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HOUSE OF REPRESENTATIVES
COMMITTEE ON
GOVERNMENTAL OPERATIONS
ANALYSIS

BILL #: HB 1941

RELATING TO: Tax on Tobacco Products

SPONSOR(S): Representative Albright

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:
(1) GOVERNMENTAL OPERATIONS
(2) FINANCE & TAXATION
(3)
(4)
(5)

I. SUMMARY:

The bill makes significant changes to the requirements for cigarette dealers and wholesale dealers in an effort to reduce the supply of "gray market" cigarettes sold.

The bill requires entities that are the primary source of supply of cigarettes for wholesale dealers to register with the Division of Alcoholic Beverages and Tobacco; it provides that wholesale dealers may not ship or accept delivery of cigarettes form another state or foreign country except directly from a primary source of supply; it prohibits affixing any stamp or other cover to a package of cigarettes that does not comply with federal labeling requirements, or affixing any tax stamp to a package that is identified as intended for use outside the United States or exempt from federal tax; it provides for the forfeiture of cigarettes in violation and for revocation of the wholesale dealer's permit; it provides that a primary source of supply's registration may be revoked or suspended in the same manner as a wholesale dealer's permit, and increases the civil penalty that may be imposed on a wholesale dealer in lieu of permit suspension or revocation.

The bill revises application requirements for permits for cigarette distributing agents, wholesale dealers, and exporters and revises provisions relating to renewal of these permits; it requires distributing agents and wholesale dealers to submit manufacturer's affirmation forms prior to receiving a permit; it revises provisions relating to expiration of temporary initial cigarette and other tobacco products permits.

The bill may result in an indeterminate increase in cigarette tax collections. The cost to the division to implement the act is indeterminate.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes [] No [] N/A []

2. Lower Taxes Yes [] No [] N/A []

3. Individual Freedom Yes [] No [] N/A []

4. Personal Responsibility Yes [] No [] N/A []

5. Family Empowerment Yes [] No [] N/A []

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Regulation by the Division of Alcoholic Beverages and Tobacco

Chapter 210, F.S., provides the regulatory and tax structure for Florida's tobacco laws. The Division of Alcoholic Beverages and Tobacco of the Department of Business and Professional Regulation is charged with supervising the distribution of cigarettes and other tobacco products including: issuing permits for cigarette distributing agents, wholesale dealers, exporters, and retail dealers; collection and deposit of related taxes and fees; conducting audits; making tax assessments; seizing non-tax paid products; conducting criminal and administrative investigations; and imposing penalties for violations. Part I of Chapter 210 addresses cigarettes and Part II addresses other tobacco products [OTP].

Cigarettes are a highly taxed and highly regulated product in the State of Florida. Florida has one of the highest excise tax rates on cigarettes in the nation. For FY 1997/98 cigarette excise taxes generated over $449.5 million in revenue for the state.

Section 210.15, F.S., requires every person or business desiring to deal in cigarettes as a distributing agent, wholesale dealer, or exporter to obtain a cigarette permit and establishes standards for qualification. Temporary permits are issued upon payment of the applicable fee and filing of a completed application which, on its face, does not disclose any impairment to licensure.

The permit fee for a distributing agent is statutorily established at $5 and is reissued annually upon payment of the $5 fee. Distributing agents receive cigarettes in interstate or intrastate commerce and typically warehouse the cigarettes while awaiting distribution instructions from the manufacturer. Distributing agents, at the direction of the manufacturer, then distribute the cigarettes to wholesale dealers or to other distributing agents.

Wholesale dealers are defined as persons or businesses who sell cigarettes to retailers or to other wholesalers. The annual permit fee for a wholesale dealer is statutorily set at $100 and is reissued annually upon payment of the $100 fee. Anyone who operates more than one cigarette vending machine in more than one location is also classified as a wholesale dealer.

Wholesale dealers may be either “stamping agents” or non-stamping “tax-paid” wholesalers. A stamping agent wholesaler pays the state cigarette excise tax required by s. 210.02, F.S., at the time the agent obtains the cigarette tax stamps from the division or the stamping agent may arrange credit terms. These stamping agents place the excise tax stamps on cigarette packages prior to resale to other wholesalers or retailers. The division regulates approximately 120 cigarette stamping agent wholesalers. Tax-paid wholesale dealers receive cigarettes from stamping agents with the tax stamps already affixed.

Exporters receive or transport tax-exempt cigarettes for delivery beyond the borders of the state and store them in bonded warehouses prior to shipment into foreign commerce. The annual permit fee for exporters is statutorily set at $100 and is reissued annually upon payment of the $100 fee.

There is no statutory definition for a cigarette importer. Importers, or persons who obtain cigarettes via foreign commerce, are licensed as wholesale dealers. These wholesalers typically receive cigarettes which have been shipped by the international arm of a domestic cigarette manufacturer to a foreign country but are diverted from that destination for various reasons. A consumption entry document for returned American goods is filed by the importer with the federal government at which time federal excise taxes are paid on the cigarettes. When the cigarettes clear U.S. Customs, they are moved from a bonded warehouse to a non-bonded facility. At that point, the wholesaler/importer is required to affix the Florida excise tax stamp to the product prior to its further distribution. The division has limited ability to monitor the movement of cigarettes through customs since the location is outside the state’s jurisdiction.

Wholesale dealers who import cigarettes from the foreign commerce stream are usually able to purchase the cigarettes at a cost substantially less than those wholesale dealers who purchase the product through the domestic market.

Recent amendments to the Internal Revenue Code will prohibit, effective January 1, 2000, the release from customs custody of previously exported cigarettes to anyone other than a cigarette manufacturer or to a bonded export warehouse. [Pub.L. 105-33, Title IX, 111 Stat. 673.]

Gray Market cigarettes

According to information provided by the Department of Legal Affairs, there are two types of “gray market” or “diverted” tobacco products. The first is “export label” product, which is manufactured domestically for export and is marked “U.S. Tax Exempt For Sale Outside the U.S.” The second type is “foreign source” product, which is manufactured outside the United States for sale abroad and may bear a variety of marks or legends that distinguish it from product made for the domestic market. Both of these types of products are being diverted into the United States by third parties for domestic sale.

According to information from the Governor’s Washington office, in the last year, there has been a dramatic increase in diversion as an unintended consequence of the tobacco settlements entered into by the states. Sales of gray market cigarettes increased 229% in Florida in a one year period. These cigarettes are sold at prices ranging from $14-18 per carton, including federal and state taxes. Domestic cigarettes are sold for $23 per carton, including a $4.50 increase based on last year’s nation wide tobacco suit settlement, a price component not included in gray market cigarettes. As gray market products supplant domestic products, states’ settlement payments are reduced accordingly.

In addition to the reduction in tobacco settlement payments, gray market cigarettes have a public health impact. The significantly lower price makes them more affordable and increases consumption, especially among minors. Additionally, they do not carry health warning labels required for cigarettes produced or imported for sale in the United States.

The Balanced Budget Act of 1997 restricts importation of gray market cigarettes to manufacturers only, effective January 1, 2000. The Act does not limit the exception to *original* manufacturers, however, creating a loophole that allows almost anyone to register as a manufacturer and import gray market cigarettes. Additionally, the act does not address foreign source products. A broad coalition including the state attorneys general, governors, state legislators (through the National Conference of State Legislatures), duty free store operators, wholesalers, retailers, and manufacturers of tobacco products are working to enact legislation at the federal level that would:

- Address the foreign source diverted product issue.
- Limit importation of previously exported tobacco products to the original manufacturer only.
- Ban the sale of any tobacco product with the legend “U.S. Tax-exempt. For use outside U.S.” or “Tax-exempt. For use outside U.S.”, which would address diverted export products stockpiled before the end of 1999 for sale after January 1, 2000.
- Apply criminal penalties for diversion to the domestic market before export of tobacco products manufactured domestically for export.
- Provide exemptions for personal use quantities and duty free sales.
- Require the destruction of diverted products seized by government.
- Make technical amendments to the civil and criminal violation sections of current law to correct enforcement problems.

C. EFFECT OF PROPOSED CHANGES:

See SECTION-BY-SECTION ANALYSIS section below.

D. SECTION-BY-SECTION ANALYSIS:

Section 1. Provides definitions for “importer” and “primary source of supply.”

Section 2. Requires the division to design tobacco tax stamps in a certain fashion.

Section 3. Prohibits the sale of cigarettes to any person unless that person is a primary source of supply or has acquired such cigarettes from a registered primary source of supply. Provides requirements for the registration form to include the brand style, manufacturer and place of manufacture of the cigarettes. Requires such primary sources of supply to monthly update this information, and supply supporting documentation for registration.

Prohibits the sale, possession or transport of any cigarette packages which bears any statement indicating the packages were not intended for sale in the U.S., or does not comply with federal warnings, or any federal trademark and copyright laws. Prohibits the sale, possession or transport of any cigarette packages which were illegally imported into the U.S., which a person has reason to know such cigarettes were not intended for sale in the U.S., for which no list of added ingredients has been submitted to the U.S. Department of Health and Human Services.

Prohibits the alteration of the package to remove, conceal or obscure any required statement, or any required federal health warning. Prohibits any person from affixing an altered required tax stamp.

Requires agents and wholesale dealers to file certain monthly reports with the division, which shall include a copy of the federal permit to import cigarettes, a copy of the customs form, a statement signed under penalty of perjury identifying the brand style and quantity, the supplier, and customers for resale, and a separate statement identifying the brands. The statement signed under penalty of perjury shall be confidential and exempt from disclosure under public records law. Requires another statement signed under penalty of perjury certifying that the manufacturer or importer has complied with federal health warning law.

Provides criminal penalties for failure to comply with this section; and provides administrative sanctions such as revocation and suspension of the permit, and seizure and forfeiture of the cigarettes. Provides that violation of this act is an unfair trade practice. Provides for the enforcement of this section by the division, and the Attorney General. Provides for injunctive relief by any person for violation of this section. Provides that this section does not apply to cigarettes imported for personal use or sold as duty-free.

Section 4. Prohibits the issuance of a permit for a distributing agent or wholesale dealer until receipt of an affirmation from each primary source of supply.

Section 5. Requires applications for temporary cigarette permits to be accompanied by an affirmation form.

Section 6. Requires the division to maintain records that identify which agent or wholesale dealer affixed the tax stamp.

Section 7. Revises the provisions for temporary tobacco permits.

Section 8. Provides for the revocation or suspension of the registration of any primary source of supply for a violation.

Section 9. Provides a severability clause.

Section 10. Provides an effective date of upon becoming a law.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

In the bill analysis by the Committee on Finance and Taxation (dated April 9, 1999) to HB 991 by Rep. Albright (1999), the COMMENTS section addressed a concern about "the loss of revenue in the tobacco settlement because of the lost count of cigarettes sold in Florida under the gray market. The monetary loss to the State of Florida is estimated at $5 to $7 million per year, although representatives of the Florida Tobacco and Candy Association estimate a loss of $20 million per year." The provisions of this bill will assist the division in tracking the movement of cigarettes in the state and may result in an indeterminate increase in collection of cigarette excise tax revenue as the supply of gray market cigarettes diminishes and the demand for cigarettes shifts back to those made for the domestic market. Such increase in tax revenue would be distributed to the following funds in accordance with the percentages specified in s. 212.20, F.S.: General Revenue Fund, Alcoholic Beverage and Tobacco Trust Fund, Public Medical Assistance Trust Fund, Municipal Financial Assistance Trust Fund, and the Revenue Sharing Trust Funds for Municipalities and Counties.

2. Expenditures:

The division will incur the costs of establishing and administering the registration process.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Sellers of cigarettes obtained from traditional domestic sources will no longer be at a competitive disadvantage relative to sellers who obtain cigarettes at a reduced price via the international market. Sellers who previously participated in the gray market will either face increased cost of products or cease operation.

D. FISCAL COMMENTS:

N/A

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require the counties or municipalities to spend funds or take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenue in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

This bill creates a public record exemption for a statement filed by agents and wholesale dealers with the division, signed under penalty of perjury, identifying the brand style and quantity, the supplier, and customers for resale. Pursuant to Art. I, sec, 24(c) of the Florida Constitution, a public record exemption needs to be created in a separate bill.

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON GOVERNMENTAL OPERATIONS:

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