



Senate Fiscal Agency  
P. O. Box 30036  
Lansing, Michigan 48909-7536

## BILL ANALYSIS



Telephone: (517) 373-5383  
Fax: (517) 373-1986  
TDD: (517) 373-0543

Senate Bill 930 (as introduced 2-7-12)  
Sponsor: Senator Roger Kahn, M.D.  
Committee: Finance

Date Completed: 2-8-12

**CONTENT**

**The bill would amend the Tobacco Products Tax Act to do the following:**

- **Require the Department of Treasury to issue a request for proposals to acquire and use digital stamps.**
- **Allow stamping agents to retain 0.5% of the tax due on cigarettes as compensation for equipment and technology upgrades necessitated by digital stamps.**
- **Allow stamping agents to retain from monthly remittances, for 18 months, 5.55% of the purchase price of equipment necessary to affix digital stamps.**
- **Allow licensees to retain a percentage of the tax otherwise due on sales of untaxed cigarettes to Indian tribes.**
- **Include the operator of a cigarette making machine as a nonparticipating manufacturer.**
- **Require the Michigan Department of State Police (MSP) to initiate inquiries or otherwise obtain data from the Treasury Department in order to support its enforcement activities.**
- **Allow the MSP to use electronic resources to perform criminal background checks on license applicants and current licensees, and require the MSP to inform the Treasury Department of the results.**
- **Allow the Department to consider the criminal history as a good cause to suspend, revoke, or refuse to issue or renew a license.**

**In addition, for fiscal year 2011-12 only, the bill would require the Department of Treasury, the MSP, and the Attorney General to use, for enforcement and administration of the Act, \$6.0 million of tobacco tax revenue before it was distributed to the General Fund.**

Digital Stamps

The Act requires the Department of Treasury to procure stamps, which wholesalers and unclassified acquirers obtain from the Department and affix to packs of cigarettes. Retailers and other licensees are prohibited from acquiring cigarettes for resale or selling cigarettes unless the packs are stamped.

The bill would require the Department, by March 1, 2012, to issue a request for proposals (RFP) to acquire and use digital stamps that contained a unique nonrepeating code that could be read by a device that identified the taxed product and contained other security and enforcement features as determined by the Department. The RFP would have to require the successful bidder to share digital stamp technology so handheld devices, including smartphones, could be readily used to further the implementation of the use of digital stamps, and so the technology and equipment used by the stamping agents could be supplied, as permitted by the Department, by the successful bidder or by any other providers.

The RFP also would have to permit the Department to manage or restrict access

rights to all or part of the information contained within the stamps or accessible from them. In addition, the RFP would have to require the successful bidder to guarantee that the stamps would be designed and manufactured to ensure that they could be affixed to individual packs of cigarettes as required by the Act.

Currently, a stamp is considered affixed if more than 50% of it is affixed to the individual pack, as determined by the Department. Under the bill, a digital stamp would be considered affixed if all unique identifying features of the stamp were readable.

The bill also provides that stamps could be affixed to an individual pack of cigarettes only if the manufacturer of the cigarettes were on the Department's lists of participating and nonparticipating manufacturers under Section 6c (which is described below).

#### Licensee Compensation

The Act levies a tax on the sale of tobacco products sold in the State, and requires licensees (other than a retailer, an unclassified acquirer licensed as a manufacturer, or a vending machine operator) to file a monthly return with the Department. At the time of filing the return, a licensee must pay the tax for tobacco products sold during the month, less compensation equal to 1.0% of the total amount of the tax due on tobacco products sold other than cigarettes, and 1.5% of the total amount of the tax due on cigarettes sold.

Under the bill, for sales of untaxed cigarettes to Indian tribes in the State, licensees also could retain an amount equal to 1.5% of the total amount of the tax due on those cigarettes sold as if those sales were taxable.

In addition, beginning on the first month after the use of digital stamps was implemented, a stamping agent could retain 0.5% of the total amount of the tax due on cigarettes sold and, for sales of untaxed cigarettes to Indian tribes in the State, 0.5% of the total amount of the tax due on those cigarettes sold as if the sales were taxable, until the stamping agent was compensated in an amount equal to the direct cost

actually incurred for upgrades to technology and equipment (excluding equipment reimbursed under the following provision), that were necessary to affix the digital stamps as determined by the Department.

Beginning on the first month after the use of digital stamps was implemented and continuing for the next 17 months, stamping agents could retain an amount equal to 5.55% of the total purchase price of the equipment necessary to affix the digital stamps.

(A stamping agent is a wholesaler or unclassified acquirer other than a manufacturer that is licensed and authorized by the Department to affix stamps to individual packs of cigarettes on behalf of themselves and other wholesalers or unclassified acquirers other than manufacturers.)

#### Cigarette Making Machines

The bill would amend the Act's definition of "manufacturer" to include a person who operates or who permits any other person to operate a cigarette making machine in Michigan for the purpose of producing, filling, rolling, dispensing, or otherwise generating cigarettes. The person would constitute a nonparticipating manufacturer for purposes of Sections 6c and 6d of the Act (described below).

A person who operates or otherwise uses a machine or other mechanical device, other than a cigarette making machine, to produce, fill, roll, dispense, or otherwise generate cigarettes would not be considered a manufacturer as long as the cigarettes were produced or otherwise generated in that person's dwelling and for his or her self-consumption (i.e., production for personal consumption or use and not for sale, resale, or any other profit-making endeavor).

The bill would define "cigarette making machine" as any machine or other mechanical device that meets all of the following criteria:

- Is capable of being loaded with loose tobacco, cigarette tubes or papers, and any other components related to the production of cigarettes, including filters.

- Is designed to automatically or mechanically produce, roll, fill, dispense, or otherwise generate cigarettes.
- Is commercial-grade or otherwise designed or suitable for commercial use.
- Is designed to be powered or otherwise operated by a main or primary power source other than human power.

(A nonparticipating manufacturer under the Act is a manufacturer who is not a participant in the master settlement agreement entered into in 1998 in *Kelley Ex Rel. Michigan v Philip Morris Incorporated, et al.* Section 6c of the Act requires a nonparticipating manufacturer to certify its compliance with Public Act 244 of 1999 (which requires tobacco product manufacturers to establish escrow accounts); requires wholesalers and unclassified acquirers to report all cigarettes they acquire from nonparticipating manufacturers; and requires the Department to maintain a list of participating and nonparticipating manufacturers that have provided a certification of compliance.)

Section 6d imposes an equity assessment of 17.5 mills per cigarette sold by nonparticipating manufacturers, and requires nonparticipating manufacturers, before selling cigarettes, to give the Department specified information and prepay the assessment.)

#### State Police; Criminal History Checks

The bill would require the MSP to initiate inquiries to, or otherwise gain access to data from, the Department of Treasury to support or in furtherance of its enforcement activities under the Act.

The bill would allow the MSP to use electronic resources, including the Law Enforcement Information Network and the National Crime Information Center, to perform criminal background checks on applicants for licenses under the Act and on current licensees. The MSP would have to inform the Treasury Department of the results of the background checks, indicating whether an applicant or licensee had a criminal history.

The Treasury Department could consider the criminal history reported as good cause to

suspend, revoke, or refuse to issue or renew a license under the Act.

(Licensees under the Act include manufacturers, wholesalers, secondary wholesalers, vending machine operators, unclassified acquirers, transportation companies, and transporters.)

#### Use of \$6.0 Million

The tax on tobacco products consists of a total of 100 mills on each cigarette sold (37.5 mills, plus 15 mills, plus 10 mills, plus another 37.5 mills, which equates to \$2 on a pack of 20 cigarettes), and 32% of the wholesale price of other tobacco products (cigars, noncigarette smoking tobacco, and smokeless tobacco). The revenue from the tax is distributed in various percentages to several different funds, including the General Fund. Specifically, the General Fund receives the following:

- 24.1% of the proceeds from 37.5 mills on cigarettes.
- 9.0% of the proceeds from 15 mills on cigarettes.
- 25.0% of the proceeds from 37.5 mills on cigarettes.
- 25.0% of the proceeds from the tax on other tobacco products.

Under the bill, for fiscal year 2011-12 only, before the distribution of these funds to the General Fund, and proportionately from those funds, \$6.0 million would have to be used by the Department of Treasury, the Attorney General, and the MSP for enforcement and administration of the Act.

MCL 205.422 et al.

Legislative Analyst: Suzanne Lowe

#### **FISCAL IMPACT**

The digital cigarette tax stamps that the bill would require are estimated to cost more than the current heat-applied stamps. The current stamp contract (which expires during FY 2012-13) provides for the State to purchase stamps at 87 cents per 1,000 stamps. Digital stamps, depending on the features of the stamps and the details of the contract, could cost between \$5 and \$8 per 1,000 stamps, according to the Department of Treasury. Currently the State's cost of cigarette tax stamps is about \$450,000 per

year. With digital stamps, the cost would be in the range of \$2.6 million to \$4.1 million per year, assuming the number of stamps purchased remained the same. The Department would incur additional costs to issue the request for proposals to acquire and use digital stamps by March 1, 2012, and for information technology improvements to gain access to and use the increased data on the movement and sale of cigarettes, which would be useful in enforcing the cigarette tax. The amount of additional revenue from the improved tax enforcement is unknown.

Under the bill, the State would reimburse stamping agents for the costs of digital stamping equipment and related technology upgrades. The total reimbursement costs are estimated to be between \$3.0 million and \$6.0 million depending on the technology adopted and the final costs involved. Stamping agents would be authorized to increase their allowable deductions from the cigarette tax revenue remitted to the State. Machine purchases would be reimbursed over 18 months, and the cost of other technology and equipment upgrades would be reimbursed through deductions of 0.5% of tax revenue collected, which the stamping agents would retain until

those costs had been fully reimbursed. Licensees also would be authorized to retain an administrative fee on untaxed cigarettes sold to Indian reservations. The Department estimates that this change would reduce State revenue by approximately \$60,000 per year.

The bill would reduce potential losses in State cigarette tax revenue by specifying that operators of cigarette making machines would be considered manufacturers, making them subject to the licensing requirements and regulations that apply to other cigarette manufacturers. This is expected to reduce the sale of untaxed cigarettes and increase cigarette tax revenue by an unknown amount.

Overall, these changes would have an indeterminate effect on State cigarette tax revenue. The change to digital stamps would increase the State's costs and also the State's tax enforcement capabilities, which would increase revenue over the current estimates. The amount of this effect is unknown, however, and would likely only partially offset the long-term trend of declining tobacco tax revenue. [Table 1](#) shows tobacco tax revenue for both cigarette and other tobacco products taxes.

**Table 1**

<b>Tobacco Tax Revenue</b>		
<b>Fiscal Year</b>	<b>Tobacco Tax Revenue<sup>1)</sup> (in millions)</b>	<b>Percent Change from Prior Year</b>
FY 2006-07 .....	\$1,129.2	(3.4)%
FY 2007-08 .....	1,073.7	(3.9)
FY 2008-09 .....	1,041.5	(3.0)
FY 2009-10 .....	1,006.5	(3.4)
FY 2010-11 Preliminary .....	968.2	(3.8)
FY 2011-12 Estimated.....	941.7	(2.7)
FY 2012-13 Estimated.....	918.6	(2.5)

<sup>1)</sup> Cigarette and other tobacco products tax.

**Source:** January 2012 Consensus Revenue Estimates

The State revenue from tobacco taxes is distributed among several funds including the General Fund and the School Aid Fund according to allocations specified in the Tobacco Products Tax Act (MCL 205.432).

The funds receiving revenue from the cigarette tax and the other tobacco products tax are shown in [Table 2](#). Revenue changes would affect all of these funds.

**Table 2**

<b>Statutory Allocation of Tobacco Tax Revenue Pursuant to MCL 205.432</b>		
	<b>Allocation of Cigarette Tax Revenue<sup>1)</sup></b>	<b>Allocation of Other Tobacco Products Tax Revenue</b>
General Fund .....	19.8%	25%
School Aid Fund .....	41.6	--
Health and Safety Fund .....	2.4	--
Healthy Michigan Fund .....	3.8	--
Medicaid Benefits Trust Fund.....	31.9	75
Wayne County Indigent Health Care....	0.6	--

<sup>1)</sup> Rounded to the nearest one-tenth of one percent.

**Source:** Senate Fiscal Agency

The bill would authorize the use of the existing appropriations of tobacco tax revenue for enforcement and administration of the Tobacco Products Tax Act by directing the use of \$6.0 million in FY 2011-12 from the General Fund portion of tobacco products tax revenue by the Department of Treasury, the Attorney General, and the Department of State Police. The funds would be used for enforcement and administration of the Act. The bill does not specify how the \$6.0 million would be allocated among the three departments and thus would have an indeterminate impact on the funding of these departments. Public Act 63 of 2011 included the budgets for these departments in FY 2011-12. That Act provided an increase of \$6.0 million from tobacco tax revenue for tobacco tax enforcement. This consisted of \$3.0 million appropriated to the Department of State Police, contingent on the availability of the funds, and \$3.0 million appropriated to the Department of Treasury. The Governor in his signing message stated that the boilerplate language that directed the spending for the Treasury appropriation was unenforceable; however, the line item was not vetoed. Thus, the bill would not make a new appropriation, but would authorize the use of existing appropriations in FY 2011-12.

The bill also would permit the State Police to engage in name background checks on licensees under the Tobacco Products Tax Act, and would require the MSP to provide the results of the name checks to the Department of Treasury, a service whose costs would be covered within existing budget resources for the MSP.

Fiscal Analyst: Bruce Baker  
Elizabeth Pratt

S1112\930sa.

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.