

DEPARTMENT OF TAXATION

2006 Fiscal Impact Statement

1. **Patron** Charles R. Hawkins

3. **Committee** House Finance

4. **Title** Cigarette Tax; Roll-Your-Own Tobacco

2. **Bill Number** SB 729

House of Origin:

 Introduced

 Substitute

 Engrossed

Second House:

 X **In Committee**

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would make roll-your-own tobacco subject to the cigarette excise tax instead of the tobacco products tax. The cigarette tax on roll-your-own tobacco, however, would be imposed at the same rate and in the same manner as the tobacco products tax. Distributors of roll-your-own tobacco would be considered cigarette stamping agents and would be required to prepare a certificate describing the manufacturer, brand, and quantity of roll-your-own tobacco included in each shipment intended for resale within the Commonwealth or for sale to consumers within the Commonwealth. A copy of the certification would be attached to the shipment and would be deemed to be the cigarette revenue stamp. Accordingly, Nonparticipating Manufacturers (NPMs) would be required to include sales of roll-your-own tobacco when determining their required annual escrow deposit. This bill would also require distributors that have paid the cigarette tax on roll-your-own tobacco to report the sales on the quarterly NPM report by quantity in ounces rather than by number of cigarettes.

Under current law, roll-your-own tobacco is subject to the tobacco products tax. As containers of roll-your-own tobacco are not subject to the excise stamping requirements of the cigarette tax, NPMs are not required to include sales of roll-your-own tobacco when determining their required annual escrow deposit.

This bill is effective January 1, 2007.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Revenue Impact

As the cigarette tax on roll-your-own tobacco would be imposed at the same rate as the tobacco products tax, this bill should have no impact on state tax revenues and the amounts deposited in the Virginia Health Care Fund. As each NPM would be required to

include sales of roll-your-own tobacco when determining its required annual escrow deposit, the amounts escrowed by manufacturers of roll-your-own tobacco would increase. The escrowed funds are available to the Commonwealth in the event the NPM is determined to have acted culpably. Otherwise, the escrowed funds will be released to the NPM after 25 years. As it is unknown whether any NPM will be found to have acted culpably, the fiscal impact to the Commonwealth is unknown.

Administrative Expenses

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

9. Specific agency or political subdivisions affected:

Department of Taxation
Office of the Attorney General

10. Technical amendment necessary: No.

11. Other comments:

Virginia Cigarette Tax

Virginia imposes a state cigarette tax at the rate of 30 cents per pack. The cigarette tax is paid by dealers who have obtained a stamping agent permit from TAX through the purchase of stamps, which must be affixed to each container from which cigarettes are sold. A discount equal to two percent of the purchase price of the cigarette stamps is available to stamping agents. Wholesalers file a monthly report with TAX showing the quantities of cigarettes purchased and stamped.

Cigarettes are any roll of tobacco wrapped in paper or in any substance not containing tobacco, and any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette.

Virginia Tobacco Products Tax

Under current law, a tobacco products tax is imposed on cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco. Cigarettes are not subject to the tax on tobacco products. Tobacco products include the following:

- Cigars -- any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco that is a cigarette).
- Smokeless tobacco --
 - Snuff -- any finely cut, ground, or powdered tobacco not intended to be smoked.
 - Chewing tobacco -- any leaf tobacco not intended to be smoked.
- Pipe tobacco -- any tobacco which, 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 be smoked in a pipe.
- Roll-your-own tobacco -- any tobacco which, 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.

The tax is imposed at the rate of 10% 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. The tax is imposed on the first "distributor" who possesses the taxable product in Virginia. Out-of-state distributors are allowed, but not required to obtain a license. A "distributor" is:

- 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 the Commonwealth.
- Any retail dealer in possession of untaxed tobacco products in the Commonwealth.

For the purpose of compensating distributors for accounting for the tobacco products tax, distributors are allowed to deduct two percent of the tax otherwise due when filing the monthly return and paying the tax if the amount due was not delinquent at the time of payment.

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. Under current law, escrowed funds may not be released to the NPM until 25 years after the date they were placed in escrow. 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 that a state is exempt from the application of the NPM adjustment contained in the MSA.

NPM Deposits

The escrow deposit required of each NPM is based on the number of cigarettes sold in the Commonwealth by the NPM, whether directly or through an intermediary, during the year in question, as measured by excise taxes collected by the Commonwealth on packs or "roll-your-own" tobacco containers bearing the excise tax stamp of the Commonwealth.

Although "roll-your-own tobacco" is not considered a cigarette for purposes of the state cigarette tax and is, instead, subject to the tobacco products tax, it is considered a cigarette for NPM purposes. For NPM purposes, 0.09 ounces of "roll-your-own" tobacco constitutes one cigarette. As roll-your-own tobacco is subject to the tobacco products tax, rather than the cigarette tax, it is not stamped with a Virginia excise stamp. Accordingly, under current law, NPMs are not required to include sales of roll-your-own tobacco when calculating their Virginia NPM escrow deposit.

Under current law, cigarette stamping agents are required to file a quarterly report with TAX that includes a list by brand family of the total number of cigarettes for which the stamping agent affixed stamps during the previous quarter.

Proposal

This bill would make roll-your-own tobacco subject to the state cigarette excise tax instead of the tobacco products tax. The cigarette tax on roll-your-own tobacco, however, would be imposed at the rate of 10% of the manufacturers sale price and the tax would be administered much like the tobacco products tax. As with the tobacco products tax, distributors of roll-your-own tobacco would file a monthly report with TAX regarding their purchases of roll-your-own tobacco in the preceding month and remit the tax due with the report. Containers of roll-your-own tobacco would not be subject to the cigarette stamping requirements and would not be reported on the monthly stamping report required of cigarette wholesalers.

Distributors of roll-your-own tobacco would be required to prepare an initial certificate describing the manufacturer, brand, and quantity of roll-your-own tobacco included in each shipment intended for resale within the Commonwealth or for sale to consumers within the Commonwealth. A copy of the initial certification would be attached to the shipment. Subsequent distributors of the product would be required to include a copy of the initial certification with subsequent shipments and indicate by addendum to the certification any changes in quantity from that reflected in the initial certification.

The initial certification would be deemed to be the cigarette revenue stamp. Accordingly, NPMs would be required to include sales of roll-your-own tobacco when determining their required annual escrow deposit. Distributors that have paid the cigarette tax on roll-your-own tobacco would be required to list sales of roll-your-own tobacco by quantity in ounces rather than by number of cigarettes on their quarterly NPM report.

Other Legislation

House Bill 1277 would require that (1) the annual certification required of cigarette manufacturers regarding their status as participating or nonparticipating manufacturers under the Master Settlement Agreement and (2) the quarterly report required of cigarette stamping agents listing the cigarettes they have stamped be filed with the Office of the Attorney General rather than TAX. House Bill 1277 would also provide that these reports would continue to be considered confidential taxpayer information.

cc : Secretary of Finance

Date: 02/21/2006 JEM