

Legislative Analysis



TOBACCO PRODUCTS TAX ACT AMENDMENTS

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 5668 as enrolled
Public Act 474 of 2004
Sponsor: Rep. Larry Julian
House Committee: Regulatory Reform
Senate Committee: Commerce and Labor

Second Analysis (1-6-05)

BRIEF SUMMARY: The bill would amend the Tobacco Products Tax Act to do the following.

** Extend to counterfeit cigarettes the same penalties that currently exist for the illegal possession, acquisition, transportation, or offering for sale of cigarettes and tobacco products, and for the falsification of a manufacturer's label on cigarettes.

** Increase the tax penalty for a person, other than a licensee under the act, who is in control or possession of a tobacco product in violation of the act, in control or possession of an individual package of cigarettes without a stamp in violation of the act, or who offers products for sale to another for purposes of resale without a license. Currently, a person committing these violations is personally liable for the taxes imposed by the act plus a penalty of 100 percent of the amount of tax due. The bill would increase this to 500 percent of taxes due.

** Alter the penalty for a person who commits a violation of the act for which a criminal penalty is not specifically provided. Currently, such a violation is a misdemeanor punishable by imprisonment for not more than one year and/or a fine of not more than \$1,000. The bill would make the fine \$1,000 or five times the retail value of the tobacco products involved, whichever was greater.

** Add provisions regarding the sale of cigarettes through the Internet, by telephone, or by mail order, including provisions to prevent sales to minors.

FISCAL IMPACT: This bill would increase the penalty for a person, other than a licensee, who is in possession of a tobacco product that is contrary to the tobacco products tax act and would impose a new penalty for transactions that violate requirements of Internet, telephone, or mail-order sales.

THE APPARENT PROBLEM:

Public Act 164 of 2004 (enrolled House Bill 5632) raised the tax on cigarettes from \$1.25 to \$2.00 per pack and increased the tax on other tobacco products, such as chewing tobacco and cigars, from 20 percent to 32 percent. This increase went into effect July 1. Historically, sales of tobacco products decline following an increase in taxes. Studies show that for every ten percent increase in the cost of cigarettes, four percent of smokers

will quit smoking. However, in New York City, where a large tax hike in July 2002 boosted the cost of a pack of cigarettes to \$7.50 or more, legitimate sales of cigarettes have dropped off markedly – from 30.4 million packs in January 2002 to 11.1 million in January of this year. According to media reports, some of the decrease in sales is attributable to a combination of sales via telephone and Internet and to criminal activity by “petty criminals to organized gangs and even terrorist organizations such as Hezbollah” (“High tax fuels black market in cigarettes”, *Crainsdetroit.com*, March 11, 2004).

Now that Michigan has increased its tax on cigarettes and other tobacco products, some people are concerned that what is happening in New York City could happen here. For instance, a carton of a popular brand of cigarettes that sells for \$46 in a chain convenience store can be bought for as little as \$26.99 online. Though some of the more than 400 online outlets for tobacco products do inform purchasers that they are responsible to remit the appropriate taxes to their local governments, there currently is little that the state can do to track sales to Michigan residents so as to ensure payment of the taxes.

Buying tobacco products from the states bordering Michigan is another lower-cost option for some. For example, where Public Act 164 raised the tax on a carton of cigarettes in Michigan to \$20, according to tobacco wholesalers, the tax on a carton of cigarettes is \$5.60 in Indiana, \$5.50 in Ohio, \$7.70 in Wisconsin, and only 30 cents in Kentucky. Michigan law only allows a person to import about two cartons of cigarettes for personal use at a time, but it is very difficult for the state to enforce the limit or to prevent someone from filling up a car trunk or van with cigarettes and then selling them to others. Some people believe, therefore, that the law should be amended to provide penalties for possessing or selling counterfeit cigarettes—those with counterfeit tax stamps or false manufacturing labels— and to increase the penalties for violations of the tobacco laws regarding cigarette packages that do not carry the required state tax stamp. In addition, more information gathering and reporting by Internet sellers needs to be required so that the state can collect the taxes from those who buy tobacco products online.

In a closely related matter, a recent study conducted by researchers at the University of North Carolina, published in the *Journal of the American Medical Association (JAMA)* in September of 2003, revealed that children, some as young as 11 years old, were successful more than 90 percent of the time in purchasing cigarettes over the Internet. More than 86 percent of these purchases were either left at the door by delivery employees or accepted by the youthful purchasers with no age verification. Though legislation has been introduced at the federal level to tighten age verification requirements, some feel that the state should take do more to protect young people through more stringent age verification requirements for Internet, telephone, and mail-order sellers at the time of a sale and when delivering the product.

THE CONTENT OF THE BILL:

The bill would amend the Tobacco Products Act. A description of the bill follows.

Counterfeit Cigarettes. The following are the existing penalties for violations of the act that would be specifically extended to counterfeit cigarettes. The bill would define a “counterfeit cigarette” as a cigarette in an individual package of cigarettes or other container with a false manufacturing label or a cigarette in an individual package of cigarettes or other container with a counterfeit stamp.

A violation involving 3,000 or more cigarettes is a felony punishable by a fine of not more than \$50,000 and/or imprisonment for not more than five years. A violation involving 1,200 to 2,999 cigarettes is a misdemeanor punishable by a fine of not more than \$5,000 and/or imprisonment for not more than one year.

The falsification of a manufacturer’s label on cigarettes is a felony punishable by imprisonment for not less than one year or more than ten years. A fine of not more than \$50,000 could also be imposed.

Internet, Phone, and Mail-Order Sales. Such sales could not be completed unless the seller had obtained from the purchaser an affirmation that included a copy of a valid government-issued document confirming the purchaser's name, address, and date of birth showing the purchaser was at least the legal minimum age to purchase cigarettes; that the cigarettes were not intended for consumption by an underage person; and a written statement signed by the purchaser that certified the purchaser’s address and that the purchaser is at least the minimum legal age. The statement would also have to confirm that the purchaser understood that signing another’s name was illegal; that the sale of cigarettes to underage persons was illegal; and that the purchase of cigarettes by underage persons was illegal in Michigan. The seller would have to verify the information contained in the certification against a commercially available database of government records or obtain a photocopy or other image of the valid, government-issued identification.

All invoices, bills of lading, sales receipts, and other documents related to the sale of cigarettes through the Internet, by telephone, or by mail order would have to contain the current seller’s valid Michigan sales tax registration number, business name and address, and a statement whether all sales taxes and tobacco taxes had been paid. All packages of cigarettes shipped from a seller to purchasers residing in Michigan would have to clearly print the package with the word “Cigarettes” on the outside of all sides of the package clearly visible to the shipper. In addition, the package would have to contain an externally visible and clearly legible notice located on the same side of the package as the delivery address, stating (in capital letters): “If these cigarettes have been shipped to you from a seller located outside of the state in which you reside, the seller has reported under federal law the sale of these cigarettes to our state tax collection agency, including your name and address. You are legally responsible for all applicable unpaid state taxes on these cigarettes.”

If an order was made as a result of an advertisement over the Internet, the tobacco retailer would have to request the electronic mail address of the purchaser and receive payment by credit card or check before shipping.

MCL 205.422 et al.

ARGUMENTS:

For:

Lawmakers recently increased the per pack tax on cigarettes by \$1.25. While this is intended to increase revenue to the state to support government services, some people are concerned that the increase will spur criminal activity, such as smuggling cigarettes from border or nearby states where taxes are much lower. For example, the City of New York has seen a rise in black market sales since their tax increase went into effect in the summer of 2002. Reportedly, the federal Bureau of Alcohol, Tobacco, Firearms and Explosives has been increasing its enforcement efforts. But, with federal agencies also feeling the pinch from reduced funding, some feel that Michigan needs to do more to discourage illegal sales and increase the state's ability to collect taxes on legal sales of tobacco products by Internet, telephone, and mail order companies. The increased penalties for smuggling cigarettes from other jurisdictions into the state should add an effective deterrent. The increased accountability and record-keeping requirements the bill would provide will go far in enabling the state to track sales to Michigan residents and then to verify whether or not those purchasers remitted the appropriate taxes to the state.

Against:

Young people trying to buy cigarettes online already face more hurdles than at the neighborhood store. For instance, few minors have a credit card in their own name, and online retailers partner with credit card companies to determine the age of the credit card user. Moreover, the policy of most, if not all, parcel delivery companies is to have a person sign for the package and show proof of age to accept packages containing tobacco products. Therefore, the bill's requirements that online, telephone, or mail order companies receive an affirmation that includes a copy of a government-issued document to verify the person's age is not really needed, nor are the additional notices that these sellers would have to provide to purchasers.

Response:

The facts as reported in the University of North Carolina study regarding online sales of cigarettes to minors do not support the above argument. Even children as young as 11 years of age were able to purchase cigarettes in over 90 percent of their attempts and were able to receive delivery of those purchases 86 percent of the time! Obviously, employees of the U.S. Postal Service and private delivery companies need to adhere more closely to company policies. However, children should not be able to buy cigarettes online in the first place. The bill's requirements would put an additional burden on retailers selling over the Internet, through the mail, or by telephone (i.e., requiring a faxed copy of a driver's license or state I.D.) to verify the name and age of the purchaser. In addition, requiring every box to be clearly marked regarding its contents may make it

tougher for minors to receive delivery. Though it may not prevent every underage sale, the bill should significantly reduce the number of incidents. With statistics showing that 4,000 children every year try smoking for the first time, and that one-half of those will become regular smokers (and one-third of those dying prematurely from smoking-related diseases), it is imperative that every effort be made to reduce underage smoking.

As to the notification requirements, many people remain unaware that taxes must be remitted for untaxed goods purchased from out-of-state Internet or mail order companies for use or consumption within Michigan. Therefore, the notification requirements should further educate the public that Internet and mail order purchases of tobacco products may be legal, but that tax avoidance is not.

Legislative Analyst: Susan Stutzky
Chris Couch
Fiscal Analyst: Rebecca Ross

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.