

Gov Agency: General Fund Taxes—Other General Fund Taxes—Tobacco Products Tax

Recommendations:

Paper No. 122 Alternative 4(d)

Comments: The governor has proposed changing the tobacco products tax from an occupational tax to an excise tax. This would mean that distributors could no longer claim exemptions from the tax for all sales to Indian tribes. Tribes would be refunded for 50% of tax collections from sales of tobacco products on reservations.

The governor's proposal specifies the refund rate in the statutes. It also authorizes DOR to enter into agreements with the tribes, specifying the rate in the agreements as well. LFB thinks this will be problematic, causing tension with the tribes. (See point 11) They suggest a better approach is to specify the statutory rate as a maximum rate and then authorize DOR to negotiate the rate (up to the maximum) with the tribes. (See point 12) Sounds like a more reasonable proposal to me.

The choice from there is to approve Alt. 3(b) or Alt. 4(d). Alt. 3 sets the rate at a maximum of 50% and Alt. 4 sets the rate at a maximum of 70%. I chose the latter based on current law refund for cigarettes (70%). Seems more logical to authorize the higher percent now to keep it in line with cigarettes, then negotiate both agreements with the tribe. Either way, however, Alt. 3(b) is fine too.

Prepared by: Julie



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

No. 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

3rd/2.

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

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

2nd 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:

- 2nd*
- 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

#1 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:

- #1*
- 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

OK

5. Maintain current law.

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

Prepared by: Faith Russell