## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 681 Taxation of Moist Smokeless Tobacco Products
**SPONSOR(S):** Richter and others
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 2328

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR |
|---|---|---|---|
| 1) Committee on Agribusiness | | Reese | Reese |
| 2) Environment & Natural Resources Council | | | |
| 3) Policy & Budget Council | | | |
| 4) | | | |
| 5) | | | |

## SUMMARY ANALYSIS


The bill defines the term "moist snuff" and makes a distinction between "moist snuff" and "dry snuff."

The bill also provides a new excise tax basis and rate for the "moist snuff" category of tobacco products. The tax is an unspecified rate per ounce, with a proportionate tax at the rate on all fractions of an ounce. The bill provides that the tax must be calculated based on the net weight as listed by the manufacturer. Moist snuff, like other non-cigarette tobacco products, is currently taxed at the rate of 25 percent of the wholesale price.

The tax rate is not stated in the bill in order to permit the Revenue Estimating Conference (REC) to determine a revenue neutral tax rate. In 2007, the REC analysis of a similar bill determined that an excise tax rate of $0.49 per ounce would be revenue neutral to the current ad valorem taxing structure for Other Tobacco Products (OTP). According to the Department of Business and Professional Regulation's Division of Alcoholic Beverages and Tobacco, the current suggested tax rate for moist snuff is $0.44 per ounce, plus a proportionate tax at the same rate on all fractional parts of an ounce.

The bill has an effective date of July 1, 2008.

## FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

**Ensure lower taxes** – The bill provides a new weight-based excise tax that may result in lower prices for some premium brands of snuff and higher prices for some discount brands.

B. EFFECT OF PROPOSED CHANGES:

**Background**

The Department of Business and Professional Regulation's Division of Alcoholic Beverages and Tobacco (division) oversees the collection of excise taxes from the sale of cigarettes and other tobacco products.

Part II, ch. 210, F.S., governs taxes on tobacco products other than cigarettes and cigars, with s. 210.25(11), F.S., defining the term "tobacco products" as:

> Loose tobacco suitable for smoking; snuff; snuff flour; Cavendish; plug and twist tobacco; fine cuts and other chewing tobaccos; shorts; refuse scraps; clippings, cuttings, and sweepings of tobacco, and other kinds and forms of tobacco prepared in such manner as to be suitable for chewing; but "tobacco products" does not include cigarettes, as defined by s. 210.01(1), or cigars.

The Internal Revenue Code defines the term "smokeless tobacco" as any snuff or chewing tobacco. "Snuff" is defined as any finely cut, ground, or powdered tobacco that is not intended to be smoked, and "chewing tobacco" to mean any leaf tobacco that is not intended to be smoked. The Internal Revenue Code defines "cigar" as "any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco" that does not meet the definition of cigarette.

**Taxation**

Part I of ch. 210, F.S., provides for the taxation of cigarettes. Part II provides the taxation of other tobacco products. Cigarettes are taxed in a different manner than other tobacco products (OTP), and cigars are not subject to an excise tax. Tobacco products, including cigars and cigarettes, are subject to the sales tax.

Cigarettes are taxed per individual cigarette. The applicable tax rate is dependent on the weight per thousand cigarettes and the length of the cigarette. The 2007 Florida cigarette excise tax ranged from 16.9 cents per package to 67.8 cents per package, depending on the number of cigarettes per package.

All OTPs are taxed at the same rate. They are taxed on an ad valorem basis at the rate of 25 percent of the wholesale sales price of the tobacco product. The tax is imposed at the time the distributor:

- Brings or causes to be brought into this state from without the state tobacco products for sale;
- Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- Ships or transports tobacco products to retailers in this state to be sold by those retailers.

The term “wholesale sales price” is defined as: The established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any diminution by volume or other discounts.[1] For FY 2005-2006, the division collected $27,394,156 in OTP taxes from monthly reports and audits, net of credits and refunds. For FY 2006-2007, the division collected $26,384,484.

**Moist Snuff (Smokeless Tobacco)**

According to representatives for the tobacco industry, smokeless tobacco, also known as snuff, moist snuff, or moist smokeless tobacco, is a tobacco product that is held in the mouth. Dry snuff, also known as snuff flour, is intended to be placed in the nose. Moist snuff products are typically packaged in small cans.[2] Existing law[3] includes moist snuff and snuff flour under the definition of tobacco products, taxed at the rate of 25 percent of the wholesale price. The 2007 Revenue Estimating Conference (REC) estimated that 88.5 percent of OTP excise taxes collected come from moist smokeless tobacco.

Moist snuff comes in three price tiers. Tier I snuff is the most expensive and Tier III the least expensive. The more expensive, higher tier brands use a better quality tobacco. Tier I snuff brands are classified as “premium snuff,” Tier II snuff is classified as “price value snuff”, and Tier III classified as “discount snuff.” The price of snuff ranges from over $3 per can to less than $1 per can. The wide range of prices for snuff products means that the tax levied and collected for snuff varies widely. For example, the tax on a $3.11 can of premium snuff is $0.78, but the tax on a same weight $0.81 can of discount snuff is $0.20.

There is no uniformity in the smokeless tobacco or OTP market regarding packaging, weight, cut, or classification. For example, although most products commonly referred to as moist snuff are packaged in small cylindrical containers of less than 2 ounces, these snuff containers typically vary in terms of size and weight. There is also variability in the manner in which OTP are intended to be used and how they are used. For example, snuff flour, or dry snuff, is intended to be used by placement in the nose, but, according to some industry representatives, the nasal use of dry snuff is a practice more common in Europe than in the United States. In the United States, industry representatives maintain, dry snuff is more commonly placed in the mouth.

It may also be difficult to distinguish between moist snuff and other tobacco products. For example, chewing tobacco may also be finely cut and is also intended to be placed in the mouth. It is unclear whether these products may also be considered to be snuff. According to the proponents of a weight-based excise tax for snuff, snuff is a term commonly understood in the industry. Other finely cut tobacco products like chewing tobacco are clearly distinguished within the industry and not confused with snuff.

**Weight-based Taxation of Snuff**

Most states tax snuff on an ad valorem basis. Based on information from the Tax Foundation, nine states tax tobacco products on a per unit or weight basis.

Proponents of weight-based taxation state that it is a more efficient tax and that it provides a more stable revenue source for taxation of snuff. The 25 percent ad valorem tax on OTP was established in 1985 at a time when, according to industry representatives, significantly lower-priced discount snuff brands were not on the market.

[1] s. 210.25(13), F.S.
[2] There are four moist snuff manufacturers distributing their products in the United States: Conwood Company, LLC (a subsidiary of Reynolds Tobacco Company); Swedish Match, NA (also known as Pinkerton Tobacco Company); Swisher International, Inc.; and U.S. Smokeless Tobacco Company (a subsidiary of U.S. Tobacco, Inc.).
[3] s. 210.25(11), F.S.

Weight-based taxation proponents also note that a market shift by consumers from higher-priced, premium brands to lower-priced, price value and discount brands has resulted in lower excise tax collections. They note that discount snuff held zero percent of the snuff market in 2001, while the premium and price value brands held 84 percent and 16 percent of the market respectively. Proponents further assert that, as of 2006, the discount brands share of the market has increased to 21 percent and the premium snuff has decreased to 65 percent of the market. The market share of the Tier II price value snuff has remained steady at approximately 14 percent.

Proponents additionally assert that the market shift from premium brands to discount brands will continue and that by 2012 the premium brands and discount brands will hold 47 percent and 40 percent of the market, respectively. Proponents project that the market share of the price value brands will remain relatively steady and decrease only one percentage point to 13 percent of the market and that the market share shift from premium to discount brands has resulted, and will continue to result, in a reduction in OTP excise tax collections.

The division records OTP tax revenues for all products, but does not track OTP based on whether it is moist snuff or dry snuff or any specific type of OTP. Consequently, the division cannot confirm whether there has been a decline in excise tax revenue from snuff based on changes in consumer buying habits. Moreover, according to the division, excise tax revenue from all OTP has been steadily increasing over recent years.

Weight-based taxation of all OTP is supported by Florida Tax Watch, which conducted a study on the issue. Florida Tax Watch determined that a weight-based tax avoids the costs and confusion associated with the price transfer litigation (see below) and also avoids any tax loss associated with consumers “trading down” to lower-priced OTP. To quote from the study’s conclusion, “The Legislature should revisit the other tobacco products tax and consider changing to a unit-based tax.”

Weight-based OTP taxes are opposed by manufacturers of price value and discount moist snuff. They assert that the change is intended to close the price gap between the higher and lower priced moist snuff products. The manufacturers also contend that a weight-based tax for moist snuff is solely intended as a means to protect the market share of the premium snuff manufacturers by increasing the prices of lower-priced competitors.

Weight-based taxation of snuff and OTP is opposed by some health advocates. The Campaign for Tobacco-Free Kids, the American Cancer Society, the American Heart Association, and the American Lung Association oppose weight-based taxation of smokeless tobacco based on its potential to promote higher levels of smokeless tobacco use by youth by lowering the price of premium smokeless tobacco.

**Price Transfer Litigation**

According to tobacco industry representatives, it has become a common practice, in and out of the tobacco industry, for business to structure their operations into separate manufacturing, sales, and marketing entities. For example, United States Smokeless Tobacco Manufacturing Company (USSTM) makes the product and sells the product at an established price to United States Smokeless Tobacco (USSTB), a wholesaler. This is the price point at which the excise tax is applied. The wholesaler then sells the product at a higher established price to another wholesaler (third-party wholesalers) who distributes the product to the retailers. The following example illustrates the difficulty that can arise in determining the proper price point to which the tax should apply.

In April 2002, McLane Suneast, Inc. (McLane), a third party distributor of moist snuff, submitted a refund request to the division for excess excise taxes paid. McLane asserted that the excise tax had been incorrectly applied because it was based on the sales price paid by McLane to USSTB, the wholesaler initially purchasing the product from USSTM, the manufacturer. McLane asserted that the excise tax should have been properly calculated based on the price paid by USSTB to USSTM.

The division denied the request, and litigation began in February 2003. The litigation of this issue is known as "price transfer litigation." According to proponents of a weight-based excise tax for snuff, the confusion regarding when the tax should be imposed is common in other states. According to the division, the litigation was ultimately settled through mediation for less than half of the requested refund amount.

In its analysis of this bill, the division states, "If adopted, this bill would end the possibility of any future refund claims regarding the correct tax base on which to compute the tax due on moist snuff. These claims have resulted in over $13 million in refunds and credits and a potential future liability."

It is the opinion of the proponents that a weight-based excise tax eliminates the confusion as to the price point at which the tax should be imposed. Opponents assert that the issue has been resolved and that the confusion, if any, is not due to uncertainty in the law but to state tax collectors misapplying the law.

**Proposed Changes**

This bill provides legislative findings that the current method of taxation of moist smokeless tobacco products is in need of reform and stabilization to simplify a complicated state tax and make it consistent with other methods of taxation regarding similar products.

The bill defines the term "moist snuff" to mean any finely cut, ground, or powdered tobacco that is not intended to be smoked, but does not include any finely cut, ground, or powdered tobacco that is intended to be placed in the nasal cavity.[4] The term "dry snuff" is added to the definition of tobacco products.

The bill also provides a separate excise tax basis and rate for the moist snuff category of tobacco products. The bill imposes a tax on moist snuff at an unspecified rate per ounce, with a proportionate tax at the rate on all fractions of an ounce. The bill provides that the tax must be calculated based on the net weight as listed by the manufacturer,[5] and preserves the 25 percent ad valorem excise tax on other non-moist snuff tobacco products.

Additionally, the bill corrects a cross-reference relating to the use of tobacco products at county detention facilities.

C. SECTION DIRECTORY:

Section 1. Amends s. 210.25, F.S., defining the term "moist snuff" and revising the definition of the term "tobacco products" to include dry snuff.

Section 2. Amends s. 210.30, F.S., providing for a tax upon the distribution of moist snuff at a specified rate per ounce; requiring that such tax be computed based on the net weight as listed by the manufacturer; providing for a tax upon the use or storage by consumers of moist snuff at a specified rate per ounce; requiring that such tax be computed on the net weight as listed by the manufacturer;

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[4] It is unclear whether the bill's definition for "moist snuff' is sufficient to distinguish the tobacco products that the bill intends to tax on a weight basis from OTP. For example, whether the term is sufficiently narrow to exclude finely cut chewing tobacco is not settled. The bill's proponents assert that the definition and the weight-based excise tax are not intended to apply to finely cut chewing tobacco. The contention is that snuff is a term commonly understood in the industry, and that other finely cut tobacco products, like chewing tobacco, are easily distinguishable within the industry and not confused with snuff.

[5] According to proponents of the bill, the tax rate is not stated in the bill in order to permit the Revenue Estimating Conference (REC) to determine a revenue neutral tax rate. In 2007, the REC conducted an analysis of an identical bill and determined that a tax rate of $0.49 per ounce of moist snuff would "break-even" relative to the current ad valorem tax structure for OTP.

providing exemptions from the imposition of such tax on the use or storage of moist snuff by consumers.

Section 3. Amends s. 951.22, F.S.; revising a cross-reference to conform.

Section 4. Providing an effective date.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   See Fiscal Comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Enactment of this legislation will affect the price of snuff paid by consumers. In 2007, the REC analysis of a similar bill determined that an excise tax rate of $0.49 per ounce would be revenue neutral to the current ad valorem taxing structure for OTP. Using a breakout of can sizes based on 2006 data, the REC determined that the tax would be $0.5880 per can of 1.2 ounces or less, $0.6468 per 1.32 ounce can, and $0.7350 per 1.5 ounce can. Consumers of lower-priced brands may see an increase in the price of those products. Consumers of higher-priced premium snuff brands may see a decrease in the price of those products.

In addition, the industry will be required to change the information on sales invoices to reflect package sizes. Computer systems will also have to be changed to reflect reporting by weight versus wholesale sales price for the moist snuff product. However, 12 states currently tax these products based on weight or unit; therefore, most manufacturers have already made the changes necessary. Florida distributors may have some additional costs to convert.

For those licensees selling the moist snuff products, the tax rate most likely will be at a reduced amount for premium priced moist snuff products, but could be at a higher amount for the value priced moist snuff products.

D. FISCAL COMMENTS:

HB 681 will have a fiscal impact on state government. The proposed tax rate for snuff tobacco is applied on a weight basis versus a monetary basis, which will effect revenues that will be paid to the state, but without a given tax rate, the extent of the impact cannot be determined. For purposes of analysis, a tax neutral rate equates to be $.435841 per ounce.

Division of Alcoholic Beverages and Tobacco:
According to the division, the tobacco tax audits will require a change in procedures to verify both weight-based and monetary-based taxes. This will increase the time to perform an audit due to the different taxing structures. It is believed that this workload can be absorbed by current staffing levels as other taxing workloads diminish.

Information Technology:
An information technology impact is anticipated. The division states that regulation of a new tax type with rates not consistent with the current rate structure will require a redesign of the programs associated with the tobacco products audit and tax collection. Due to the extensive changes necessary, a work effort of approximately 300 man-hours will be required. The estimated cost for these changes is $50,000.

## III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable because this bill does not appear to require the counties or cities to spend funds or take an action requiring the expenditure of funds; reduce the authority that cities or counties have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with cities or counties.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill does not provide the division with specific rulemaking authority to apply the new tax basis for the moist snuff category of OTP. According to the division, however, the bill will require that the division revise its invoice and monthly report forms through rulemaking; therefore, rulemaking authority is needed.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill imposes a tax on snuff at an unspecified rate per ounce. An amendment will be needed to specify, once determined, the tax rate per ounce.

D. STATEMENT OF THE SPONSOR

No statement submitted.

## IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES

N/A