



1 February 23, 2011, but the hearing was again postponed because petitioners requested additional time  
2 to prepare and submit an opening brief.

### 3 BACKGROUND

4 Petitioner Frederick McAllister, who qualifies as an “Indian” for purposes of California Code  
5 of Regulations, title 18, section (Regulation) 1616, commenced business as a sole proprietor in April  
6 2004, operating a business known as Black Hawk Tobacco Shop, selling primarily Native American  
7 tobacco products (cigarettes). The business was incorporated in October 2005, as Black Hawk  
8 Tobacco, Inc. (Black Hawk), but petitioners did not notify the Board of the change in business  
9 ownership. The Sales and Use Tax Department (Department) became aware of the incorporation of  
10 the business during an audit of the sole proprietorship. The Department issued two Notices of  
11 Determination (determinations) to Mr. McAllister for the portion of the audit period during which he  
12 operated the business as a sole proprietor, which are the subjects of Case ID 417165 (April 1, 2004,  
13 through December 31, 2004) and Case ID 445001 (January 1, 2005, through December 31, 2005<sup>1</sup>).  
14 The Department issued a determination to Black Hawk for the period October 11, 2005, through  
15 December 31, 2007 (Case ID 445011), and a determination to Mr. McAllister as a predecessor to  
16 Black Hawk for the same period (Case ID 469656).

### 17 UNRESOLVED ISSUES

18 **Issue 1:** Whether petitioners were required to collect and remit use tax with respect to sales of  
19 Native American tobacco products on Indian reservation land. We find petitioners were required to  
20 collect and remit the use tax.

21 Petitioners filed sales and use tax returns, claiming all sales as nontaxable sales for resale. The  
22 Department examined petitioners’ purchase invoices and concluded that all purchases represented  
23 taxable merchandise, primarily cigarettes and tobacco products. Petitioners did not present any  
24 evidence to support the claimed sales for resale. Petitioners’ bookkeeper stated that petitioners did not  
25 retain such documentation and that very few of their sales were to Indians. The Department regarded  
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27 <sup>1</sup> Although the period for this determination ends December 31, 2005, the amount of tax determined for the fourth quarter  
28 2005 is based on sales through October 10, 2005, only.

1 two percent of petitioners' sales as exempt sales to Indians residing on reservation land and concluded  
2 the remaining sales were subject to tax.

3         Petitioners do not dispute the audited amounts. Instead, petitioners contend that any California  
4 legal authorities that impose a use tax collection requirement on petitioners conflict with federal  
5 authority and therefore are preempted or invalid. Petitioners contend that sales on Indian reservations  
6 of tobacco products manufactured on Indian reservations by Indian-owned manufacturers are exempt  
7 from state tax.

8         Sales tax does not apply to sales by Indian retailers, such as petitioners, that are negotiated on  
9 an Indian reservation where the property is delivered to the purchaser on the reservation. (Cal. Code  
10 Regs., tit. 18, § 1616, subd. (d)(3)(A).) When the purchaser is an Indian who resides on a reservation,  
11 use tax generally does not apply, but where such sales are made to Indians who do not reside on a  
12 reservation or to non-Indians, Regulation 1616, subdivision (d)(3)(A)2. requires that the retailer collect  
13 use tax from the purchasers and report and pay that use tax to the Board. Contrary to petitioners'  
14 contention that federal authorities require a different result, the courts have consistently allowed states  
15 to impose sales and use tax obligations on tribes when the legal incidence of the tax does not fall on the  
16 tribe or on Native Americans who reside on reservations. It is also constitutionally permissible for  
17 states to require Indian tribes to assist with the collection of taxes, and we therefore conclude it is also  
18 permissible to require petitioners to assist with the collection of the taxes due. Accordingly, we find  
19 that petitioners are liable for the use tax they were required to collect and remit to the Board.

20         **Issue 2:** Whether petitioners were negligent. We conclude that they were.

21         The Department applied the 10-percent penalty for negligence to each determination because  
22 petitioners claimed all their sales as nontaxable sales for resale, but they presented no evidence to  
23 support the claimed exclusion from tax. Further, petitioners' bookkeeper stated that petitioners made  
24 very few sales to Indians. Petitioners have not specifically disputed the negligence penalties.

25         It is undisputed that petitioners did not maintain records to support the claimed nontaxable sales  
26 for resale, nor have petitioners provided any evidence to refute the bookkeeper's statement that there  
27 were few sales to Indians. Since use tax was applicable to virtually all of petitioners' sales, we find the  
28 fact that petitioners reported no use tax to be evidence that petitioners did not exercise due care in

1 reporting. Accordingly, we find that the understatements were the result of negligence, and that the  
2 penalties were properly applied.

3 **Issue 3:** Whether Mr. McAllister is liable as a predecessor for the amounts assessed against  
4 Black Hawk for the period October 11, 2005, through December 31, 2007. We find that he is.

5 We note that this “issue” is not actually disputed since Mr. McAllister has relied only on the  
6 same argument addressed under issue 1 to dispute this determination.

7 Mr. McAllister’s sole proprietorship was incorporated as Black Hawk Tobacco, Inc. in October  
8 2005, with Mr. McAllister as the sole shareholder. Petitioners did not notify the Board, and Black  
9 Hawk did not obtain a seller’s permit. Instead, Black Hawk filed sales and use tax returns under the  
10 seller’s permit issued to Mr. McAllister. The Department became aware of the incorporation during its  
11 audit of the sole proprietorship, and it concluded that Mr. McAllister is liable as a predecessor for the  
12 amounts assessed against Black Hawk for the period October 11, 2005, through December 31, 2007.  
13 Based on the undisputed facts, we conclude that Mr. McAllister is subject to predecessor liability for  
14 the period October 11, 2005, through December 31, 2007. (Rev. & Tax. Code, § 6071.1, subd. (a);  
15 Cal. Code Regs., tit. 18, § 1699, subd. (f).)

16 **OTHER DEVELOPMENTS**

17 None.

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19 Summary prepared by Rey Obligacion, Retired Annuitant  
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