

# SENATE BILL REPORT

## ESB 6623

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As of Third Reading

**Title:** An act relating to state government.

**Brief Description:** Concerning tobacco by clarifying cigarettes produced from roll-your-own machines are subject to the cigarette tax and providing for a special license endorsement for cigar lounges and retail tobacconist shops.

**Sponsors:** Senators Delvin, Ericksen and Swecker.

**Brief History:**

**Committee Activity:** Ways & Means:

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### SENATE COMMITTEE ON WAYS & MEANS

**Staff:** Dean Carlson (786-7305)

**Background:** *Roll-Your-Own-Cigarettes.* 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. Since July 1, 2009, all collected tobacco taxes have been deposited in the state General Fund, except for approximately 21 percent of cigarette taxes that are deposited in the Education Legacy Trust Account (\$83 million in 2009).

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). The additional cigarette tax is deposited in the state General Fund. The amount of cigarette tax deposited into the Education Legacy Trust Account is adjusted to 14 percent of the total cigarette tax to reflect its approximate share of the new total cigarette tax.

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

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unlawful for any person to place a cigarette tax stamp on a package of cigarettes unless the brand family is listed 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 wholesale sales price, with some exceptions (cigars and snuff). 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.

Tobacco Master Settlement Agreement (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 has a fund against which they can recover any judgment or settlement monies, 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. 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.

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 Liquor Control Board (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.

Cigars. Licensing of Cigarette and Tobacco Products Sellers. Persons selling cigarettes or tobacco products in this state are required to hold either a wholesaler or retailer cigarette license or a distributor or retailer tobacco products license (for all tobacco products other than cigarettes) through the Department of Licensing's Master License Service.

The Liquor Control Board (Board) has authority to approve, deny, suspend, or revoke retail, wholesale, or distributor cigarette and tobacco products licenses. If the Board makes an initial decision to deny a license or renewal, or suspend or revoke a license, the applicant may request a hearing under the Administrative Procedure Act.

The Board enforces the tax on tobacco products. The Board's Tobacco Tax Enforcement Unit ensures that people who sell tobacco are properly licensed, have paid the appropriate state taxes, and do not sell tobacco to those under 18 years of age.

Smoking in Places of Employment. In 2005 voters passed Initiative 901, which expanded a ban on smoking in public places to include schools, bars, taverns, bowling allies, casinos, reception areas, at least 75 percent of the sleeping quarters in hotels and motels, and places of employment. A place of employment includes an area under the control of an employer that employees are required to pass through during the course of employment.

**Summary of Bill:** *Roll-Your-Own-Cigarettes.* The definition of cigarette used for excise taxation is modified to explicitly include roll-your-own (RYO) cigarettes. Several new definitions are created including cigarette paper, cigarette tube, commercial cigarette-making machine, and roll-your-own cigarettes.

A tax enforcement and regulatory system for RYO cigarettes is established that requires RYO retailers to:

- purchase tax stamps that must be affixed to the containers that are provided by the retailer and used by consumers to transport RYO cigarettes from the retailer's place of business;
- limit consumer access to a RYO machine;

- pay an additional \$93 annual RYO retailer licensing fee; and
- use only commercial RYO machines that have metering devices.

Retailers that purchase RYO cigarette stamps are provided with compensation to offset the tobacco products tax. The amount is equal to \$0.05 per cigarette.

The provisions relating to roll your own cigarette machines are delayed until 2017.

**Cigars.** Cigar products retailer licensee may apply for a special endorsement as a cigar lounge or a retail tobacconist shop through the Master Licensing System. Applicants must pay a fee and submit an affidavit to the Board certifying several items to obtain the endorsement. The Board determines the form and manner of submission of the affidavit. The Board may request additional documentation or information from an applicant.

Endorsements are effective for the same period as the tobacco products retailer's license. The affidavit, however, must be completed and verified each year by the Board and the appropriate fee paid in full before any endorsement to a tobacco retailer license is issued or renewed. Endorsement decisions must be made by the Board within 21 business days of application. Rejections of an application for an endorsement may be appealed under the same process provided for other licenses issued by the Board.

**Cigar Lounge Endorsement.** An applicant for a cigar lounge endorsement must designate an area for the smoking of tobacco products, which is physically separated from any areas where smoking is prohibited under state law. For the purposes of this requirement, physically separated means an area that is enclosed on all sides by solid, impermeable walls or windows extending from the floor to ceiling with self-closing doors.

The applicant must:

- not allow cigarettes to be smoked in the designated area;
- hold a valid spirits, beer, and wine license from the Board; and
- have a valid uniform business identifier number and have paid all applicable state business and occupation taxes in the year prior to application for endorsement.

In addition, the applicant must obtain a signed letter from a heating, ventilation, air-conditioning, and refrigeration contractor registered with the Department of Labor and Industries, which certifies that the ventilation and exhaust system for the designated area:

- is separate and distinct from the location's general heating, ventilation, and air-conditioning system;
- has an air flow, as calculated in cubic feet per minute, that provides for at least 13 or more air changes within the space served by the ventilation and exhaust system;
- uses the correct quantity of filters recommended by the manufacturer of the ventilation and exhaust system and that those filters have a minimum efficiency rating value of 14 or higher; and
- uses a loose-fill, rechargeable-type sorbent material positioned across the airflow in such a configuration that gaseous contaminants have a residence time of one-tenth of one second or more within the sorbent material.

Each employee who works in the designated area must sign an acknowledgment that the employee has been advised of and accepts that environmental tobacco smoke may be present in their potential work area. The applicant must maintain the acknowledgement on file.

The applicant must post signage indicating that environmental tobacco smoke may be present in the designated area. This signage must be in the form and manner provided by the Board and must be placed in a conspicuous location at each entry to the designated area.

Retail Tobacconist Shop Endorsement. An applicant for a retail tobacconist shop endorsement must be an establishment whose primary purpose is the sale of tobacco products and tobacco product related paraphernalia and that is physically separated from any adjacent location where smoking is prohibited under state law. For the purposes of this requirement, physically separated means an area that is enclosed on all sides by solid, impermeable walls or windows extending from the floor to ceiling with self-closing doors.

The applicant must:

- not allow cigarettes to be smoked in the designated area;
- prohibit entry into the designated area to any person under the age of 18; and
- have a valid uniform business identifier number and have paid all applicable state business and occupation taxes in the year prior to application for endorsement.

In addition, the applicant must obtain a signed letter from a heating, ventilation, air-conditioning, and refrigeration contractor registered with the Department of Labor and Industries, which certifies that the ventilation and exhaust system for the designated area:

- is separate and distinct from the location's general heating, ventilation, and air-conditioning system;
- has an air flow, as calculated in cubic feet per minute, that provides for at least 13 or more air changes within the space served by the ventilation and exhaust system;
- uses the correct quantity of filters recommended by the manufacturer of the ventilation and exhaust system and that those filters have a minimum efficiency rating value of 14 or higher; and
- uses a loose-fill, rechargeable-type sorbent material positioned across the airflow in such a configuration that gaseous contaminants have a residence time of one-tenth of one second or more within the sorbent material.

Each employee who works in the designated area must sign an acknowledgment that the employee has been advised of and accepts that environmental tobacco smoke may be present in their potential work area. The applicant must maintain the acknowledgement on file.

The applicant must post signage indicating that environmental tobacco smoke may be present in the establishment. This signage must be in the form and manner provided by the Board and must be placed in a conspicuous location at each entry to the designated area.

Fees. To obtain a cigar lounge endorsement, a licensee must pay a \$17,500 fee. The fee for a retail tobacconist shop endorsement is \$6,000. Up to 5 percent of the fees collected must be deposited into the Liquor Revolving Account to cover the administrative costs of implementing and enforcing the license endorsements. The remaining funds collected must

be deposited into the Tobacco Prevention and Control Account solely for appropriation for tobacco usage prevention and treatment programs.

**Retaliation.** No employer may discharge, threaten to discharge, demote, deny a promotion to, sanction, discipline, retaliate against, harass, or otherwise discriminate against an employee solely for refusing to consent to or sign the acknowledgment required for the endorsements.

**Endorsement Caps.** The Board may not allow the total number of cigar lounge endorsements in the state to exceed 100 or the total number of retail tobacconist shop endorsements in the state to exceed 500. The Board must administer the distribution of cigar lounge or retail tobacconist shop endorsements and must ensure that the collective number of endorsements located in all counties with a population of over 500,000 never exceed one-half of the endorsements allowed for each endorsement.

Renewing applicants must be given priority over new applicants for endorsements.

**Appropriation:** None.

**Fiscal Note:** Available.

[OFM requested ten-year cost projection pursuant to I-960.]

**Committee/Commission/Task Force Created:** No.

**Effective Date:** The bill takes effect on July 1, 2012.

**Staff Summary of Public Testimony on 2E2SHB 2565:** PRO: This bill is a matter of fairness and we urge you to keep it moving. This makes all cigarettes taxed at the same rate. After many policies that have negatively affected convenience stores, this bill helps stop the bleeding. Many people are buying these lower taxed roll your own (RYO) cigarettes at the detriment to the convenience stores.

CON: RYO machines have had little impact on convenience stores, where this bill will put us out of business. RYO products are not half price of all cigarettes. Some products just cost a little more. The people that buy these are looking for the cheaper cigarettes and will continue to do so after we are forced to close. People will go back to the reservations to buy cigarettes. This will put 65 businesses out of business that employ 250 people. Voting for this bill will be a death sentence on these businesses.

**Persons Testifying:** PRO: Mark Johnson, Washington Retail Association; T.k. Bentler, Washington Association of Neighborhood Stores.

CON: Lisa Sauve, Maxx Tobacco; Wayne Brown, U Count Tobacco; Ron Main, RYO Machine Rental.