



## Legislative Fiscal Bureau

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

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Joint Committee on Finance

Paper #121

### **Regulation of Cigarette Sales (General Fund Taxes -- Excise Taxes and Regulation of Alcohol and Tobacco)**

[LFB 2001-03 Budget Summary: Page 48, #3]

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#### **CURRENT LAW**

In general, all cigarettes received in this state for sale or distribution within this state are subject to the cigarette excise tax of \$.59 per pack. The tax is imposed at the time and place of the first taxable event occurring in this state. Cigarettes sold for shipment outside this state in interstate commerce are not subject to the tax.

The tax is paid through the purchase of tax stamps from the Department of Revenue (DOR), generally by a manufacturer or distributor. It is unlawful for most persons to possess more than 400 cigarettes unless the required tax stamps are properly affixed. This provision does not apply to cigarette manufacturers, distributors or warehouse operators possessing valid permits issued by DOR or to common carriers that are licensed to carry cigarettes in interstate commerce. No retailer may possess cigarettes purchased from any person except a manufacturer, distributor or jobber who holds a valid permit from DOR.

#### **GOVERNOR**

Modify provisions regulating the sale of cigarettes as follows:

Prohibit affixing cigarette tax stamps to: (a) a cigarette package on which a statement, label, stamp, sticker or notice indicates that the manufacturer did not intend the cigarettes to be sold, distributed or used in the U.S.; (b) a cigarette package that is labeled as required under federal law as not intended for consumption in the U.S.; (c) a package that is not labeled as provided under federal law; (d) a package that is modified by a person who is not the

manufacturer; or (e) cigarettes that are imported into the U.S. after December 31, 1999, in violation of federal law.

Prohibit altering cigarette packages before the sale or distribution to the ultimate consumer so as to remove, conceal or obscure any statement, label, stamp, sticker or notice described above or any warning that is specified or conforms with federal requirements regarding warnings prescribed by the U.S. Surgeon General for cigarette packages. Prohibit affixing cigarette tax stamps to any package that is so altered.

Specify that any person could bring an action for illegally affixing tax stamps or altering cigarette packages under the provisions outlined above for actual damages sustained as a result of the violation and for injunctive relief. The court could order the violator to pay the prevailing party's costs and reasonable attorney fees. The trier of fact could increase recovery to an amount not exceeding three times the actual damages if the trier determines that the violation was willful.

Prohibit the possession of more than 400 cigarettes on which tax stamps have been unlawfully affixed under the above provisions; and the sale and distribution of such cigarettes; except for cigarettes that may be brought into the U.S. for personal use and cigarettes that are sold or intended for sale by a duty-free enterprise, as provided under federal law. Provide the following penalties for violations of this provision: (a) for fewer than 6,000 cigarettes, a fine of up to \$200, imprisonment for up to six months or both; (b) for 6,000 to 36,000 cigarettes, a fine of up to \$1,000, imprisonment for up to one year or both; or (c) for more than 36,000 cigarettes, a fine of up to \$10,000, imprisonment for up to three years or both. These penalties currently apply to unlawful possession of untaxed cigarettes.

Prohibit distributors from affixing tax stamps to cigarette packages unless the distributor certifies to DOR, in a manner prescribed by the Department, that the distributor purchases cigarettes directly from a manufacturer. In addition, specify that the definition of "manufacturer" under the cigarette tax statutes would include an authorized agent of a cigarette manufacturer.

## **DISCUSSION POINTS**

1. Gray-market cigarettes are cigarettes manufactured in the U.S. for export that have been brought back into the U.S. for sale, generally at prices well below the prevailing U.S. prices. Gray-market cigarettes also include cigarettes manufactured abroad that are intended for sale in non-U.S. markets but are then diverted for sale in the U.S. In many instances, the required taxes and duties have not been paid on the cigarettes, and they typically do not incorporate the required health warnings for cigarettes.

2. Federal law bans the re-importation of cigarettes manufactured for export. However, according to DOR, enforcement of the gray market cigarette provisions is not a high priority for the federal government relative to enforcement of restrictions on firearms and narcotics. Current state law imposes penalties for the possession of cigarettes if the state excise tax has not been paid (as evidenced by a tax stamp), but state law does not impose penalties for the possession or distribution of gray-market cigarettes if a valid tax stamp has been affixed to the cigarette package. The Governor's recommendation would make the possession and distribution of gray-

market cigarettes a violation of state law, as well as federal law. According to the National Conference of State Legislatures, most states have statutory anti-gray market cigarette provisions.

3. DOR indicates that U.S. cigarette manufacturers are not party to their exported cigarettes being returned to the U.S. for sale. Manufacturers have advised their distributors and large retailers that, if they sell gray-market cigarettes, they will stop selling cigarettes to them.

4. Since Wisconsin's payments under the tobacco Master Settlement Agreement are tied to nationwide volume-shipments by the participating manufacturers, the potential loss of market share to sellers of gray-market cigarettes by the participating manufacturers could result in reduced payments to the state under the agreement. The banning of gray-market cigarettes and the implementation of appropriate enforcement efforts are intended to help circumvent this potential problem.

5. Several changes to the gray-market cigarette provisions incorporated in the bill [and current law] have been suggested with the goal of strengthening enforcement of the bill's provisions. These changes would: (a) expand authority for state enforcement action by allowing the state to take action against every person in the gray-market distribution chain rather than against only the tax stampers or against tax stamped product; (b) prohibit the sale of cigarettes for which the manufacturer has not submitted ingredient information to the federal government, as required by law; (c) revise the Governor's proposal to reflect the provisions of the new federal gray market law and the federal labeling law, that requires cigarettes sold in the U.S. to bear the Surgeon General's warning; (d) clarify that the prohibitions on gray market cigarettes would not apply to cigarettes imported into the U.S. for personal use or to cigarettes sold at duty free stores, unless the cigarettes are brought into the U.S. for resale; (e) eliminate the provision in the bill that would allow possession of up to 400 [20 cartons] of gray-market cigarettes; (f) narrow the right to bring an action for appropriate injunctive relief from "any person" to any person who sells, distributes or manufactures cigarettes and sustains direct economic or commercial injury as a result of a violation; (g) require the destruction of all gray-market cigarettes seized by the state; and (h) incorporate several cross-references to update language in the bill and current statute with provisions that would accomplish the steps described above.

6. The Department of Revenue believes these modifications would improve the provisions of the bill.

## **ALTERNATIVES TO BILL**

1. Approve the Governor's recommended language regarding gray-market cigarettes.
2. Approve the Governor's recommendation with the revisions identified above.
3. Maintain current law.

Prepared by: Drew B. Larson