the evidence shows the Member was fully knowledgeable of and intimately involved in the business of the Company, including the purchases of other tobacco products from Wichita, and that said purchases were required to be reported and the tax paid thereon.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes as a matter of law that:

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. Supp. 2002, § 221(D).

2. The Tax Commission pursuant to § 403.1 of the Tobacco Act abolished the practice of purchasing and affixing stamps to tobacco products[13] as evidence of the payment of the excise tax levied on the sale, distribution, use, exchange, barter or possession of tobacco products within this State and instead requires the payment of the excise taxes through monthly tobacco product tax reports by the licensed manufacturer, wholesaler, warehouseman, distributor, or jobber first possessing, selling, using, distributing, exchanging, bartering, or in any manner dealing with such tobacco products in this State. *OAC*, 710:70-5-1(a) and (b); and 710:70-5-2.

3. "Every licensed manufacturer, and every wholesaler, * * * licensed by the Oklahoma Tax Commission, to possess, use or in any manner deal with tobacco products subject to the excise tax, upon which such tax has not been paid, shall report, to the Oklahoma Tax Commission, all purchases and invoices of all such tobacco products and merchandise subject to such excise tax monthly". *OAC*, 710:70-5-3. The monthly tobacco products tax report is required to include among other things: (1) all purchases or deliveries, * * * of all tobacco products received in the previous calendar month; (2) invoice numbers of all purchases or deliveries of such product for the previous calendar month; and (3) a copy of each invoice or all purchases or deliveries of such product for the previous month. Id.

4. The monthly tobacco products tax reports are due on or before the fifteenth (15th) day of the calendar month immediately following the calendar month in which the tobacco products subject to taxation are first received, delivered, possessed, used or in any manner dealt with in this State. *OAC*, 710:70-5-5(a). Payment of the excise tax due on such tobacco products is required to accompany the monthly reports. Id.

5. Interest and penalty shall be collected as part of the tobacco products excise tax if the tax is not timely paid. *OAC*, 710:70-5-7. Interest shall be calculated at a rate of one and one-fourth percent (1 1/4%) per month from the date the tax becomes delinquent ("due date") until payment of the tax. *OAC*, 710:70-5-7(a), citing 68 O.S., § 217(a). Penalty shall be calculated at a rate of ten percent (10%) of the total amount of delinquent tax and shall be collected if the tax is not paid

[13] "Tobacco products" is defined by the Tobacco Act to "mean any cigars, cheroots, stogies, smoking tobacco (including granulated, plug cut, crimp cut, ready rubbed and any other kinds and forms of tobacco suitable for smoking in a pipe or cigarette), chewing tobacco (including cavendish, twist, plug, scrap and any other kinds and forms of tobacco suitable for chewing), however prepared; and shall include any other articles or products made of tobacco or any substitute therefor." 68 O.S. 2001, § 401(g).

within thirty (30) calendar days after the tax becomes delinquent. *OAC*, 710:70-5-7(b), citing 68 O.S., § 217(c).

6. Protestants have the burden of proof to show the action or proposed action of the Division is incorrect, and in what respect. *OAC*, 710:1-5-47. *See*, ***Enterprise Management Consultants, Inc. v. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359. The burden of proof standard is "preponderance of evidence." 2 Am.Jur.2d *Administrative Law* § 357. "Preponderance of evidence" means "[e]vidence which is of greater weight or more convincing than the evidence offered in opposition to it; that is, evidence which as a whole shows the fact sought to be proved is more probable than not * * * evidence which is more credible and convincing to the mind * * * that which best accords with reason and probability." Black's Law Dictionary 1064 (5th ed. 1979). Each element of the claim must be supported by reliable, probative, and substantial evidence of sufficient quality and quantity as to show the existence of the facts supporting the claim are more probable than their nonexistence. 2 Am.Jur.2d *Administrative Law* § 357. If the taxpayer fails to prove a prima facie case, the protest may be denied solely on the grounds of failure to prove sufficient facts which would entitle the taxpayer to the requested relief. *OAC*, 710:1-5-47; ***Continental Oil Company v. Oklahoma Tax Commission***, 1976 OK 23, 570 P.2d 315.

7. In general, personal liability of corporate officers or managers and members of limited liability companies for the unpaid excise tax levied on tobacco products is not expressly authorized by the Uniform Tax Procedure Code[14] or the Tobacco Products Tax Act[15]. The Division cites 18 O.S., § 2017 for the proposition that the Member of the Company can be held liable for the assessed tobacco products excise taxes, interest and penalties because "the purchases of tobacco were not made in good faith and involve intentional misconduct or a knowing violation of law". *Position Letter of the Compliance Division*, p. 5. While the undersigned is unsure the breadth of § 2017's reach includes a manager's personal liability to third parties, it is analogous to the common law doctrine of "piercing the corporate veil".

The Supreme Court of Oklahoma by dicta has found that "piercing the corporate veil" may be applicable in certain tax cases to secure compliance. See, ***Tulsa Tribune Company v. Oklahoma Tax Commission***, 1989 OK 13, 768 P.2d 891, 894-895. "While there are no Oklahoma court decisions regarding piercing the veil of an L.L.C., decisions in other states indicate the principles applied to corporations will be applied to L.L.C.s." 73 OBJ 18, *Using One-Member L.L.C.s as 'Disregarded Entities'*, Timothy M. Larason (2002), citing *Ditty v. Checkrite, Ltd., Inc.*, 973 F.Supp 1320 (D. Utah 1997); and Faught, OKLAHOMA BUSINESS ORGANIZATIONS, 13.402(c). See, ***Shelter Mortgage Corporation v. Castle Mortgage Company, L.C.***, 117 Fed.Appx. 6, 2004 WL 2107710 (C.A. 10 (Utah)). "The general factors that courts claim to use when determining whether or not to pierce the veil of corporations include: (1) fraud, (2) inadequate capitalization, (3) failure to adhere to corporate formalities, and (4) abuse of the corporate entity that results in complete dominance by the shareholder or shareholders." 51 OKLR 427, *Theories of the Corporation and the Limited Liability Company: How should Courts and Legislatures articulate rules for piercing*

[14] See, 68 O.S. 2001, § 253 which provides for personal liability of principal officers of corporations and managers or members of limited liability companies for unpaid sales taxes, withheld income taxes and motor fuel taxes.

[15] 68 O.S. 2001, § 401 et seq., as amended.

the veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?, David L. Cohen (1998), citing Stephen B. Presser, *Piercing the Corporate Veil* (1997). See, 73 OBJ 18, infra. Cohen surmises that one possible explanation for another author's stance that [dominance of an LLC by its shareholders is fraudulent] "is a feeling that close corporation and LLC members might use their entities to hide from their duties as citizens, which under the communitarian theory of limited liability would be valid grounds to discard the entity" and at footnote 163 opines:

> Perhaps then, under the communitarian theory, the alter ego doctrine does represent a fraud, the fraud being the misrepresentation by the LLC member to the state that he will not use the rights he is granted to avoid his duties. The LLC member has certain duties as a citizen that cannot be avoided by contract. He asked the state to grant him certain rights under the condition that he would not avoid his duties as a normal citizen. But the whole purpose of asking for those rights was to gain protection so that he could avoid his duties. This is fraud and cannot be allowed.

Id. at 457.

The evidence presented shows the Member set up the account with WHOLESALE CO. and WHOLESALE CO. invoiced both the Company and the Member for the product sold. The Member on behalf of the Company assumed the duty to report the purchase of tobacco products and remit the taxes thereon, and in fact did report the purchase of tobacco products from other vendors. While the evidence shows there was a second shareholder of the Company, the record is devoid of any evidence to show the shareholder materially participated in the business of the Company. The record supports the conclusion that the Company was the alter ego of the Member and the Member sought the rights granted to the Company (tobacco products license) to gain the protection to avoid his duties to the State. Accordingly, the Company should be disregarded.

8. Protestants failed to come forward with any evidence to show the proposed assessments are incorrect. Accordingly, Protestants' protests to the proposed assessments of tobacco products excise taxes, interest and penalties should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protests of the Company, COMPANY and the Member, MEMBER be denied. It is further ORDERED that the amounts of the proposed assessments, inclusive of any additional accrued and accruing interest, be fixed as the deficiency due and owing by the Company and the Member, respectively.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.