DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. Patron Israel D. O'Quinn

2. Bill Number HB 1204

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. Committee House Finance

4. Title Incentive Payments; Nonparticipating Manufacturers Using Domestic Tobacco

5. Summary/Purpose:

This bill would extend the making of incentive payments for manufacturing cigarettes with domestic tobacco to nonparticipating manufacturers ("NPMs") who have assigned their escrow accounts and payments to the Commonwealth until January 1, 2015. The incentive payment to each NPM for each calendar year would continue to be limited to 5 percent of the amount the NPM paid into his escrow account in the prior calendar year. The aggregate amount of incentive payments each year would continue to be limited to $3 million.

Under current law, every tobacco product manufacturer who does not participate in the Master Settlement Agreement is required to make an annual payment into its escrow fund by April 15 of each year based on the number of cigarettes sold during the previous calendar year. NPMs may assign all of the funds in their escrow accounts and future payments to the Commonwealth, which may withdraw the funds. A portion of the funds may be used to make tax incentive payments to small tobacco product manufacturers for their use of domestic tobacco. Currently, the tax incentive payments are set to expire at the end of calendar year 2012.

The effective date of this bill is not specified.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

<u>Administrative Costs</u>

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

Revenue Impact

As it is not known how many NPMs would take part in the program in Fiscal Years 2013 and 2014, nor the amount of funds the NPMs would be assigning to the Commonwealth, the revenue impact of this bill is not known.

9. Specific agency or political subdivisions affected:

Department of Taxation
Office of the Attorney General

10. Technical amendment necessary: No.

11. Other comments:

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. 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 a state is exempt from the application of the NPM adjustment contained in the MSA. Although PMs are allowed an income tax business expense deduction for MSA payments, NPM escrow payments are not deductible

Virginia's Nonparticipating Manufacturers Statute

The NPM Statute requires any tobacco product manufacturer selling cigarettes after July 1, 1999, who does not participate in the MSA to make deposits into a qualified escrow fund. Under current law, escrowed funds may not be released to the NPM until 25 years after the date they were placed in escrow unless the NPM establishes that the amount it was required to place into escrow in a particular year was greater than the Commonwealth's allocable share of the total payments that the NPM would have been required to make in that year under the MSA had it been a PM.

Senate Bill 1332 (2005)

Senate Bill 1332 (*Acts of Assembly 2005*, Chapter 901) authorized NPMs to assign all of the funds in their escrow accounts and all future escrow payments to the Commonwealth and authorized the Commonwealth to withdraw the assigned funds from the escrow account. A portion of the funds may be used to make tax incentive payments to small tobacco product manufacturers for their use of domestic tobacco, with the remaining funds deposited into the Virginia Health Care Fund. A manufacturer is not eligible for any incentive payment regarding the purchase of tobacco grown by an agent or director of the manufacturer.

"Domestic tobacco" is defined as tobacco grown, produced, and processed entirely within the United States. "Small tobacco product manufacturer" is defined as an NPM (1) who is in compliance with Virginia's NPM statute; (2) that has made an escrow assignment to the Commonwealth; (3) that directly and not exclusively through any affiliate manufactures fewer than 5 billion cigarettes; and (4) whose cigarettes contain a minimum of 75 percent domestic tobacco. NPMs seeking incentive payments are required to apply to the Department by January 1 of each year and certify the percentage of domestic tobacco contained in their cigarettes and the amount paid for domestic tobacco used in manufacturing cigarettes in the prior calendar year.

The incentive payments equal the price of the domestic tobacco purchased by the NPM in the prior calendar year. In each of the calendar years 2007 through 2011, the incentive payment was limited to the following percentage of the amount that the manufacturer paid into its escrow account in the prior calendar year as of April 16:

Calendar Year	Percentage Limitation
2007	20
2008	15
2009	10
2010	5
2011	5

In addition, the aggregate amount of the incentive payments to NPMs was capped at $8 million for payments made in 2008 for calendar year 2007, $6 million for payments made in 2009, $4 million for payments made in 2010, and $3 million for payments made in 2011 and 2012. The tax incentive payments are currently set to expire at the end of calendar year 2012, for payments based on domestic tobacco use in calendar year 2011.

Proposal

This bill would extend the making of incentive payments for manufacturing cigarettes with domestic tobacco to NPMs who have assigned their escrow accounts and payments to the Commonwealth until January 1, 2015. The incentive payment to each NPM for each calendar year would continue to be limited to 5 percent of the amount the NPM paid into his escrow account in the prior calendar year. The aggregate amount of incentive payments each year would continue to be limited to $3 million.

The effective date of this bill is not specified.

Similar Legislation

Senate Bill 618 is identical to this bill.

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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