DEPARTMENT OF TAXATION
2004 Fiscal Impact Statement

1. Patron R. Lee Ware, Jr.

2. Bill Number HB 862
House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee House Finance

4. Title Cigarette Tax; Procedures for Selling Cigarettes

5. Summary/Purpose:

This bill would change the current statutory procedures for selling cigarettes by (a) eliminating the current dealer discount on the purchase of Virginia revenue stamps; (b) making it unlawful to purchase, possess, or affix stamps without first obtaining a permit from the Department of Taxation; (c) increasing the penalties for the failure to affix stamps; and (d) requiring stamping agents to file a monthly report with the Department regarding the cigarettes to which they affixed stamps.

The effective date of this bill is not specified.

6. Fiscal Impact Estimates are: Preliminary. (See Line 8.)
6b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2003-04	$50,000	GF
2004-05	$1.6 million	GF
2005-06	$1.6 million	GF
2006-07	$1.6 million	GF
2007-08	$1.6 million	GF
2008-09	$1.6 million	GF
2009-10	$1.6 million	GF

7. Budget amendment necessary: Yes
ITEM(S): Page 1, Revenue Estimates

8. Fiscal implications:

The Department of Taxation would not incur any administrative costs implementing this bill. By eliminating the dealer discount, effective July 1, 2005, this bill would increase state cigarette tax revenues by $50,000 in FY 2004 and $1.6 million in FY 2005 and fiscal years thereafter.

9. **Specific agency or political subdivisions affected:**

Department of Taxation

10. **Technical amendment necessary: No.**

11. **Other comments:**

Master Settlement Agreement

On November 23, 1998, leading United States tobacco product manufacturers, called participating manufacturers (PMs) entered into the Master Settlement Agreement (MSA) with the Commonwealth and 45 other states. The agreement obligated PMs, in return for release from past, present and certain future claims against them, to pay substantial sums to the Commonwealth. Tobacco product manufacturers who are not parties to the MSA, called nonparticipating manufacturers (NPMs), must pay sums into a qualified escrow fund from which claims may be paid if such manufacturers are determined in future years to have acted culpably. The escrow fund serves as a financial responsibility mechanism to guarantee a source of compensation and to prevent NPMs from becoming judgment-proof before liability may arise. The NPM statute must be diligently enforced to ensure a state is exempt from the application of the NPM adjustment contained in the MSA.

Virginia's Nonparticipating Manufacturers Statute

The NPM Statute requires any tobacco product manufacturer selling cigarettes after July 1, 1999, who does not participate in the MSA to make deposits into a qualified escrow fund. The NPM statute also requires that each NPM certify to the Office of the Attorney General annually that it is in compliance with the statute.

Every tobacco product manufacturer whose cigarettes are sold in Virginia must certify annually to the Tax Commissioner and the Attorney General that it is a PM or NPM in compliance with the NPM statute. In addition to making this designation, each tobacco product manufacturer must include with its certification a list of brand families sold in Virginia. NPMs must also report detailed information on how many units of each brand were sold in the Commonwealth in the preceding year. Only brands covered under the MSA or in the NPM escrow fund may be certified. All manufacturers must maintain records necessary for the certification for a period of five years.

Any person who is authorized to affix stamps to cigarettes or required to pay the excise tax on cigarettes must submit quarterly reports to the Tax Commissioner and the Attorney General that includes a list by brand of the number of cigarettes that such person affixed stamps to during the previous quarter or otherwise paid the tax due for such cigarettes.

Virginia Cigarette Tax Procedures for Selling Cigarettes

Under current law, it is not necessary to obtain a permit to purchase, possess or affix Virginia cigarette revenue stamps. However, wholesale dealers holding a permit from the Department of Taxation are afforded a 2.5 cents per carton discount on the purchase of stamps. The *Virginia Code* does not specify an expiration date for these permits.

Wholesale and retail dealers must begin stamping cigarettes within one hour after the receipt of unstamped cigarettes. Stamping must be continued with reasonable diligence by the dealer until all of the cigarettes have been stamped. Cigarettes destined for wholesale sale outside of Virginia, or in certain circumstances, to the federal government need not be stamped, but must be segregated from taxable cigarettes.

Dealers are required to retain invoices and other records regarding their purchases and sales indefinitely. Although retail dealers receiving cigarettes from outside the Commonwealth must mail duplicate invoices to the Department of Taxation, dealers do not file reports with the Department of Taxation. Any person who transports cigarettes must obtain a permit or waiver from the Department Taxation and retain records of all deliveries of cigarettes.

The current penalty for selling, storing or receiving cigarettes for the purpose of distribution within the Commonwealth without affixing the required stamps is $25. Where willful intent exists to defraud the Commonwealth of cigarette taxes, the penalty is $250.

Proposal

This bill would amend the Commonwealth's cigarette tax procedures in order to assist in the enforcement of the NPM statute. Only manufacturers, wholesale dealers and retail dealers would be permitted to act as cigarette stamping agents. It would be unlawful for any person to purchase, possess or affix Virginia revenue stamps without first obtaining a permit to do so from the Department of Taxation. Permits would be valid for three years unless revoked by the Department of Taxation.

Effective July 1, 2004, this bill would eliminate the dealer discount on the purchase of Virginia revenue stamps. Dealers who hold a cigarette stamping permit as of June 30, 2004 would continue to be allowed the discount until July 1, 2005.

Stamping agents would be required to stamp cigarettes within one day of receipt and file a monthly report with the Department of Taxation regarding the cigarettes stamped during the preceding month. The report would list number of packs stamped, by brand, and list the manufacturer and the entity from which the cigarettes were obtained.

Wholesale dealers would also be required to report the number of packs set aside for sale outside of the Commonwealth. If the dealer is unable to furnish evidence to the Department of Taxation of sufficient stamp purchases from other states to cover these cigarettes, a prima facie presumption would arise that the cigarettes were sold without the proper stamps.

Wholesale dealers would also be required to report all cigarettes sold to the federal government for resale to or consumption by members of the armed services or veterans of the armed services located in hospitals and homes of the Veterans Administration.

Stamping agents would be required to retain records for 5 years and such records would be subject to examination by the Department of Taxation. The Department of Taxation would be authorized to revoke the permit of any stamping agent that fails to comply with these procedures.

This bill would increase the civil penalties for the failure to affix stamps from $25 to $250 and where willful intent exists to defraud the Commonwealth of cigarette taxes, from $250 to $2,500.

cc : Secretary of Finance

Date: 2/2/2004 JEM