



## Legislative Fiscal Bureau

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May 24, 2005

Joint Committee on Finance

Paper #330

### **Direct Marketing of Cigarettes and Tobacco Products (General Fund Taxes -- Excise Taxes and Regulation of Tobacco and Alcohol)**

[LFB 2005-07 Budget Summary: Page 199, #1]

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#### **CURRENT LAW**

Current state law provides that no person may sell cigarettes or tobacco products at retail without first obtaining a retail license from the municipality in which the sale is to be made. This provision essentially prohibits direct market sales of cigarettes and tobacco products. In addition, under provisions referred to as the Jenkins Act, federal law requires a person who sells and ships cigarettes into another state to anyone other than a licensed distributor to file reports to the state on such sales. Federal law provides that a person who violates these provisions is guilty of a misdemeanor and is to be fined not more than \$1,000, or imprisoned for not more than six months, or both. States, however, lack the authority to enforce the Jenkins Act.

#### **GOVERNOR**

Create statutory provisions and change existing statutes to permit and regulate the sale of cigarettes and other tobacco products through direct marketing activities.

The bill would create state permits and associated reporting requirements and enforcement provisions for the direct marketing of cigarettes and tobacco products to Wisconsin consumers.

The main components of the direct marketing provisions recommended by the Governor are outlined below. The Appendix provides a detailed description of the Governor's proposal.

- The bill would provide that a person holding a permit from the Department of Revenue (DOR) as a direct marketer of cigarettes or tobacco products and who sells such

products solely as a direct marketer could sell the products in Wisconsin without obtaining a municipal retailer's license.

- In order to obtain a direct marketing permit, a person would have to file an application with DOR and submit the following fee with the application: (a) \$500 if the person sells fewer than 600,000 cigarettes annually; or (b) \$1,000 if the person sells 600,000 or more cigarettes annually. The permit fee for a tobacco products direct marketing permit would be \$500. The bill also includes provisions regarding the qualifications of permittees.

- The bill would require that the state cigarette and tobacco products excise taxes and sales taxes be paid on sales of cigarettes and tobacco products through direct marketing.

- All sales of cigarettes and tobacco products to Wisconsin residents through direct marketing would have to be credit card transactions and direct marketers would have to provide DOR any information the Department considers necessary to administer these provisions.

- No person could sell cigarettes to consumers in this state by direct marketing unless the person verifies that the cigarette brands are approved by DOR and listed in the directory of certified tobacco product manufacturers and brands as provided under the cigarette Master Settlement Agreement (MSA).

- No cigarettes or tobacco products could be shipped to a person who is under 18 years of age or to a post-office box. Every package used to ship cigarettes or tobacco products from a direct marketer and delivered to a person in this state would have to be clearly labeled to indicate that the package contains cigarettes or tobacco products and could not be delivered to a person under 18 years of age.

- Direct marketers would be required to verify the consumer's identity and that the consumer is at least 18 years old by either: (a) using a database, approved by DOR, that includes information based on public records; or (b) obtaining a notarized copy of an identification card, on which the name matches the name of the consumer and the birth date verifies that the purchaser is at least 18 years of age; or (c) a different mechanism, if approved by DOR.

- No sale of cigarettes to a consumer in this state by direct marketing could exceed 10 cartons for each invoice or 20 cartons in a 30-day period for each purchaser or address.

- Under current law, with exceptions, it is unlawful for any person to possess in excess of 400 cigarettes (two cartons) unless the required tax stamps are properly affixed. The bill would delete the allowance of up to 400 unstamped cigarettes so that possession of any number of unstamped cigarettes would be illegal.

- The bill would provide that any person who manufactures or sells cigarettes in this state without holding the proper permit under the cigarette tax statutes is guilty of a Class I felony. The penalty for a Class I felony is a fine, not to exceed \$10,000, or imprisonment, not to exceed three years and six months, or both. Under current law, any person who manufactures or

sells cigarettes in this state without holding the proper permit would be subject to the general penalty for violations of the cigarette and tobacco products tax statutes for which no other penalty is provided, which includes a fine of \$100 to \$1,000, imprisonment for 10 to 90 days, or both.

- The bill would create penalties for other violations of the new provisions, and a number of other penalties for violations of the statutes relating to the sale and taxation of cigarettes and tobacco products would be increased.

These provisions would take effect on July 1, 2006. The administration estimates that these provisions would result in additional cigarette and tobacco products tax revenues of \$1,105,000 in 2006-07 and additional revenue from permit fees in 2006-07 of \$161,500.

## **DISCUSSION POINTS**

1. As described above, based on a requirement that a seller hold a retail permit to sell cigarettes and tobacco products to Wisconsin consumers, current state law essentially prohibits direct market sales of cigarettes and tobacco products in the state. The federal Jenkins Act requires a person who sells and ships cigarettes into another state to anyone other than a licensed distributor to file reports to the state on such sales. The Jenkins Act is intended to enable states to collect cigarette excise taxes from consumers associated with remote sales, such as sales through the Internet. According to a report by the General Accounting Office (GAO) in May, 2003, however, the federal government has had limited involvement with enforcing the Jenkins Act with respect to Internet cigarette sales. The GAO report refers to an estimate by a national research firm that states will lose approximately \$1.4 billion in tax revenue to Internet tobacco sales in 2005. In the absence of federal enforcement of the Jenkins Act, it has not been possible for Wisconsin and other states to obtain comprehensive information about Internet sales of cigarettes and tobacco products to state residents on which taxes have not been paid. For any direct marketer without a physical presence in the state (nexus), Wisconsin lacks authority to require collection of state taxes and has limited ability to enforce current restrictions on sales into Wisconsin without appropriate municipal retailers' permits.

2. AB 100 would create permits for direct marketing of cigarettes and tobacco products and associated administrative procedures and penalties for noncompliance. Holders of direct marketing permits would be authorized to sell cigarettes and tobacco products in Wisconsin through direct marketing without obtaining municipal retailer licenses. In addition, holders of direct marketing permits would be required to either pay the taxes on cigarettes and tobacco products or to purchase for resale products on which taxes had already been paid. Sales of such products by direct market permit holders would also have to include relevant sales or use taxes.

3. The administration has requested a number of changes to the direct marketing provisions included in AB 100. The requested changes are described below.

## **Changes to AB 100 Requested by the Administration**

4. The first request is for a technical change to provisions related to sales and use tax with respect to the proposed direct marketing permits. As described in the Appendix, the administration's intention was to require a person with a permit to sell cigarettes or tobacco products as a direct marketer to either hold a seller's permit or to be registered to collect, report, and remit use tax under the sales and use tax statutes. However, as written, AB 100 would mistakenly modify a section of the statutes related to licenses or permits issued by municipalities, rather than permits that would be issued by DOR. The administration recommends deleting this language and, instead, inserting language that would require DOR to obtain proper proof that the direct marketer had a seller's permit or was or will be registered to collect, report, and remit use tax under the sales and use tax statutes before issuing a direct marketing permit.

5. The second requested modification would be to clarify that DOR would be required to provide a copy of each application form for cigarette and tobacco retail licenses in the state to each city, village, and town, rather than to provide a copy of each application for such licenses (which are received by municipalities, rather than by DOR).

6. The third request is for a technical change that would correct a reference under the proposed tobacco products direct marketing provisions to current law requirements applicable to all other cigarette and tobacco products permits.

7. The administration has also requested that the current law definition of "manufacturer" under the tobacco products statutes be amended to be consistent with the proposed definition of the term in the cigarette statutes. To comply with this request, a tobacco products "manufacturer" would be defined to mean any person who directly manufactures tobacco products for the purpose of sale, including the authorized agent of a person who directly manufactures tobacco products for the purpose of sale. Under current law, a tobacco products manufacturer is a person who manufactures and sells tobacco.

8. Finally, the administration also suggests revisions to two items pertaining to tobacco products permits. The first request is to change the title of the statutory section on tobacco products permits to read "Permits Required" rather than listing the permits in the title. As written, the bill would add "direct marketer" to the permits listed under current law. The requested modification would make the title consistent with the title of the corresponding section in the cigarette tax statutes and would accommodate the administration's second request related to tobacco products permits. Under the current permit provisions, a person engaged in business as a distributor or subjobber of tobacco products at any place of business is required to have a permit from DOR to engage in that business at the place specified in the permit. AB 100 would add "direct marketer" to this provision. The administration is requesting that this section be further modified to also specify that no person may manufacture tobacco products in this state or sell tobacco products in this state and no person may operate a warehouse in this state for the storage of tobacco products for another person without first obtaining the proper permit to perform such operations from DOR.

Current law does not require out-of-state manufacturers to obtain permits to sell tobacco products in this state. However, in order to comply with requirements under the Master Settlement Agreement that DOR track sales of certain tobacco products in the state, current law requires manufacturers to keep records and make available for inspection records of all sales into the state. The requested modification to AB 100 that would require a permit for out-of-state tobacco products manufacturers would be consistent with the bill's treatment of the corresponding cigarette tax statutes and would enhance the state's ability to comply with the MSA requirements.

The request to include the warehouse provisions would be consistent with the current law cigarette tax statutes. If the requested change is approved, then a reference to the cigarette statutes related to warehouses for cigarettes would also have to be included under the tobacco products statutes.

### **Summary Comparison of AB 100 and AB 249**

9. With a number of exceptions, the direct marketing provisions under AB 100 are generally similar to the provisions of 2005 Assembly Bill 249, which was introduced on March 18, 2005, and referred to the Assembly Committee on State Affairs. The differences between the two sets of provisions are briefly summarized in the following section.

10. AB 249 would create an annual PR appropriation of \$126,000 annually for the administration of cigarette direct marketing permits and penalties. The appropriation would be funded with monies received from direct marketers' permits issued by the Department, penalties assessed under the cigarette and tobacco products direct marketing provisions, and proceeds from the sale of cigarettes seized from direct marketers. AB 100 would provide no funding to DOR for administration and enforcement of the direct marketing provisions.

11. A second difference between the direct marketing provisions under AB 100 and AB 249 relates to fines and penalties. AB 249 would provide larger penalties for violations of the proposed direct marketing requirements than would AB 100. Under AB 100, a person who sold cigarettes in excess of the number permitted by the direct marketing permit would pay a penalty equal to the greater of \$1,000 or \$50 for every 200 cigarettes. Under AB 249, the penalty would be the greater of \$5,000 or \$50 for every 200 cigarettes. In addition, AB 249 would impose the following penalties for unlawful possession of cigarettes: (a) in the case of 6,000 or fewer cigarettes -- a fine of not more than \$1,000 or imprisonment for not more than one year in the county jail or both [as compared to the penalty under both current law and AB 100 of not more than \$200 or imprisonment for not more than six months or both]; and (b) in the case of 6,001 to 36,000 cigarettes -- classify the violation as a Class H felony, which carries penalties of a fine not to exceed \$10,000, imprisonment for up to six years, or both [as compared to the penalty under both current law and AB 100 of not more than \$1,000 or imprisonment for not more than six months or both]. DOR is in favor of the higher penalties under AB 249.

12. In some cases, the Governor's proposal would also provide stricter limits related to direct marketing. For example, AB 100 would limit direct market purchases of cigarettes and

tobacco products to credit card transactions, while AB 249 would allow credit cards and personal checks. Also, AB 100 would create a new provision specifying that proof of four facts by a direct marketer who sells cigarettes or tobacco products to a person under the age of 18 pertaining to the purported age of the purchaser would be a defense to any prosecution for a violation of the restrictions on such sales. AB 249 would include a similar provision, but proof of any (rather than all) of the four facts would be considered a defense against prosecution.

13. In multiple instances, AB 100 would include provisions that have similar intentions as those included under AB 249 but would further enhance clarity and as well as consistency with other statutory provisions. For example, AB 100 would provide a clearer definition of an "identification card" for purposes of verifying the age of a purchaser and would more clearly describe requirements related to salespersons of cigarettes and tobacco products, circumstances under which a municipal retail license would not be needed to sell cigarettes and tobacco products, and who a distributor would be permitted to acquire stamped cigarettes from. AB 100 would also provide a uniform application for retail licenses for cigarettes and tobacco products, which is not provided under current law or AB 249, and would authorize an alternate method of applying tax impressions in lieu of stamps to allow for newer methods that are now available.

14. AB 100 would also attempt to provide clarity by separately defining a bonded and a nonbonded direct marketer, in acknowledgement that some direct marketers would buy unstamped cigarettes and affix the tax stamps while others would buy stamped cigarettes. The appropriate requirements for the two types of direct marketers would vary. AB 100 would define a "bonded direct marketer" as a person who acquires unstamped cigarettes from the manufacturer thereof, affixes stamps to the packages or other containers, stores them, and sells them by direct marketing to consumers for their own personal use. A bonded direct marketer would also be able to acquire stamped cigarettes from manufacturers or distributors for such sales. A "nonbonded direct marketer" would be any person who acquires stamped cigarettes from manufacturers or distributors, stores them, and sells them by direct marketing to consumers for their own personal use. This type of direct marketer would not be permitted to purchase unstamped cigarettes or to import cigarettes into the state on which the state's excise tax had not been paid. Bonded direct marketers would be subject to similar rules and regulations as distributors. However, nonbonded direct marketers would be treated more like jobbers, who can only purchase and sell stamped cigarettes. The distinction between the two types of direct marketers would make it easier to correctly refer to the type of direct marketer to whom certain requirements would apply. AB 249 would not distinguish between the two types of direct marketers.

15. A final difference between the two sets of direct marketing provisions pertains to the fee for a permit as a direct marketer of cigarettes. Under AB 249, the permit fee would be as follows: (a) \$1,000 if the person sells no more than 30,000 cigarettes annually; (b) \$5,000 if the person sells more than 30,000 but no more than 600,000 cigarettes annually; or (c) \$10,000 if the person sells more than 600,000 cigarettes annually. Under AB 100, the permit fee would be: (a) \$500 if the person sells fewer than 600,000 cigarettes annually; or (b) \$1,000 if the person sells 600,000 or more cigarettes annually. In each case, the fee would be an annual fee. DOR believes that the lower fee structure under AB 100 would be preferable.

## **Assembly Bill 411**

16. Assembly Bill 411, related to direct marketing of cigarettes, was introduced on May 11, 2005, and referred to the Assembly Committee on State Affairs. The following section provides a brief description of the direct marketing provisions under AB 411.

17. Unlike AB 100 and AB 249, AB 411 pertains to direct market sales of cigarettes only and does not address direct market sales of other tobacco products. In addition, and also unlike the other two proposals, AB 411 would not require a permit for direct marketing of cigarettes. Rather, AB 411 would specify that a person could not sell cigarettes to consumers in this state as a direct marketer or solicit sales of cigarettes to consumers in this state by direct marketing unless the person submitted to DOR the person's name, trade name, address of the person's principal place of business, phone number, email address, and Web site address and met certain additional requirements.

18. While AB 411 would appear to allow direct marketing of cigarettes, the bill would not amend a provision under current law specifying that no person may sell cigarettes or tobacco products at retail without first obtaining a retail license from the municipality in which the sale is to be made. Therefore, as drafted, in order to sell cigarettes to consumers as a direct marketer, the seller would still be required to have a municipal license for each municipality into which such sales were made.

19. AB 411 would require a direct marketer to keep similar records as those required of cigarette permittees. However, a direct marketer would be under no requirement by the state to provide such records to DOR. As under current law, the federal Jenkins Act would still require a direct marketer to report all sales to DOR. However, as noted, federal enforcement of the Jenkins Act has been limited.

20. Similar to AB 100 and AB 249, AB 411 would require a direct marketer to either acquire cigarettes to which tax stamps had already been applied or to acquire unstamped cigarettes and apply the tax stamps. AB 411 would require a direct marketer of cigarettes to register with credit card and debit card companies, but would permit purchases using checks as well as credit and debit cards. (AB 249 would also allow the use of personal checks for purchases of cigarettes via direct market transactions).

21. AB 411 would provide that the provisions related to direct marketing would not apply to any retailer or wholesaler who sells cigarettes in the state and has a valid seller's permit. The intent and effect of this provision is unclear.

22. Under AB 411, current law penalties for violations of selling cigarettes without the appropriate license or permit would apply to direct market sales of cigarettes. No penalties would be imposed specific to the direct marketing provisions.

23. Finally, AB 411 would specify that no delivery of cigarettes could be made unless the seller provided proof to the delivery agent that the seller had complied with the direct marketing

provisions under the bill. While the method of providing such proof is unclear, it is possible that such a requirement could strengthen the provisions requiring direct marketers to provide certain information to DOR (described under #17, above). In addition, AB 411 would provide additional restrictions against a person providing cigarettes to any person under age 18 years of age and would specify associated penalties.

### **Estimated Fiscal Effect**

24. Under AB 100, the administration estimated that cigarette and tobacco products tax revenues would increase by \$1,105,000 in 2006-07 as a result of the proposed direct marketing provisions. It is not expected that the requested modifications, described above, would affect these projections.

25. The basis for the administration's estimate is an effort made by California in 2000 to collect cigarette excise taxes on cigarettes sold over the Internet to California residents. At that time, the California Board of Equalization (BOE) contacted all of the Internet sites it could find selling cigarettes on the web and demanded that the web-based vendors provide the names and addresses of all California customers (as is required under the federal Jenkins Act). As a result of these efforts, the State of California collected \$400,000 in excise taxes it would not have otherwise received. The estimate of revenue from the direct marketing provisions under AB 100 is based on the \$400,000 figure, adjusted to reflect differences between California and Wisconsin in terms of population and tax rates, and also adjusted to reflect current and projected total numbers of cigarettes sold in Wisconsin.

26. The California information is somewhat dated. According to DOR, to do a completely new estimate that would not rely solely on the California data would require an analysis of recent trends underlying the sale of cigarettes via the Internet and a search for additional data sources. However, for reasons discussed above related to lack of enforcement of current federal and state laws with respect to direct marketing, it is difficult to obtain information on the value of untaxed sales into the state. According to a briefing by Sonia Arrison of the Pacific Research Institute to the Tax Foundation in April, 2001, many on-line cigarette shops are refusing to provide information to states on privacy grounds. Some websites are using this refusal as a marketing tool. Growing interest among consumers in privacy rights provides an additional deterrent to any effort to make lists of purchasers available to government agencies.

27. Even if more information was available to help estimate the loss in state tax revenue from Internet sales of cigarettes and tobacco, it is unclear whether vendors currently engaged in directly marketing into Wisconsin would actually apply for a direct marketer's permit and pay the taxes. While AB 100 would provide penalties for violating the direct marketing requirements, the state would still have limited ability to enforce the provisions with respect to out-of-state sellers that do not have nexus with the state. Vendors voluntarily agreeing to comply with the provisions would have to increase their prices to include Wisconsin taxes (approximately \$1 per pack for the cigarette excise tax and sales tax). Therefore, it is expected that the number of vendors currently selling as direct marketers without paying Wisconsin taxes that would voluntarily agree to obtain a direct

marketing permit and pay such taxes would be minimal.

28. On the other hand, it is possible that some manufacturers currently selling at wholesale to in-state distributors would prefer to obtain direct marketing permits and sell directly to customers over the Internet. In February, 2003, for example, a document by Philip Morris was released as a "Proposed Cigarette Delivery Sales Bill" for states to consider that would allow direct marketing of cigarettes and provide for the restriction of sales to minors, collection of state taxes, and the imposition of fines for violations. If a manufacturer that was currently selling through in-state retailers were to obtain a direct marketer's permit, it is likely that the majority of subsequent Internet sales by the manufacturer would replace existing sales by the vendor on which taxes are currently being paid. Therefore, it does not appear likely that the direct marketing provisions could be counted on to result in increased revenues to the state either from vendors that are currently selling without paying taxes or manufacturers that are currently selling through in-state retailers and paying taxes. In addition, while a small amount of program revenue might be received from permit fees, it is anticipated that the amount would be minimal.

29. An additional element of uncertainty about the effect of the proposal was introduced as a result of a recent decision by major credit card companies to no longer accept payment for tobacco products purchased on-line. The decision, which was announced on March 17, 2005 (after the Governor's budget proposal had been introduced), is the result of an agreement between the credit card companies and state and federal law enforcement officials aimed at reducing sales of cigarettes to minors and sales of untaxed cigarettes, generally. The agreement would not prevent smokers from buying cigarettes over the Internet, but they would not generally be allowed to do so using a major credit card. The New York Times reported on April 4, 2005, that scores of Internet cigarette merchants had effectively lost the means to do business profitably as a result of the agreement, and were either "limping along or have shut down their operations altogether." While some on-line vendors may attempt to create their own credit cards, it is generally expected that the credit card company embargo will significantly reduce cigarette sales over the Internet.

30. AB 249 was introduced on March 18, 2005, and DOR provided a fiscal estimate of the bill on April 26, 2005. In describing the estimated fiscal effect, DOR stated that a fiscal estimate of the bill was not feasible. One of the reasons provided was the decision by major credit card companies to deny service to online vendors of cigarettes and tobacco. DOR has not yet provided a fiscal estimate of AB 411. However, it is expected that, as with AB 249, a fiscal estimate will not be feasible.

31. The administration recommends approval of the direct marketing permit provisions in spite of the credit card issue and in spite of the lack of certainty that out-of-state direct marketers that are currently not paying Wisconsin taxes on cigarette and tobacco products sales would agree to obtain permits and to pay such taxes. The administration's primary argument for doing so would be to send a clear message to direct marketers that they should be remitting the taxes. In addition, such legislation could be cited as evidence to the federal government of the continuing problem for the state of the lack of enforcement of the Jenkins Act. Currently, as reflected in the GAO report on Internet cigarette sales, states' efforts to promote compliance with the Jenkins Act have had limited

results. State efforts to curb untaxed sales of cigarettes and tobacco products over the Internet also appear to have had little effect. While it is not clear that offering direct marketing permits would be a more successful route to curbing the sale of untaxed cigarettes and tobacco products, it is possible that more states will consider such permits as an alternate method of attempting to address the problem of lost tax revenues as a result of direct market sales of cigarettes and tobacco. It should be noted, however, that to the extent that persons applying for and obtaining direct market permits merely shifted in-state retail sales to direct market sales over the Internet, resultant sales through in-state retail stores could be expected to decrease.

## ALTERNATIVES

1. Approve the Governor's proposal, as modified by one or more of the following changes requested by the administration.

a. Approve the following technical corrections to AB 100: (i) eliminate the bill's modification to certain statutes related to licenses or permits issued by municipalities with respect to licensing requirements for direct marketing permits and, instead, insert language requiring DOR to obtain the proper proof that a direct marketer has a seller's permit or is or is to be registered by DOR to collect, report, and remit use tax under the sales and use taxes before issuing a direct marketing permit; (ii) clarify that DOR will make a copy of each application form for cigarette and tobacco retail licenses to municipalities (rather than a copy of each application); and (iii) correct a reference under the proposed tobacco direct marketing provisions related to current law requirements applicable to all other cigarette and tobacco products permits.

b. Modify the current law definition of "manufacturer" under the tobacco statutes to be consistent with the proposed definition for the cigarette statutes.

c. Change the title of the statutory section on tobacco products permits to read "Permits Required" and modify the section to include a provision specifying that no person may manufacture tobacco products in this state without first obtaining the proper permit to perform such operations from DOR.

d. In addition to option 1c, modify the section to include a provision specifying that no person may operate a warehouse in this state for the storage of tobacco products for another person without first obtaining the proper permit to perform such operations from DOR. Also, update a reference under the tobacco products statutes related to warehouses for cigarettes to a related section of the cigarette statutes.

In addition, eliminate the estimated increase in tax revenues under the bill of \$1,105,000 in 2006-07 and reduce estimated GPR-Earned by \$161,500 as a result of estimating minimal program revenues from direct marketing permit fees. The total reduction to the general fund would be \$1,266,500 in 2006-07.

<u>Alternative 1</u>	<u>GPR-REV</u>
<b>2005-07 REVENUE</b> (Change to Bill)	- \$1,266,500

2. In addition to the alternatives selected above, substitute the larger penalties for violations of the proposed direct marketing requirements that would be provided under AB 249 for the violations provided under the bill.

3. Maintain current law. Eliminate estimated tax revenues of \$1,105,000 in 2006-07 and reduce estimated GPR-Earned by \$161,500 associated with direct marketing permit fees. The total reduction to the general fund would be \$1,266,500 in 2006-07.

<u>Alternative 3</u>	<u>GPR-REV</u>
<b>2005-07 REVENUE</b> (Change to Bill)	- \$1,266,500

Prepared by: Faith Russell  
Attachment



## APPENDIX

### Summary Of Cigarette And Tobacco Products Direct Marketing Provisions In AB 100

#### **Modifications Related To Retail Licenses And Restrictions On Cigarette And Tobacco Products Sales Or Gifts**

The following section describes proposed changes to provisions related to municipal retail licenses to sell cigarettes and tobacco products as well as restrictions on sales and gifts of such products.

#### **Cigarette and Tobacco Products Municipal Retail Licenses**

Under current law, as provided in the statutes relating to cigarette and tobacco products retailer licenses under Chapter 134, "Miscellaneous Trade Regulations", no person may sell, expose for sale, possess with intent to sell, exchange, barter, dispose of, or give away any cigarettes or tobacco products to any person not holding a license or permit for the sale of cigarettes or tobacco products without first obtaining a license from the clerk of the city, village, or town where such products are to be sold or otherwise disposed of. Under this provision, a direct marketer is not allowed to sell to consumers in Wisconsin without holding a municipal retail license in each municipality into which a sale is made. The bill would provide that a person holding a permit from the Department of Revenue as a direct marketer of cigarettes or tobacco products and who sells such products solely as a direct marketer could sell the products in Wisconsin without obtaining a municipal retailer's license.

Current law prohibits a city, village, or town clerk whose duty it is to issue licenses or permits to engage in a business involving retail sales subject to the sales and use tax from issuing such licenses or permits without proof that the applicant holds a seller's permit or has been informed by DOR that a seller's permit will be issued to the applicant. The bill would modify this provision to permit a municipality to also issue municipal licenses and permits if the applicant is registered to collect, report, and remit use tax or has been informed by DOR that the Department will register the applicant to do so. (However, the administration has indicated that the intention was to require a person with a permit to sell cigarettes or tobacco products as a direct marketer to either hold a seller's permit or to be registered to collect, report, and remit use tax under the sales and use tax statutes. The bill would have to be amended to accomplish this intent.)

The bill would require DOR to prepare an application form for cigarette and tobacco products retailers' licenses. In addition to providing information required under current law with respect to whether the cigarettes or tobacco products are to be sold over the counter, or in a vending machine, or both, the application form would have to require all of the following information: (a) the applicant's history relevant to the applicant's fitness to hold a license; (b) the

kind of license for which the applicant is applying; (c) the premises where cigarettes or tobacco products will be sold or stored; (d) if the applicant is a corporation, the identity of the corporate officers and agent; (e) if the applicant is a limited liability company (LLC), the identity of the company members or managers and agent; (f) the applicant's trade name, if any; and (g) any other information required by the Department.

Each applicant for a cigarette and tobacco products retailer license would be required to use the application form prepared by DOR, to swear to the application, and to submit the application with the clerk of every city, village, or town where the intended place of sale is located. The Department would be required to provide a copy of the application to each city, village, and town. Within 10 days of any change in any fact set forth in an application, the applicant or license holder would have to file a written description of the change with the clerk of the city, village, or town where the application was submitted.

The bill would authorize any person to inspect an application for a cigarette or tobacco products retailer license. The clerk of each city, village, or town where such applications are submitted would be required to retain all applications submitted for five years.

The bill would prohibit a municipality from issuing a cigarette or tobacco products retailer's license to any person who: (a) has an arrest record or conviction record (subject to nondiscrimination provisions); (b) has been convicted of a felony, or as a repeat or habitual offender, unless pardoned (also subject to nondiscrimination provisions); (c) or has not submitted proof that the person holds a sales tax seller's permit or that DOR will issue a seller's permit to the person. These requirements would apply to all partners of a partnership, all members and agents of an LLC, and all agents and officers of a corporation. Subject to nondiscrimination provisions, if a business entity has been convicted of a crime, the entity could not be issued a license unless the entity had terminated its relationship with the individuals whose actions directly contributed to the conviction.

Under current law, any person violating the cigarette and tobacco products retailer license provisions is subject to a fine of \$25 to \$100 for a first offense and a fine of \$25 to \$200 for a second or subsequent offense. If, upon such a second or subsequent violation, the person was personally guilty of a failure to exercise due care to prevent the violation, the person is subject to a fine of \$25 to \$300, imprisonment for up to 50 days, or both. Technically, these penalties currently apply in the case of a direct marketer selling without a municipal retail license. However, the administration indicates that it is not practical to enforce such penalties with respect to direct marketers.

The bill would modify this provision by increasing the penalty for a first offense to a fine of \$500 to \$1,000 and by increasing the penalty for a second or subsequent offense to a fine of \$1,000 to \$5,000, imprisonment for up to 180 days, or both. The current provision imposing additional fines and/or imprisonment for individuals who are guilty of failing to exercise due care to avoid a second or subsequent violation would be deleted. Under the bill, a direct marketer holding a permit from DOR as a direct marketer (as provided under the bill) would not be subject

to the penalties described above but would be subject to specific penalties provided under the bill, as described below.

Current law also provides that the municipality must terminate the license of any person who is convicted of being personally guilty of a failure to exercise due care to prevent the violation for a period of five years, during which the person may not act as the servant or agent of a licensed cigarette or tobacco products retailer for the performance of acts authorized by the license. The proposal would make this provision apply only to second or subsequent convictions.

### **Restrictions on Sales or Gifts of Cigarettes or Tobacco Products**

The bill would add a definition of a "direct marketer" in Chapter 134 through a reference to a proposed definition of the term in Chapter 139 (described below).

Under current law, with certain exceptions, none of the following persons may sell, or provide for nominal or no consideration, cigarettes or tobacco products to any person under the age of 18: (a) a retailer, manufacturer, distributor, jobber, or subjobber; (b) an agent, employee, or independent contractor of a retailer, manufacturer, distributor, jobber, or subjobber; or (c) an agent or employee of an independent contractor. However, a vending machine operator is not liable for the purchase of cigarettes or tobacco products from his or her vending machine by a person under the age of 18 if the vending machine operator was unaware of the purchase. Current law also prohibits the persons described above from selling, or providing for nominal or no consideration, cigarettes or tobacco products to any person except in a place where no person younger than 18 years of age is present or permitted to enter unless that person is accompanied by his or her parent or guardian or by his or her spouse who has attained the age of 18 years. The bill would add the term "direct marketer" to the list of persons to whom these provisions would apply.

Current law prohibits a retailer from selling cigarettes in a form other than as a package or container on which a cigarette tax stamp is affixed. Under the bill, this provision would also apply in the case of a direct marketer.

The bill would create a new provision specifying that proof of all of the following facts by a direct marketer who sells cigarettes or tobacco products to a person under the age of 18 would be a defense to any prosecution for a violation of the restrictions on such sales: (a) that the direct marketer used a mechanism, approved by DOR, for verifying the age of the purchaser; (b) that the purchaser falsely represented that he or she had attained the age of 18 and presented a copy or facsimile of an identification card; (c) that the name and birth date of the purchaser, as indicated by the purchaser, matched the name and birth date on the identification card; and (d) that the sale was made in good faith, in reasonable reliance on the mechanism approved by DOR and the representation of identification as required above, and in the belief that the purchaser had attained the age of 18. Similar provisions currently exist for persons who sell cigarettes directly to consumers.

## **Modifications To The Cigarette Tax Statutes**

The following section describes proposed changes to the cigarette tax statutes under Chapter 139 to permit and regulate direct marketing of cigarettes.

### **Definitions**

The bill would create the following new definitions:

a. "Bonded direct marketer" would mean any person who acquires unstamped cigarettes from the manufacturer thereof, affixes stamps to the packages or other containers, stores them and sells them by direct marketing to consumers for their own personal use, and who may also acquire stamped cigarettes from manufacturers or distributors for such sales;

b. "Consumer" would mean any individual who receives cigarettes for his or her personal use or consumption or any individual who has title to or possession of cigarettes for any purpose other than for sale or resale;

c. "Direct marketer" would mean a bonded direct marketer or a nonbonded direct marketer;

d. "Direct marketing" would mean publishing or making accessible an offer for the sale of cigarettes to consumers in this state, or selling cigarettes to consumers in this state, using any means by which the consumer is not physically present at the time of sale on a premise that sells cigarettes.

e. "Identification card" would have the meaning provided in Chapter 134, which defines the term to mean either a Wisconsin driver's license containing a photograph, an alternative approved for state residents who do not have a driver's license, or certain cards that had been approved under 1987 law related to identification cards for alcohol beverages;

f. "Nonbonded direct marketer" would mean any person who acquires stamped cigarettes from manufacturers or distributors, stores them, and sells them by direct marketing to consumers for their own personal use; and

g. "Person" would mean any individual, sole proprietorship, partnership, LLC, corporation, or association or any owner of a single-owner entity that is disregarded as a separate entity under the income and franchise tax statutes.

The bill would also modify certain current law definitions in the cigarette tax statutes. Currently, a "distributor" means any person who: (a) acquires unstamped cigarettes from the manufacturer, affixes stamps to the packages or other containers, stores them, and sells for resale; or (b) who acquires stamped cigarettes from another permittee for such sales. The bill would modify the definition so that "a" (which is the acquisition of unstamped cigarettes from a manufacturer) would be the key component of the definition, rather than one of two possibilities.

Under the bill, a person who bought unstamped cigarettes from a manufacturer could also buy stamped cigarettes and still be a distributor. But a person who bought only stamped cigarettes would not be a distributor. (Such a person would qualify for a jobber's permit, as under current law.) This modification would make the definition of "distributor" more consistent with other provisions related to distributors under current law.

The bill would also change part "b" of the current definition of distributor to specify that the stamped cigarettes that a distributor could purchase would have to be from a manufacturer or distributor, rather than a permittee. This modification would prohibit a distributor from purchasing stamped cigarettes from jobbers, multiple retailers, or vending machine operators, which is possible under current law, and would reflect the intended pattern of wholesale cigarette sales.

The bill would strike the current law definition in the cigarette tax statutes of "retailer" as a person who sells, exposes for sale, or possesses with intent to sell cigarettes to consumers. Instead "retailer" would be defined through a reference to a definition of the term under Chapter 134 (where a retailer means a person with a municipal retail license to sell cigarettes and tobacco products). The current law definition of a "retailer" could include a direct marketer. However, under these modifications, "retailer" would only include a direct marketer who also held a municipal cigarette or tobacco products retailer license.

The current law definition of a manufacturer as any person who manufactures cigarettes for the purpose of sale, including the authorized agent of such a person, would be modified to refer to a person who directly manufactures cigarettes for the purpose of sale.

### **Payment of Cigarette Tax**

The cigarette tax is paid through the purchase of tax stamps from DOR, generally by a manufacturer or distributor. The tax stamp must be affixed to each pack of cigarettes prior to its first sale in the state. Under current law, "first sale" excludes a sale by a manufacturer to a distributor or by a distributor to certain permittees who are allowed to possess unstamped cigarettes (for example, cigarettes sold to post exchanges of the armed forces of the United States and cigarettes sold for shipment outside this state in interstate commerce). The bill would also permit a manufacturer to sell unstamped cigarettes to a bonded direct marketer.

The bill would permit the Secretary of DOR to authorize the use of impressions applied by the use of machines in lieu of tax stamps. Current law allows authorization of meter machines in lieu of stamps.

The bill would extend the following provisions that apply to manufacturers and distributors with a permit from DOR under current law to all manufacturers, authorized distributors, and bonded direct marketers: (a) the availability of a discount of 1.6% of the tax paid on stamp purchases; (b) the requirement to pay DOR for the cost of printing and shipping

stamps purchased; and (c) permission to purchase stamps on credit under conditions prescribed by DOR by rule.

### **Unlawful Possession of Cigarettes**

Under current law, with exceptions, it is unlawful for any person to possess in excess of 400 cigarettes (two cartons) unless the required stamps are properly affixed. These provisions do not apply to manufacturers, distributors, or warehouse operators possessing valid permits issued by DOR. The bill would delete the allowance of up to 400 unstamped cigarettes and add bonded direct marketers to the list of persons to whom the provision does not apply.

### **Use Tax on Cigarettes**

Currently, only licensed distributors may import more than 400 cigarettes on which the excise tax has not been paid into this state. Such cigarettes must be declared and the tax on them paid within 15 days. However, members of the armed forces are exempt from these requirements if the cigarettes have been issued by the government or purchased in military post exchanges or service stores. A penalty of \$25 per 200 cigarettes is imposed if the tax is not paid when due, and interest on the delinquent tax and penalty accrues at the rate of 1.5% per month, or fraction thereof, from the date the tax became due until paid. The bill would modify these requirements to: (a) delete the current allowance of 400 unstamped cigarettes; (b) provide that a bonded direct marketer authorized by DOR to purchase and affix tax stamps is also excluded from the restriction on importing unstamped cigarettes; and (c) provide that the exclusion for members of the armed forces applies only with respect to cigarettes for their personal use or consumption.

### **Permit Requirements for Cigarette Manufacturers and Distributors**

Under current law, no person may manufacture cigarettes in this state or sell cigarettes in this state as a distributor, jobber, vending machine operator, or multiple retailer and no person may operate a warehouse in this state for the storage of cigarettes for another person without first filing an application for and obtaining the proper permit to perform such operations from DOR. This provision applies to all officers, directors, agents, and stockholders holding 5% or more of the stock of any corporation applying for a permit. The proposal would apply the permit requirement to direct marketers, and would also clarify that an out-of-state manufacturer selling in this state would be required to have a permit. [This provision is needed to assist Wisconsin in complying with a requirement under the Master Settlement Agreement (MSA) between 46 states and certain tobacco companies with respect to reporting of cigarette sales.] In addition, the provision regarding corporate officers, directors, agents, and stockholders would be repealed.

Under current law, subject to nondiscrimination provisions, a permit to manufacture or sell cigarettes may not be granted to any person to whom any of the following applies: (a) the person has been convicted of a misdemeanor not involving Chapters 340 to 349 (relating to motor vehicles) at least three times; (b) the person has been convicted of a felony, unless

pardoned; (c) the person is addicted to the use of a controlled substance or controlled substance analog; (d) the person has income that comes principally from gambling or has been convicted of two or more gambling offenses; (e) the person has been guilty of crimes relating to prostitution; (f) the person has been guilty of crimes relating to loaning money or anything of value to persons holding licenses or permits pursuant to the provisions regarding the regulation of alcohol beverages; or (g) the person does not hold a sales tax seller's permit, if the person is a retailer.

The proposal would repeal items (a) through (f) and, instead, provide that no permit could be granted to any person who: (a) has an arrest record or a conviction record (subject to nondiscrimination provisions); (b) has been convicted of a felony, or as a repeat or habitual offender, unless pardoned (also subject to nondiscrimination provisions); or (c) has not submitted proof that the person holds a sales tax seller's permit or that DOR will issue a seller's permit to the person. The proposal would also specify that these provisions apply to: all partners of a partnership; all members of an LLC; all agents, directors, or shareholders of an LLC or corporation; and all officers of a corporation. In addition, subject to nondiscrimination provisions, if a business entity had been convicted of a crime, the entity could not be issued a permit unless the entity had terminated its relationship with the individuals whose actions directly contributed to the conviction.

Prior to affixing tax stamps to cigarettes, current law requires a distributor of cigarettes to certify to DOR, in a manner prescribed by DOR, that the cigarettes to which it will attach the tax stamps required under these provisions were purchased directly from a manufacturer. The bill would apply this requirement to a bonded direct marketer as well as a distributor.

Currently, a separate permit is required for each class of permittee under the cigarette tax statutes, and the holder of any permit may only perform the operations thereby authorized. Such a permit is not transferable among persons or premises. A separate permit is required for each place where cigarettes are stored for sale at wholesale, through vending machines, or multiple retail outlets. Under the bill, a separate permit would also be required for each place where cigarettes are stored for sale by direct marketing.

Current law authorizes a vending machine operator or a multiple retailer to acquire unstamped cigarettes from manufacturers thereof and affix the stamps to packages or other containers only if the vending machine operator or multiple retailer also holds a permit as a distributor. Under the bill, a vending machine operator or multiple retailer could also satisfy these requirements by holding a permit as a bonded direct marketer.

The law also currently provides that the holder of a warehouse permit is entitled to store cigarettes on the premises described in the permit. The warehouse permit does not authorize the holder to sell cigarettes. Unstamped cigarettes stored in a warehouse for a manufacturer or distributor may be delivered only to a person holding a permit as a manufacturer or distributor. The bill would provide that a bonded direct marketer authorized by DOR to purchase and affix tax stamps would also be permitted to receive deliveries of unstamped cigarettes stored in a warehouse.

## **Direct Marketing of Cigarettes**

The proposal would specify that no person could sell cigarettes to consumers in this state as a direct marketer or solicit sales of cigarettes to consumers in this state by direct marketing unless the person has obtained a permit from DOR to make such sales or solicitations. The person would have to file an application for a permit with DOR, in the manner prescribed by the Department, and submit the following fee with the application: (a) \$500 if the person sells fewer than 600,000 cigarettes annually; or (b) \$1,000 if the person sells 600,000 or more cigarettes annually. A permit issued under this provision would expire on December 31 of each year.

DOR would be prohibited from issuing a direct marketing permit to a person unless the person certifies to the Department, in the manner prescribed by the Department, that the person will: (a) acquire unstamped cigarettes from the manufacturer, pay the state cigarette tax, affix tax stamps to the cigarette packages or containers, store such packages or containers, and sell only such packages or containers to consumers in this state by direct marketing; or (b) purchase stamped cigarettes from a licensed distributor and sell only such packages or containers to consumers in this state by direct marketing.

No person could be issued a direct marketer's permit unless the person certifies to DOR, in the manner prescribed by the Department, that all cigarette sales to consumers in this state will be credit card transactions; that the invoices and all means of solicitation for all shipments of cigarette sales from the person will bear the person's name, address, and permit number; and that the person will provide DOR any information the Department considers necessary to administer this provision.

No direct marketer could purchase tax stamps or sell cigarettes in excess of the number of cigarette sales specified in his or her permit unless the person pays the applicable higher permit fee. Any person who sells cigarettes in excess of the number of cigarette sales specified in his or her permit would have to pay a penalty to DOR of the greater of \$1,000 or an amount equal to \$50 for every 200 cigarettes or fraction thereof.

No person could sell cigarettes to consumers in this state by direct marketing unless the cigarette tax is paid on such cigarettes and tax stamps are affixed to the cigarette packages or containers. No person could sell cigarettes to consumers in this state by direct marketing unless the sales or use tax is paid on the sale of such cigarettes.

No person could sell cigarettes to consumers in this state by direct marketing unless the person verifies that the cigarette brands are approved by DOR and listed in the directory of certified tobacco product manufacturers and brands as provided under the MSA. In addition, to sell cigarettes to a consumer in this state by direct marketing, a person would be required to verify the consumer's identity and that the consumer is at least 18 years old by either: (a) using a data base, approved by DOR, that includes information based on public records; or (b) obtaining a notarized copy of an identification card, on which the name matches the name of the consumer

and the birth date verifies that the purchaser is at least 18 years of age; or (c) a different mechanism, if approved by DOR.

Any person who, without having a valid permit, sells or solicits sales of cigarettes to consumers in this state by direct marketing would have to pay a penalty to DOR of the greater of \$5,000 or an amount equal to \$50 for every 200 cigarettes, or fraction thereof, sold to consumers in this state by direct marketing

No sale of cigarettes to a consumer in this state by direct marketing could exceed 10 cartons for each invoice or 20 cartons in a 30-day period for each purchaser or address. Any person who sells cigarettes that exceed these maximum amounts would have to pay a penalty to DOR of the greater of \$5,000 or an amount equal to \$50 for every 200 cigarettes, or fraction thereof, sold above the maximum amounts. Any person who purchases cigarettes that exceed the maximum amount permissible for direct marketers to sell to a consumer in this state would have to pay a penalty to DOR of \$25 per carton. In addition, the person would have to apply for a wholesale cigarette permit with DOR. (While it is unlikely that the person would subsequently qualify to obtain a wholesaler's permit, the provision is intended to make it clear that a consumer could not purchase quantities of cigarettes from a direct marketer without acting in a wholesaler capacity and satisfying associated requirements.)

No cigarettes could be shipped to a person who is under 18 years of age or to a post-office box. Every package used to ship cigarettes from a direct marketer and delivered to a person in this state would have to be clearly labeled to indicate that the package contains cigarettes and could not be delivered to a person under 18 years of age.

### **Cigarette Tax -- Administrative Procedures**

The following modifications related to administrative procedures would also be provided:

**Transfers.** A current law provision requiring all sales and transfers of tax stamps to be made only by DOR to permit-holding manufacturers and distributors would be modified to also permit sales and transfers of tax stamps by DOR to bonded direct marketers who have been authorized to purchase and affix tax stamps.

**Records.** Under current law, every distributor is required to keep records of purchases and sales of cigarettes. Every manufacturer and distributor holding a permit from DOR with the right to purchase and apply stamps must also keep records of purchases and distributions of stamps. These provisions would be modified to also require every direct marketer to keep records of purchases and sales of cigarettes. In addition, the requirement to keep records of purchases and disposition of stamps mentioned above would apply for every manufacturer, bonded direct marketer, and distributor authorized by DOR to purchase and apply stamps.

In general, cigarette permittees currently must render a true and correct invoice of every sale of cigarettes at wholesale and, on or before the 15th day of each calendar month, file a verified report of all cigarettes purchased, sold, received, warehoused, or withdrawn during the

preceding calendar month. However, certain permittees may be allowed to file the reports quarterly rather than monthly. The bill would also apply these provisions to direct marketers, and would allow a nonbonded direct marketer who only sells cigarettes taxed under these provisions to file on a quarterly basis.

Under the bill, the records of purchases and sales of cigarettes that direct marketers are required to keep must indicate the following: the invoice date and number; the quantity of cigarettes shipped; the brand name of the cigarettes shipped; the manufacturer of the cigarettes shipped and the point of origin; the purchaser's name, address, and birth date; the name of the person to whom the cigarettes were shipped; the address to which the cigarettes were shipped; and any other information DOR requires. This information would be required for each shipment of cigarettes into the state in the month preceding the verified report described above.

**Personal Liability.** The bill would provide that any officer, employee, fiduciary, or agent who is responsible for paying taxes, interest, penalties, or other charges incurred by another person is personally liable for those taxes, interest, penalties or other charges. Certain provisions related to appeals of income or franchise tax assessments would apply to appeals of assessments related to the administration and enforcement of cigarette taxes.

**Theft of Tax Moneys.** Current law provides that all cigarette tax moneys received by a distributor or manufacturer for the sale of cigarettes on which the cigarette tax has become due and has not been paid are trust funds in the hands of the distributor or manufacturer and are the property of this state. In addition, any distributor or manufacturer who fraudulently withholds, appropriates, or otherwise uses cigarette tax moneys that are the property of the state is guilty of theft, regardless of whether or not the person has or claims to have an interest in the moneys. These provisions would be modified to also apply with respect to bonded direct marketers.

**Seizures.** Current law provides that all cigarettes acquired, owned, imported, possessed, kept, stored, made, sold, distributed, or transported in violation of the cigarette tax statutes, and all personal property used in connection therewith is unlawful property and subject to seizure by the Secretary of DOR or any peace officer. If cigarettes that do not bear the proper tax stamps or on which the tax has not been paid are seized under these provisions, they may be given to law enforcement officers for use in criminal investigations or sold to qualified buyers by DOR, without notice. If the cigarettes are sold, the proceeds of the sale, after deducting for costs of the sale and the keeping of the property, are to be paid into the state treasury. The Secretary of DOR may also order the cigarettes to be destroyed or given to a charitable or penal institution for free distribution to patients or inmates. Under the bill, these provisions would apply to any cigarettes that have been seized as a result of violations of the cigarette tax statutes (not just those that do not bear a tax stamp or on which the tax has not been paid).

**Class I Felony.** The bill would provide that any person who manufactures or sells cigarettes in this state without holding the proper permit under the cigarette tax statutes is guilty of a Class I felony. The penalty for a Class I felony is a fine, not to exceed \$10,000, or imprisonment, not to exceed three years and six months, or both. Under current law, any person

who manufactures or sells cigarettes in this state without holding the proper permit would be subject to the general penalty for violations of the cigarette and tobacco products tax statutes for which no other penalty is provided, which includes a fine of \$100 to \$1,000, imprisonment for 10 to 90 days, or both.

**Prosecutions by Attorney General.** Under current law, upon request by the Secretary of DOR, the Attorney General may represent this state or assist a district attorney in prosecuting any case arising under the cigarette tax statutes. The bill would extend this authority to violations of Chapter 134 involving cigarette and tobacco products retail licenses and restrictions on sales and gifts of such products.

### **Modifications To Tobacco Products Tax Statutes**

In order to permit and regulate the direct marketing of tobacco products, the bill would make the following modifications to the tobacco products tax statutes under Chapter 139:

#### **Definitions**

The bill would create the following definitions:

a. "Direct marketer" would mean any person who solicits or sells tobacco products to consumers in this state by direct marketing;

b. "Direct marketing" would mean publishing or making accessible an offer for the sale of tobacco products to consumers in this state, or selling tobacco products to consumers in this state, using any means by which the consumer is not physically present on a premise that sells tobacco products;

c. "Person" would mean any individual, sole proprietorship, partnership, LLC, corporation, association, or any owner of a single-owner entity that is disregarded as a separate entity under the income tax statutes; and

d. "Identification card" would reference the meaning provided under Chapter 134, as described above with respect to the cigarette tax.

The bill would also modify a number of definitions under the current tobacco products tax statutes. Currently, a "consumer" means any person who has title to, or possession of, tobacco products in storage for use or other consumption in this state. The bill would change the definition to mean any individual who receives tobacco products for his or her own personal use or consumption or any individual who has title to, or possession of, tobacco products for any purposes other than sale or resale.

Under current law, a tobacco products "distributor" means, among other things, any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from outside the state any tobacco products for sale. The bill would

change this definition to specify that "distributor" would mean, among other things, any person in this state engaged in the business of selling tobacco products who brings, or causes to be brought, into this state from outside the state any tobacco products for sale (underline added to emphasize the location of the phrase "in this state"). These modifications would clarify current law and reflect current practice.

The current definition of "distributor" also includes any person engaged in the business of selling tobacco products outside this state who ships or transports tobacco products to retailers in this state to be sold by those retailers. The proposal would modify this definition to refer to any person outside this state engaged in the business of selling tobacco products who ships or transports tobacco products to retailers in this state to be sold by those retailers (underline added to emphasize location of the phrase "outside of this state"). These modifications would clarify current law and reflect current practice.

The definition of "distributor" would also be expanded to include any person outside this state engaged in the business of selling tobacco products who ships or transports tobacco products to consumers in this state. Under this provision, a person outside this state that sells tobacco products to consumers in the state through direct marketing would be defined as a distributor (in addition to a direct marketer) and would be required to obtain a permit as a distributor (in addition to a permit as a direct marketer). The modification is intended to make it clear that a direct marketer would be responsible for collecting and remitting the excise tax on tobacco products and also for submitting to DOR required reports on any wholesale sales of tobacco products made by the direct marketer.

"Retail outlet" is currently defined to mean each place of business from which tobacco products are sold to consumers. The bill would clarify that the definition applies to such products sold to consumers by a retailer.

A "retailer" is currently defined to mean any person engaged in the business of selling tobacco products to ultimate consumers. The bill would delete this definition and replace it with a reference to the definition under Chapter 134, which means any person with a municipal cigarette or tobacco products retailer license.

### **Tobacco Products Tax and Associated Permits**

With certain exceptions, the bill would specify that no person could possess tobacco products in this state unless the excise tax on tobacco products is paid on such products, and that no person other than a distributor with a valid permit under these provisions could import into this state tobacco products for which the tobacco products tax has not been paid.

Currently, no person may engage in the business of a distributor or subjobber of tobacco products at any place of business unless that person has filed an application for and obtained a permit from DOR to engage in that business at such place. The bill would similarly prohibit a

person from engaging in the business of a direct marketer of tobacco products without a proper permit.

### **Direct Marketing of Tobacco Products**

The bill would prohibit a person from selling tobacco products by direct marketing to consumers in this state as a direct marketer or soliciting sales of tobacco products to consumers in this state by direct marketing unless the person has obtained a permit from DOR to make such sales or solicitations. The person would have to file an application for a permit with DOR, in the manner prescribed by the Department, and submit a \$500 fee with the application.

No person could be issued a direct marketing permit unless the person holds a valid tobacco products distributor's permit.

Under current law, the following provisions that apply with respect to cigarette permits also apply in the case of tobacco products wholesaler permits: (a) the provisions requiring denial of a permit by DOR to persons who have been convicted of certain crimes; (b) requirements related to certification from the Department of Financial Institutions before a foreign corporation or a foreign LLC may be granted a permit; and (c) the requirements that: a separate permit be issued for each class of permittee; that the holder of any permit could only perform the operations thereby authorized; that such a permit could not be transferred among persons or premises; and that a separate permit would be needed for each place where tobacco products are stored for sale at wholesale, through vending machines, through direct marketing, or through multiple retail outlets. The bill would also provide that these requirements apply in the case of a permit for direct marketing of tobacco products. (It should be noted, however, that the reference under these provisions in the bill to the requirement described under "c" is incorrect, and refers, instead, to a provision related to cigarette tax stamps. The administration has indicated that the reference should be corrected to accomplish the intent of the bill.)

No person could be issued a permit under these provisions unless the person certifies to DOR, in the manner prescribed by the Department, that all tobacco product sales to consumers in this state will be credit card transactions; that the invoice for all shipments of tobacco product sales from the person will bear the person's name, address, and permit number; and that the person will provide DOR any information the Department considers necessary to administer these provisions.

No person could sell tobacco products by direct marketing to consumers in this state unless the tobacco products tax and sales or use tax have been paid with regard to such products.

No person could sell tobacco products to consumers in this state by direct marketing unless the person: (a) verifies the consumer's age, using a mechanism approved by DOR; (b) receives from the consumer, at the time of purchase, a copy or facsimile of an identification card and the name specified on the card matches the name of the consumer; or (c) uses another mechanism approved by DOR to verify the age and identity of the consumer.

Any person who, without having a valid direct marketing permit, sells or solicits sales of tobacco products to consumers in this state by direct marketing would have to pay a penalty to DOR of the greater of \$5,000 or an amount that is equal to 50% of the tax due on the tobacco products the person sold, without having a valid permit, to consumers in this state by direct marketing.

No tobacco products could be shipped to a person who is under 18 years of age or to a post-office box. Every package used to ship tobacco products that are sold as provided under these provisions and delivered to a person in this state would have to be clearly labeled to indicate that the package contains tobacco products and may not be delivered to a person who is under 18 years of age.

## **Additional Provisions**

### **Provisions Affecting Both Cigarette and Tobacco Products Tax Statutes**

The following modifications would apply to both the cigarette and tobacco products tax provisions.

**Salespersons of Cigarettes and Tobacco Products.** Current law provides that no person may sell or take orders for cigarettes or tobacco products for resale in Wisconsin for a manufacturer or permittee without first obtaining a salesperson's permit from DOR. Further, under current law no manufacturer or permittee can authorize a person to sell or take orders for cigarettes or tobacco products without that person having secured a salesperson's permit. Currently, DOR must issue the required number of permits to manufacturers and permittees who hold a valid business tax registration certificate. Each application for a permit must disclose the name and address of the employer, and the permit will remain effective only while the salesperson represents that employer. If the salesperson is later employed by another manufacturer or permittee, the salesperson must obtain a new salesperson's permit. Each manufacturer or permittee is required to notify DOR within 10 days after the resignation or dismissal of a salesperson holding a permit.

The bill would modify these requirements to provide that: (a) no person in this state could sell or solicit sales of cigarettes or tobacco products unless the person has filed for and obtained a valid Wisconsin business tax registration certificate and a salesperson's permit; (b) no permittee could authorize a person to sell or take orders for cigarettes or tobacco products without that person having secured a valid Wisconsin business tax registration certificate and a salesperson's permit; (c) no person could authorize the sale or solicitation of cigarettes or tobacco products in this state unless that person had a valid business tax registration certificate and a valid permit under the cigarette or tobacco products tax statutes; and (d) soliciting sales of cigarettes or tobacco products would be covered under these provisions in addition to actual sales. References to employers of salespersons would be modified so that brokers soliciting sales on behalf of a person other than an employer would be subject to the same requirements as those applicable to a salesperson of an employer. In addition, certain references to a "manufacturer and

a permittee" would be changed to a "permittee." (Under the bill, a "permittee" would include any manufacturer manufacturing or selling in this state.)

**Penalties for Failure to Keep Required Records or to Allow Inspection.** Under current law, any cigarette or tobacco products permittee who fails to keep the records required under the cigarette or tobacco products tax statutes may be fined not less than \$100 nor more than \$500 or imprisoned not more than six months or both. The proposal would, instead, specify that the penalty for a first offense would be a fine of \$500 to \$1,000. For a second or subsequent offense, the penalty would be a fine of \$1,000 to \$5,000, imprisonment for up to 180 days, or both.

Currently, any person who refuses to permit any examination or inspection of its premises or records as authorized under the cigarette or tobacco products tax statutes may be fined not more than \$500 or imprisoned not more than 90 days or both. The proposal would increase the penalty to a fine of \$500 to \$1,000, imprisonment for up to 180 days, or both.

**Other Penalties.** Under current law, in addition to the penalties imposed for violations of the cigarette or tobacco products tax statutes or any of the rules of DOR, the permit of any person convicted must be automatically revoked and he or she may not be granted another permit for a period of two years following the revocation. Under the bill, revocation of the permit would automatically occur after a second or subsequent conviction and would be for a period of five years, during which the person could not act as the employee or agent of a cigarette permittee to perform acts authorized by any permit issued under the cigarette tax provisions.

#### **Effective Date and Estimated Fiscal Effect**

These provisions would take effect on July 1, 2006. The administration estimates that the direct marketing provisions would result in additional cigarette and tobacco products tax revenues of \$1,105,000 in 2006-07 and additional program revenue from permit fees in 2006-07 of \$161,500. The program revenue would be transferred to the general fund as GPR-Earned.