

February 21, 2017

**VIA ELECTRONIC MAIL  
AND FACSIMILE**

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
Post Office Box 942879  
Sacramento, California 94279-0080

Re: Proposed Regulation - California Code of Regulations,  
Title 18, Section 4001, Definition of "Retail Stock"

Dear Mr. Bennion:

I am tax counsel for the Table Mountain Rancheria Band of Indians, a Federally-Indian tribe ("TMR").

I am in receipt of a copy of the Notice of Proposed Regulatory Action announced by the State Board of Equalization (the "Board") on January 5, 2017, (the "Notice of Proposed Regulatory Action"), indicating that the Board, pursuant to the authority vested in it by Section 30451 of the California Revenue and Taxation Code (the "R&T Code"), proposes to adopt Section 4001 of Title 18 of the California Code of Regulations (the "CCR") to define the term "retail stock" for purposes of the California Cigarette and Tobacco Products Tax Law (Part 13, Division 2, of the R&T Code) and the regulation promulgated thereunder (Chapter 9, Division 2, of Title 18 of the CCR), ("Proposed Regulation 4001"). Pursuant to the Notice of Proposed Regulatory Action, it is my understanding that the public hearing before the Board on Proposed Regulation 4001 will be held on February 22, 2017, and that written comment period for Proposed Regulation 4001 began on January 5, 2017, and ends on February 22, 2017.

On behalf of TMR, I am providing the following written comments to Proposed Regulation 4001 pursuant to the Notice of Proposed Regulatory Action. Please present these written comments to the members of the Board for their consideration at the public hearing scheduled for February 22, 2017, and before the Board decides to adopt Proposed Regulation 4001. Depending upon the action taken by the Board at the public hearing on February 22, 2017, or thereafter, in connection with Proposed Regulation 4001, TMR reserves the right to provide additional written comments to Proposed Regulation 4001.

Craig A. Houghton  
*Attorney at Law*  
choughton@bakermanock.com

Fig Garden Financial Center

5260 North Palm Avenue

Fourth Floor

Fresno, California 93704

Tel: 559.432.5400

Fax: 559.432.5620

www.bakermanock.com

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 2

## **Background Information**

In Board Publication 146, *Sales to American Indians and Sales in Indian Country* (July 2016), ("Publication 146"), the Board states the following in connection with Cigarette and Tobacco Products Taxes:

### ***"Distributors***

There are no special exemptions from the state's cigarette and tobacco products taxes for sales of cigarettes and tobacco products to Indians. A non-Indian cigarette distributor who sells cigarettes to an Indian must pay cigarette and tobacco products taxes and apply California cigarette tax stamps to the cigarette packages.

### ***Indian retailers***

An Indian retailer in California who buys untaxed cigarettes without a California tax stamp, or buys untaxed tobacco products, and sells them to non-Indians in Indian country is required to collect the cigarette and tobacco products tax from those purchasers and pay the tax to the BOE. If the Indian retailer does not collect and pay the tax due, the non-Indian purchaser is ultimately liable for the tax. Non-Indians who purchase cigarettes without California tax stamps, or purchase untaxed tobacco products, owe the cigarette and tobacco products tax. The non-Indian must register with the BOE and pay applicable California excise tax."

(Publication 146, p. 23)

Similarly, in the Cigarette & Tobacco Products Tax – FAQs published by the Board on its website ([www.boe.ca.gov/sptaxprog/cig\\_n\\_tob\\_prod\\_tax\\_faq.htm](http://www.boe.ca.gov/sptaxprog/cig_n_tob_prod_tax_faq.htm)), (the "BOE FAQs"), the BOE states as follows:

**"Are sales to American Indians exempt? The term 'Indian' will be used here because that is the term used in state and federal law for 'American Indian'.**

There are no special exemptions from the cigarette and tobacco products taxes for sales of cigarettes and tobacco products to Indians. A non-Indian cigarette distributor who sells cigarettes to an Indian must pay cigarette and tobacco products taxes and apply California cigarette tax stamps to the cigarette packages."

Notwithstanding the foregoing, in the Analysis of California Cigarette and Tobacco Products Tax Law prepared by the Board and published in the Business Taxes Law Guide, the Board has acknowledged that certain exemptions apply to the California Cigarette and Tobacco Products Tax, including, without limitation, the following exemption:

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 3

*"6. Distributions which this state is prohibited from taxing under the Constitution or laws of the United States or under the Constitution of this state are exempt. These include, for example, shipments by distributors to purchasers in other states, territories or foreign countries of cigarettes or tobacco products which are not to be returned to this state before use." [Emphasis Added].*

(Business Taxes Law Guide, Volume 3 – Special Taxes, p. 7108 (2013-1)).

Similarly, in the BOE FAQs, the Board states, in pertinent part, as follows:

**"Are there any transaction not subject to the tax?"**

Yes. The following sales and distributions of cigarettes and tobacco products generally are not subject to the cigarette and tobacco products taxes. The list is not intended to be all-inclusive. . . .

*Sales and distributions of cigarettes and tobacco products that cannot be taxed by the state under the U.S. Constitution or federal law, or under the California Constitution or state law, such as shipments to purchasers in other states, territories, or foreign countries when the cigarette and tobacco products are not to be returned to California before use."* [Emphasis Added]

Thus, notwithstanding the provisions of Publication 146 and the portion of the BOE FAQs quoted above, the State of California is prohibited from imposing its cigarette and tobacco products tax on the distribution and/or sale of cigarettes and/or other tobacco products in the State of California if such distribution or sale is exempt under the United States Constitution or Federal law.

The United States Supreme Court has, on several occasions, acknowledged an exemption from a State's cigarette and tobacco products tax if an Indian or Indian tribe sells cigarettes and tobacco products to Indians or to its tribal members within Indian country, (including, without limitation, the Indian tribe's reservation) and has limited a State's power to tax the sale of cigarettes and tobacco products sold by such Indian or Indian tribe within Indian country (including, without limitation, the Indian tribe's reservation) to sales to non-Indians or to non-tribal members.

In *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation, et al.* (1976) 425 U.S. 463, 96 S.Ct. 1634, 48 L.Ed.2d 96, the United States Supreme Court considered the question of whether the State of Montana could impose a State tax upon on-reservation sales of cigarettes by an Indian who operated a smokeshop on land leased from the Indian tribe to Indians and non-Indians. In *Moe v. Confederated Salish and Kootenai Tribes of*

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 4

*the Flathead Reservation, et al.*, 411 U.S. at 475-476, the United States Supreme Court stated as follows:

"In *McClanahan [v. Arizona State Tax Commission]* (1973) 411 U.S. 164, 93 S.Ct. 1257, 36 L.Ed.2d 129] this Court considered the question whether the State had the power to tax a reservation Indian, a Navajo, for income earned exclusively on the reservation. We there looked to the language of the Navajo treaty and the applicable federal statutes 'which define the limits of state power.' 411 U.S. at 172, 93 S.Ct. at 1262, 36 L.Ed.2d, at 136. Reading them against the 'backdrop' of the Indian sovereignty doctrine, the Court concluded 'that Arizona ha(d) exceeded its lawful authority' by imposing the tax at issue. *Id.*, at 173, 93 S.Ct., at 1263, 36 L.Ed.2d, at 136. In *Mescalero [Apache Tribe v. Jones]* (1973) 411 U.S. 145, 93 S.Ct. 1267, 36 L.Ed.2d 114], the companion case, the import of *McClanahan* was summarized:

'(I)n the special area of state taxation, absent cession of jurisdiction or other federal statutes permitting it, there has been no satisfactory authority for taxing Indian reservation lands or Indian income from activities carried on within the boundaries of the reservation, and *McClanahan v. Arizona State Tax Commission, supra*, lays to rest any doubt in this respect by holding that such taxation is not permissible absent congressional consent.' 411 U.S., at 148, 93 S.Ct, at 1270, 36 L.Ed.2d, at 119."

After analyzing and rejecting the State of Montana's attempts to avoid *McClanahan v. Arizona State Tax Commission, supra*, in *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation, et al.*, 411 U.S. at 480-481, the United States Supreme Court held, *inter alia*, that

"the [State of Montana] cigarette sales tax, as applied to on-reservation sales by Indians to Indians,<sup>16</sup> conflict[s] with the congressional statutes which provide the basis for decision with respect to such impositions. *McClanahan, supra; Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 93 S.Ct. 1267, 36 L.Ed.2d 114 (1973).<sup>17</sup>

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<sup>16</sup> The District Court noted two further distinctions within its ruling. It extended its holding to sales of cigarettes to Indians living on the Flathead Reservation irrespective of their actual membership in the plaintiff Tribe. The State has not challenged this holding, and we therefore do not disturb it. Secondly, while recognizing that different rules may apply 'where Indians have left the reservation and become assimilated into the general community,' *McClanahan*, 411 U.S., at 171, 93 S.Ct., at 1262, 36 L.Ed.2d, at 135, the District Court on the present record did not decide whether the cigarette sales tax

would apply to on-reservation sales to Indians who resided off the Flathead Reservation. That question, too, is therefore not before us.

<sup>17</sup> It is thus clear that the basis for the invalidity of these taxing measures, which we have found to be inconsistent with existing federal statutes, is the Supremacy Clause, U.S. Const., Art. VI, cl. 2, and not any automatic exemptions 'as a matter of constitutional law' either under the Commerce Clause of the intergovernmental-immunity doctrine as laid down originally in *M'Culloch v. Maryland*, 4 Wheat. 316, 4 L.Ed. 579 (1819). If so, then the basis for convening a three-judge court in this type of case has effectively disappeared, for this Court has expressly held that attacks on state statutes raising only Supremacy Clause invalidity do not fall within the scope of 28 U.S.C. s 2281. *Swift & Co. v. Wickham*, 382 U.S. 111, 86 S.Ct. 258, 15 L.Ed.2d 194 (1965). Here, however, the District Court properly convened a s 2281 court, because at the outset the Tribe's attack asserted unconstitutionality of these statutes under the Commerce Clause, a not insubstantial claim since *Mescalero* and *McClanahan* had not yet been decided. See *Goosby v. Osser*, 409 U.S. 512, 93 S.Ct. 854, 35 L.Ed.2d 36 (1973)."

In *Washington v. Confederated Tribes of the Colville Indian Reservation, et al. v. United States, et al.* (1980) 447 U.S. 134, 100 S.Ct. 2069, 65 L.Ed.2d 10, the United States Supreme Court considered the question of whether the State of Washington could impose a cigarette excise tax and a sales tax on on-reservation sales of cigarettes by the tribe to non-members. Unlike the State cigarette tax in *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation, et al., supra*, the State of Washington cigarette excise expressly tax permitted Indian tribes to possess untaxed and unstamped cigarettes for purposes of resale to members of the tribe, and only required an Indian tribe to collect the cigarette excise tax with respect to sales to non-members of the tribe. (*Washington v. Confederated Tribes of the Colville Indian Reservation, et al.*, 447 U.S. at 141).

In *Washington v. Confederated Tribes of the Colville Indian Reservation, et al. v. United States, et al.*, 447 U.S. at 150-151, the United States Supreme Court cited *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation, et al., supra*, and stated that in that case, the Court upheld the State of Montana's cigarette tax on sales by smokeshops operated by tribal members and located on leased trust lands within the tribe's reservation to sales to non-Indians because the legal incidence of the tax fell on the non-Indian purchasers, but struck down the State of Montana's cigarette tax as applied to sales to Indians. Thus, in *Washington v. Confederated Tribes of the Colville Indian Reservation, et al. v. United States, et al.*, 447 U.S. at 159, the United States Supreme Court held that the State of Washington's cigarette excise tax was valid, and further held as follows:

"The simple collection burden imposed by Washington's cigarette tax on tribal smokeshops is legally indistinguishable from the collection burden upheld in *Moe*, and

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 6

we therefore hold that the State may validly require the tribal smokeshops to affix tax stamps purchased from the State to individual packages of cigarettes prior to the time of sale to nonmembers of the Tribe."

In *Washington v. Confederated Tribes of the Colville Indian Reservation, et al.*, 447 U.S. at 159-160, the United States Supreme Court also upheld as valid the State of Washington's recordkeeping requirements that required smokeshop operators to keep detailed records of taxable and nontaxable transactions, to record the number and dollar volume of taxable sales to non-members of the tribe, and, with respect to nontaxable sales, to record and retain the names of all Indian purchasers, their tribal affiliations (as verified, if not known), the Indian reservation upon which the sales were made, and the dollar amounts and dates of sales.

In light of the foregoing, clarification of the scope of the State of California's ability to impose its cigarette and tobacco products tax in the case of both (i) the distribution, purchase or sale of cigarettes and/or tobacco products to Indians, Indian tribes, and other Indian organizations for resale to Indians and non-Indians, within Indian country (including, without limitation, a reservation) and (ii) the sale of cigarettes and/or tobacco products by such Indians, Indian tribes, and other Indian organizations to Indians and non-Indians within Indian country (including, without limitation, a reservation), is needed to confirm that the State of California is precluded from imposing its cigarette and tobacco products tax on the distribution, purchase or sale of cigarettes and/or tobacco products by a distributor, manufacturer or other person to Indians, Indian tribes, and other Indian organizations for resale to tribal members within Indian country (including, without limitation, a reservation), and to the sale of such cigarettes and/or tobacco products by such Indians, Indian tribes, and other Indian organizations to tribal members within Indian country (including, without limitation, a reservation).

### **Specific Comments to Proposed Regulation 4001**

As stated in the Notice of Proposed Regulatory Action, Proposed Regulation 4001 is limited to the definition of "retail stock". However due to the definition of "retail stock" set forth in Proposed Regulation 4001 as currently proposed by the staff of the Board, "retail stock" will include cigarettes and tobacco products distributed to, sold to, purchased by or held by an Indian, Indian tribe or other Indian organization for resale to tribal members within Indian country (including, without limitation, a reservation) even though the distribution to, sale to, purchase of or holding of such cigarettes and tobacco products by such Indian, Indian tribe or other Indian organization for resale to tribal members within Indian country (including, without limitation, a reservation), and the sale of such cigarettes and tobacco products by such Indian, Indian tribe or other Indian organization to tribal members within Indian country (including, without limitation, a reservation), are clearly exempt from the California cigarette and tobacco products tax under *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation*,

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 7

*et al., supra*, and *Washington v. Confederated Tribes of the Colville Indian Reservation, et al. v. United States, et al, supra*.

In order to avoid this problem, on behalf of TMR, I propose that Proposed Regulation 4001 be revised to read as set forth in the enclosed Revised Proposed Text of California Code of Regulations, Title 18, Section 4001, *Retail Stock* (the "Revised Proposed Text of Regulation 4001"). As you will see from the Revised Proposed Text of Regulation 4001, our approach is to allow an Indian retailer (as defined in paragraph (b)(3) of the Revised Proposed Text of Regulation 4001) to purchase, maintain, hold for sale, and sell two classes of inventory – (i) untaxed cigarettes and untaxed tobacco products without tax stamps affixed thereto for resale to its tribal members from a location within Indian country or its reservation, and (ii) taxed cigarettes and taxed tobacco products with tax stamps attached thereto for resale to non-tribal members from the same location. As a result, the Indian retailer and its exempt, tribal member purchasers will be able to receive the exemption from the California cigarette and tobacco products tax allowed to them under *Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation, et al., supra*, and *Washington v. Confederated Tribes of the Colville Indian Reservation, et al. v. United States, et al, supra*.

Due to a prior commitment, I will be unable to attend the hearing before the Board relating to Proposed Regulation 4001 scheduled for February 22, 2017.

On behalf of TMR, I would like to thank the members of the Board and you for their and your consideration of the foregoing written comments to Proposed Regulation 4001. Consistent with TMR's and my prior working with the members of the Board, as well as with the attorneys within the Legal Division and the members of the staff of the Board, we appreciate the opportunity to work with the members of the Board, the attorneys within the Legal Division, and the members of the staff of the Board on a government-to-government basis relating to this project.

Thank you for your assistance and cooperation. If you have any questions with regard to the foregoing or the enclosed Revised Proposed Text of Regulation 4001, please contact me. If you receive my voice mail or I am otherwise unavailable when you call, please dial "0" and ask our receptionist to transfer your call to Ms. Cristina Lopez, my assistant.

Very truly yours,



Craig A. Houghton  
BAKER MANOCK & JENSEN, PC

CAH:cgl  
Enclosure

Mr. Richard Bennion, Regulations Coordinator  
State Board of Equalization  
February 21, 2017  
Page 8

cc: Leanne Walker-Grant, Chair, Tribal Council (with enclosure)  
Daniel E. Casas, Esq. (with enclosure) – via electronic mail  
Angela Karst, Esq. (with enclosure) – via electronic mail  
Ms. Betty T. Yee (with enclosure) – via electronic mail  
Ms. Yvette Stowers, Deputy Controller – Tax (with enclosure) – via electronic mail  
Mr. George Runner (with enclosure) – via electronic mail  
Ms. Fiona Ma, CPA (with enclosure) – via electronic mail  
Mr. Jerome E. Horton (with enclosure) – via electronic mail  
Ms. Diane L. Harkey (with enclosure) – via electronic mail  
Pamela Mash, Esq. (with enclosure) – via electronic mail



**Revised Proposed Text of  
California Code of Regulations, Title 18, Section 4001,  
Retail Stock**

(A new regulation to be added to the California Code of Regulations)

4001. Retail Stock.

(a) "Retail stock" means and includes:

(1) All cigarettes and tobacco products intended and available for sale to consumers by a person who holds a retailer license; and

(2) All cigarettes and tobacco products displayed for sale to consumers by a person who concurrently holds a distributor license and a retailer license at the same location.

(A) Cigarettes and tobacco products that are stored in the area where retail sales are made are deemed to be retail stock. Cigarettes and tobacco products that are securely stored away from the area where retail sales are made are not considered retail stock.

(i) Examples of areas that are separated and segregated from retail stock include, but are not limited to, the following secured areas:

- store room or closet,
- back office,
- inside a locked cabinet, safe, or other similar storage container, or
- behind a locked wire-cage door or similar encumbrance.

(ii) Untaxed cigarettes and tobacco products must be in the original manufacturer packaging, with an unbroken seal, and they must be secured, segregated, and separated from inventory accessible by consumers. Untaxed tobacco products must be segregated and secured separately from tax-paid tobacco products away from the retail area.

(B) Walk-in humidors. Tobacco products inside a walk-in humidor displayed for sale to consumers are retail stock. Tobacco products inside a walk-in humidor in the original manufacturer packaging with an unbroken seal, secured, segregated and separated from retail stock, and not displayed for sale to consumers are not retail stock. Examples of areas that are separated and segregated from retail stock include, but are not limited to, the following secured areas:

- inside a locked cabinet, safe, or other similar secured storage container, or
- behind a locked wire-cage door or similar encumbrance.

(b) Notwithstanding paragraph (a) of this regulation, "retail stock" shall not mean or include:

(1) Any untaxed cigarettes or any untaxed tobacco products purchased by an Indian retailer (as defined in paragraph (b)(3) of this regulation) without tax stamps affixed thereto from a

distributor or otherwise that are intended and available for sale by such Indian retailer to Indian members (as defined in paragraph (b)(4) of this regulation) at any location within Indian country (as defined in Section 30101.7(c)(5) of the Revenue and Taxation Code) or within a reservation (as defined in paragraph (d)(2) of Regulation 1616), whether or not such Indian retailer holds a retailer license; and

(2) Any untaxed cigarettes or any untaxed tobacco products without tax stamps affixed thereto displayed for sale to Indian members by an Indian retailer who concurrently holds a distributor license and a retailer license at the same location.

(3) For purposes of this regulation, "Indian retailer" means and includes any Indian or Indian organization (each as defined in paragraph (d)(2) of Regulation 1616) who sells cigarettes and/or tobacco products to Indian members and/or to non-Indian members at a location located within Indian country (as defined in Section 30101.7(c)(5) of the Revenue and Taxation Code) or within a reservation (as defined in paragraph (d)(2) of Regulation 1616).

(4) For purposes of this regulation, "Indian members" means and includes all Indians (as defined in paragraph (d)(2) of Regulation 1616) each of whom is (i) a member of the same Indian tribe of the Indian retailer, if such Indian retailer is an individual; (ii) a member of the Indian retailer, if such Indian retailer is an Indian tribe; or (iii) a member of the Indian tribe to which the Indian retailer is affiliated or related, if such Indian retailer is an Indian organization (as defined in paragraph (d)(2) of Regulation 1616) other than an Indian tribe.

(cb) A person (other than an Indian retailer) who is both a licensed retailer and a licensed distributor, but who only makes retail sales to consumers and does not make any sales for resale to other licensees, holds all inventory intended for sale in retail stock. Any Indian retailer who is both a licensed retailer and a licensed distributor, but who only makes retail sales to consumers (including Indian members and non-Indian members) and does not make any sales for resale to other licensees, holds any inventory intended for sale to non-Indian members in retail stock, but does not hold any inventory intended for sale to Indian members in retail stock.

(de) Presumption of Distribution.

(1) All cigarettes and tobacco products placed in retail stock have been distributed. Tax is due upon distribution. This presumption shall not apply to untaxed cigarettes and untaxed tobacco products described in paragraph (b)(1) or paragraph (b)(2) of this regulation.

(2) Unless the contrary is established, it shall be presumed that all cigarettes and tobacco products no longer in a distributors possession (other than untaxed cigarettes and untaxed tobacco products described in paragraph (b)(1) or paragraph (b)(2) of this regulation), including when they have been lost through an unexplainable disappearance, have been distributed. The presumption may be rebutted by a preponderance of the evidence demonstrating that an explainable disappearance, such as theft, has occurred.

Examples of evidence that may overcome the presumption include, but are not limited to, the following:

- (A) Police reports (Required and must have been filed timely)
- (B) Insurance claims
- (C) Insurance reimbursements
- (D) Video surveillance
- (E) Photographs
- (F) Detailed tobacco inventory reports
- (G) Cigarette and tobacco purchase invoices (Required)
- (H) Proof of prosecution related to charges of theft of cigarettes or tobacco products.

Note: Authority cited: Section 30451, Revenue and Taxation Code. Reference: Sections 30008 and 30109, Revenue and Taxation Code.