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TOBACCO PRODUCTS REGULATION

Senate Bill 809 as passed by the Senate
First Analysis (10-27-99)

Sponsor: Sen. Joanne G. Emmons
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

Public Act 368 of 1998 put provisions in the Revenue Act aimed at preventing the importation into Michigan of cigarettes manufactured in the United States for overseas sale or manufactured overseas to be sold illegally here (so-called look-alike or knockoff products). These provisions, however, have not been successful in preventing the sale of certain products, according to the Department of Treasury, because of loopholes in the statutory language (and in the interface between state and federal tobacco regulations). Michigan is said to have become a target state for the sale and distribution of cigarettes manufactured in the United States for sale in foreign countries. These cigarettes can be sold at lower prices than cigarettes manufactured in the U.S. for U.S. distribution because reportedly cigarette companies sell cigarettes overseas at lower prices. This puts Michigan tobacco wholesalers and their retail customers at a competitive disadvantage because they only sell cigarettes manufactured for the U.S. market and must sell them at a higher price than the cigarettes intended for export. This problem is made worse by the fact that cigarettes are expensive in Michigan, which has a 75 cents-per-pack tax. The tax was raised from 25 cents per pack as part of Proposal A, which overhauled the state's school finance system. (Some people say cigarettes intended for export may be manufactured to different standards and contain more nicotine than those manufactured for the U.S. market and so pose special health hazards.)

Some individuals and businesses purchase cigarettes made for export and re-introduce them or "repatriate" them into the U.S. and distribute them to retailers. The cigarette packs typically contain a notice that they were manufactured for export; they might say, "U.S. Tax Exempt", "For Use Outside the United States", or something similar. Once re-introduced into this country, the required federal and state taxes are paid and stamps affixed. Apparently, this practice is not illegal under federal laws, although a number of states have prohibited it. Legislation has been introduced to tighten language regarding the distribution of made-for-export and foreign cigarettes.

THE CONTENT OF THE BILL:

The bill would amend the Revenue Act in the following ways.

** A person would be prohibited from acquiring, possessing, selling, distributing, or importing into the state a tobacco product or container of tobacco products if one or more of the following applied:

– – The tobacco product or container of tobacco products contained any statement, label, stamp, sticker, or notice indicating that the manufacturer intended that the tobacco product be sold or distributed outside the United States, including but not limited to a non-United States health warning or labels or markings stating "for export only", "U.S. tax exempt", "for use outside U.S.", or similar wording.

– – The tobacco product, container of tobacco products, or any statement, label, stamp, sticker, or notice on a tobacco product or container of tobacco products had been altered from the manufacturer's original packaging to conceal the fact that the manufacturer intended that the tobacco product be sold or distributed outside the United States.

– – The tobacco product or any statement, label, stamp, sticker, or notice on a tobacco product or container of tobacco products had been removed from the manufacturer's original packaging to conceal the fact that the manufacturer intended that the tobacco product be sold or distributed outside the United States.

– – The person knew or should have known that the manufacturer intended the tobacco product to be sold or distributed outside the United States.

– – The tobacco product was imported into the U.S. after January 1, 2000 in violation of the Internal Revenue Code.

** A person could not place a stamp or a counterfeit stamp on a tobacco product unless the package of tobacco products complied with provisions listed above and all federal laws and regulations.

** At present, the act prohibits a person from importing into the state a tobacco product that violates any federal requirement for the placement of labels, warnings, or other information, including health hazards, required to be placed on the container or individual package. This provision would be rewritten to prohibit a person from acquiring, possessing, selling, distributing, or importing into the state a tobacco product that violated any federal law or regulation, including but not limited to requirements concerning health warnings or other information.

** The act currently makes a person subject to criminal charges under the Tobacco Products Tax Act if he or she acquires, possesses, sells, or offers for sale packages of tobacco products stamped or marked in violation of specified Revenue Act provisions. Under the bill, a person who acquired, possessed, sold, offered for sale, imported, or distributed packages of tobacco products who knew or should have known that the tobacco product was possessed, sold, offered for sale, imported, or distributed in violation of the provisions described earlier would be subject to criminal penalties.

** A tobacco product or container of tobacco products that did not comply with the provisions above and books and records associated with those products would be subject to seizure and confiscation by the Department of Treasury, a police officer, or a designated agent under the same terms and conditions as provided in Section 9 of the Tobacco Products Tax Act. The department is currently able to revoke the license of a licensee for violations of the Revenue Act; the bill would also permit the revocation of a license. The department is currently authorized to obtain and exchange information with the United States Customs Service for the purpose of enforcing tobacco provisions in the Revenue Act; the bill would also authorize cooperation with any other federal law enforcement agency or any state law enforcement agency.

** Any person injured by another person who violated the tobacco provisions could bring an action in circuit court for damages or equitable or injunctive relief, including reasonable attorney fees. In awarding damages, the court would be able to award up to three times the actual damages if the violation was intentional. A manufacturer of tobacco products whose

products were acquired, possessed, sold, distributed, or imported into the state in violation of the Revenue Act would be presumed to be injured under this provision.

MCL 205.14

BACKGROUND INFORMATION

Michigan adopted a 75 cent-per-pack tax on cigarettes in 1994. Prior to that, the tax had been 25 cents per pack. The tax increase led to increased cigarette smuggling. In response, the legislature enacted a tobacco tax stamping program, with the passage of Public Act 187 of 1997. As of September 1, 1998, a pack of cigarettes could not be sold to the general public without a tax stamp. The Senate Fiscal Agency, in its analysis of Senate Bill 809 dated 10-22-99, reports Department of Treasury estimates that in 1999, the tax stamp program will result in $136 million in increased tobacco tax revenues.

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that the greater degree of enforcement of the tobacco stamp laws could result in increased tobacco tax revenues, although the amount cannot be determined. (HFA fiscal note dated 10-25-99)

The Senate Fiscal Agency notes that the 1999-2000 fiscal year budget provides $1.725 million for cigarette tax enforcement. (SFA analysis dated 10-22-99)

ARGUMENTS:

For:

The bill would help prevent the introduction of cigarettes into Michigan that were intended for foreign markets or were manufactured in other countries to be sold illegally in the United States. Since foreign countries have different manufacturing regulations and standards, the sale of these products could pose health risks to Michigan smokers. Since other states have already prohibited the sale of cigarettes intended for foreign markets, Michigan has become a prime market for these cigarettes. The bill would eliminate Michigan as a target market, increase the supply of legally stamped cigarettes in the state, and ensure that the content of cigarettes sold in the state was uniform. The bill would also allow the Department of Treasury to provide additional enforcement of the current tax stamp program by ensuring that the wholesale locations were readily available. It would also allow private lawsuits against those who violate the law on behalf of anyone injured by the violations.

For:

Michigan wholesalers and retailers who follow the tobacco sale rules (many of them small, family-owned businesses) are at a competitive disadvantage when others sell cigarettes intended for foreign markets but "reintroduced" into the United States. Customers believe retailers are gouging them when they can find products that look the same at lower prices. These products are specifically manufactured for sale out-of-the-country and contain words to that effect on the packaging (although it might be obscured). Yet they are being sold here at bargain prices. The Department of Treasury has said that the products are only available through a "loophole" in the current tobacco enforcement laws. This bill would close the loophole and allow the department to take these products out of circulation.

Against:

A representative of "repatriators", companies that purchase cigarettes that are manufactured in the United States for sale outside of the country and then bring them back for sale in the United States, testified that this bill would make illegal a business practice that is currently legal and would reduce competition in cigarette sales. According to this spokesperson, repatriated cigarettes are essentially the same as cigarettes manufactured for sale in the U.S. and once brought back from overseas are subject to all the same federal and state taxes as cigarettes manufactured for sale in the U.S. They can be sold for less, he said, because of the pricing practices of cigarette manufacturers; cigarettes sold overseas can be purchased for about one-third of the cost of cigarettes sold in the U.S. and remain cheaper even with the additional transportation costs. This practice is not smuggling. It is not illegal and is highly regulated by federal agencies. The companies must keep strict records. The products are not "imports" since they are manufactured in the U.S. The bill would make it illegal to fix a Michigan tax stamp to these repatriated cigarettes and thus prevent them from being sold in the state. It is anti-competitive.

POSITIONS:

The Department of Treasury supports the bill. (10-26-99)

The Michigan Distributors and Vendors Association supports the bill. (10-26-99)

The Service Station Dealers Association supports the bill. (10-26-99)

Phillip Morris supports the bill. (10-26-99)

R.J. Reynolds Tobacco U.S.A. has indicated support for the bill. (10-26-99)

The Associated Food Dealers of Michigan has indicated support for the bill. (10-26-99)

Spartan Stores has indicated support for the bill, with immediate effect. (10-26-99)

A representative of National Trade Industries testified in opposition to the bill. (10-26-99)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.