STORAGE NAME: h1941s1.go
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HOUSE OF REPRESENTATIVES
COMMITTEE ON
GOVERNMENTAL OPERATIONS
ANALYSIS

BILL #: CS/HB 1941

RELATING TO: Tax on Tobacco Products

SPONSOR(S): Committee on Governmental Operations and Representative Albright

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:
(1) GOVERNMENTAL OPERATIONS YEAS 5 NAYS 0
(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 prohibits the sale, and the importation or possession for the purpose of selling, of unlawfully imported cigarettes, prohibits the alteration of packages of such cigarettes, and prohibits placing a tax stamp on an unlawful or altered package of cigarettes. The bill establishes criminal, administrative, and civil remedies and penalties. The bill broadens the definition of “cigarette,” for purposes of the new prohibitions only, to include “bidis” and similar products within these prohibitions. The bill requires the Division to design cigarette tax stamps and maintain records in a way that permits identification of the agent or wholesale dealer that affixed the stamp to a particular pack of cigarettes.

The bill amends sections 210.05 and 210.19 and creates section 210.185, Florida Statutes.

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

On March 30, 2000, the Committee on Governmental Operations adopted an amendment and reported the bill out favorably as a committee substitute.

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.

“Bidis” are small, unfiltered cigarettes, wrapped in leaves, with flavors such as chocolate, strawberry, and vanilla. According to newspaper articles, the cost for a pack of bidis is $2 or less for a pack of 20, less than a pack of regular cigarettes. According to the Center for Disease Control and Prevention, bidis release considerably more tar and nicotine than regular cigarettes.

C. EFFECT OF PROPOSED CHANGES:

The bill amends s. 210.05, F.S., to require the Division to design the cigarette tax stamps in a way that permits identification of the agent or wholesale dealer that affixed the stamp to the particular pack of cigarettes by means of a serial number or other mark on the stamp.

The bill creates s. 210.185, F.S., to enact the provisions sought by the coalition at the federal level. Subsection 210.185(1), F.S., establishes three prohibited or unlawful acts. The first prohibition, contained in paragraph 210.185(1)(a), F.S., bars selling certain cigarettes or importing or possessing those cigarettes with the intent to sell. The banned cigarettes would be: packages that bear a label indicating they were produced domestically for export; packages that do not comply with all federal requirements regarding warnings and other information on packages of cigarettes manufactured, packaged, or imported for sale, distribution, or use in the United States; cigarettes imported into the United States on or after January 1, 2000, in violation of federal law or regulations; cigarettes for which there has not been submitted to the Secretary of the U.S. Department of Health and Human Services the list or lists of the ingredients added to tobacco; and any other cigarettes that a person knows or has reason to know the manufacturer did not intend to be sold, distributed, or used in the United States.

The second prohibition, contained in paragraph 210.185(1)(b), F.S., makes it unlawful to alter a package of cigarettes before sale or distribution to the ultimate consumer so as to remove, conceal, or obscure any statement, label, stamp, sticker, or notice stating, "For Export Only," "U.S. Tax-Exempt," "For Use Outside U.S.," or similar wording, or any health warning that is not specified in or does not conform with federal requirements.

The third prohibition, contained in paragraph 210.185(1)(c), F.S., makes it unlawful to affix a tax stamp or any other required stamp to the package of any cigarettes described in paragraph (a) or altered in violation of paragraph (b).

The bill also establishes documentation requirements, requiring that on the first business day of each month, each person permitted to affix the tax stamp to cigarettes must file with the Division, for all cigarettes imported into the United States to which the person has affixed the tax stamp in the preceding month, a copy of the importer's federal tax permit; a copy of the customs form containing the internal revenue tax information required by the U.S. Bureau of Alcohol, Tobacco and Firearms; and a statement, signed by an officer of the manufacturer or importer under penalty of perjury, certifying that the manufacturer or importer has complied with the federal package health warning and ingredient reporting requirements with respect to those cigarettes.

The bill establishes criminal, administrative, and civil remedies and penalties. As to the criminal penalties, any person who sells the prohibited cigarettes, or imports or possesses them with the intent to sell, either knowing or having reason to know he or she is doing so, or who fails to comply with the documentation requirements, commits a felony of the third degree.

As to administrative penalties, upon a violation of the statute or any implementing rule, the Division may revoke or suspend the permit of any distributing agent, wholesale dealer, or exporter, and impose on the permittee a civil penalty, in an amount not to exceed the greater of 500 percent of the retail value of the cigarettes involved or $5,000. Additionally, any cigarettes that are acquired, held, owned, possessed, transported in, imported into, sold, or distributed in this state in violation of the section are considered contraband and are subject to seizure and forfeiture. The cigarettes are considered contraband whether the violation is knowing or otherwise.

As to civil remedies and penalties, the bill makes a violation an unlawful trade practice under part II of chapter 501, F.S., the Florida Deceptive and Unfair Trade Practices Act. This allows a state attorney or the Attorney General, as appropriate, and any aggrieved person to bring an action under the deceptive and unfair trade practices act. Included in the remedies and penalties which a state attorney or the Attorney General may seek under this Act are an injunction against any person who has violated, is violating, or is otherwise likely to violate the Act; actual damages for one or more consumers caused by an act or practice in violation of the Act; and appropriate orders, including, but not limited to, an order: to sequester or freeze assets; to reimburse consumers; to order any defendant to divest herself or himself of any interest in any enterprise, including real estate; to impose reasonable restrictions upon the future activities of any defendant to impede her or him from engaging in or establishing the same type of endeavor; to order the dissolution or reorganization of any enterprise; or to grant other appropriate relief. The enforcing authority may also seek civil penalties of not more than $10,000 per violation.

Additionally, the bill provides that any person may bring an action for appropriate injunctive or other equitable relief for a violation of this section for actual damages, if any, sustained by reason of the violation; and, as determined by the court, for interest on the damages from the date of the complaint, taxable costs, and reasonable attorney's fees. If the trier of fact finds that the violation is flagrant, it may increase recovery to an amount not in excess of three times the actual damages sustained by reason of the violation.

The Division is to enforce the bill, and if requested by the Division, any law enforcement agency must enforce it. For enforcement purposes, the Division and any agency to which the Division has delegated enforcement responsibility may request information from any state or local agency, and may share information with, and request information from, any federal agency or any agency of any other state or any local agency thereof.

The bill defines “cigarette” for purposes of the newly created gray market statute to include a “bidi” cigarette; it defines “importer” as defined in 26 U.S.C. 5702(1); and defines “package” as defined in 15 U.S.C. 1332(4).

The applicability provision states that the bill does not apply either to cigarettes allowed to be imported or brought into the United States for personal use or cigarettes sold or intended to be sold as duty-free merchandise by a duty-free sales enterprise. It does apply, however, to any cigarettes that are brought back into the customs territory for resale within the customs territory. The applicability provision also states that the bill’s penalty provisions are in addition to any penalties imposed under any other law.

The bill amends s. 210.19, F.S. to require that the Division maintain records that identify which agent or wholesale dealer affixed the tax stamp to each package of cigarettes, and to keep such records open to inspection for three years.

The bill contains a severability clause, providing that if any provision of the bill, or the application of the bill to any person or circumstance, is held invalid, the invalidity does not affect other provisions or applications of the bill which can be given effect without the invalid provision or application.

The bill takes effect July 1, 2000.

D. SECTION-BY-SECTION ANALYSIS:

N/A

III. <u>FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT</u>:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. <u>Revenues</u>:

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:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On March 30, 2000, the Committee on Governmental Operations adopted an amendment and reported the bill out favorably as a committee substitute.

VII. SIGNATURES:

COMMITTEE ON GOVERNMENTAL OPERATIONS:

Prepared by:	Staff Director:
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