

DEPARTMENT OF TAXATION

2005 Fiscal Impact Statement

1. **Patron** R. Lee Ware, Jr.

3. **Committee** House Finance

4. **Title** Tobacco Products Tax

2. **Bill Number** HB 1885

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

The Department understands the patron will introduce a substitute for the legislation that was introduced. This fiscal impact statement addresses the substitute bill.

This bill would (1) impose the tobacco products tax on the actual price paid by distributors of tobacco products; (2) change the due date of the tobacco products tax return to the twentieth of each month; (3) require all distributors to apply for a license from the Department of Taxation, pay a licensing fee and undergo a background check; (4) provide detailed recordkeeping and audit requirements for the tax; and (5) authorize the Department of Taxation to seize tobacco products from tax evaders and destroy the products.

Under current law, (1) the tobacco products tax is generally imposed on the selling price charged by wholesalers; (2) the tobacco products tax return is due on the tenth of each month; and (3) wholesalers and retailers are required to register but not obtain a license from the Department of Taxation.

This bill would be effective January 1, 2006.

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

6a. **Expenditure Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2004-05	\$0	0	GF
2005-06	\$59,760	0	GF
2006-07	\$0	0	GF
2007-08	\$0	0	GF
2008-09	\$0	0	GF
2009-10	\$0	0	GF
2010-11	\$0	0	GF

6b. Revenue Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2004-05	\$0	HCF
2005-06	<\$0.5 million>	HCF
2006-07	<\$1.4 million>	HCF
2007-08	<\$1.5 million>	HCF
2008-09	<\$1.5 million>	HCF
2009-10	<\$1.6 million>	HCF
2010-11	<\$1.7 million>	HCF

7. Budget amendment necessary: Yes.

Item(s): 284 and 286, Department of Taxation

8. Fiscal implications:

Administrative Costs

It is estimated that the Department would incur administrative costs of \$59,760 in Fiscal Year 2006 for systems changes required to implement this bill.

Revenue Impact

By changing the base of the tax from the wholesaler's selling price to the purchase price, this bill would decrease the tax base by the amount of the wholesaler's markup. Assuming a wholesale markup of 10%, it is estimated that this bill would decrease revenues to the Health Care Fund by \$0.5 million in Fiscal Year 2006, \$1.4 million in Fiscal Year 2007, \$1.5 million in Fiscal Year 2008, \$1.5 million in Fiscal Year 2009, \$1.6 million in Fiscal Year 2010 and \$1.7 million in Fiscal Year 2011.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Tobacco Products Tax

Under current law, a tobacco products tax will be imposed on cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco, effective March 1, 2005. Cigarettes are not subject to the tax on tobacco products.

In general, the tax will be imposed on wholesale dealers located within the Commonwealth that sell tobacco products to retail dealers or institutional, commercial or industrial users located within the Commonwealth. The tax will be imposed at a rate of 10 percent of the sales price charged by the wholesale dealer. Chain store distribution centers that distribute tobacco products to their stores for sale at retail will be deemed to be wholesale dealers selling to retail dealers and the tax will be imposed at a rate of 10

percent of the purchase price paid by the distribution center. In the case of a retail dealer located within the Commonwealth that purchases tobacco products from a wholesale dealer located outside the Commonwealth, the tax will be imposed on the retail dealer at a rate of 10 percent of the purchase price paid by the retail dealer. The retail dealer, however, is not required to collect and remit the tax if the out-of-state wholesale dealer is registered to collect and remit the tax.

Every wholesale and retail dealer subject to the tobacco products tax must register with TAX. Out-of-state wholesale dealers may voluntarily register with TAX to file monthly returns regarding their sales to retail dealers located within the Commonwealth and to remit the tax due on these sales.

Beginning in April 2005, wholesale and retail dealers subject to the tax will file monthly returns no later than the tenth of each month concerning their sale or purchase of tobacco products during the preceding month. The tax due on tobacco products sold or purchased in the preceding month will be paid at the time the return is filed. A return must be filed by each registered wholesale and retail dealer each month even if no tax is due for that month.

Under the current tobacco products tax, many of the requirements related to the administration of the tax are not specifically addressed in the law. TAX has developed guidelines to address these issues. The tobacco products tax does not provide any exemptions. However, TAX will notify taxpayers that the tax does not apply in situations where it would violate the U.S. Constitution. Likewise, the tax does not provide for credits and other adjustments. TAX will allow credits and adjustments for previously taxed tobacco products that have been returned to the manufacturer, destroyed, exchanged, or sold in other states.

There are currently no special recordkeeping, audit or inspection provisions for the tobacco products tax. TAX will notify taxpayers that the recordkeeping, audit and inspection provisions that apply to all taxes administered by TAX apply to the tobacco products tax. Current law does not authorize TAX to seize tobacco products sold by those attempting to evade the tax.

Under current law, all of the revenue from the tobacco products tax is deposited into the Virginia Health Care Fund. Moneys deposited to the fund are used solely for the provision of health care services as appropriated in the state budget. Health care services include, but are not limited to, Medicaid payments, disease diagnosis, prevention and control and community health services.

Proposal

This bill would modify Virginia's tobacco products tax to make it more consistent with the way similar taxes are imposed and administered in other states. It would impose the tobacco products tax on the first "distributor" who possesses the taxable product in Virginia. Out-of-state distributors would be allowed, but not be required to obtain a license. Distributor would be defined as:

- Any person engaged in the business of selling tobacco products within Virginia who brings, or causes to be brought, tobacco products into Virginia for sale.
- Any person who manufactures or stores tobacco products in Virginia for sale in Virginia.
- Any person engaged in the business of selling tobacco products without the Commonwealth who ships or transports tobacco products to any person in the business of selling tobacco products in this Commonwealth.
- Any retail dealer in possession of untaxed tobacco products in this Commonwealth.

This bill would base the tax on the "manufacturers sales price," which is defined as the actual price for which a manufacturer, manufacturers' representative, or any other person sells tobacco products to an unaffiliated distributor.

This bill would require all distributors to obtain a distributor's license by applying to TAX. TAX would be authorized to conduct background investigations, including criminal records checks on applicants. To offset the costs of the investigations, the Department would be authorized to charge an application or renewal fee not to exceed \$750 to be applied to the costs of processing applications. The Department would be authorized to deny a license to an applicant that has been convicted of a felony or certain other crimes. Any person who makes a false statement in an application would be guilty of a Class 1 misdemeanor.

The license would need to be publicly displayed. TAX would be required to list all distributors on its website. Retailers who do not also obtain a distributor's license would be prohibited from buying tobacco products from unlicensed distributors.

Distributors would be required to file a monthly return with TAX by the 20th of each month. The bill would expressly authorize adjustments for tobacco products returned to the manufacturer or destroyed by the distributor.

The bill would provide detailed recordkeeping requirements. Licensees would be required to keep records at each licensed location. Licensees would be required to allow TAX to access their records and their premises. The bill would allow TAX to seize tobacco products from tax evaders and destroy it.

The current Tobacco Products Tax goes into effect March 1, 2005. The revised Tobacco Products Tax proposed by this bill would go into effect January 1, 2006.

Other Legislation

House Bill 1887 would provide additional definitions for the tobacco products tax.

cc : Secretary of Finance

Date: 1/30/2005 JEM