

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 2676

SPONSOR: Regulated Industries Committee and Senator Haridopolos

SUBJECT: Cigarettes/Transportation & Sale

DATE: March 15, 2004 REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Oxamendi</u>	<u>Imhof</u>	<u>RI</u>	<u>Fav/CS</u>
2.	_____	_____	<u>CM</u>	_____
3.	_____	_____	<u>FT</u>	_____
4.	_____	_____	<u>AGG</u>	_____
5.	_____	_____	<u>AP</u>	_____
6.	_____	_____	_____	_____

## I. Summary:

The bill requires manufacturers, importers, exporters, distributing agents, and wholesale dealers of cigarettes desiring to engage in business in this state apply to the Division of Alcoholic Beverages and Tobacco (division) for a permit, and provides grounds for the denial, disqualification or revocation of such permits.

The bill defines the terms “wholesale dealer” and “retail dealer” to include a person or persons in or outside this state. The bill defines the term “counterfeit cigarettes,” to mean “cigarettes that have false manufacturing labels, tobacco product packs without tax stamps or counterfeit tax stamps, or any combination thereof.” The bill defines the terms “importer,” and “manufacturer” as a person with a valid Federal cigarette permit. The bill also creates definitions for the terms “stamp or stamps,” “person,” and “brand family.”

The bill prohibits the transporting of cigarettes from Florida to another state without first affixing to the cigarettes the tax stamp required of the state in which the cigarettes are to be sold, or paying any other excise tax required by that state. It also prohibits the stamping of cigarettes for, paying taxes to, or selling cigarettes in another state if the other state prohibits either action. It establishes reporting requirements for cigarette sales made to another state.

The bill provides the following additional requirements:

- requires every dealer in the state must affix the required tax stamps within ten days of receipt of the products;
- requires dealers outside the state must affix the excise tax stamp before cigarettes are shipped into the state;

- prohibits dealers, except as provided in s. 210.09(1), F.S., from holding or possessing unstamped cigarettes received from a manufacturer or importer;
- requires unstamped cigarette packages must be stocked separately from stamped packages;
- prohibits dealers to transfer unstamped cigarette packages to another facility of the dealer within this state or to another person in this state;
- limits sales and other transactions to only between persons holding valid state and federal permits;
- requires the filing of a notice with the division before a person may ship unstamped cigarettes into this state to a person without a valid and current wholesale dealer permit;
- provides for the destruction of all cigarettes seized, confiscated, and forfeited to the state; and
- provides fines, and criminal penalties for the possession, removal, deposit, or concealment of counterfeit cigarettes.

This bill would take effect upon becoming law.

This bill substantially amends the following sections of the Florida Statutes: 210.01, 210.05, 210.06, 210.09, 210.12, 210.15, and 210.18.

This bill creates sections 210.085 and 210.181, Florida Statutes.

## **II. Present Situation:**

Federal law requires a permit before engaging in business as a manufacturer or importer of tobacco products, or as an export warehouse proprietor.<sup>1</sup>

The Division of Alcoholic Beverages and Tobacco (“the division”) of the Department of Business and Professional Regulation is the agency authorized to enforce the provisions of ch. 569, F.S., relating to the regulation of tobacco products, and ch. 210, F.S., relating to the taxation of tobacco products, including cigarettes.

Part I of ch. 210, F.S., which includes ss. 210.01-210.22, F.S., concerns the taxation of cigarettes, and part II of ch. 210, F.S., which includes ss. 210.25-210.75, F.S., concerns the taxation of tobacco products other than cigarettes or cigars.

### **Definitions**

Section 210.01(1), F.S., defines a "cigarette" as:

[A]ny roll for smoking, except one of which the tobacco is fully naturally fermented, without regard to the kind of tobacco or other substances used in the inner roll or the nature or composition of the material in which the roll is wrapped, which is made wholly or in part of tobacco irrespective of size or shape

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<sup>1</sup> 26 U.S.C. s. 5712

and whether such tobacco is flavored, adulterated or mixed with any other ingredient.

Sections 210.01(5) and (6), F.S., define a "dealer" and a "wholesale dealer" as:

[A]ny person who sells cigarettes to retail dealers or other persons for purposes of resale only, or any person who operates more than one cigarette vending machine located in more than one place of business.

A "distributing agent" is any person, firm, or corporation who receives cigarettes and distributes them to wholesalers or other distributing agents inside or outside the state.<sup>2</sup> An "agent" is any person authorized by the division to purchase and affix adhesive or meter stamps under part I of ch. 510, F.S.<sup>3</sup> A "wholesale dealer" sells cigarettes to retail dealers or other persons for purposes of resale only, or any person who operates more than one cigarette vending machine located in more than one place of business.<sup>4</sup> An "exporter" is a person who transports tax-exempt cigarettes into Florida under bond for delivery beyond state borders.<sup>5</sup>

Section 210.25(5), F.S., defines "manufacturer" as "any person who manufactures and sells tobacco products." As the term is used in part II of ch. 210, F.S., the term manufacturer does not include a manufacturer of cigarettes or cigars. Therefore, the term cigarette manufacturer is not defined in the Florida Statutes.

Section 210.15, F.S., requires every person, firm or corporation desiring to deal in cigarettes in Florida as a distributing agent, wholesale dealer, or exporter to apply for a cigarette permit.

### **Cigarette Excise Tax**

The division oversees the collection of excise taxes from the sale of cigarettes and other tobacco products. The current excise tax in Florida ranges from 16.9 cents per package to 67.8 cents per package, depending on the number of cigarettes per package.<sup>6</sup> The current excise tax is 33.9 cents per standard 20-cigarette pack cigarettes.<sup>7</sup>

Section 210.06, F.S., requires that every dealer affix a tax stamp as evidence that the excise tax has been paid before the cigarettes can be offered for sale in this state. Sections 210.02 and 210.04, F.S., provide that excise taxes must be paid by the wholesale dealer upon the first sale or transaction within this state whether or not such sale or transfer is to the ultimate purchaser or consumer. Because wholesalers may purchase cigarettes from other wholesalers, only the first sale is taxed. Distributing agents, acting as agents to the manufacturers, are not required to pay taxes for the distribution of cigarettes to wholesalers. Collected excise taxes are paid to the division.

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<sup>2</sup> Section 210.01(14), F.S.

<sup>3</sup> Section 210.01(9), F.S.

<sup>4</sup> Section 210.01(6), F.S.

<sup>5</sup> Section 210.01(17), F.S.

<sup>6</sup> See ss. 210.02(3) and (4), F.S.

<sup>7</sup> Section 210.02(3)(b), F.S.

Section 210.05(1), F.S., provides for paying the tax by affixing stamps to cigarette packages. The tax insignia (stamps) are affixed with metering machines. The division may appoint cigarette dealers and manufacturers of cigarettes as agents to affix the tax stamps. Stamps representing various denominations of tax are purchased in bulk by wholesale dealers and are affixed to packages as proof of payment. Cigarettes that are not properly stamped may not be sold in Florida. The amount of the tax then becomes a part of the price of the cigarettes to be paid by the purchaser or consumer.

According to the division, it received \$418,191,500 in cigarette excise taxes from stamping wholesale distributors for the FY 02-03.

### **Permit Requirements**

Section 569.003, F.S., requires a retail tobacco products dealer permit for the retail sale of tobacco products within this state. The same permit is required to allow a tobacco products vending machine to be located on premises. A retail tobacco products dealer permit is required for each place of business where tobacco products are sold.

A manufacturer of tobacco products, including cigarettes, is not required to have a permit or license under Florida law. Section 210.15, F.S., requires a cigarette permit for each place of business of every person, firm, or corporation desiring to sell, store, or deal in cigarettes as a distributing agent, wholesale dealer, or exporter. Section 210.35(1), F.S., requires a distributor's license for any person engaged in the business of selling or dealing in tobacco products, not including cigarettes or cigars, as a distributor. A permit is also required by a person outside this state who ships or transports tobacco products, not including cigarettes or cigars, to retailers in this state, to be sold by retailers. According to the department, there are over 430 cigarette wholesale dealers permitted to distribute cigarettes in Florida.

### **Tobacco Settlements Background**

In February, 1995, the State of Florida sued a number of tobacco manufacturers and other defendants, asserting various claims for monetary and injunctive relief on behalf of the State of Florida. In March, 1996, the state entered into a settlement agreement to settle all of its claims against Liggett Group, Inc., Brooke Group, Ltd., and Liggett & Myers, Inc.

In August, 1997, the "Big Four" tobacco companies (Phillip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corp., and Lorillard Tobacco Company) entered into the landmark \$368.5 billion tobacco settlement agreement with Florida for all past, present and future claims by the state, including reimbursement of Medicaid expenses, fraud, RICO and punitive damages.<sup>8</sup> These cigarette producers held approximately 97.35 percent of the tobacco market share in the U.S.<sup>9</sup> The remaining market share is held by various, smaller producers who were not named in the state's suit as defendants and therefore, are not a part of the settlement.

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<sup>8</sup> See s. 215.56005(1)(f), F.S., which defines the tobacco settlement agreement to mean *State v. American Tobacco Co. et al.*, Case no. 95-1466AH (Fla. 15th Cir. Ct. 1996).

<sup>9</sup> The Council of State Governments, *Tobacco Settlement and Declining State Revenues*, Trends Alert (March, 2002), page 5.

Under the settlement agreement, as subsequently amended by a Stipulation of Amendment,<sup>10</sup> there are non-monetary and monetary sanctions imposed on the tobacco manufacturers. The non-monetary provisions involve restrictions or limitations on billboard and transit advertisements, merchandise promotions, product placement, and lobbying relating to all tobacco products.

From the date of the settlement, Florida is to receive \$11.3 billion over the next 25 years and an additional \$1.7 billion over the next 5 years as a result of a most favored nation clause in the settlement agreement as amended. The amounts of these annual tobacco settlement payments are based on several factors, including the volume of U.S. cigarette sales, share of market, net operating profits (undefined in the agreement), and consumer price indices. Any adjustment to those payments would be based on a formula set forth in an appendix to the settlement agreement and involve a ratio of volume of U.S. cigarette sales as existed in 1997 and the volume of such sales in the applicable year. Statutory guidelines were established to govern the expenditure of the tobacco settlement proceeds.<sup>11</sup>

Subsequent to Florida's settlement, the major tobacco companies settled with 46 states, the District of Columbia, and five U.S. territories in November, 1998, by entering into the Master Settlement Agreement (MSA).<sup>12</sup> The tobacco companies also agreed to marketing restrictions. The unadjusted cost of the states' settlements ranges between \$212 billion to \$246 billion over the next 25 years, subject to numerous adjustments ranging from inflation to fluctuations in cigarette consumption and market share.<sup>13</sup>

Because under both Florida's settlement agreement and the MSA the settling-manufacturers' payments under the agreements are based on market share, the amounts received under the tobacco settlements may be adversely affected by diversionary marketing practices that can supplant domestic tobacco product sales or divert market share to nonsettling tobacco product manufacturers. A reduction in market share has been observed in the 46 states that are a party to the MSA.<sup>14</sup>

Section 210.185, F.S., regulates the importation of cigarettes into this state. This provision makes unlawful the importation of "gray market" or diverted tobacco products, in which sellers or other third parties obtain cigarettes for domestic sale at reduced prices via the international market, by prohibiting the acquiring, holding, owning, possessing, or transporting or importation, for sale or

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<sup>10</sup> Florida also negotiated an A Most Favored Nations clause in the settlement, which provided the state with additional monies for a period of time after Minnesota settled with the defendants on terms more favorable than Florida's.

<sup>11</sup> See s. 569.21, F.S.

<sup>12</sup> Florida, Minnesota, Mississippi, and Texas were not parties to the Master Settlement Agreement.

<sup>13</sup> According to a report prepared by WEFA, Inc., an international econometric and consulting firm, on behalf of the Westchester Tobacco Asset Securitization Corporation, dated December 15, 1999, consumption of cigarettes by adults declined 0.65% annually for the period 1965 to 1981, 3.31% for the period 1981 to 1990, and 2.47% for the period 1991 to 1998. If these trends hold, cigarette consumption could decline from the roughly 539 million cigarettes consumed in 1990 to less than 200 million cigarettes for the year 2040.

<sup>14</sup> According to the U.S. General Accounting Office, adjustments of settlement payments based, in part, on market share led to a \$1.6 billion reduction in the payments from projections between 1999 and 2001. See U.S. General Accounting Office, *Tobacco Settlement: States' Use of Master Settlement Agreement Payment* 8 (GAO-01-851, June 2001). See also *Issues Affecting MSA Payment, Issue Brief Summary* from the National Conference of State Legislatures, dated October 1, 2003, at 11 (page number of the PDF file).

distribution in this state of cigarettes that the manufacturer did not intend to sell or distribute in the United States.

### **Contraband Cigarettes**

The sale of counterfeit cigarettes also deprives the state of excise and sales tax revenue, and it may supplant legal sales and thereby cost the state tobacco settlement money. A recent U.S. Government Accounting Office (GAO) report found a link between international terrorist groups and the illicit trafficking in contraband cigarettes and counterfeit cigarette tax stamps. According to the GAO, law enforcement officials have determined that international terrorist groups used cigarette trafficking to raise funds.<sup>15</sup>

### **III. Effect of Proposed Changes:**

**Section 1.** The bill amends s. 210.01(6), F.S., to further define the definition of “wholesale dealer” to include a person in or outside this state. It also provides that the term does not include a manufacturer, export warehouse proprietor, or importer who holds a permit under 26 U.S.C. s. 5712, if the person sells or distributes cigarettes to in the this state to dealers holding valid permits under s. 210.15, F.S, or to an export warehouse proprietor or another manufacturer.

The bill amends the definition of “retail dealer” in s. 210.01(7), F.S., to provide that the term includes a person in or outside this state. It also provides that the term does not apply to any person licensed under s. 569.003, F.S., which relates to retail tobacco dealer permits.

The bill defines the term “counterfeit cigarettes,” to mean “cigarettes that have false manufacturing labels, tobacco product packs without tax stamps or counterfeit tax stamps, or any combination thereof.”

The bill defines the terms “importer,” and “manufacturer” as a person with a valid cigarette permit under the applicable federal provisions.<sup>16</sup> The bill also creates definitions for the terms “stamp or stamps,” and “brand family.”

**Section 2.** The bill amends s. 210.05, F.S., to add subsection (6), which prohibits the transporting of cigarettes from Florida to another state without first affixing to the cigarettes the tax stamp required of the state in which the cigarettes are to be sold, or paying any other excise tax required by that state.

The bill prohibits the stamping of cigarettes for, paying taxes to, or selling cigarettes in another state if the other state prohibits either action. Anyone who sells cigarettes into another state must, by the 10th day of each month, report to the division the quantity, brand information, and recipient information for any sales made out of this state in the preceding calendar month.

The bill also defines the term “person,” for the purposes of this section, to mean any individual, partnership, committee, association, corporation, or any other organization or group of persons.

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<sup>15</sup> *Terrorist Financing: U.S. Agencies Should Systematically Access Terrorists’ Use of Alternative Financing Mechanisms*, GAO Report 04-163, November 2003.

<sup>16</sup> 26 U.S.C. 5712.

It provides that the term does not include any common or contract carrier or public warehouse that is not owned, in whole or in part, directly or indirectly by such person.

**Section 3.** The bill amends s. 210.06, F.S., to require every dealer in the state to affix the required tax stamps within ten days of receipt of the products. The bill requires dealers outside the state to affix the stamps before the cigarettes are shipped into the state. It deletes the provision that requires the tax stamp to be affixed before the cigarettes are offered for sale, consumed or otherwise disposed of in this state.

The bill prohibits dealers, except as provided in s. 210.09(1), F.S., from holding or possessing unstamped cigarettes received from a manufacturer or importer in accordance with this section and s. 210.085, F.S. However, dealers may set aside, without applying stamps, the part of the dealer's stock identified for sale or distribution outside this state, but unstamped cigarette packages must be stocked separately from stamped packages. The bill prohibits dealers to transfer unstamped cigarette packages to another facility of the dealer within this state or to another person in this state.

In addition, s. 210.06, F.S., would require that:

- all cigarette packages subject to the excise tax must be stamped;
- no stamp shall be applied to cigarette packages exempt from tax under 26 U.S.C. 5704; and
- dealers may only apply stamps to cigarettes received directly from a manufacturer or importer with a valid and current permit under 26 U.S.C. 5712.

**Section 4.** The bill creates s. 210.051, F.S., to provide that manufacturers, importers, or distributing agents may only sell or distribute cigarettes to a dealer with a valid permit under s. 210.15, F.S., and dealers may only sell or distribute the cigarettes if they have a valid and current permit under s. 569.003, F.S. The bill provides that dealers may only obtain cigarettes from a manufacturer or importer with a valid permit under 26 U.S.C. 5712, or from a distributing agent with a valid and current permit under s. 210.15, F.S., and a retail dealer may only obtain cigarettes from a manufacturer or dealer with a valid and current permit under s. 210.15, F.S.

**Section 5.** The bill amends s. 210.09, F.S., to require any person who ships unstamped cigarettes into this state to a person without a valid and current permit under s. 210.15, F.S., must first file with the division a notice of such shipment. This requirement does not apply to common or contract carriers.

The bill authorizes the division, law enforcement, or authorized agents to stop and seize cigarettes where there is knowledge, or reasonable grounds to believe, that the cigarettes are being transported in violation of part I of ch. 210, F.S.

**Section 6.** The bill amends s. 210.12, F.S., to provide for the forfeiture to the state of all fixtures, equipment, and other material and personal property on the premises if any dealer or retail dealer violates record keeping or reporting requirements, commits fraud other attempts to evade the requirements of part II of ch. 210, F.S.

The bill provides that all cigarettes seized, confiscated, and forfeited to the state must be destroyed. The bill deletes the provision in subsection (1) of s. 210.12, F.S., that provides that forfeited cigarettes may be used for the benefit of the state.

**Section 7.** The bill amends s. 210.15, F.S., to require manufacturers, importers, exporters, distributing agents, and wholesale dealers of cigarettes desiring to engage in business in this state apply to the division for a permit. Current law requires a permit for exporters, distributing agents, and wholesale dealers of cigarettes, but not importers and manufacturers. A separate permit would be required for each place of business located in this state, or the principal place of business if there is no place of business located in this state.

The bill prohibits the issuance, maintenance, or renewal of a permit if any person or persons owning, directly or indirectly, more than 10 percent of the ownership interest in the applicant:

- owes \$500 or more in delinquent cigarette taxes;
- has had a permit revoked by the division in the previous two years; or
- has been convicted of violations involving stolen or counterfeit cigarettes.

**Section 8.** The bill amends s. 210.18, F.S., to provide that any person who, with the intent to defraud the state, fails to comply with any requirement of ch. 210, F.S., commits a third degree felony.

The bill deletes the provision in subsection (6)(a) of s. 210.18, F.S., which provides that the possession, removal, deposit, or concealing of 50 or fewer cartons of unstamped cigarettes constitutes a second degree misdemeanor.

The bill provides for the seizure of counterfeit cigarettes and related machinery. The bill also provides the following penalties for possession of less than two counterfeit cartons of cigarettes or the equivalent amount of other cigarettes:

- a fine not to exceed \$1000 or five times the value of the cigarettes, whichever is greater, or imprisonment not to exceed five years, or both; and
- a subsequent violation results in revocation of the violator's permit and a fine not to exceed \$5000 or five times the value of the cigarettes, whichever is greater, or imprisonment not to exceed five years, or both.

The following penalties for possession of two or more counterfeit cartons of cigarettes or the equivalent amount of other cigarettes:

- a fine not to exceed \$2000 or five times the value of the cigarettes, whichever is greater, or imprisonment not to exceed five years, or both; and
- a subsequent violation results in revocation of the violator's permit and a fine not to exceed \$50,000 or five times the value of the cigarettes, whichever is greater, or imprisonment not to exceed five years, or both.



The bill requires that all counterfeit cigarettes seized by the division must be destroyed.

**Section 9.** The bill creates s. 210.181, F.S., to provide for a fine in addition to any other penalty provided for in part II of ch. 210, F.S. The authorized fine is \$1000 or five times the retail value of the cigarettes involved in the violation, whichever is greater.

**Section 10.** This bill would take effect upon becoming law.

#### IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

The Commerce Clause of the U.S. Constitution may be implicated if the tax stamping, reporting, and shipping restrictions are found to be a burden on interstate commerce. Under the Commerce Clause, Congress has the power to regulate commerce among the states.<sup>17</sup> Though phrased as a grant of regulatory power to Congress, the clause has long been understood to have a negative or dormant aspect that denies the states the power to unjustifiably discriminate against or burden the interstate flow of articles of commerce.<sup>18</sup> In its negative aspect, the Commerce Clause prohibits economic protectionism, i.e., state regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.<sup>19</sup> Assuming the provisions of the bill are nondiscriminatory, the standard for evaluating whether a state action is an unconstitutional burden on interstate commerce is whether the effects of the regulation on interstate commerce are only incidental and the burden imposed does not exceed the public benefit.<sup>20</sup>

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<sup>17</sup> See art. I, s. 8, *U.S. Constitution*.

<sup>18</sup> *Id.*

<sup>19</sup> See *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996); and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 110 S.Ct. 2238, 946 U.S. 18 (Fla. 1990).

<sup>20</sup> See *Pike v. Bruce, Inc.* 397 U.S. 137, 142, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970).

**V. Economic Impact and Fiscal Note:****A. Tax/Fee Issues:**

According to the DBPR, the bill may increase permit fees received by the department for the additional required permits. However, it is indeterminate how many additional in-state and out-of-state entities will become permitted and remit fees and excise taxes because of this bill.

**B. Private Sector Impact:**

The extent of any private sector costs associated with the reporting requirements of the bill have not been determined.

**C. Government Sector Impact:**

The department estimates it will need one-time set-up costs of \$250,000 to contract the development and establishment of the computer system to capture the data reported under the requirements of this bill. It would also need annual budget authority of \$30,000 to fund license agreements and maintenance, and one System Project Analyst position to provide technology support relating to the new database.

According to the DBPR, it would require one additional Regulatory Specialist II position in the Bureau of Licensing, four additional Revenue Specialist II positions, and one Tax Auditor I position in the Bureau of Auditing, to administer this bill, along with space and equipment applicable to the positions. The Division of Information Technology would require one Systems Project Analyst, \$250,000 one-time programming costs, and \$30,000 in recurring expenses.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The provisions of section 2 of the bill are substantively the same as the provisions of section 2 of SB 2112, which creates s. 210.0207, F.S.

**VIII. Amendments:**

None.