# DEPARTMENT OF TAXATION
# 2017 Fiscal Impact Statement

**1. Patron** Janet D. Howell

**2. Bill Number** SB 1390
**House of Origin:**
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

**3. Committee** Passed House and Senate

**4. Title** Retail Sales and Use Tax; Exemption Certificates for Stamped Cigarettes

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

**5. Summary/Purpose:**

This bill would require possession of a newly created Department-issued exemption certificate to purchase cigarettes bearing Virginia revenue stamps for resale, exempt from Retail Sales and Use Tax, beginning January 1, 2018. Taxpayers that do not meet certain criteria would be required to apply for the exemption certificate and undergo a background investigation during a waiting period of at least 30 days. The Department would be authorized to charge an application fee, not to exceed $50, for the cigarette exemption certificate. Taxpayers who meet certain criteria would go through an expedited process with no application fee, waiting period, or background investigation. Taxpayers qualifying for the expedited process would include: i) taxpayers possessing an active license, in good standing, issued by the Department of Alcoholic Beverage Control to sell alcohol; ii) taxpayers possessing an active tobacco products tax distributor's license, in good standing, issued by the Department; and iii) such other categories of taxpayers as identified by the Department.

The Department would be required to develop guidelines regarding the exemption certificate with provisions including, but not limited to: i) defining categories of taxpayers who qualify for the expedited process, ii) prescribing the form of the applications for the cigarette exemption certificate, iii) establishing procedures for suspending and revoking the certificate, and v) establishing procedures for renewing the certificate.

The Department of Taxation would be required to issue or deny the cigarette exemption certificate prior to January 1, 2018, to any taxpayer who qualifies under the expedited process or applies for the certificate before December 1, 2017.

The bill would provide that any person who purchases 5,000 or fewer cigarettes using a forged or invalid cigarette exemption certificate would be guilty of a Class 1 misdemeanor for a first offense and a Class 6 felony for a second or subsequent offense. Any person purchasing more than 5,000 would be guilty of a Class 6 felony for a first offense and a Class 5 felony for a second or subsequent offense. The bill would provide civil penalties for using a forged or invalid cigarette tax exemption certificate to purchase cigarettes of i) $2.50 per pack, but not less than $5,000, for a first offense; ii) $5 per pack, but not less

than $10,000, for a second offense committed within a 36 month period; and ii) $10 per pack, but not less than $50,000, for a third or subsequent offense committed within a 36 month period. The civil penalties would be assessed and collected by the Department of Taxation as other taxes are collected.

The bill also would require any person who ships, sells, or distributes more than 50 cartons of cigarettes, or cigarettes with a value greater than $10,000 in any single transaction or multiple related transactions, provide information about the shipment, receipt, sale, and distribution of such cigarettes on a newly created form prescribed by the Office of the Attorney General.

Under current law, cigarettes may be purchased exempt from the sales tax by presenting a "self-executed" resale exemption certificate. The majority of exemption certificates are "self-executed" or "self-issued." Purchasers may download the exemption certificate from the Department's website, complete it, and present it to the merchant at the time of purchase.

The effective date of this bill is not specified.

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

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

**8. Fiscal implications:**

Administrative Costs Impact

*Department of Taxation*

The Department considers implementation of this bill as "routine" and does not require additional funding.

*Virginia Criminal Sentencing Commission*

By expanding the applicability of existing felony offenses, the proposal may increase the state responsible (prison) bed space needs of the Commonwealth. 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 780 of the 2016 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 is $0 for periods of commitment to the custody of the Department of Juvenile Justice.

Revenue Impact

To the extent that requiring a Department-issued exemption certificate to purchase stamped cigarettes for resale would decrease evasion of the Retail Sales and Use Tax, the bill would result in a positive impact on sales tax revenues. Based on a 2015 study by the Tax Foundation determining that approximately 22.6 percent of the cigarettes sold in

Virginia are purchased by smugglers for sale outside the Commonwealth, the Department estimates that requiring the Department issued exemption certificate could result in sales tax revenues increasing by approximately $10.45 million annually. However, as the bill would result in businesses that are denied the exemption certificate paying sales tax on cigarettes purchased for smuggling, the bill would result in increased prices of cigarettes for such businesses. As the amount of cigarettes sold decreases as price increases, the bill could result in less cigarettes being purchased by smugglers. This decrease in the number of cigarettes sold is estimated to decrease Retail Sales and Use Tax revenues by approximately $300,000 and decrease Cigarette Tax revenues by approximately $310,000.

The provision requiring Department-issued exemption certificates is estimated to result in an increase in net revenues of approximately $9.84 million annually. The following chart shows the estimated net revenue impact on the various funds for Fiscal Year 2018 and Fiscal Year 2019:

**Revenue Impact: Exemption Certificate for Purchases for Resale of Cigarettes**
($ in millions)

| **Fund** | **FY 2018** | **FY 2019** |
|---|---|---|
| GF - Unrestricted | $ 1.70 | $ 4.07 |
| GF- Restricted | $ 0.83 | $ 2.00 |
| Transportation* | $ 0.60 | $ 1.44 |
| Local Option | $ 0.75 | $ 1.80 |
| HMOF (GF transfer) | $ 0.07 | $ 0.18 |
| Regional Trans. Funds (0.7%) | $ 0.28 | $ 0.66 |
| **Total Retail Sales and Use Tax** | **$ 4.23** | **$ 10.15** |
| **Health Care Fund (Cigarette Tax)** | **($0.13)** | **($0.31)** |
| **Net Revenue Impact** | **$4.10** | **$9.84** |

To the extent that requiring sellers to report certain transactions to the Office of the Attorney General and the penalties proposed in this bill would decrease sales of cigarettes, the bill would result in a minimal unknown negative impact on Cigarette Tax and Retail Sales and Use Tax revenues.

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

Department of Taxation
Office of the Attorney General

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

**11. Other comments:**

Retail Sales and Use Tax Exemption Certificates

The majority of exemption certificates are "self-executed" or "self-issued." Purchasers may download the exemption certificate from the Department's website, complete it, and present it to the merchant at the time of purchase. One example of a self-executed exemption certificate is the certificate for the sale for resale exemption.

Currently, the Department only issues exemption certificates to taxpayers who are engaged in specific types of businesses, such as: real property contractors, data centers and their tenants, and non-profit entities. To obtain an exemption certificate issued by the Department, the purchaser must apply in writing to the Department and generally must meet certain statutorily defined requirements. For example, to obtain an exemption certificate to be used in the purchase of computer equipment used in a data center, the purchaser must enter into a memorandum of understanding with the Virginia Economic Development Partnership Authority and the data center must result in i) new capital investment of at least $150 million and ii) the creation of 50 new jobs paying at least one and one-half the prevailing wage in the locality or 25 such jobs if the locality is located in an enterprise zone or has a high unemployment rate.

Proposal

This bill is intended to significantly reduce sales tax evasion by fraudulent businesses purchasing cigarettes to sell out of state. The Department-issued exemption certificate would prevent fraudulent businesses from purchasing cigarettes exempt from the sales tax while minimizing the impact on legitimate sales tax dealers.

This bill would require possession of a newly created Department-issued exemption certificate to purchase cigarettes bearing Virginia revenue stamps for resale, exempt from Retail Sales and Use Tax, beginning January 1, 2018. Taxpayers that do not meet certain criteria would be required to apply for the exemption certificate and undergo a background investigation during a waiting period of at least 30 days. The Department would be authorized to charge an application fee, not to exceed $50, for the cigarette exemption certificate. Taxpayers who meet certain criteria would go through an expedited process with no application fee, waiting period, or background investigation. Taxpayers qualifying for the expedited process would include: i) taxpayers possessing an active license, in good standing, issued by the Department of Alcoholic Beverage Control to sell alcohol; ii) taxpayers possessing an active tobacco products tax distributor's license, in good standing, issued by the Department; and iii) such other categories of taxpayers as identified by the Department.

The Department would be required to develop guidelines regarding the exemption certificate with provisions including, but not limited to: i) defining categories of taxpayers who qualify for the expedited process, ii) prescribing the form of the applications for the cigarette exemption certificate, iii) establishing procedures for suspending and revoking the certificate, and v) establishing procedures for renewing the certificate.

The Department of Taxation would be required to issue or deny the cigarette exemption certificate prior to January 1, 2018, to any taxpayer who qualifies under the expedited process or applies for the certificate before December 1, 2017.

The bill would provide that any person who purchases 5,000 or fewer cigarettes using a forged or invalid cigarette exemption certificate would be guilty of a Class 1 misdemeanor for a first offense and a Class 6 felony for a second or subsequent offense. Any person purchasing more than 5,000 would be guilty of a Class 6 felony for a first offense and a Class 5 felony for a second or subsequent offense. The bill would provide civil penalties for using a forged or invalid cigarette tax exemption certificate to purchase cigarettes of i) $2.50 per pack, but not less than $5,000, for a first offense; ii) $5 per pack, but not less than $10,000, for a second offense committed within a 36 month period; and ii) $10 per pack, but not less than $50,000, for a third or subsequent offense committed within a 36 month period. The civil penalties would be assessed and collected by the Department of Taxation as other taxes are collected.

The bill also would amend the Cigarette Tax definition of “authorized holder” allowing persons to possess more than 25 cartons of stamped cigarettes to exclude anyone convicted of a criminal violation of the Cigarette Tax. Additionally, the bill would require retail dealers and wholesale dealers, or their affiliates, to possess a valid sales tax exemption certificate for cigarettes in order to be an authorized holder.

The bill would require any person who ships, sells, or distributes more than 50 cartons of cigarettes, or cigarettes with a value greater than $10,000 in any single transaction or multiple related transactions, provide information about the shipment, receipt, sale, and distribution of such cigarettes on a newly created form prescribed by the Office of the Attorney General. The report would be transmitted to the Office of the Attorney General on a regular basis, as determined by the Office of the Attorney General. Stamping agents delivering cigarettes to a purchaser's place of business would be exempt from receiving such form from the purchaser. The purchaser would be required to complete the form for the seller, present a valid photo identification issued by a state or federal government agency, and sign the form acknowledging an understanding of the applicable sales limit and the criminal penalties for providing false statements or misrepresentations.

The effective date of this bill is not specified.

Similar Legislation

**House Bill 1913** is identical to this bill.

**House Bill 1950** would require localities that use stamps as evidence of payment of the local cigarette tax to provide a refund for any stamps that are returned to the locality.

cc : Secretary of Finance

Date: 2/21/2017 AM
DLAS File Name: SB1390FERS1161