

TOBACCO PRODUCTS TAX ACT

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Senate Bill 970 (S-2) as passed by the Senate

Sponsor: Sen. Jim Runestad

House Committee: Tax Policy

Senate Committee: Finance

Revised 11-27-20

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

Senate Bill 970 would amend the Tobacco Products Tax Act to revise provisions concerning the sale of tobacco products in Michigan by out-of-state sellers. The bill would require sales of tobacco products from out of state to be made only by wholesalers or unclassified acquirers licensed under the act. The bill would add out-of-state sellers to the definition of “unclassified acquirers” and would make operating a place of business in Michigan part of what defines a “retailer.” The bill would also revise or add definitions for several other terms used in the act and make additional changes as described below.

The Tobacco Products Tax Act imposes an excise tax on tobacco products and regulates the purchase, acquisition, sale, importation, transportation, exportation, and distribution of tobacco products to, from, and within Michigan.¹ The tax is imposed on cigarettes at the rate of \$2 per pack of 20 (i.e., 10 cents per cigarette). Other tobacco products are taxed at the rate of 32% of their wholesale price. (For cigars, this tax is capped at 50 cents per individual cigar.)

The tax is generally precollected and remitted to the state by wholesalers and unclassified acquirers, which must be licensed under the act. (Other license types include manufacturer, secondary wholesaler, vending machine operator, transportation company, and transporter.) Retailers do not remit the tobacco tax or file returns and are not licensed under the act.

Definitions of certain entities

The bill would change the definitions of “retailer,” “wholesaler,” and “unclassified acquirer” as described below.

Retailers

Currently, “retailer” means a person other than a transportation company who operates a place of business for the purpose of making sales of a tobacco product at retail.

The bill would amend this definition to require the place of business to be in Michigan and to provide that a person does not need to own the place of business to qualify as a retailer.

Under the bill, **retailer** would mean a person other than a transportation company who operates a place of business in this state, or who directs, manages, or has control over the day-to-day operations of a place of business in this state, for the purpose of making sales of a tobacco product at retail. Such a person would qualify as a retailer regardless of whether the person owned the place of business.

¹ See https://www.michigan.gov/documents/taxes/Tobacco_Guidance_2019_UPDATE_07252019_661882_7.pdf

Unclassified acquirers

"Unclassified acquirer" currently means either of the following:

- A person, except a transportation company or a purchaser at retail from a retailer licensed under the General Sales Tax Act, who imports or acquires a tobacco product from a source other than a licensed wholesaler or secondary wholesaler for use, sale, or distribution.
- A person who receives cigars, smokeless tobacco, or noncigarette smoking tobacco directly from a licensed manufacturer or another source outside Michigan that is not licensed under the act.

Under the bill, ***unclassified acquirer*** would mean any of the following:

- A person, except a transportation company or a purchaser at retail from a retailer licensed under the General Sales Tax Act, who imports or acquires a tobacco product from a source other than a licensed wholesaler or secondary wholesaler for use, sale, or distribution in Michigan.
- A person who purchases or receives tobacco products directly from a licensed manufacturer or another source outside Michigan that is not licensed under the act.
- A person not located in Michigan that sells a tobacco product, through a mail order, catalog sale, telephone order, internet sale, or any other means, to a retailer or other person in Michigan that is not licensed as a wholesaler, unclassified acquirer other than a manufacturer, or secondary wholesaler.

Under both current law and the bill, "unclassified acquirer" does not include a wholesaler.

Wholesalers

Currently, "wholesaler" means a person who does all of the following:

- Purchases all or part of his or her tobacco products from a manufacturer.
- Sells 75% or more of those tobacco products to others for resale.
- Maintains an established business where substantially all of the business is the sale of tobacco products or cigarettes and related merchandise at wholesale and where at all times a substantial stock of tobacco products and related merchandise is available to retailers for resale.

The bill would remove the third bulleted item above, so that ***wholesaler*** would mean a person who purchases all or part of its tobacco products from a manufacturer and sells 75% or more of those tobacco products to others for resale.

Under both current law and the bill, "wholesaler" includes a chain of stores retailing a tobacco product to the consumer if 75% of its stock of tobacco products is purchased directly from the manufacturer.

Tobacco products from out of state

The act currently prohibits a person from selling or soliciting a sale of a tobacco product to be shipped, mailed, or otherwise sent or brought into Michigan to a person that is not licensed under the act unless the tobacco product is to be sold to or through a wholesaler.

The bill would instead prohibit a person that is not licensed as a wholesaler or as an unclassified acquirer that is not a manufacturer from selling or soliciting a sale of a tobacco product to be

shipped, mailed, or otherwise imported, sent, or brought into Michigan to a person that is not licensed under the act, unless the tobacco product is to be sold through a wholesaler or unclassified acquirer that is not a manufacturer.

In addition, the bill would prohibit a person in Michigan that is not licensed under the act from ordering, purchasing, or otherwise engaging in a transaction to acquire a tobacco product that is to be shipped, mailed, imported, sent, or brought into Michigan unless the tobacco product is to be sold through a wholesaler or an unclassified acquirer that is not a manufacturer.

A tobacco product ordered, purchased, or acquired by a person in violation of the above provision would be contraband subject to seizure and forfeiture under the act. A person who violated the provision would be considered to be in possession of a tobacco product in violation of the act, regardless of whether it had been sold, consumed, or otherwise disposed of, and would thus be personally liable for the tax imposed by the act, plus a penalty of 500% of the amount of tax due. In determining this liability, the cap on the tax on cigars would not be taken into account.

Tobacco products bought, possessed, or sold by retailers

The bill would prohibit a retailer in Michigan from purchasing, possessing, acquiring for resale at retail, or selling a tobacco product in Michigan unless the tobacco product was purchased or otherwise acquired directly from a wholesaler, unclassified acquirer that is not a manufacturer, or secondary wholesaler.² A retailer who violated this provision would be considered to be in possession of a tobacco product in violation of the act, regardless of whether the product had been sold, consumed, or otherwise disposed of, and would thus be personally liable for the tax imposed by the act, plus a penalty of 500% of the amount of tax due. In determining this liability, the cap on the tax on cigars would not be taken into account.

A retailer would be in compliance with the above provision if at the time of the purchase or acquisition of the tobacco product the retailer obtained a copy of the unexpired license of the wholesaler, secondary wholesaler, or unclassified acquirer that is not a manufacturer and kept it in the same manner as required of other records under the act.

Internet, phone, and mail-order sales

The act currently requires, and provides protocols for, sellers of cigarettes through the internet, by telephone, or in a mail-order transaction to do all of the following:

- Verify that the purchaser is old enough to buy cigarettes.
- Include certain information about the sales and use taxes and the tobacco tax.
- Print or stamp the word “CIGARETTES” on the outside of the package.
- For an internet sale, wait until payment is received before completing the sale.
- Include a warning that the buyer is responsible for unpaid state taxes on the cigarettes

The bill would amend these provisions to refer to tobacco products instead of cigarettes. The bill would also remove the final bulleted requirement and provide that, except for age verification, the remaining requirements do not apply to licensed wholesalers and unclassified acquirers.

² However, this prohibition would not apply to representatives of a licensed manufacturer as provided in section 8(2) of the act.

Required sign

Currently, the act requires a retailer that is not licensed as an unclassified acquirer, retail importer of tobacco products other than cigarettes, to post a sign, visible to the public inside the retail establishment, that informs purchasers of cigars through catalog or internet sales of their responsibility to pay all applicable unpaid state taxes on those cigars.

The bill would instead provide that a retailer that is not otherwise licensed or required to be licensed under the act must post a sign, visible to the public inside the retail establishment, that informs purchasers of cigars through catalog sales, telephone or mail orders, or internet sales of their liability for any applicable unpaid state taxes on those cigars and that cigars purchased in violation of the act are contraband.

Definition of “wholesale price”

The bill would amend the definition of “wholesale price” for purposes of the act. Currently, “wholesale price” means the actual price paid for a tobacco product, including any tax, by a wholesaler or unclassified acquirer to a manufacturer, excluding any discounts or reductions.

Under the bill, *wholesale price* would mean the actual price paid to a seller for a tobacco product by a wholesaler or unclassified acquirer to acquire the tobacco product from the seller. It would include any tax, fee, licensing charge, or other charge reflected on the invoice, bill of sale, purchase order, or other document evidencing the sale. It would not include, if separately stated, shipping or handling charges for cigarettes or reasonable shipping or handling charges for other tobacco products. If other items (not tobacco products) were included in a transaction, charges for those items, including shipping and handling, could be excluded from the wholesale price if separately stated. The wholesale price could not be reduced due to a rebate, trade allowance, licensing or exclusivity agreement, volume or other discount, or any other reduction given by or received from the seller. If the wholesaler or unclassified acquirer had a relationship with the seller as described in section 267(b) of the Internal Revenue Code,³ the Department of Treasury could establish the wholesale price for the tobacco products based on the best available information or another reasonable proxy for the wholesale price, such as that paid by other taxpayers within the past four years.

Definition of “manufacturer”

The bill would amend the definition of “manufacturer” to enumerate certain activities that do not of themselves mean that a person is a manufacturer under the act.

Currently and under the bill, *manufacturer* means a person who manufactures or produces a tobacco product or a person who operates (or allows someone else to operate) a cigarette making machine to make cigarettes.

The bill would add that a person who does any of the following is not a manufacturer:

- Mixes or blends two or more different tobacco products to create a custom mix or blend of those products, as long as each of the constituent tobacco products mixed or

³ See <https://www.govinfo.gov/content/pkg/USCODE-1998-title26/pdf/USCODE-1998-title26-chap1-subchapB-partIX-sec267.pdf>

blended together is a finished tobacco product that the person could or does otherwise sell to consumers and on which the tax has been paid under the act.⁴

- Creates or produces, by filling a fruit with hookah tobacco, what is commonly known as a fruit bowl or fruit head for use in a hookah.
- Rolls a cigar for his or her own consumption.

Definition of “container” and “shipping case”

The bill would add a definition for the terms “container” and “shipping case.” These terms (and the related but undefined term “shipping container”) are used in sections 6, 6a, and 6d of the act, as well as in the definitions of the terms “counterfeit cigarette” and “individual package.” Under the bill:

Container or *shipping case* would mean an individual receptacle, such as a box or a tote, within which a tobacco product or group of tobacco products is placed for shipment or distribution. However, the following would not be a container or shipping case:

- A cigarette carton or individual package of cigarettes.
- The package or other article containing the tobacco product that is sold directly to the ultimate consumer.
- A bag or similar package containing bulk or loose tobacco that a retailer uses to fill bins, barrels, or tubs from which the tobacco is sold.
- A pallet or similar device on which a receptacle or group of receptacles containing tobacco products is placed for shipment or distribution.
- Property, including shrink wrap or other wrapping materials, that is used as a protective covering for a receptacle or group of receptacles in which the tobacco product is placed for shipment or distribution, or that is used to keep items together during shipment or distribution, but excluding the protective covering that forms, gives shape to, or otherwise constitutes the receptacle within which the tobacco product is placed for shipment or distribution.

Various tobacco product definitions

Finally, the bill would revise and add several definitions for tobacco products. These amendments would not appear to change what tobacco products are subject to the act. Although the bill would add definitions for such products as pipe tobacco, those products would appear to be already subject to the act without being specifically named and defined. (For example, pipe tobacco would fall under the current definition of “nongarette smoking tobacco,” as it is “tobacco sold in loose or bulk form that is intended for consumption by smoking.”)

Currently under the act:

“Tobacco product” means cigarettes, cigars, nongarette smoking tobacco, or smokeless tobacco.

⁴ This appears to address the Michigan Supreme Court’s ruling in *People v Shami*, 501 Mich 243 (2018), that a person who combines multiple tobacco products into a blend that the person then relabels and offers for sale is a tobacco product manufacturer for purposes of the act.

<https://courts.michigan.gov/Courts/MichiganSupremeCourt/Clerks/Recent%20Opinions/17-18%20Term%20Opinions/155273.pdf>

“Noncigarette smoking tobacco” means tobacco sold in loose or bulk form that is intended for consumption by smoking and includes roll-your-own cigarette tobacco.

“Smokeless tobacco” means snuff, chewing tobacco, and any other tobacco that is intended to be consumed by means other than smoking.

Under the bill:

Tobacco product would mean a product containing any amount of tobacco regardless of form including cigarettes, ***cigars***, ***noncigarette smoking tobacco***, or ***smokeless tobacco***. A tobacco product would not include drugs, devices, or combination products authorized for sale by the United States Food and Drug Administration, as those terms are defined in the federal Food, Drug, and Cosmetic act, 21 USC 351 to 360fff-7.

Noncigarette smoking tobacco would mean tobacco sold in loose or bulk form that is intended for consumption by smoking and would also include ***roll-your-own cigarette tobacco***, ***hookah tobacco***, ***pipe tobacco***, or a ***wrap***.

Smokeless tobacco would mean snuff, snus, chewing tobacco, moist snuff, and any other tobacco that is intended to be used or consumed, whether heated, chewed, absorbed, dissolved, inhaled, snorted, sniffed, or ingested, by any means other than smoking or combustion.

Cigar would mean any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco. Cigar would not include a cigarette.

Hookah tobacco would mean tobacco sold in loose or bulk form that is intended for consumption by smoking in a ***hookah*** and that is flavored with honey, molasses, fruit, or other flavors. Hookah tobacco would include those products commonly known or referred to as narghile, argileh, shisha, hubble-bubble, or goza.

Hookah would mean a device used for smoking hookah tobacco that consists of a tube connected to a chamber where the smoke is cooled passing through water.

Pipe tobacco would mean any tobacco that, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to smoke in a pipe.

Roll-your-own cigarette tobacco would mean any tobacco that, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes.

Wrap would mean an individual tobacco wrapper that is made wholly or in part from tobacco, including reconstituted tobacco, whether in the form of tobacco leaf, sheet, or tube, if the wrap is designed to be offered, or is offered, for sale to consumers to create or to use as a component part of a tobacco product.

The bill would not change the act's current definition of "cigarette":

"Cigarette" means a roll for smoking made wholly or in part of tobacco, irrespective of size or shape and irrespective of the tobacco being flavored, adulterated, or mixed with any other ingredient, which roll has a wrapper or cover made of paper or any other material. Cigarette does not include cigars.

MCL 205.422 and 205.431

FISCAL IMPACT:

To the extent that the bill increases both in-state and out-of-state tax collections on other tobacco products (OTP) through enhanced collection practices, the bill would increase general fund and Medicaid Trust Fund revenues by an indeterminate amount. Increased revenue would primarily result from enhanced enforcement on out-of-state cigar sellers. Generally speaking, OTP are taxed at 32% of the wholesale price, with the exception of premium cigars, which have a tax cap of 50 cents per cigar. Revenue generated from the tax on OTP is distributed to the general fund (25%) and Medicaid Trust Fund (75%).

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