

**1999 DRAFTING REQUEST**

**Assembly Amendment (AA-AB133)**

Received: 06/11/99

Received By: dykmapj

Wanted: Soon

Identical to LRB:

For: Legislative Fiscal Bureau 6-3847

By/Representing: Russell

This file may be shown to any legislator: NO

Drafter: dykmapj

May Contact:

Alt. Drafters:

Subject: Tax - cigarettes and t.p.

Extra Copies: JK

**Pre Topic:**

LFB:.....Russell -

**Topic:**

Cigarette tax refund and tobacco tax

**Instructions:**

See Attached Paper 121 alternative 3B plus Paper 122 alternative 4D

**Drafting History:**

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/1	dykmapj 06/11/99	gilfokm 06/11/99		_____			
/2			mclark 06/13/99	_____	lrb_docadmin 06/13/99		
/3	dykmapj 06/14/99	gilfokm 06/14/99	mclark 06/14/99	_____	lrb_docadmin 06/14/99		

FE Sent For:

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/1	dykmapj 06/11/99	gilfokm 06/11/99	lrb_wpo	_____	_____	_____	_____
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19. The success of such a process would require the state and each tribe to agree in separate negotiations to the same rate. The change would subsequently have to be approved by the Legislature. The process would be lengthy and there would be no guarantee that all parties involved would agree on a single rate.

20. Another option would be to adopt a modified version of the system used by the State of Minnesota. Under such a system, the statutes could be changed to specify the 70% refund rate as the maximum allowable rate. DOR could be required to refund a percentage of the taxes, at a rate less than or equal to the maximum 70%, that would be determined in agreements between the state and the individual tribes. A representative for the state, such as the Secretary of DOA or the Secretary of DOR, could be authorized to enter into agreements that would specify the refund rate for taxes on sales to non-tribal members. In order to comply with federal law, the statutes would continue to specify that such agreements would provide for the refunding of 100% of cigarette taxes imposed on sales to tribal members.

### ALTERNATIVES

1. Approve the Governor's recommendation to reduce, from 70% to 50%, the percentage of cigarette tax collections from sales of cigarettes on reservations or trust lands that would be refunded to Indian tribes. However, modify the estimated reduction in refunds under the proposal to \$1,836,000 in 1999-00 and \$2,397,000 in 2000-01. The revised estimates are \$664,000 smaller in 1999-00 and \$603,000 smaller in 2000-01 than the administration's estimates.

<b>Alternative 1</b>	<b>GPR</b>
1999-01 FUNDING (Change to Bill)	\$1,267,000

2. Delete the Governor's recommendation. Instead, direct DOR to enter into negotiations with the tribes and pursue statutory changes subsequent to such negotiations. Under this alternative, estimated cigarette tax refunds for 1999-01 would be the same as the modified estimates under current law (which would be \$2,500,000 greater in 1999-00 and \$3,000,000 greater in 2000-01 than the estimates included in the bill).

<b>Alternative 2</b>	<b>GPR</b>
1999-01 FUNDING (Change to Bill)	\$5,500,000

3. Delete the Governor's recommendation. Instead, specify a maximum refund rate of 70% and require DOR to refund a percentage of the taxes at a rate determined in individual agreements with the tribes. In addition, authorize a state official to enter into agreements that would specify the refund rate (at or below the 70% maximum) for taxes on sales to non-tribal members. The statutes would continue to specify that such agreements would provide for the refunding of 100% of cigarette taxes imposed on sales to tribal members. Specify that the state official authorized

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to negotiate such agreements with the tribes would be:

a. The Secretary of DOA; or

b. The Secretary of DOR.

<b>Alternative 3 (either "a" or "b")</b>	<b>GPR</b>
1999-01 FUNDING (Change to Bill)	\$5,500,000

4. Maintain current law.

<b>Alternative 4</b>	<b>GPR</b>
1999-01 FUNDING (Change to Bill)	\$5,500,000

Prepared by: Faith Russell



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

June 7, 1999

Joint Committee on Finance

Paper #121

### **Cigarette Tax Refund Percentage (General Fund Taxes -- Other General Fund Taxes)**

[LFB 1999-01 Budget Summary: Page 44, #1]

#### **CURRENT LAW**

As set forth in the Constitution of the United States, treaties, statutes and court decisions, Congress may limit the authority of Indian tribes, but within those limits an Indian tribe is a legitimate governmental entity possessing attributes of sovereignty over its members and territory. State taxation of tribal members on reservations is prohibited where the subject matter is pre-empted by federal law or where the tax would infringe on the right of Indians living on reservations to self-government. Under federal law, states are prohibited from imposing a cigarette tax on sales of cigarettes by Native Americans to Native Americans on reservations. However, a state may assess a cigarette tax on sales that occur on tribal lands to non-Native American purchasers and may require the Native American seller to collect the tax for the state on such sales.

Wisconsin statutes direct the Department of Revenue (DOR) to refund 70% of cigarette taxes from all sales on reservations or trust lands of an Indian tribe that were designated as such on or before January 1, 1983. The statutes further authorize DOR to enter into agreements with the tribes to provide for the refunding of 100% of cigarette tax collections from sales on reservations to tribal members. The net effect of these provisions is a 70% refund on sales to non-tribal members and a 100% refund on sales to tribal members.

Ten of the 11 Indian tribes in the state have signed agreements in which the tribes agree to sell only stamped (taxed) cigarettes and the state agrees to provide refunds to the tribes of 100% of cigarette taxes paid on sales to tribal members. The agreements specify that the tribal council will be reimbursed for 70% of taxes paid on all of its cigarette purchases (or purchases by a person authorized to sell cigarettes by the council on the reservation) and specify the process for estimating and paying the remaining 30% of taxes for sales to tribal members. The

agreement is in effect until terminated in writing by either party upon thirty days notice to the other party.

The tribe that does not have an agreement with the state sells unstamped (untaxed) cigarettes to tribal members and stamped cigarettes to non-tribal members. For this tribe, the only taxes collected are from the sale of stamped cigarettes to non-tribal members. The state refunds 70% of such taxes and retains the remaining 30%.

Cigarette tax refunds to Native American tribes are paid through a sum sufficient GPR appropriation.

## **GOVERNOR**

Reduce, from 70% to 50%, the percentage of cigarette tax collections that would be refunded to Indian tribes on sales to non-tribal members and reduce funding for such refunds by \$2,500,000 in 1999-00 and \$3,000,000 in 2000-01.

This provision would first apply to taxes imposed on the first day of the second month beginning after publication of the bill.

## **DISCUSSION POINTS**

1. The administration has estimated that the change in the refund rate would lead to reductions in refunds to Native American tribes of \$2,500,000 in 1999-00 and \$3,000,000 in 2000-01. The estimates for the first year assume an effective date of September 1, 1999. However, the bill would also provide that these provisions take effect on the first day of the second month beginning after publication of the bill. Assuming that the bill would be published in August, 1999, the effective date of the provisions would be October 1, 1999.

The estimates are also based on the administration's projections of refunds under current law of \$10,400,000 in 1999-00 and \$10,900,000 in 2000-01. However, based on a revised estimate of refunds under current law to \$9,520,000 in 1999-00 and \$9,320,000 in 2000-01 (see Issue Paper #120) and adjusting to the October 1, 1999, effective date, it is now estimated that the proposed decrease in the refund rate would lead to reductions in refunds of \$1,836,000 in 1999-00 and \$2,397,000 in 2000-01. These estimates, which are lower than the administration's figures by \$664,000 in the first year and \$603,000 in the second year, assume that the tribes that are currently selling only stamped cigarettes would continue to do so. As described below, if this were not the case, the state could expect to see reductions in both tax collections and refunds from cigarette sales on reservations.

2. The refund rate is specified in agreements with the tribes as well as in the statutes. Therefore, if the statutory refund rate were changed, the agreements would have to be renegotiated. If the tribes did not agree to the new rate, it is possible that they would choose not to enter into new



agreements and would stop selling stamped cigarettes to tribal members.

The absence of agreements would have no net impact on the general fund as long as the tribes continued to sell stamped cigarettes to non-tribal members and the state continued to provide refunds on these sales based on the statutory rate. Enforcement of the sale of stamped cigarettes to non-tribal members could prove to be more difficult, however, as it did prior to the current refund arrangement (see discussion below). If the tribes were to sell unstamped cigarettes to non-tribal members, net general fund revenues could decrease.

3. The current refund process was negotiated in the early 1980s, partially as a means of resolving the problem of black market cigarettes being sold on reservations that developed following a decision of the U.S. Supreme Court. Prior to late 1978, Native American retailers sold stamped cigarettes. A 1978 Supreme Court decision barring the state of Montana from imposing its cigarette tax on Native American sellers was interpreted to apply to Wisconsin. This determination was made because, at that time, Wisconsin's cigarette tax was imposed as an occupational tax (a tax on sellers for the privilege of engaging in a particular business). As a result of the court decision, Native American retailers began selling unstamped (untaxed) cigarettes beginning in December, 1978, and sales on reservations grew from approximately 2.6 million packs in 1979-80 to 19.2 million packs in 1982-83. It was estimated that most of these sales were to non-tribal members.

4. Under state law, non-Native American consumers were liable for the amount of tax due through a parallel use tax on cigarettes. However, it was difficult for the Department of Revenue to enforce the use tax. Enforcement agents would stop individuals leaving Native American retail shops, determine whether the individual was a tribal member and search the individual for unstamped cigarettes. Penalties were assessed if needed and cigarettes could be confiscated. This approach was costly when compared to the amount of revenue collected. In addition, the Department's enforcement efforts were unpopular with customers of the Native American retailers. Native American retailers also found it difficult to determine who was eligible to purchase untaxed cigarettes and objected to filing reports indicating the volume of taxable and exempt sales. Finally, non-Native American retailers were concerned that they were being unfairly competed against.

5. To remedy the enforcement problem, address the concerns of non-Native American retailers and to lessen the paperwork burden on Native American sellers, the tax on cigarettes was converted from an occupational tax to an excise tax (a tax on the consumer) as part of the 1983-85 biennial budget (1983 Wisconsin Act 27) and the current reimbursement provisions were established. The Department of Revenue subsequently negotiated agreements with ten of the 11 tribes to sell only taxed cigarettes (as described under current law, the tribe without an agreement currently sells unstamped cigarettes to tribal members and stamped cigarettes to non-tribal members). In exchange, the state agreed to provide refunds to the tribes of 100% of taxes paid on sales to Native Americans and 70% of taxes paid on sales to non-Native Americans.

6. A number of Wisconsin's neighboring states have also made agreements regarding the taxation of cigarettes sold by Native American retailers. The state of Illinois does not have any

Native American tribes within its borders. It should be noted that, although none of the neighboring states have delineated the specifics of their agreements in statute, other states, such as Wisconsin, have.

*a. Iowa.* There are two small tribes in the state of Iowa. The Native American retailers sell stamped cigarettes and can apply for a refund for the tax paid on cigarettes sold to tribal members. When applying for a refund, the retailers submit cash register receipts and information on the number of packs sold to tribal members. They are audited periodically for compliance. No refund is provided for cigarettes sold to non-tribal members. This refund procedure was arrived at by negotiation with the tribes and it not specified in the Iowa statutes.

*b. Michigan.* There are 11 Native American tribes in the state of Michigan. Until recently, the state had agreements with seven of the tribes under which the tribes purchased tax-free cigarettes from certain designated distributors and collected tax on sales to non-tribal members. These agreements have expired, and the state is currently negotiating new agreements with all of the tribes. In the meantime, the seven tribes that had such agreements are operating under the expired agreements. Distributors notify the Michigan Department of Treasury monthly of the number of cigarette packs sold to Native American retailers. The tribal retailers are required to collect the tax on all cigarettes sold to non-tribal members and are audited each year to determine the amount of tax due. Although the tribal retailers are audited for compliance, the Treasury Department is not confident that all of the tax owed is being collected. The state would prefer to negotiate agreements in which taxes would be collected at the wholesale level and the tribes would apply for refunds based on estimated per capita sales.

Agreements with the tribes are not specified in the Michigan statutes. One tribe has a separate agreement with the state under which the tribe buys taxed cigarettes and is refunded monthly for sales to tribal members based on a study of cigarette consumption by its tribal members. There are no agreements with the other three tribes since they are very small and do not have any tribal-owned retail shops.

*Minnesota.* Minnesota statutes provide the Commissioner of Revenue with broad authority to enter into agreements to share taxes with tribes. The statutes do not specify the refund rate or other details of these agreements. The statutes explicitly state that tribes may purchase unstamped cigarettes from wholesalers in amounts that would meet the personal consumption needs of tribal members. However, as described below, none of the 11 tribes in Minnesota are purchasing untaxed cigarettes for tribal consumption.

The state recently entered into new agreements with ten of the 11 tribes located in Minnesota that cover sales, cigarette, tobacco, liquor and gasoline taxes. These agreements provide that the tribes sell taxed products to tribal members as well as non-tribal members. The state, in turn, agrees to refund the tribes for 100% of taxes collected on sales of cigarettes (as well as the other products) to tribal members based on per capita estimated consumption, and 50% of taxes from sales to non-tribal members. In 1992, the Revenue Department sent letters to the tribes indicating that the state wanted to renegotiate the prior agreements, which were based

on a 70% refund rate. A new agreement was negotiated with each of the ten tribes at the 50% refund rate. The first new agreement was signed in 1995. The tribe that does not have an agreement buys taxed cigarettes from distributors and does not apply for refunds from the state.

7. Cigarette tax rates have increased from 25¢ per pack when the agreements were first negotiated to the current rate of 59¢ per pack. The administration has pointed out that the original tribal share of 17.5¢ (70% of 25¢), adjusted for inflation, would be 29¢ per pack today, which would be comparable to the proposed 50% refund rate (the 50% refund would be 29.5¢ per pack based on the current tax rate of 59¢).

8. The administration has also stated that its overall goal in modifying the cigarette tax refund provision was to ensure that tribal revenues were held constant following the 15¢ increase in cigarette taxes from 44¢ to 59¢ in November, 1997. Cigarette tax refunds averaged \$8,151,000 for 1995-96 and 1996-97, the two fiscal years prior to the 15¢ increase. It is estimated that current law refunds would be \$9,520,000 in 1999-00 and \$9,320,000 in 2000-01. This paper estimates that, with the lower refund percentage in the bill, cigarette tax refunds would be \$7,684,000 in 1999-00 and \$6,923,000 in 2000-01. Based on these estimates, refunds at the 50% rate would be less than the average refund in the two years prior to the 15¢ tax increase by \$467,000 in 1999-00 and \$1,228,000 in 2000-01.

9. According to the administration, when the cigarette tax revenue sharing process was developed in Wisconsin it was viewed as a means of promoting Native American economic development in addition to being a practical way to resolve the problem of black market cigarettes being sold on reservations. With the recent rise of Native American gaming, the economic status of the tribes has been changing. In light of changes in the tax rate and improved economic conditions of some of the tribes, the revenue sharing arrangement may be viewed by some, including competing non-Native American retailers, as unnecessarily generous.

10. It could be argued that all of the taxes collected from sales of cigarettes to non-tribal members should be retained by the state. It has been suggested that one way to do so would be to collect taxes on cigarettes using a procedure similar to that used to collect taxes on motor vehicle fuel sold on reservations.

Like the cigarette tax, the tax on motor vehicle fuel is an excise tax that is generally collected at the wholesale level but is to be paid by the ultimate consumer. Native Americans are not subject to taxes on the fuel they purchase if the fuel is delivered to them on their tribal reservation, except where any of the fuel is purchased for resale to both Native Americans and to non-Native Americans. In such cases, the motor vehicle fuel tax is pre-collected, meaning that reservation retailers purchase fuel at prices that include the motor vehicle fuel tax. When making a nontaxable sale to a tribal member, the reservation retailer is required to obtain an exemption certificate from the buyer. The retailer may then sell the fuel at a retail price that excludes fuel taxes and claim a refund from DOR of taxes it paid on nontaxable sales to Native Americans.

Because of limitations imposed by federal law, states are prohibited from requiring pre-

collection of taxes on all cigarettes sold to tribes or their approved tribal retailers as is done for motor vehicle fuel taxes. Pre-collection of taxes would mean that the tribes could only buy stamped cigarettes. However, a state could pass legislation to require that a quota be established on the quantity of unstamped cigarettes that wholesalers may sell to tribes and tribal retailers. The purpose of a quota system would be to limit sales of unstamped cigarettes to the tribes, thereby minimizing the likelihood that unstamped cigarettes would be sold to non-tribal members. The right of a state to establish such a quota was upheld by the U.S. Supreme Court in a 1994 decision, Department of Taxation and Finance of New York, et al., v. Milhelm Attea & Bros., Inc., et al. (Milhelm Attea), as described below.

11. The Department of Taxation and Finance of the State of New York adopted administrative rules limiting the quantity of untaxed cigarettes that wholesalers could sell to tribes and tribal retailers out of concern that cigarette taxes were not being collected on sales to non-tribal members. Before being implemented, the cigarette wholesalers filed suit to enjoin enforcement of the regulations (Milhelm Attea). In June, 1994, the U.S. Supreme Court held that the quota system and reporting requirements were justified by New York's legitimate interest in preventing the illegal sale of tax-exempt cigarettes and that they did not unduly interfere with Native American trading.

By early May of 1997, New York had reached agreements with six Native American tribes for implementation of the regulations. However, on May 22, 1997, the Governor of New York directed the Department of Taxation and Finance to repeal the regulations due to violence that resulted. Subsequently, a bill was introduced to modify New York law to allow reservation retailers to sell tax-free cigarettes. Although New York clearly has the legal right to require the Native American retailers to collect and remit the cigarette tax on sales to non-tribal members, other extenuating factors have prevented these regulations from being enforced.

12. New York is again engaged in litigation regarding cigarette taxes, this time in a case brought by the New York Association of Convenience Stores to protest the lack of enforcement of cigarette taxes on sales on reservations to non-tribal members. The initial case commenced in August, 1995, and has not yet been resolved. According to the New York Department of Taxation and Finance, there are also a number of bills in the New York Legislature addressing taxation of cigarettes sold by the tribes, but there is no consensus on a long-term solution.

13. Legally, Wisconsin could implement a quota system and reporting requirements similar to the regulatory scheme adopted by the state of New York that was upheld by Milhelm Attea. However, it is possible that Wisconsin would experience problems with implementation similar to those experienced in New York. If such problems led to the abandonment of a quota system, as they did in New York, and there was not a system of partial refunds to tribes for taxes on cigarette sales to non-tribal members, it is likely that the tribes would sell unstamped cigarettes and the enforcement challenges experienced prior to the enactment of the refund provision would reoccur. It is also possible that lack of effective enforcement would result in litigation such as the State of New York has been in for nearly five years.

14. If the state eliminated the partial refunds of taxes collected on cigarette sales on

reservations to non-tribal members, the tribes would experience a significant loss in revenue, as long as they continued to sell taxed cigarettes to non-tribal members. However, if the tribes were to sell unstamped cigarettes to non-tribal members, the state could experience a loss in general fund revenues.

15. In 1997-98, the 70% refund of taxes on sales to non-tribal members was an estimated \$8,570,000. According to DOR, the tribes continue to rely on the refunds to fund their governmental services. Tribal representatives indicate that some tribes depend on the refunds to finance health care, day care, housing and family programs.

16. An additional issue to that of the economic impact on tribal budgets of a change in the refund rate is the process under which a change in the rate would be made. A number of tribes have objected to the Governor's proposal for what they perceive to be a unilateral action on the part of the state with respect to a previously negotiated arrangement. One tribe has referred to the Governor's proposal to change the statutory rate without consulting the tribes as an act of bad faith and disrespect. Members of the Legislature's American Indian Study Committee have also objected to the lack of consultation with the tribes; the Chairperson of the Committee has requested that the treatment of cigarette and tobacco products taxes be removed from the budget for consideration as separate legislation so that the state and the tribes could consult on the proposals.

17. The administration discussed reducing the refund rate with representatives of the Oneida Nation prior to submitting the budget bill. However, while the administration believes that the Oneida Nation agreed to the reduced refund rate, representatives for the tribe have stated that the tribe agreed only to discuss such a reduction at a future time. After September 1, 1998, DOR began to adjust the cigarette tax refund claim forms submitted by the Oneida Nation to reflect a refund rate of 50% of taxes collected. The tribe voided and returned the refund checks, requesting refunds at the 70% rate specified in the statutes and in the written agreement between the Oneida Nation and the state.

Since that time there has been a series of correspondence between the Oneida Nation and DOR. The tribe repeatedly returned refund checks it received that were based on a 50% refund rate. The Department subsequently stopped sending refund checks and has instead deposited refunds into an escrow account. Such deposits are based on the 70% refund rate. According to an attorney for the Oneida Nation, the tribe is currently investigating options with respect to litigation on this issue. The tribe is also considering additional options, such as ending its agreement with the state to sell only taxed cigarettes.

18. In order to avoid additional conflicts with the tribes over the refund rate and the process used to change the rate, it may be desirable to approach a modification of the refund provision by renegotiating agreements with tribes before reducing the statutory percentage. In this way, if a new agreement could be reached, a reduction in the statutory rate could be proposed without the tribes perceiving that the state was unilaterally changing the terms of what had previously been considered to be a negotiated agreement.

percentage for sales to non-tribal members at 70%. Estimate the fiscal effect to be an increase in general fund tax collections of \$375,000 in the first year and \$500,000 in the second year and an increase in refunds to Indian tribes of \$262,500 in the first year and \$350,000 in the second year.

Compared to current law, the net effect of these provisions on the general fund would be an increase of \$112,500 in 1999-00 and \$150,000 in 2000-01. Compared to the estimates used in the bill, the general fund would experience a loss of \$96,000 in 1999-00 and \$100,000 in 2000-01.

<u>Alternative 2</u>	<u>GPR</u>
1999-01 REVENUE (Change to Bill)	\$875,000
1999-01 FUNDING (Change to Bill)	\$1,071,000

3. Approve the Governor's recommendation with a modification to provide that the refund rate would be a maximum of 50% and authorize a state official to enter into agreements that would specify the refund rate at or below the maximum. Specify that the state official authorized to negotiate such agreements with the tribes would be:

- a. The Secretary of DOA; or
- b. The Secretary of DOR.

Under this alternative, both revenue and funding would remain at the base level as negotiations with the tribes would have to occur before a change could be implemented.

<u>Alternative 3 (either "a" or "b")</u>	<u>GPR</u>
1999-01 FUNDING (Change to Bill)	\$458,500

4. Approve the Governor's recommendation with a modification to provide that the refund rate would be a maximum of 70% and authorize a state official to enter into agreements that would specify the refund rate at or below the maximum. Specify that the state official authorized to negotiate such agreements with the tribes would be:

- c. The Secretary of the DOA; or
- d. The Secretary of DOR.

Under this alternative, both revenue and funding would remain at the base level as negotiations with the tribes would have to occur before a change could be implemented.

<u>Alternative 4 (either "a" or "b")</u>	<u>GPR</u>
1999-01 FUNDING (Change to Bill)	\$458,500

LRS - 06/19/11

5. Maintain current law.

<b>Alternative 5</b>	<b>GPR</b>
<b>1999-01 FUNDING (Change to Bill)</b>	<b>\$458,500</b>

Prepared by: Faith Russell



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

June 7, 1999

Joint Committee on Finance

Paper #122

### **Tobacco Products Tax (General Fund Taxes -- Other General Fund Taxes)**

[LFB 1999-01 Budget Summary: Page 44, #1]

#### **CURRENT LAW**

Under current law, the Wisconsin tax on tobacco products is an occupational tax imposed on distributors. "Tobacco products" refers to all tobacco-based products other than cigarettes and includes products such as cigars, snuff and chewing tobacco. For domestic tobacco products sold by distributors, the distributors are required to pay a tax at the rate of 20% of the manufacturer's established list price (for imported products, federal tax is added to the list price before applying the 20% tax rate). However, the statutes provide exceptions to the tobacco products tax for the following:

- a. Tobacco products sold to or by post exchanges of the U.S. armed forces;
- b. Tobacco products sold to or by state-operated veterans hospitals in this state;
- c. Tobacco products sold to an interstate carrier of passengers for hire to be resold to bona fide passengers of such carriers;
- d. Tobacco products sold for shipment outside this state in interstate commerce; and
- e. Tobacco products that, under the Constitution and laws of the United States, may not be taxed by this state.

The U.S. Constitution and federal law have been interpreted in a manner that exempts sales of tobacco products by distributors to Indian tribes from the tobacco products tax under Wisconsin's current law. According to the Department of Revenue (DOR), in-state distributors of tobacco products typically claim exemptions from the tobacco products tax for their sales to Indian tribes.



## GOVERNOR

***Change from an Occupational to an Excise Tax.*** The Governor's recommendation would change the tobacco products tax from an occupational tax to an excise tax. The tax would continue to be imposed at the distributor level. However, the bill would specify that the tax be passed on to the ultimate consumer of the tobacco products.

The bill would also eliminate the current exemption for sales that may not be taxed under the U.S. Constitution or federal law [item (e) above]. The bill would further specify that all tobacco products received in this state for sale or distribution in this state would be subject to the tax, unless they were specifically exempted. The bill would provide that a distributor of tobacco products who failed to file required reports and to collect and remit the tax on all tobacco products not specifically exempted would be subject to the following: (a) a fine of not less than \$1,000 nor more than \$5,000; (b) imprisonment for not less than 90 days nor more than one year; or (c) both types of penalties.

***50% Refund to Tribes.*** The bill would require DOR to refund 50% of tobacco products tax collections in respect to sales on reservations or trust lands of an Indian tribe to the tribal council having jurisdiction over the reservation or trust land if all of the following conditions were met: (a) the tribal council had filed a claim for the refund with DOR; (b) the tribal council had approved the retailer; (c) the land on which the sale occurred had been designated a reservation or trust land on or before January 1, 1983; (d) the tobacco products had not been delivered by the retailer to the buyer by means of a common carrier, a contract carrier or the U.S. postal service; and (e) the retailer had not sold tobacco products to another retailer or to a subjobber. The bill would also expand the sum sufficient appropriation for cigarette tax refunds to include refunds related to the tobacco products tax.

***Agreements with Tribes.*** The bill would authorize DOR to enter into agreements with Indian tribes to refund 100% of the tobacco products tax imposed on tobacco products sold on reservations or trust lands to enrolled members of the tribe residing on the tribal reservation.

These provisions on tobacco tax refunds and agreements with tribes would parallel current provisions related to cigarette tax collections.

***Effective Date.*** The changes in the tobacco products tax would first apply to tobacco products taxes imposed, and to claims for refunds of such taxes filed, on the first day of the second month beginning after publication of the bill.

## DISCUSSION POINTS

1. The tobacco products tax generated \$9.3 million in 1997-98, which represented less than 0.1% of total general fund tax collections.
2. Under the current tax structure, in which the tobacco products tax is an occupational

tax, it appears that the tax is generally not being imposed on products sold on Native American reservations in Wisconsin.

3. Under the bill, with the conversion of the occupational tax to an excise tax, distributors could not claim exemptions from the tax for all sales to Indian tribes. The bill would specify that the tax was to be passed on to the ultimate consumer. Therefore, products delivered to reservations by in-state distributors for resale to non-tribal members would have to include the tobacco products tax in the wholesale price to the retailer.

4. In a process parallel to that used for cigarette taxes, tribes would be refunded for 50% of tax collections from sales of tobacco products on reservations or trust lands (under current law, 70% of taxes from sales of cigarettes to non-tribal members are refunded, which the bill would change to 50%). In addition, tribes could enter into agreements with the state to sell only taxed tobacco products and to be refunded for 100% of tax collections on sales to tribal members.

5. The administration has estimated the fiscal effect of these provisions to be a reduction in refunds to Indian tribes of \$208,500 in 1999-00 and \$250,000 in 2000-01, for a total of \$458,500 for the biennium. It should be noted that these estimates represent the anticipated net effect on the general fund, rather than an actual decrease in refunds to Indian tribes. In addition, the administration's estimates for the first year assume an effective date of September 1, 1999. However, the bill would also provide that these provisions take effect on the first day of the second month beginning after publication of the bill. Assuming the bill would be published in August, 1999, the effective date of the provision would be October 1, 1999.

Adjusting the administration's estimate to the October 1, 1999, effective date and reflecting both the increased tax collections and refunds that would result from these provisions, it is estimated that tax collections on tobacco products would increase by \$375,000 in 1999-00 and \$500,000 in 2000-01 and refunds to the tribes would increase by \$187,500 in 1999-00 and \$250,000 in 2000-01 (which is equal to 50% of tax collections). The net positive effect on the general fund would be the remaining 50% of tax collections, or \$187,500 in 1999-00 and \$250,000 in 2000-01.

Compared to the estimates used in the bill, the net general fund impact of the revised estimates is a loss of \$21,000 in 1999-00, due to the effective date adjustment.

6. The administration's estimate of tobacco sales on reservations was made after reviewing the exemptions for sales to Native Americans currently claimed by Wisconsin distributors as well as the records of some manufacturers known to sell directly to the tribes. However, tribes may also purchase tobacco from out-of-state distributors that do not report such sales to DOR. The Department does not have information on the quantity of such sales. As a result, the estimated fiscal impact of these provisions or any provisions for refunds of tobacco products taxes is speculative.

7. It should be noted that, due to differences in the nature of the tobacco products and cigarette taxes, determining the amount of tax paid on sales to tribal members versus non-tribal

members would be more difficult in the case of tobacco products. For cigarettes, the tax per product is a fixed amount. But for tobacco products, the tax is a percentage of the manufacturer's list price to the distributors. There are a variety of tobacco products, which are sold at a variety of prices that fluctuate with the market. The state and the tribes would have to agree on a process to determine the amount of tax paid that would be attributed to sales to tribal members, such as using a specified percentage of total taxes collected.

8. Perhaps due to the lack of consistency in the tax, there is no stamp system in place for tobacco products such as that used for cigarettes that could serve as an indication that the tax has been paid. In addition, since the tax is included in the retail price of tobacco products, receipts provided to retail customers would not show the amount of excise tax paid. In the absence of some system to indicate that products sold at retail include the tobacco products tax, verification of compliance with tax law would be more challenging in the case of tobacco products than cigarettes. For this reason, it would be especially advantageous to the state to have the tribes agree to sell only tobacco products on which the tax had been paid.

9. Wisconsin's neighboring states with Native American tribes within their borders treat taxation of tobacco products sold by the tribes as follows:

*Iowa.* In Iowa, the tribes buy taxed tobacco products. In order to receive tax refunds for taxes on sales to tribal members, the tribes would need to submit cash register receipts, indicating sales to tribal members. According to staff with the Iowa Department of Revenue and Finance, neither of the two tribes in Iowa applies for a refund of taxes on tobacco products sold to tribal members.

*Michigan.* Michigan imposes an occupational tax on tobacco products. The tribes purchase products that have already been taxed and do not receive refunds for sales to tribal members. The tax on tobacco products is not part of the current discussions being held with the tribes to renegotiate agreements regarding cigarette taxes.

*Minnesota.* Minnesota, on the other hand, negotiates agreements with the tribes for refunding a portion of tobacco products taxes as part of such agreements with respect to cigarette taxes. Minnesota statutes specify that the tribes have the right to purchase untaxed tobacco products in amounts necessary to meet the personal consumption needs of qualified purchasers. However, none of the tribes sell untaxed tobacco products. Ten of the 11 tribes in Minnesota have agreements with the state in which: (a) the tribe agrees to sell taxed tobacco products; (b) the state agrees to refund 100% of taxes paid on sales to tribal members; and (c) the state agrees to refund 50% of taxes paid on sales to non-tribal members. The remaining tribe buys taxed products and does not apply for a refund.

The 50% refund rate is not specified in Minnesota statutes. Instead, the Minnesota Commissioner of Revenue is provided with broad authority to enter into agreements to share taxes with tribes.

10. Under the Governor's proposal, the 50% refund rate would be specified in the statutes. In addition, because DOR would be authorized to enter into agreements with the tribes, it appears that the rate would be specified in the agreements as well. This could result in conflict with the tribes over the refund rate and the process to be used in the future to make changes to the rate.

11. In order to minimize this potential for conflict with the tribes about the refund rate, it may be desirable to specify the statutory rate as a maximum rate and to authorize a representative of the state to negotiate the rate (up to the maximum amount in the statutes) in agreements with the tribes.

12. Because of the similarity of the proposed refund provisions for tobacco products taxes with those for cigarettes, one could argue that the same refund rate and process to change the rate should be used for both. The current law refund rate for cigarettes is 70%. Based on the estimated increases in tobacco products tax collections of \$375,000 in 1999-00 and \$500,000 in 2000-01, it is estimated that a 70% refund rate for tobacco products would increase refunds to the tribes by \$262,500 in 1999-00 and \$350,000 in 2000-01. These increases would exceed the refund estimates at the 50% rate by \$75,000 in the first year and \$100,000 in the second year.

## ALTERNATIVES

1. Approve the Governor's recommendation to do the following: (a) change the tobacco products tax from an occupational tax to an excise tax; (b) delete the tax exemption for tobacco products that may not be taxed under the Constitution and laws of the United States; (c) require DOR to refund 50% of tobacco products tax collections on reservations and trust lands under certain conditions; and (d) authorize DOR to enter into agreements with tribes to refund 100% of taxes collected on sales to tribal members.

However, modify the estimated fiscal effect to reflect an effective date of October 1, 1999, and to include both the increases in tax collections and refunds (rather than decreased refunds as in the bill). Estimate the fiscal effect to be an increase in general fund tax collections of \$375,000 in the first year and \$500,000 in the second year and an increase in refunds to Indian tribes of \$187,500 in the first year and \$250,000 in the second year. The net effect of these provisions on the general fund would be an increase of \$187,500 in 1999-00 and \$250,000 in 2000-01.

Compared to the estimates used in the bill, the net general fund impact of the reestimates is a loss of \$21,000 in the first year, due to the adjusted effective date.

<u>Alternative 1</u>	<u>GPR</u>
1999-01 REVENUE (Change to Bill)	\$875,000
1999-01 FUNDING (Change to Bill)	\$896,000

2. Approve the Governor's recommendation with a modification to set the refund

## Dykman, Peter

---

**From:** Russell, Faith  
**Sent:** Saturday, June 12, 1999 1:36 PM  
**To:** Dykman, Peter  
**Subject:** RE: Sin tax refunds to Indian tribes LRBb065/1

Hi Peter -

I spoke to someone at your house who said you were on the way into the office, so I thought I'd send this email there. I think this is very close. I have a couple of changes and two questions/suggestions.

First the changes. On p. 2, #6, line 9 and line 11, replace "cigarettes" with "tobacco products". In addition, I'm going back on something I described to you earlier. For 139.325, please change line 10 to say "...the agreement may provide for..." and use the same language on p. 2, line 1. There is one tribe that sells untaxed cigarettes to tribal members, but still gets the 70% refund. They may want an agreement that allows them to continue to sell untaxed cigarettes to tribal members.

Now the questions/suggestions.

1. Under current law, 139.323 provides for the 70% refund on sales on "reservations or trust lands". However, under 139.325 it refers to "reservations" only. Yet I'm quite certain that 139.325 applies to trust lands as described under 139.323 as well. My team leader, Rob, and I both think it would be good to be consistent and refer to "reservations or trust lands" throughout. Also, the reservations and trust lands referred to are limited under 139.323 (3). Should that limitation be specified under 139.325 as well?

If you agree that "trust lands" should be included, then both your suggested changes to 139.325 and to 139.805 would have to be revised in several places. Perhaps there would be a simpler way, but I'd like to see what you think.

2. Rob suggests that the following be added as 139.323 (6) and as 139.803 (6):

"The department has entered into an agreement with the tribe under section 139.325 (139.805 for tobacco products)."

If you need to talk to me please e-mail me and I'll give you a call. Thanks!

Faith

-----Original Message-----

**From:** Dykman, Peter  
**Sent:** Friday, June 11, 1999 5:06 PM  
**To:** Russell, Faith  
**Cc:** 'Our Family'  
**Subject:** Sin tax refunds to Indian tribes

<< File: 99b0654/1 >>

**THIS DRAFT HAS NOT BEEN EDITED!** You can call me at home at 798-2982 or e-mail at the cc to this e-mail -Our Family (pjdykman@execpc.com) as well as to work. I will be in tomorrow afternoon and will be checking my voice mail and e-mail.

Attorney Peter Dykman  
Wisconsin Legislative Reference Bureau  
100 N. Hamilton Street, Fifth Floor  
P.O. Box 2037  
Madison, Wisconsin 53701-2037  
Tel: (608) 266-7098  
Fax: (608) 264-8522  
Email: Peter.Dykman@legis.state.wi.us



State of Wisconsin  
1999 - 2000 LEGISLATURE

LRBb0654/1

PJD...: King

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LFB:.....Russell - Cigarette tax refund and tobacco tax

FOR 1999-01 BUDGET - NOT READY FOR INTRODUCTION

LFB AMENDMENT

TO 1999 ASSEMBLY BILL 133 AND 1999 SENATE BILL 45

1 B

1 At the locations indicated, amend the bill as follows:

2 ✓ 1. Page 1022, line 9: delete the material beginning with "shall" and ending  
3 with "50%" on ~~Page 1022~~ line 10 and substitute "shall may refund 70% a portion".

4 ✓ 2. Page 1022, line 12: after "made" insert "only".

5 ✓ 3. Page 1022, line 13: after that line insert:

6 ~~SECTION 2172m.~~ INS. 1A 139.325 of the statutes is amended to read:

7 **139.325 Agreements with Indian tribes.** The department may enter into  
8 agreements with Indian tribes to provide for the refunding of the cigarette tax  
9 imposed under s. 139.31 (1). If the department enters into an agreement with an  
10 Indian tribe, the agreement shall provide for refunding 100% of that tax on cigarettes  
11 sold on reservations the tribal reservation to enrolled members of the tribe residing

or trust lands

may

-2-  
~~page~~

1 on the tribal reservation <sup>or</sup> ~~and~~ <sup>or trust lands</sup> and may provide for refunding not more than 70% of that  
2 tax on cigarettes sold on the tribal reservation to persons who are not enrolled  
3 members of the tribe residing on the tribal reservation." ) or trust lands

History: 1983-87

INS. DB ←

or trust lands

4 ✓ 4. Page 1023, line 18: delete "shall refund 50%" and substitute "may refund  
5 a portion".

made Δ

2A

6 ✓ 5. Page 1023, line 21: delete "made" and substitute "only".

7 ✓ 6. Page 1024, line 10: ~~after "may"~~ <sup>add "may"</sup> ". If the department enters into an  
8 agreement with an Indian tribe, the agreement shall provide for refunding 100% of  
9 that tax on cigarettes sold on the tribal reservation to enrolled members of the tribe  
10 residing on the tribal reservation and may provide for refunding not more than 70%  
11 of that tax on cigarettes sold on the tribal reservation to persons who are not".  
*on tobacco products*  
*on tobacco products*

12 ✓ 7. Page 1459, line 5: substitute "sections" for "section".

13 ✓ 8. Page 1459, line 6: after "(intro.)" insert "and 139.325".

(END)

# Page 1024, line 11: after  
"reservation" insert "or trust lands".

→ delete "on tobacco products  
sold on reservations to"  
and substitute

1A ✓

# Reg 1022 plus 137  
that we must

# SECTION 2172g. 139.323(6)  
of the statute is created to read:

# 139.323(6) The department  
has entered into an agreement  
with the Indian tribe under  
s. 139.325. ~~(13)~~



1B

# Page 1022, <sup>text</sup> line 7: after that line insert:  
"SECTION 2171 m. 139.30 (13 m) of the  
statute is created to read:

(B)

139.30 (13 m)

~~165.92(1)(d)~~

"Trust lands" means any lands in this state held in trust by the ~~United States~~ government for the benefit of a tribe or a member of a tribe. "

U.S.

2A ✓

✓ # Page 1024, line 6; after  
that line insert: ~~§ 139.803~~

(2) (3) (6) of the  
statute to read:

→ (A) (B) (3) (6) The department  
has entered into an agreement  
with the Indian tribe under  
P. 139.805. "

(text: treat) #

(2B)

A Page 1022, line 19: after that line  
(12m) west:  
of SECTION 2175m, 139.75(42)(m)  
of the statute is created to read:

165.92(1)(d)

(d) "Trust lands" means any lands in this state held in trust by the United States government for the benefit of a tribe or a member of a tribe.

139.75(12m) (B) (12m) "Trust lands" has  
the meaning given in  
D. 139.30(13m). "



State of Wisconsin  
1999 - 2000 LEGISLATURE

LRBb0654/2

PJD:kmg:mrc

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*mm*

LFB:.....Russell - Cigarette tax refund and tobacco tax

FOR 1999-01 BUDGET - NOT READY FOR INTRODUCTION

LFB AMENDMENT

TO 1999 ASSEMBLY BILL 133 AND 1999 SENATE BILL 45

*Today*

1 At the locations indicated, amend the bill as follows:

2 1. Page 1022, line 7: after that line insert:

3 "SECTION 2171m. 139.30 (13m) of the statutes is created to read:

4 139.30 (13m) "Trust lands" means any lands in this state held in trust by the

5 U. S. government for the benefit of a tribe or a member of a tribe."

6 2. Page 1022, line 9: delete the material beginning with "shall" and ending

7 with "50%" on line 10 and substitute "~~shall~~ may refund 70% a portion".

8 3. Page 1022, line 12: after "made" insert "only".

9 4. Page 1022, line 13: after that line insert:

10 "SECTION 2172g. 139.323 (6) of the statutes is created to read:

*keep*

1           139.323 (6) The department has entered into an agreement with the Indian  
2           tribe under s. 139.325.

3           **SECTION 2172m.** 139.325 of the statutes is amended to read:

4           **139.325 Agreements with Indian tribes.** The department may enter into  
5           agreements with Indian tribes to provide for the refunding of the cigarette tax  
6           imposed under s. 139.31 (1). If the department enters into an agreement with an  
7           Indian tribe, the agreement may provide for refunding 100% of that tax on cigarettes  
8           sold on reservations ~~the tribal reservation or trust lands~~ to enrolled members of the  
9           tribe residing on the tribal reservation ~~or trust lands~~ and may provide for refunding  
10          not more than 70% of that tax on cigarettes sold on the tribal reservation ~~or trust~~  
11          lands, to persons who are not enrolled members of the tribe residing on the tribal  
12          reservation ~~or trust lands~~.”

13          **5.** Page 1022, line 19: after that line insert:

14          **SECTION 2175m.** 139.75 (12m) of the statutes is created to read:

15          139.75 (12m) “Trust lands” has the meaning given in s. 139.30 (13m).”

16          **6.** Page 1023, line 18: delete “shall refund 50%” and substitute “may refund  
17          a portion”.

18          **7.** Page 1023, line 21: delete “made” and substitute “made only”.

19          **8.** Page 1024, line 6: after that line insert:

20          “(6) The department has entered into an agreement with the Indian tribe  
21          under s. 139.805.”.

22          **9.** Page 1024, line 10: delete “on tobacco products sold on reservations to” and  
23          substitute “. If the department enters into an agreement with an Indian tribe, the  
24          agreement may provide for refunding 100% of that tax on tobacco products sold on

1 the tribal reservation or trust lands to enrolled members of the tribe residing on the  
2 tribal reservation or trust lands and may provide for refunding not more than 70%  
3 of that tax on tobacco products sold on the tribal reservation or trust lands to persons  
4 who are not".

5 ~~10. Page 1024, line 11: after "reservation" insert "or trust lands".~~

6 **11.** Page 1459, line 5: substitute "sections" for "section".

7 **12.** Page 1459, line 6: after "(intro.)" insert "and 139.325".

8 (END)



State of Wisconsin  
1999 - 2000 LEGISLATURE

LRBb0654/3  
PJD:kmg:mrc

LFB:.....Russell - Cigarette tax refund and tobacco tax

FOR 1999-01 BUDGET — NOT READY FOR INTRODUCTION

LFB AMENDMENT

TO 1999 ASSEMBLY BILL 133 AND 1999 SENATE BILL 45

1 At the locations indicated, amend the bill as follows:

2 **1.** Page 1022, line 7: after that line insert:

3 **"SECTION 2171m.** 139.30 (13m) of the statutes is created to read:

4 139.30 (13m) "Trust lands" means any lands in this state held in trust by the

5 U. S. government for the benefit of a tribe or a member of a tribe."

6 **2.** Page 1022, line 9: delete the material beginning with "shall" and ending

7 with "50%" on line 10 and substitute "shall may refund 70% a portion".

8 **3.** Page 1022, line 12: after "made" insert "only".

9 **4.** Page 1022, line 13: after that line insert:

10 **"SECTION 2172g.** 139.323 (6) of the statutes is created to read:

1           139.323 (6) The department has entered into an agreement with the Indian  
2 tribe under s. 139.325.

3           **SECTION 2172m.** 139.325 of the statutes is amended to read:

4           **139.325 Agreements with Indian tribes.** The department may enter into  
5 agreements with Indian tribes to provide for the refunding of the cigarette tax  
6 imposed under s. 139.31 (1). If the department enters into an agreement with an  
7 Indian tribe, the agreement may provide for refunding 100% of that tax on cigarettes  
8 sold on reservations ~~the tribal reservation~~ to enrolled members of the tribe residing  
9 on the tribal reservation and may provide for refunding not more than 70% of that  
10 tax on cigarettes sold on the tribal reservation to persons who are not enrolled  
11 members of the tribe residing on the tribal reservation.”.

12           **5.** Page 1022, line 19: after that line insert:

13           **“SECTION 2175m.** 139.75 (12m) of the statutes is created to read:

14           139.75 (12m) “Trust lands” has the meaning given in s. 139.30 (13m).”.

15           **6.** Page 1023, line 18: delete “shall refund 50%” and substitute “may refund  
16 a portion”.

17           **7.** Page 1023, line 21: delete “made” and substitute “made only”.

18           **8.** Page 1024, line 6: after that line insert:

19           **“(6)** The department has entered into an agreement with the Indian tribe  
20 under s. 139.805.”.

21           **9.** Page 1024, line 10: delete “on tobacco products sold on reservations to” and  
22 substitute “. If the department enters into an agreement with an Indian tribe, the  
23 agreement may provide for refunding 100% of that tax on tobacco products sold on  
24 the tribal reservation to enrolled members of the tribe residing on the tribal



1 reservation and may provide for refunding not more than 70% of that tax on tobacco  
2 products sold on the tribal reservation to persons who are not”.

3 **10.** Page 1459, line 5: substitute “sections” for “section”.

4 **11.** Page 1459, line 6: after “(intro.)” insert “and 139.325”.

5 (END)