

# DEPARTMENT OF TAXATION

## 2012 Fiscal Impact Statement

1. **Patron** Ryan T. McDougle

2. **Bill Number** SB 347

**House of Origin:**

  X   **Introduced**

      **Substitute**

      **Engrossed**

3. **Committee** Senate Courts of Justice

4. **Title** Counterfeit and Contraband Cigarettes;  
Penalties

**Second House:**

      **In Committee**

      **Substitute**

      **Enrolled**

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

The bill would define contraband cigarettes and dedicate civil penalties collected for possession of counterfeit and contraband cigarettes to the newly established Cigarette Enforcement Fund. The bill would also require retail dealers to maintain certain records for transactions of more than five cartons of cigarettes. This bill would also impose criminal penalties for possessing and selling contraband and counterfeit cigarettes.

The Commonwealth currently imposes the state cigarette tax at the rate of 1.5 cents per cigarette (30 cents per pack of 20 cigarettes). Under current law, all revenues from the Cigarette Tax are deposited into the Health Care Fund.

The effective date of this bill is not specified.

6. **Budget amendment necessary:** No.

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

#### 7a. **Expenditure Impact:**

<i><b>Fiscal Year</b></i>	<i><b>Dollars</b></i>	<i><b>Positions</b></i>	<i><b>Fund</b></i>
2011-12	\$0	0	GF
2012-13	\$165,000	0	GF
2013-14	\$0	0	GF
2014-15	\$0	0	GF
2015-16	\$0	0	GF
2016-17	\$0	0	GF
2017-18	\$0	0	GF

## **8. Fiscal implications:**

### Administrative Costs

#### *Department of Taxation*

The Department would incur administrative costs of approximately \$165,000 in Fiscal Year 2013 in order to make the systems changes necessary to implement this bill.

#### *Virginia Criminal Sentencing Commission*

By defining new Class 6 felony offenses, the proposal may increase the state responsible (prison) bed space needs of the Commonwealth. Similarly, the legislative proposal may have an impact on juvenile correctional center bed space needs. Pursuant to § 30-19.1:4, the estimated amount of the necessary appropriation cannot be determined for periods of imprisonment in state adult correctional facilities; therefore Chapter 890 of the 2011 Acts of Assembly requires the Virginia Criminal Sentencing Commission to assign a minimum fiscal impact of \$50,000. Pursuant to § 30-19.1:4, the estimated amount of the necessary appropriation cannot be determined for periods of commitment to the custody of the Department of Juvenile Justice.

### Revenue Impact

The revenue impact of this bill is unknown, but likely minimal. If the requirement that retail dealers maintain records on sales of five or more cartons of cigarettes resulted in less volume sales of cigarettes, the provision may result in a decrease in Health Care Fund revenues. To the extent that the maintenance of records requirement and the criminal penalties would decrease evasion of the tax, the provisions may result in an increase in Health Care Fund revenues. Additionally, the bill would dedicate civil penalties for counterfeit and contraband cigarettes to the newly established Cigarette Enforcement Fund.

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

Department of Taxation  
Office of the Attorney General

## **10. Technical amendment necessary: Yes.**

If the intent of the legislation is to provide the same penalties for failing to affix stamps as for possessing unstamped cigarettes except as otherwise provided by law, the Department suggests that a substitute be drafted with Va. Code § 58.1-1013 amended in the same manner as Va. Code § 58.1-1017.

## 11. Other comments:

### Background

House Bill 820 and Senate Bill 476 (2010 *Acts of Assembly*, Chapters 35 and 471) reduced the penalties related to unstamped cigarettes. As a result, the Department issued comprehensive Guidelines and Rules Related to Enforcement (August 13, 2010) in order to provide guidance to taxpayers regarding the civil penalties, the appeals process, and other matters regarding the enforcement of the state cigarette tax.

Stamping agents who fail to properly affix revenue stamps are required to pay a penalty of \$2.50 per pack, up to \$500, for the first violation by a legal entity within a 36 month period, \$5 per pack, up to \$1,000, for the second violation by the legal entity within a 36 month period, and \$10 per pack, up to \$50,000, for the third or subsequent violation by the legal entity within a 36 month period. Stamping agents are required to pay a civil penalty of \$25 per pack, up to \$250,000, where willful intent exists to defraud. Persons other than stamping agents who sell, purchase, transport, receive, or possess unstamped cigarettes, except as otherwise provided by law, are also subject to the same civil penalties.

### Affidavit Process

The Department has issued procedures for the state cigarette tax to allow retailers who have been audited by the Department and found to possess unstamped cigarettes to obtain affidavits from stamping agents stating that the stamping agent was the source of the unstamped cigarettes. Once a stamping agent has issued such an affidavit, the Department will typically issue the penalty to the stamping agent instead of the retailer. The stamping agent may then file an appeal or offer-in-compromise with the Department and seek a reduction or abatement of the penalty.

The penalties set forth for the failure to affix stamps in *Va. Code* § 58.1-1013 intentionally mirror the penalties for the possession of unstamped cigarettes for persons other than stamping agents set forth in *Va. Code* § 58.1-1017 in order to facilitate this process. While this legislation amends the penalties set forth in *Va. Code* § 58.1-1017, it does not amend the penalties in *Va. Code* § 58.1-1013 in the same manner.

### Proposal

#### *Counterfeit Cigarettes*

This bill would include cigarettes manufactured, fabricated, assembled, processed, packaged, or labeled by persons other than the owner of the trademark or a person authorized by the owner in the definition of counterfeit cigarettes and impose criminal penalties for selling or possessing counterfeit cigarettes. The bill would also provide that any person, except as otherwise provided by law, possessing counterfeit cigarettes is required to pay any cigarette taxes owed on such cigarettes.

### *Contraband Cigarettes*

The bill would also define tax-paid cigarettes as cigarettes that either i) bear valid Virginia cigarette tax stamps or ii) were purchased outside the Commonwealth and evidence can be provided that the applicable excise taxes have been paid. The bill would define contraband cigarettes as cigarettes that are i) not tax-paid cigarettes in the possession of any person other than an authorized holder or ii) more than 25 cartons of tax-paid cigarettes in the possession of any person other than an authorized holder or retail dealer. The bill would also impose criminal penalties for the second or subsequent violation where willful intent to defraud the Commonwealth exists and for any person possessing more than 50 cartons of contraband cigarettes.

### *Civil Penalties*

Additionally, the bill would provide that the current civil penalties for any person, except as otherwise provided by law, who possesses unstamped cigarettes apply to any person knowingly possessing contraband cigarettes. Knowledge would be presumed if the person possesses more than five cartons of contraband cigarettes. The bill would dedicate any civil penalties collected for counterfeit cigarettes, contraband cigarettes, failure to affix stamps, and any other violation of the Cigarette Tax to a newly established Cigarette Enforcement Fund. Moneys deposited to the Cigarette Enforcement Fund would be used by the law-enforcement agency responsible for discovering the violation that resulted in the civil penalty to offset reasonable costs and expenses and to further enforcement efforts, including the creation of a tip line and a fund for rewards for information.

### *Seizure of Contraband Cigarettes*

The bill would also provide that any law-enforcement officer of the Commonwealth may seize and destroy contraband cigarettes. Additionally, the bill would provide for the seizure and forfeiture of fixtures, equipment, materials, and personal property used to create, sell, purchase, transport, receive, or possess contraband cigarettes by the Department of Taxation and law-enforcement officers.

### *Maintenance of Records*

The bill would require retail dealers who sell or distribute more than five cartons of cigarettes in a single transaction, other than transactions between retail dealers, to maintain records consisting of the name, address, vehicle license number, and driver's license number of the purchaser or person receiving the cigarettes. The Attorney General would be authorized to prescribe by rules or regulations the form and manner in which the records must be kept and any additional requirements the Attorney General considers appropriate.

The effective date of this bill is not specified.

### Similar Legislation

**House Bill 479** is identical to this bill.

**House Bill 52** would authorize the disclosure to a tobacco product manufacturer required to establish a qualified escrow fund pursuant to the implementation of the Tobacco Master Settlement Agreement of certain reports, returns, financial documents, or other information filed with or provided to the Attorney General by a stamping agent pursuant to the implementation of the Tobacco Master Settlement Agreement when such information is requested in writing.

**House Bill 160** would increase the Cigarette Tax rate from \$0.30 per pack to \$1.45 per pack of 20 cigarettes and would increase the tax on roll-your-own tobacco from 10% to 50% of the manufacturer's sales price. The bill would also increase the Tobacco Products Tax on certain tobacco products from 10% to 50% of the manufacturer's sales price.

**House Bill 314** and **Senate Bill 74** would provide that any person who maintains or operates a machine at a retail establishment that enables a person to process a product that is made or derived from tobacco onto a roll or tube, "roll-your-own cigarette machine", shall be deemed a manufacturer of cigarettes. The resulting product would be deemed a cigarette sold to a consumer.

cc : Secretary of Finance

Date: 1/28/2012 AM  
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