

HOUSE BILL REPORT

HB 2565

As Reported by House Committee On:
Business & Financial Services
Ways & Means

Title: An act relating to persons who operate a roll your own cigarette machine at retail establishments.

Brief Description: Providing for the operation of roll your own cigarette machines at retail establishments.

Sponsors: Representatives Kirby, Harris, Dammeier, Walsh, Orwall, Kelley, Moscoso and Zeiger.

Brief History:

Committee Activity:

Business & Financial Services: 1/24/12, 1/27/12, 1/31/12 [DPS];
Ways & Means: 2/6/12, 2/27/12 [DP2S(w/o sub BFS)].

Brief Summary of Second Substitute Bill

- Requires retailers providing roll-your-own cigarette machines to collect the state cigarette tax.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Kirby, Chair; Kelley, Vice Chair; Bailey, Ranking Minority Member; Hudgins, Hurst, Kretz, Pedersen, Rivers and Ryu.

Minority Report: Do not pass. Signed by 3 members: Representatives Buys, Assistant Ranking Minority Member; Blake and Condotta.

Staff: Jon Hedegard (786-7127).

Background:

Definition of Cigarette.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

"Cigarette" is defined as "any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains: (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition." The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

Definition of Manufacturer.

"Tobacco Product Manufacturer" means an entity that:

- manufactures cigarettes anywhere intended to be sold in the United States, including cigarettes intended to be sold in the United States through an importer except excluded by meeting the criteria in the Tobacco Master Settlement Agreement (Master Settlement);
- is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or
- becomes a successor of an entity described above.

Tobacco products are subject to various taxes, including state retail sales and use taxes and tobacco taxes that are paid by wholesalers or distributors of the products in the state.

Cigarette Taxes.

The cigarette tax is added directly to the price of cigarettes before the sales tax is applied. The cigarette tax is due from the first person who sells, uses, consumes, handles, possesses, or distributes the cigarettes in the state. The taxpayer pays the cigarette tax by purchasing cigarette tax stamps that are placed on cigarette packs. On May 1, 2010, the cigarette tax rate was increased from \$0.10125 to \$0.15125 per cigarette (from \$2.025 to \$3.025 per pack of 20 cigarettes).

Taxpayers pay the tax by purchasing cigarette tax stamps from banks authorized by the Department of Revenue (Department). The stamps are placed on cigarette packs. A licensed wholesaler may possess cigarettes for a reasonable period before affixing stamps. Except for licensed wholesalers, it is unlawful to possess unstamped cigarettes unless the possessor files a notice of intent to possess with the Department before receiving the cigarettes. It is unlawful for any person to place a cigarette tax stamp on a package of cigarettes unless the brand family is on the list on the Attorney General's website. Cigarettes without tax stamps are contraband and subject to seizure if in the possession of anyone other than a licensed wholesaler or a person who filed a notice of intent to possess.

Tobacco Products Taxes.

The tobacco products tax applies to all tobacco products, except cigarettes, which are taxed separately. Examples of tobacco products include cigars, pipe tobacco, snuff, and chewing tobacco. The tobacco products tax is due from the distributor when the distributor brings tobacco products into the state, manufactures tobacco products in the state, or ships tobacco products to retailers in the state.

Beginning May 1, 2010, the tobacco products tax was increased from 75 percent to 95 percent of the taxable sales price, with some exceptions. The tobacco products tax rate is 95 percent of the wholesale price, with some exemptions (cigars and snuff) but for cigars the tax is capped at 50 cents per cigar. The wholesale price is, generally, the actual purchase or selling price charged by the manufacturer or distributor. These tobacco products are not subject to any stamp requirement.

Master Settlement.

The Master Settlement is an agreement between 46 states, the District of Columbia, six territories, and a number of tobacco product manufacturers (participating manufacturers). Under the agreement, participating manufacturers agree to make specified payments to the states and agree to abide by extensive public health restrictions on the advertising, promotion, and marketing of cigarettes. In exchange, the states agreed to release the participating manufacturers from claims by the states. Tobacco product manufacturers that did not sign the agreement (non-participating manufacturers) were not released from potential state claims and did not undertake any of the payment obligations or agree to abide by the public health restrictions. In order to ensure that any state that successfully sues a non-participating manufacturer in the future will have a fund against which they can recover any judgment or settlement moneys, the agreement included a proposed statute (Model Statute) which requires non-participating manufacturers to make annual payments into an escrow fund based on the number of cigarettes sold in the state. The Model Statute is also intended to prevent non-participating manufacturers from reaping a windfall benefit by selling cigarettes in a state without bearing the costs that cigarette smoking imposes on the state. Washington enacted the Model Statute in 1999.

Tobacco Manufacturers.

Every tobacco manufacturer must provide an annual certification to the Attorney General. For participating manufacturers, the certification must include a list of brand families. A brand family means all styles of cigarette sold under a particular brand name. For non-participating manufacturer's, the certification must include additional information about the number of units sold under each brand family.

A non-participating manufacturer must also certify that it:

- is registered to do business in the state, or has appointed an agent for service of process;
- maintains an escrow fund approved by the state;
- is in full compliance with the escrow statute; and
- identifies the financial institution where it has established the escrow fund and identifies all deposits and withdrawals to and from the fund. All manufacturers must accept responsibility for the brands they have listed, in terms of compliance with the Model Statute or the escrow requirements.

The Attorney General must publish on its website a list of the brand families of tobacco manufacturers who have complied with the certification and escrow requirements.

Foreign and nonresident non-participating manufacturers must provide an agent in this state for receipt of legal process. Non-participating manufacturers must provide information to the Attorney General as requested on the amount of money and activity in escrow accounts. Wholesalers and distributors of cigarettes must provide quarterly reports to the Director of the Department on sales of cigarettes and make available invoices and documentation of sales. Wholesalers, distributors, and manufacturers must provide information to the Department, Liquor Control Board (Board), or Attorney General as requested to show compliance.

Tobacco Prevention and Control Account.

The Tobacco Prevention and Control Account (TPC Account) and the Tobacco Settlement Account were created in 1999, following Washington's entry into the Master Settlement. Revenue for the TPC Account comes from the Tobacco Settlement Account, investments, donations, and other revenue directed by law. Expenditures from the TPC Account are subject to appropriations.

Tobacco Tracking Code.

Within one year of the date that the federal government requires a tobacco code to track tobacco products, all individual packages must contain the code that would verify if taxes have been paid on the product. If the federal government does not implement a tobacco code by July 1, 2011, the Department must, by July 1, 2014, recommend to the Legislature a method of determining whether tax has been paid on a product.

Tobacco Sales Regulation.

A retailer that sells tobacco products must be licensed and must comply with laws that:

- provide signage standards;
- limit access to minors; and
- prohibit sampling.

The Board may impose sanctions for statutory violations.

Enforcement.

The Board may revoke or suspend the license of any wholesaler who violates tax and stamping provisions. The Board or Department may impose civil penalties for a violation, not to exceed the greater of 500 percent of the retail value of the cigarettes or \$5,000. The Attorney General may seek a court injunction to restrain a threatened or actual violation. It is a gross misdemeanor to sell, distribute, or possess cigarettes with tax stamps that have been affixed in violation of the requirements. Cigarettes not in compliance with the tax stamp requirements may be seized as contraband.

The Attorney General may bring a Consumer Protection Action to enforce laws regarding tobacco manufacturers.

Summary of Substitute Bill:

Every owner or retailer of a machine that enables the person to process a product made or derived from tobacco into a roll or tube is a manufacturer of cigarettes for the purposes of the statutes on:

- the Master Settlement;
- tobacco product manufacturers; and
- taxes on cigarettes.

The resulting product made or derived from processing tobacco into a roll or tube is a cigarette.

A retailer is prohibited from permitting the use of the machine by a person:

- with tobacco, rolls, or tubes that are not purchased from that retail establishment; and
- at a time that is not contemporaneous to the time of the purchase of the tobacco, rolls, or tubes.

Substitute Bill Compared to Original Bill:

A retailer may allow a person to process a product made or derived from tobacco into a roll or tube by use of a machine. A machine owner is deemed to be a manufacturer. An operator of a machine is no longer deemed to be a manufacturer. A retailer is prohibited from permitting the use of the machine by a person: (1) with tobacco, rolls, or tubes that are not purchased from that retail establishment; and (2) at a time that is not contemporaneous to the time of the purchase of the tobacco, rolls, or tubes.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on January 31, 2012.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) The high cigarette taxes in this state lead to creative ways to avoid the taxes. There are a number of factors that need to be weighed as this issue is considered, including lost revenue, the impact on the entrepreneurial spirit, the increase in regulation, and the inability to fund some state priorities. The purpose of this bill is to have that discussion. If a manufacturer faces extensive regulation and high taxes, there is a concern that a competitor that does not have to comply with those laws or pay as high of taxes will undercut the manufacturer's price. There are concerns regarding access for minors. The machines should be banned. If allowed, the retailers with the machines should be under the same rules as a manufacturer. If new revenue is received, it should be deposited into the Youth Tobacco Prevention Account. Tobacco is a leading cause of death in this state. There may be some technical questions and those issues are being worked on. There is a complaint filed with the

Board regarding these machines. The federal government is looking into the use of these machines because of the related taxation issues. Convenience stores pay state and federal cigarette taxes. Convenience stores also pay higher business and occupation taxes and higher sales taxes than the retailers using these machines. Wholesalers and manufacturers are subject to a number of laws that are being avoided by the use of a roll your own machine. State cigarette taxes are approximately \$30 a carton under state law and another \$10 a carton under federal law. Several tobacco manufacturers are subject to the Master Settlement. Those manufacturers pay millions of dollars based on market share. The amount will drop as their market share drops. The state has some of the highest taxes in the country. This provides incentive to roll your own cigarettes and to traffic in contraband cigarettes. The amount of state taxes lost to these roll your own products may be as high as \$26 million. Manufacturers are subject to fire safe paper laws. These machines are not required to use fire safe paper. This is a safety issue. The neighborhood stores comply with the law and get undercut on price. These machines are spreading quickly across the state. Roll your own stores exploit a tax loophole and threaten the existence of stores that play by the rules. It costs the state money now and it will cost more in the future. There should be a level playing field for everyone who sells cigarettes. High taxes drive consumers across state lines. Retailers support open and fair competition on level playing fields.

(Opposed) These are legal businesses that pay taxes and follow applicable laws. This bill will close 65 stores and cost the state 250 jobs. Other states have looked into this issue and declined to act. This bill is an attempt to restrict competition. This issue is being litigated in federal court. Customers must roll their own cigarettes. They can do it at home or by renting a machine. The use of a machine is an option. Most customers are over 40 years old. Most customers are long-term smokers. While there may be some concerns with materials or tobacco brought into a retailer, most would generally allow the rental of the machine for rolling another's tubes or tobacco. It takes time to use these machines. Most people will not wait the 10 to 20 minutes in order to save \$30 to \$40. It would be impossible for a retailer to comply with the federal requirements for manufacturers. There are federal preemption issues. This bill would lead to litigation. Casinos sell major brands for the cost of the roll your own cigarettes. Customers can track their preferences and tailor their smokes to their preferences. Many customers used to shop for cigarettes in Idaho or Oregon. This product is often chosen by people with lower incomes. The Attorney General opposes the bill. The approach in the bill is to involve the Master Settlement. This approach is not in the best interest of the state. There is an ongoing dispute about the amount of money owed under the Master Settlement. This bill would possibly weaken the state's arguments in that dispute. There are other ways to address the issue. Arkansas simply banned the machines. Other states are considering such a ban. There would be no federal preemption issues and the state's position in the disputes regarding the Master Settlement would not be threatened.

Persons Testifying: (In support) Representative Kirby, prime sponsor; Mary Selecky, Secretary of Health; T.K. Bentler, Washington State Association of Neighborhood Stores; Dylan Doty, Washington Fire Chiefs; Jeannie Lee, Korean American Grocers Association; Craig Haines, Harbor Wholesale Foods; and Mark Johnson, Washington Retail Association.

(Opposed) Ron Main, Roll Your Own Machine Rentals LLC; Joe Baba and James Salter, Roll Your Own Northwest LLC; Wayne Brown; Jeanne Wood, Butts Tobacco; Chuck Bertrand, Pay Less Smokes; and Robert Fallis, Office of the Attorney General.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON WAYS & MEANS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Business & Financial Services. Signed by 19 members: Representatives Hunter, Chair; Darneille, Vice Chair; Hasegawa, Vice Chair; Bailey, Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Carlyle, Cody, Dickerson, Haigh, Haler, Hudgins, Hunt, Kagi, Kenney, Pettigrew, Ross, Seaquist, Springer and Sullivan.

Minority Report: Do not pass. Signed by 8 members: Representatives Alexander, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Chandler, Hinkle, Ormsby, Parker, Schmick and Wilcox.

Staff: Rick Peterson (786-7150).

Summary of Recommendation of Committee On Ways & Means Compared to Recommendation of Committee On Business & Financial Services:

The second substitute bill eliminates the provision of the substitute bill that makes a roll-your-own (RYO) retailer a manufacturer for purposes of the tobacco master settlement agreement (MSA). The second substitute bill establishes a tax enforcement and regulatory system for RYO cigarettes by requiring RYO retailers to: purchase tax stamps that must be affixed to the containers provided by the retailer and used by consumers to transport RYO cigarettes from the retailer's place of business; pay an additional \$100 annual RYO retailer licensing fee; use only RYO tobacco that meets certification requirements related to the MSA; and use only commercial RYO machines that have metering devices.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 27, 2012.

Effective Date of Second Substitute Bill: The bill takes effect on July 1, 2012.

Staff Summary of Public Testimony:

(In support) If these machines are in Washington then the cigarettes should be taxed. Some of the money should go into the tobacco prevention account. These machines are popping up all over the state. The price for a carton of these cigarettes is \$36.50 compared to up to \$80 for a carton of regular cigarettes. The Washington Association of Neighborhood Stores (WANS) has invested in land and brick and mortar stores. Cigarette sales represent up to 35 percent of revenue in a convenience store. There are 4,000 convenience stores around the state with thousands of employees. Washington is one of the highest cigarette tax states and the WANS is playing by the rules and needs your help to stop the bleeding.

(Opposed) The bill adds the cigarette tax to existing loose tobacco taxes. This makes the total tax higher than pre-manufactured cigarettes. If the bill passes, all our stores will shut

down. Our customers will not switch to store bought cigarettes. Three to 4 percent of cigarette smokers roll their own cigarettes, including cigarettes rolled by our machines. These consumers will continue to roll their own cigarettes. The fiscal note is incorrect. Our 65 stores are averaging slightly over 30,000 cartons per month. Our customers will return to four different sources: roll your own; internet and gray market; cross border sales; and Indian stores. We are willing to discuss being taxed in a fair way. We are playing by the rules. We are paying all the applicable taxes. This bill is not leveling the playing field but shutting us down – letting Goliath beat David. Our store makes 25 cartons a day. There are 80 convenience stores in our area. Our sales represent only three packs a day for each store. Our sales are not devastating to the convenience stores in any way. The other tobacco products' tax rate is 95 percent; this should be sufficient for the state. Our customers roll their own now. They cannot afford to buy cigarettes in regular stores. We are not taking sales away from other stores. There will be 65 empty buildings. We are helping the economy. This will ruin lives. We have invested our life savings. It will be devastating to shut us down.

Persons Testifying: (In support) Mary Selecky, Department of Health; and T.K. Bentler, Washington Association of Neighborhood Stores.

(Opposed) Ron Main, Joe Baba, and Joshua Baba, Roll Your Own Northwest; Jean Wood, Butts Tobacco; Joni Bragg, Tobacco Tavern; Lisa Suave; Ron Bromfield; Wayne Brown; Rebecca Rice; Renee Goodall; Kandis Hougardy; and Larry Wood.

Persons Signed In To Testify But Not Testifying: None.