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BILL ANALYSIS

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Senate Bill 930 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Roger Kahn, M.D.
Committee: Finance

Date Completed: 3-7-12

CONTENT

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

-- Include as a "nonparticipating manufacturer" a person who operates or permits another person to operate a commercial-grade cigarette making machine.
-- Require the Department of Treasury to issue a request for proposal 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 direct costs incurred for the initial purchase of eligible equipment.
-- Allow licensees to retain a percentage of the tax otherwise due on sales of untaxed cigarettes to Indian tribes.
-- 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.
-- Provide that, before proceeds from taxes, fees, and penalties were distributed, the Department of Treasury, the Attorney General, and the MSP could use the funds, upon appropriation, for enforcement and administration of the Act.

In addition, for fiscal year 2011-12 only, the bill would appropriate the following from tobacco tax revenue allocated to the General Fund: $4.0 million to the State Police, $1.5 million to the Treasury Department, and $500,000 to the Attorney General, for enforcement and administration of the Act.

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, within 45 days after the bill's effective date, to issue a request for proposal (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 the Department permitted, 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. The bill would increase this to 90% or more, upon implementation of the digital stamps.

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 Returns & 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 with the Department of Treasury a monthly return on a form prescribed by the Department. Under the bill, the Department also could require licensees to report cigarette acquisition, purchase, and sales information in other formats and frequency.

The Act requires a licensee, at the time of filing the return, to 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.

Beginning on the bill's effective date, 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 the 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, for the initial purchase of eligible equipment necessary to affix digital stamps, a stamping agent could retain an amount equal to 5.55% of the total net purchase price, as reimbursement of direct costs actually incurred by the stamping agent. This reimbursement would have to exclude reimbursement for any costs of the installation or for ongoing maintenance related to eligible equipment. A stamping agent could receive reimbursement for the purchase of eligible equipment only to the extent that the equipment purchased did not exceed the total number of the agent's existing equipment as certified by the agent on a form prescribed by the Department.

(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 itself and other wholesalers or unclassified acquirers other than manufacturers.

The bill would define "eligible equipment" as a cigarette tax stamping machine that meets all of the following conditions:

-- Was purchased by a stamping agent who was licensed as a stamping agent as of December 31, 2011.
-- Enables the stamping agent to affix digital stamps to individual packs of cigarettes as required by the Act.
-- Was purchased for the primary purpose of permitting the stamping agent to affix digital stamps to individual packs of cigarettes to be sold in this State after the implementation of the use of digital stamps.

"Existing equipment" would mean a cigarette stamping machine that was owned by a person licensed as a stamping agent as of December 31, 2011, and was a cigarette tax stamping machine used before January 1, 2012, by the stamping agent to apply stamps using rolls of 30,000 stamps.)

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 operating or otherwise using 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 is a manufacturer that is not a participant in the Master Settlement Agreement that Michigan and 45 other states entered into with four major United States tobacco companies in 1998. 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.)

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

Appropriation of Tobacco Tax Revenue

The Act allocates proceeds from the payment of taxes, fees, and penalties, as well as licensee fees. Under the bill, before funds were distributed as required, the funds could be used by the Department of Treasury, the Attorney General, and the MSP, subject to appropriations, for enforcement and administration of the Act.

The tax on tobacco products consists of a total of 100 mills on each cigarette sold (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.

Under the bill, for fiscal year 2011-12 only, from the funds directed to the General Fund, $6.0 million would be appropriated as follows for enforcement and administration of the Act:

-- Department of State Police, $4.0 million.
-- Department of Treasury, $1.5 million.
-- Department of Attorney General, $500,000.

MCL 205.422 et al.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would appropriate $6.0 million in FY 2011-12 from the General Fund portion of tobacco tax revenue for enforcement and administration of the Tobacco Products Tax Act. The funds would be appropriated as follows: $1.5 million to the Department of Treasury, $500,000 to the Department of Attorney General, and $4.0 million to the Department of State Police. The appropriations would increase the funding for enforcement and administration of the Act.

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 proposal to acquire and use digital stamps 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 approved 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. <u>Table 1</u> shows tobacco tax revenue for both cigarette and other tobacco products taxes.

Table 1

Tobacco Tax Revenue		
Fiscal Year	**Tobacco Tax Revenue[1] (in millions)**	**Percent Change from Prior Year**
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)

1) 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. The bill would provide ongoing authority for appropriation of tobacco tax revenue to the Departments of Treasury, State Police, and Attorney General for tobacco tax enforcement and administration. While the FY 2011-12 appropriations in the bill would be from only the General Fund portion of the distribution, in subsequent years all funds would be affected, unless the appropriation specified differently.

Table 2

Statutory Allocation of Tobacco Tax Revenue Pursuant to MCL 205.432		
	Allocation of Cigarette Tax Revenue[1]	**Allocation of Other Tobacco Products Tax Revenue**
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	--

1) Rounded to the nearest one-tenth of one percent.

Source: Senate Fiscal Agency

Fiscal Analyst: Elizabeth Pratt

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