Legislative Analysis

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TOBACCO PRODUCTS TAX ENFORCEMENT:
DIGITAL STAMPS & ENFORCEMENT APPROPRIATIONS

Senate Bill 930 (S-2)
Sponsor: Sen. Roger Kahn, M.D.
House Committee: Tax Policy
Senate Committee: Finance

Complete to 3-20-12

A REVISED SUMMARY OF SENATE BILL 930 AS PASSED BY THE SENATE 2-22-12

The tobacco tax is a tax imposed on the consumer of tobacco products at the time of purchase. It is a violation of the Michigan Tobacco Products Tax Act (TPTA) to purchase cigarettes that do not bear a valid Michigan stamp. The TPTA establishes specific requirements for licensing manufacturers, wholesalers, secondary wholesalers, vending machine operators, unclassified acquirers, transportation companies, and transporters; for stamping packages of cigarettes and other tobacco products; and for collecting and remitting tobacco taxes. The act provides civil and criminal penalties for violations. Generally speaking, the tax on tobacco products is $2 on a pack of 20 cigarettes and 32% of the wholesale price of other tobacco products (cigars, noncigarette smoking tobacco, and smokeless tobacco).

Senate Bill 930 would amend the Tobacco Products Tax Act to do the following:

- Require the Department of Treasury to issue a request for proposal to acquire and use digital stamps.
- Allow stamping agents to retain 0.5% of the tax due on cigarettes as compensation for the direct costs actually incurred for equipment and technology upgrades required by the use of digital stamps.
- Allow stamping agents to keep from monthly remittances, for 18 months, 5.55% of the total net purchase price of eligible equipment, as compensation for direct costs.
- Allow licensees to retain, from sales of untaxed cigarettes to Indian tribes, an amount equal to 1.5% of the tax due on those cigarettes sold as if the sales were taxable.
- Require the Michigan Department of State Police (MSP) to initiate inquiries or otherwise obtain data from the Treasury Department to support MSP enforcement activities.
- Allow the Department of Treasury, the Attorney General, and the MSP to use proceeds from taxes, fees, and penalties, upon appropriation, for enforcement and administration of the act, before those proceeds are distributed.
- Appropriate, for fiscal year 2011-12 only, the following amounts from tobacco tax revenue allocated to the General Fund: $4 million to the State Police, $1.5 million to the Treasury Department, and $500,000 to the Attorney General, for enforcement and administration of the act.
- Include as a "nonparticipating manufacturer," a person who operates or permits another person to operate a commercial-grade cigarette making machine.

Digital Stamps
Retailers and other licensees are prohibited from acquiring cigarettes for resale or selling cigarettes unless the packs are stamped. The act requires the Department of Treasury to procure stamps, which wholesalers and unclassified acquirers then obtain from the department and affix to packs of cigarettes.

Senate Bill 930 would require the department, within 45 days after the bill's effective date, to issue a request for proposal (RFP) to acquire and use digital stamps that contained a unique nonrepeating code that can be read by a device that identifies the taxed product and contains other security and enforcement features as determined by the department. The RFP must require the successful bidder to share digital stamp technology so that handheld devices, including smartphones, could be readily used to further the implementation of the use of digital stamps, and so that the technology and equipment used by the stamping agents could be supplied, as the department permitted, by the successful bidder or by any other providers.

The RFP also must permit the department to manage or restrict access rights to all or part of the information contained within the stamps or accessible from them. In addition, the RFP would have to require the successful bidder to guarantee that the stamps would be designed and manufactured to ensure that they could be affixed to individual packs of cigarettes as required by the act.

Currently, a stamp is considered affixed if more than 50% of it is affixed to the individual pack, as determined by the Department. The bill would increase this to 90% or more, upon implementation of the digital stamps.

The bill also provides that stamps could be affixed to an individual pack of cigarettes only if the manufacturer of the cigarettes is on the department's lists of participating and nonparticipating manufacturers under Section 6c (which is described below).

Licensee Returns & Compensation
The act levies a tax on the sale of tobacco products sold in the state, and requires licensees (other than a retailer, an unclassified acquirer licensed as a manufacturer, or a vending machine operator) to file with the Department of Treasury a monthly return on a form prescribed by the department. Under the bill, the department also could require licensees to report cigarette acquisition, purchase, and sales information in other formats and frequency.

The act requires a licensee, at the time of filing the return, to pay the tax for tobacco products sold during the month, less compensation equal to 1% of the total amount of the tax due on tobacco products sold other than cigarettes, and 1.5% of the total amount of the tax due on cigarettes sold.

Beginning on the bill's effective date, for sales of untaxed cigarettes to Indian tribes in the state, licensees also could retain an amount equal to 1.5% of the total amount of the tax due on those cigarettes sold as if the sales were taxable.

In addition, beginning on the first month after the use of digital stamps was implemented, a stamping agent could retain 0.5% of the total amount of the tax due on cigarettes sold and, for sales of untaxed cigarettes to Indian tribes in the state, 0.5% of the total amount of the tax due on those cigarettes sold as if the sales were taxable, until the stamping agent was compensated in an amount equal to the direct cost actually incurred for upgrades to technology and equipment (excluding equipment reimbursed under the following provision) needed to affix the digital stamps, as determined by the department.

Beginning on the first month after the implementation of the use of digital stamps and continuing for the next 17 months, a stamping agent could retain an amount equal to 5.5% of the total net purchase price of the equipment needed to affix the digitals stamp. This reimbursement would have to exclude reimbursement for any costs of equipment installation or ongoing maintenance related to eligible equipment. A stamping agent could receive reimbursement for the purchase of eligible equipment only to the extent that the equipment purchased did not exceed the total number of the agent's existing equipment as certified by the agent on a form prescribed by the department.

(A stamping agent is a wholesaler or unclassified acquirer other than a manufacturer that is licensed and authorized by the department to affix stamps to individual packs of cigarettes on its own behalf and for other wholesalers or unclassified acquirers other than manufacturers.)

The bill would define "eligible equipment" as a cigarette tax stamping machine that meets all of the following conditions:

- Was purchased by a stamping agent who was licensed as a stamping agent as of December 31, 2011.
- Enables the stamping agent to affix digital stamps to individual packs of cigarettes as required by the act.
- Was purchased for the primary purpose of permitting the stamping agent to affix digital stamps to individual packs of cigarettes to be sold in this state after the implementation of the use of digital stamps.

"Existing equipment" would mean a cigarette stamping machine owned by a person licensed as a stamping agent as of December 31, 2011, and was a cigarette tax stamping machine used before January 1, 2012, by the stamping agent to apply stamps using rolls of 30,000 stamps.

Cigarette Making Machines

The bill would amend the act's definition of "manufacturer" to include a person who operates or who permits any other person to operate a cigarette making machine in Michigan for the purpose of producing, filling, rolling, dispensing, or otherwise generating cigarettes. The person would constitute a nonparticipating manufacturer for purposes of Sections 6c and 6d of the act (described below).

A person operating or otherwise using a machine or other mechanical device, other than a cigarette making machine, to produce, fill, roll, dispense, or otherwise generate cigarettes would not be considered a manufacturer as long as the cigarettes were produced or otherwise generated in that person's dwelling and for self-consumption.

The bill would define "cigarette making machine" as any machine or other mechanical device that meets all of the following criteria:

- Is capable of being loaded with loose tobacco, cigarette tubes or papers, and any other components related to the production of cigarettes, including filters.
- Is designed to automatically or mechanically produce, roll, fill, dispense, or otherwise generate cigarettes.
- Is commercial-grade or otherwise designed or suitable for commercial use.
- Is designed to be powered or otherwise operated by a main or primary power source other than human power.

(A "nonparticipating manufacturer" is a manufacturer that is not a participant in the Master Settlement Agreement that Michigan and 45 other states entered into with four major U.S. tobacco companies in 1998. Section 6c of the act requires a nonparticipating manufacturer to certify its compliance with Public Act 244 of 1999, which requires tobacco product manufacturers to establish escrow accounts; requires wholesalers and unclassified acquirers to report all cigarettes they acquire from nonparticipating manufacturers; and requires the department to maintain a list of participating and nonparticipating manufacturers that have provided a certification of compliance.)

Appropriation of Tobacco Tax Revenue

The act allocates proceeds from the payment of taxes, fees, and penalties, as well as licensee fees. Under the bill, before funds were distributed as required, the funds could be used by the Department of Treasury, the Attorney General, and the MSP, subject to appropriations, for enforcement and administration of the act.

Under the bill, for fiscal year 2011-12 only, from the funds directed to the General Fund, $6 million would be appropriated as follows for enforcement and administration of the act: Department of State Police, $4 million; Department of Treasury, $1.5 million; and Department of Attorney General, $500,000.

MCL 205.422 et al.

FISCAL IMPACT:

Tobacco products tax revenue would increase by an indeterminate amount due to the digital stamping, the increased enforcement, and from expanding the definition of a "nonparticipating manufacturer."

To enforce and administer the provisions of Senate Bill 930, the bill appropriates a total of $6.0 million of the General Fund portion of tobacco tax revenue. Specifically, the Department of Treasury would receive $1.5 million; the Attorney General would receive $500,000; and the Department of State Police would receive $4.0 million.

The bill would require digital cigarette tax stamps to replace the heat-applied stamps that are currently in use. According to the Department of Treasury, this change would increase the cost of stamps from a current annual amount of $369,000 to approximately $2.7 million (a $2.3 million increase), all else remaining equal. The bill could also increase costs related to information technology and data collection under the new digital stamps.

A licensee who sells cigarettes to Indian tribes (untaxed) would be authorized to receive a refund equal to 1.5% of the tax due on those cigarettes sold as if those cigarette sales were taxable sales under the act. The Department of Treasury has estimated the cost of this provision to be $45,600 annually. Additionally, stamping agents would be able to recoup costs for upgrades to technology and equipment that are necessary to affix the digital stamp. The Department of Treasury has estimated this will cost $4.5 million annually. Under the provisions of the bill, the stamping agent would be allowed to recoup retain 0.5% of the tax until the stamping agent is compensated in an amount equal to the direct cost incurred for upgrades to technology and equipment.

The bill would also allow for stamping agents to recoup the initial costs (excluding installation and maintenance) of "eligible equipment" over an 18-month period. Specifically, the Department of Treasury would reimburse the stamping agent at 5.55% of the total net purchase price on a monthly basis. The stamping agent would be limited in the amount of equipment for which they could be reimbursed to the amount of equipment they currently had in existence. The Department of Treasury estimates that if 50 machines were purchased at $150,000 per machine, there would be a one-time cost of $7.5 million. However, at this time it is unknown how many machines will be purchased.

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