

# DEPARTMENT OF TAXATION

## 2007 Fiscal Impact Statement

1. **Patron** Robert Hurt

3. **Committee** House Finance

4. **Title** Illegal Substances Excise Tax

2. **Bill Number** HB 2754

**House of Origin:**

       **Introduced**

  X   **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

TAX understands that the patron will introduce a substitute for this legislation. This fiscal impact statement addresses the substitute bill.

This bill would create an excise tax on illegal substances, which would be administered and enforced by TAX. This tax would be required to be paid by a dealer who possessed an illegal substance in the Commonwealth within 48 hours after the individual acquired possession of the illegal substance. In addition, state and local law-enforcement agencies in the Commonwealth would be required to file a report with TAX within 48 hours after (i) seizing an illegal substance upon which a revenue stamp had not been affixed or (ii) making an arrest of a dealer in possession of an illegal substance upon which a revenue stamp had not been affixed. Upon receipt of this report, TAX would be required to assess the tax, applicable penalties, and interest against the dealer who possessed the unstamped illegal substance.

Revenue from this tax would be credited to a special nonreverting fund to be known as the Illegal Substances Tax Revenues Fund. After transferring moneys from the Fund to TAX in order to pay for the costs of administering this tax, 75% of the Fund revenues would be distributed to the law-enforcement agencies in the Commonwealth that conducted the investigation of the dealer possessing the illegal substance or substances that resulted in the tax assessment. The remaining 25% of the Fund would be credited to the Commonwealth's General Fund.

TAX would be required to publish guidelines for the purposes of implementing this tax by November 1, 2007.

The provisions of this act would become effective on January 1, 2008.

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

**6a. Expenditure Impact:**

<i><b>Fiscal Year</b></i>	<i><b>Dollars</b></i>	<i><b>Positions</b></i>	<i><b>Fund</b></i>
2006-07	\$123,860	0	GF
2007-08	\$347,190	4	NGF
2008-09	\$607,800	10	NGF
2009-10	\$710,300	12	NGF
2010-11	\$716,800	12	NGF
2011-12	\$733,800	12	NGF
2012-13	\$751,500	12	NGF

**7. Budget amendment necessary: Yes.**

ITEM(S): 265, Department of Taxation

F. The Department of Taxation is authorized to retain, as special revenue, its reasonable share of any funds collected by the Illegal Substances Tax Revenues Fund to reimburse the Department for any start-up and ongoing costs of administration incurred by the Department in collecting the tax as provided by § 58.1-1742, Code of Virginia.

**8. Fiscal implications:**

Administrative Costs

The Department would incur administrative costs of \$123,860 for FY 2007, \$347,190 for FY 2008, \$607,800 for FY 2009, \$710,300 for FY 2010, \$716,800 for FY 2011, \$733,800 for FY 2012, and \$751,500 for FY 2013. These costs represent the amount needed for the development of new forms and systems modifications. In addition, TAX would be required to hire twelve additional full-time employees in order to administer this tax. Four employees would be hired in FY 2008 to begin collecting this tax; and this number would be increased until there was a total of twelve employees by FY 2010.

The first year of these costs would be paid from the General Fund, which would be reimbursed by the Illegal Substances Tax Revenues Fund, which would also pay for the ongoing costs of administering this tax.

Revenue Impact

This bill would have an unknown positive revenue impact on General Fund and local revenues. In order to generate an estimate, the amounts of tax collected by North Carolina and Tennessee were examined. These amounts were then adjusted for the population of Virginia. Based on that information, this proposal could generate \$1.75 million in the first year and \$5 million in the second year. Please note that this estimate should be considered to be tentative. Actual revenue generated would depend heavily on the activities of law enforcement agencies. In addition, this revenue gain would be dependent on TAX having the resources to enforce this tax.

Revenues generated by this tax would initially be deposited into the new Illegal Substances Tax Revenue Fund. After TAX received funds to pay for the costs of administering this tax, 75% of the amount in the Fund would go to the local law

enforcement agencies responsible for generating the assessment of the proposed excise tax. The remaining 25% would be credited to the General Fund.

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

Department of Taxation  
Department of State Police  
Local Law Enforcement Agencies

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

**11. Other comments:**

Other States

Currently, over twenty states administer some sort of tax on illegal substances. This number includes three of Virginia's surrounding states: Kentucky, North Carolina and Tennessee. Of those three states, North Carolina was the first to pass legislation imposing the tax in 1989. Kentucky followed in 2001; and Tennessee passed its law in 2004. Kentucky, however, has not chosen to assess this tax in an aggressive fashion. As a result, it is more helpful to examine the experiences of North Carolina and Tennessee.

Although taxpayers in both North Carolina and Tennessee may purchase tax stamps for unauthorized substances without providing any identifying information, very few people have chosen to do so. Instead, this tax is typically imposed as a result of reports made by state and local law enforcement agencies. The laws in North Carolina and Tennessee require state and local law enforcement agencies to file a report with the Department of Revenue after seizing an unstamped unauthorized substance or arresting an individual in possession of an unstamped unauthorized substance. These reports must be filed within forty-eight hours of the seizure or arrest. The Department of Revenue then issues an assessment of the tax based on that information.

Both states have collected a great deal of revenue as a result of this tax. In North Carolina, during January through June of 1990, which were the first six months that the tax was in place, the tax generated \$107,000. During the first fiscal year of the tax, which was FY 1991, the tax generated \$1.12 million. Finally, in its most recent fiscal year, FY 2005, the tax generated \$9.3 million. These numbers represent the amounts that were actually collected. North Carolina was unable to provide information regarding the total amount of tax that was assessed. This tax program currently costs \$1.3 million a year and utilizes twenty-five employees.

As the law in Tennessee was passed in 2004, that state was only has one year of revenue data available. During the calendar year of 2005, the state assessed \$32,172,918 of this tax. Out of this amount, Tennessee actually collected \$1,714,565. This program had a one-time set-up cost of \$376,400. In addition, the program has recurring costs of \$802,568 a year; and it is run with eleven total employees.

Court Challenges

Excise taxes on illegal substances have faced legal challenges because there is a question as to whether they constitute a punishment for the purposes of the Double Jeopardy Clause. In the Fourth Circuit, the Court has made several rulings regarding the North Carolina unauthorized substances tax.

In 1998, the Fourth Circuit Court issued an opinion concluding that the North Carolina tax was actually a criminal penalty<sup>1</sup>. The Court noted that the North Carolina tax had a high rate, which in this case was eight times the market value of the drugs, and was conditioned upon the commission of a crime. In response to state arguments that the North Carolina tax could be paid prior to an arrest, the Court noted that no taxpayers had self-reported for this tax and that the Secretary of the Department of Revenue had in fact never prepared a reporting form. Thus, the only way that the tax could possibly be assessed was after an arrest. Finally, the Court pointed out that the taxpayer had no property right in the drugs at the time of assessment, as they had been confiscated by the police. As a result, the Court ruled that the tax was a criminal penalty and could not be enforced without the constitutional safeguards attached to criminal proceedings.

Following this decision, North Carolina modified its excise tax several times and has continued to assess and collect its unauthorized substances tax. North Carolina state courts have consistently ruled that the modified tax is not a criminal penalty. In addition, the Fourth Circuit Court later indicated that it might be more receptive to the state argument that the tax is not conditioned upon the commission of a crime, as the tax is due at the time the taxpayer takes possession of the controlled substance, not when an arrest occurs.<sup>2</sup>

Additionally, in a 2003 case, the Fourth Circuit Court discussed the fact that the unauthorized substances tax had been modified since the Court ruled that it was a criminal penalty in 1998<sup>3</sup>. The Court pointed out that the North Carolina General Assembly had made the tax payable upon receipt of the drugs, lowered the tax rate, abolished the special interest and penalty section and strongly indicated that the purpose of the tax was to raise revenue through a civil tax.

### Proposal

This bill would create an excise tax for illegal substances, which would be administered and enforced by TAX. The illegal substances subject to this tax would be controlled substances, marijuana, and illegally manufactured alcoholic beverages. Dealers who legally possess these substances would not be required to pay the tax.

A “controlled substance” would be a drug, substance or immediate precursor in Schedules I through VI in the Drug Control Act (§ 54.1-3400 et seq.). In addition, a “low-street-value drug” would be a specified anabolic steroid, depressant, hallucinogenic substance, stimulant, or other controlled substance.

A “dealer” would be person who actually or constructively possesses more than 42.5 grams of marijuana, 7 or more grams of any other controlled substance that is sold by

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<sup>1</sup> Lynn v. West, 134 F.3d 582 (4<sup>th</sup> Cir. 1998)

<sup>2</sup> Vick v. Williams, 233 F.3d 213 (4<sup>th</sup> Cir. 2000)

<sup>3</sup> Nivens v. Gilchrist, 319 F.3d 151 (4<sup>th</sup> Cir. 2003)

weight, or 10 or more dosage units of any other controlled substance that is not sold by weight, or a person who actually or constructively possesses an illegally manufactured alcoholic beverage for sale in violation of Title 4.1 (§ 4.1-100 et seq.).

An “illegally manufactured alcoholic beverage” would be an alcoholic beverage that is manufactured in the Commonwealth by a person who is not licensed to manufacture such an alcoholic beverage.

“Marijuana” would be defined as any part of a plant of the genus *Cannabis*, whether growing or not, its seeds or resin; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds, or its resin.

The rate of the tax would be:

- Forty cents for each gram, or fraction thereof, of harvested marijuana stems and stalks that have been separated from and are not mixed with any other parts of the marijuana plant;
- Three dollars and fifty cents for each gram, or fraction thereof, of marijuana, other than the separated stems and stalks;
- Fifty dollars for each gram, or fraction thereof, of cocaine;
- Two hundred dollars for each gram, or fraction thereof, of any controlled substance that is sold by weight;
- Fifty dollars for each 10 dosage units, or fraction thereof, of any low-street-value drug that is not sold by weight
- Two hundred dollars for each 10 dosage units, or fraction thereof, of any other controlled substance that is not sold by weight; and
- Twenty dollars for each gallon of illegally manufactured alcoholic beverage.

The Tax Commissioner would be required to issue revenue stamps to be affixed to the illegal substances in order to indicate payment of this tax. Taxes could be paid and stamps could be issued either by U.S. mail or in person. A dealer purchasing the stamps would not be required to give his name, address, social security number, or other identifying information. Any information obtained during this process would be confidential and could not be disclosed or used in a criminal prosecution. In addition, the stamps themselves would not be allowed to be used in a criminal prosecution. Any individual who did disclose this information would be guilty of a Class 1 misdemeanor.

This tax would be due upon possession by a dealer of an illegal substance upon which the tax had not been paid and would be required to be paid by the dealer within 48 hours after the individual acquired possession. After payment of the tax, the dealer would be required to permanently affix the revenue stamps to the illegal substance.

State and local law-enforcement agencies in the Commonwealth would be required to file a report with TAX within 48 hours after (i) seizing an illegal substance upon which a revenue stamp had not been affixed or (ii) making an arrest of a dealer in possession of an illegal substance upon which a revenue stamp had not been affixed. The report would have to be filed when the arrest or seizure involved more than 42.5 grams of marijuana, seven or more grams of any controlled substance that is sold by weight, ten or more dosage units of any other controlled substance that is not sold by weight, or any illegally manufactured alcoholic beverage.

The Tax Commissioner would be responsible for assessing this tax against a dealer who possessed an unstamped illegal substance. The Tax Commissioner would be required to notify the dealer in writing of the amount of tax, penalty, and interest due, and demand its immediate payment. If the dealer did not pay immediately upon receipt of the notice and demand, the Tax Commissioner would collect the amount, unless the dealer filed a bond in the amount of the asserted liability for the tax, penalty, and interest.

The revenue from this tax would be credited to a special nonreverting fund to be known as the Illegal Substances Tax Revenues Fund. After transferring moneys from the Fund to TAX to pay for the costs of administering this tax, 75% of the Fund revenues would be distributed to the law-enforcement agencies in the Commonwealth that conducted the investigation of the dealer possessing an illegal substance or substances that resulted in the tax assessment. The remaining 25% of the Fund would be credited to the Commonwealth's General Fund.

TAX would be required to publish guidelines for the purposes of implementing this tax by November 1, 2007. These guidelines would be exempt from the Administrative Process Act.

cc : Secretary of Finance

Date: 1/26/2007 AMS  
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