

The Florida Senate
PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

Prepared By: Regulated Industries Committee

BILL: CS/SB 2402

INTRODUCER: Regulated Industries Committee and Senator Haridopolos

SUBJECT: Tobacco Products

DATE: March 27, 2007

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>GA</u>	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill provides a new excise tax basis and rate for the “moist snuff” category of tobacco products. Moist snuff is a tobacco product that is not smoked but intended to be held in the mouth. 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. Currently, moist snuff, like other non-cigarette tobacco products, is taxed at the rate of 25 percent of the wholesale price.

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. It also adds the term “dry snuff” to the definition of tobacco products. Dry snuff flour is a tobacco product that is intended to be placed in the nose.

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. The REC determined that a tax rate of \$0.49 would be the most revenue neutral.

The bill has an effective date of July 1, 2007.

This bill substantially amends the following sections of the Florida Statutes: 210.25, 210.30, and 951.22.

II. Present Situation:

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

Taxation of Tobacco

Section 210.01(1), defines the term “cigarette” to mean:

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

Section 210.25(11), F.S., defines the term “tobacco products” to mean:

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.

There is no definition for cigars in the Florida Statutes. There is a definition of the term “tobacco products in s. 944.115(2)(d), F.S., relating to the smoking prohibition in state correctional facilities, which defines tobacco products to mean:

Items such as cigars, cigarettes, snuff, loose tobacco, or similar goods made with any part of the tobacco plant, which are prepared or used for smoking, chewing, dipping, sniffing, or other personal use.

The Internal Revenue Code defines the term “smokeless tobacco” to mean any snuff or chewing tobacco,¹ the term “snuff” to mean any finely cut, ground, or powdered tobacco that is not intended to be smoked,² and “chewing tobacco” to mean any leaf tobacco that is not intended to be smoked.³ The Internal Revenue Code defines the term “cigar” to mean “any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco” that does not meet the definition of cigarette.⁴

The term “other tobacco products” or OTP refers to all tobacco products except cigarettes and cigars. Part I of ch. 210, F.S., provides for the taxation of cigarettes. Part II of ch. 210, F.S., provides for the taxation of other tobacco products. Cigarettes are taxed in a different manner

¹ Title 26 U.S.C. s. 5702(m)(1).

² Title 26 U.S.C. s. 5702(m)(2).

³ Title 26 U.S.C. s. 5702(m)(3).

⁴ Title 26 U.S.C. s. 5702(a).

from other tobacco products. 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 cigarettes.⁵ The applicable tax rate is dependent on the weight per thousand cigarettes and the length of the cigarette. The current cigarette 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.⁶ The current excise tax is 33.9 cents for a standard 20-cigarette pack.⁷

All OTP are taxed at the same rate. “Other tobacco products” are taxed on an *ad valorem* basis at the rate of 25 percent of the wholesale sales price of the tobacco product.⁸ The tax is imposed at the time the distributor:

- (a) Brings or causes to be brought into this state from without the state tobacco products for sale;
- (b) Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- (c) Ships or transports tobacco products to retailers in this state, to be sold by those retailers.⁹

Section 210.25(13), F.S., defines the term “wholesale sales price” to mean:

The established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any diminution by volume or other discounts.

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 (through February 2007) the division has collected \$22,332,607.

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. Section 210.25(11), F.S., includes moist snuff and snuff flour under the definition of tobacco products and is taxed at the *ad valorem* rate of 25 percent of the wholesale price. The Revenue Estimating Conference estimated that 88.5 percent of OTP excise taxes collected come from moist smokeless tobacco.

There are four moist snuff manufacturers distributing their product in the United States:

- Conwood Company, L.L.C. (a subsidiary of Reynolds Tobacco Company);
- Swedish Match, NA (also known as Pinkerton Tobacco Company);

⁵ Section 210.02, F.S.

⁶ Section 210.02(3) and (4), F.S.

⁷ Section 210.02(3)(b), F.S.

⁸ Section 210.30, F.S.

⁹ *Id.*

- Swisher International, Inc; and
- U.S. Smokeless Tobacco Company (a subsidiary of U.S. Tobacco, Inc.).

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 termed “premium snuff,” Tier II snuff is termed “price value snuff,” and Tier III is termed “discount snuff.” The price of snuff ranges from over three dollars per can to less than one dollar per can. The wide range of prices for snuff products means that the tax levied and collected for snuff varies. For example, the tax on a \$3.11 can of premium snuff is \$0.78, but the tax on a \$0.81 can of discount snuff, of the same weight, is \$0.20.

There is no uniformity in the smokeless tobacco or OTP market regarding the 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 two ounces, these snuff containers typically vary in terms of size and weight. There is also variability in the manner in which OTP products 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 U.S. In the U.S., they maintain, dry snuff, although it can be used in the nose, 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 not clear 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 and that other finely cut tobacco products like chewing tobacco are clearly distinguished within the industry and are 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,¹⁰ nine states tax tobacco products on a per unit or weight basis.¹¹

Proponents of weight-based taxation state that it is a more efficient tax, and that it provides a more stable revenue means for snuff taxation. The 25 percent *ad valorem* excise tax on OTP was established in 1985¹² at a time when, according to industry representatives, significantly lower-priced discount snuff brands were not on the market.

Proponents of a weight-based snuff taxation 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

¹⁰ The Tax Foundation describes itself as a non-partisan educational organization that conducts tax research. *See*: <http://www.taxfoundation.org/about/>.

¹¹ See Gerald Prante, *What is Proper Tax Policy for Smokeless Tobacco Products?*, Tax Foundation, September 22, 2006. Available at <http://www.taxfoundation.org/news/show/1858.html> (Lasted visited March 22, 2007).

¹² *See* s. 1, ch. 85-141, L.O.F.

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 of weight-based OTP taxation 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. They 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. They assert that this market share shift from premium to discount brands has resulted, and will continue to result, in a reduction in OTP excise tax collections.

According to the division, it 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 an erosion of excise tax revenue from snuff based on changes in consumer buying habits. Moreover, according to division, excise tax revenue from all OTP has been steadily increasing over recent years.

Weight base taxation of all OTP is supported by Florida Tax Watch, which conducted a study of the issue.¹³ Florida Tax Watch determined that a weight-based tax would avoid the costs and confusion associated with the price transfer litigation and would also avoid any tax loss associated with consumers “trading down” to lower-priced OTP.

Weight-based OTP taxes are opposed by the manufacturers of price value and discount moist snuff because, they assert, that the change is intended to close the price gap between the higher and lower priced moist snuff products. They assert 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 their lower-priced competitors while decreasing the cost of their products.

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 because they believe that it can 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 businesses to structure their operations into separate, manufacturing, sales, and marketing entities. For example, U.S. Smokeless Tobacco Manufacturing Company (USSTM) makes the product and sells the product at an established price to U.S. Smokeless Tobacco (USSTB), a wholesaler. This is the price point at which the excise tax is applied. The

¹³ See Florida Tax Watch, *Legislature Should Consider a Unit-Based Tobacco Products Tax*, April 2006. A copy of this report is available at: <http://www.floridatxwatch.org/resources/pdf/BriefingsTobaccoTaxes0406.pdf> (Last visited March 27, 2007).

wholesaler then sells the product at a higher established price to another wholesaler (third-party wholesalers) who distributes the product to the retailers.

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, which was the wholesaler who initially purchased the product from the manufacturer (USSTM). McLane asserted that the excise tax should have been properly calculated based on the price paid by USSTB to the manufacturer, USSTM.

The refund request was denied by the division, and litigation started 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, this 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.

Proponents of a weight-based excise tax for snuff assert that a weight-based excise tax would eliminate this confusion as to the price point at which the tax should be imposed. Opponents of a weight-based tax 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.

III. Effect of Proposed Changes:

The bill amends s. 210.25, F.S., to define 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.

It is not clear whether the bill’s definition for “moist snuff” is sufficiently clear to distinguish the tobacco products that the bill intends to tax on a weight basis from other tobacco products. For example, it is not clear whether the term is sufficient narrow to not include finely cut chewing tobacco.¹⁴ The proponents of the bill assert the definition, and the weight-based excise tax, are not intended to apply to finely cut chewing tobacco. Proponents of the bill assert that the definition for moist snuff in the bill is sufficiently clear, that snuff is a term commonly understood in the industry, and that other finely cut tobacco products like chewing tobacco are clearly distinguished within the industry and are not confused with snuff.

The bill also and adds the term “dry snuff” to the definition of tobacco products.

The bill amends s. 210.30, F.S., to provide 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.

The bill amends s. 951.22, F.S., relating to the use of tobacco products at county detention facilities, to correct a cross-reference.

¹⁴ The definition of tobacco products in s. 210.25(11), F.S., refers to “fine cuts and other chewing tobaccos.”

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. The Revenue Estimating Conference conducted an analysis of this 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.

The bill maintains the 25 percent *ad valorem* excise tax on other non-moist snuff tobacco products.

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

The bill has an effective date of July 1, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill would affect the price of snuff paid by consumers. The Revenue Estimating Conference conducted an analysis of this bill and 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 conference 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.

C. Government Sector Impact:

The Revenue Estimating Conference conducted an analysis of this bill and determined that a tax rate of \$0.49 per ounce of snuff would break relative to the current *ad valorem* tax structure for OTP, but would result in an increase in other tobacco tax excise tax revenue of \$200,000 per year.

VI. Technical Deficiencies:

The bill imposes a tax on snuff at an unspecified rate per ounce. The bill should be amended to reflect a specific excise tax rate per ounce.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
