**Tax Stamps: Cigarettes**

This Act is based on Idaho Senate Bill 21, which became law in 2002. This Act prohibits stamping or paying taxes on cigarettes or roll-your-own tobacco products that are produced by manufacturers that are not participating in the Master Settlement Agreement.

On November 23, 1998 46 states, the District of Columbia and 6 territories reached the Master Settlement Agreement with the four Original Participating Manufacturers (OPMs). The OPMs represent the biggest tobacco companies in the industry. All together Philip Morris, RJ Reynolds, Brown & Williamson, and Lorillard constituted 99% of the cigarette market in 1997. Since 1998, 31 Subsequent Participating Manufacturers (SPMs), which are now subject to all of the terms of the agreement, have signed the MSA as well. The total estimated payout for the states was approximately $206 billion spread over the next 25 years.

In addition to OPMs and SPMs, there are those tobacco manufacturers that have not signed the MSA. These companies are known as non-participating manufacturers or NPMs. In order to hold these companies accountable, all 46 MSA states passed legislation (Exhibit T of the MSA) that forces NPMs to place money in privately established escrow accounts in each state. These accounts ensure that money is available in the event that a state sues an NPM. If states do not win a lawsuit against the NPM, those monies put into the escrow will be released back to the originating company after the 25-year payout plan has expired.

Each of the participating states and territories has been allocated a percentage of the MSA agreement based on the state’s population and the number of cigarette sold in their state. Each year, the payment is subject to a volume adjustment based on the number of cigarettes sold compared to the number of cigarettes sold in 1997.

In addition to the volume adjustment, the payment amount is also subject to an inflation adjustment using the consumer price index and an NPM adjustment. The NPM adjustment is calculated by multiplying the market share loss for the OPM from the previous year by 3 in those states that do not have the model statute in place to hold NPMs accountable or are not enforcing it. In other words a 2 percent loss of marke share by the OPMs would result in a 6 percent reduction in the allocated payment to the settling states. Based on the MSA, a reduction in the total percentage of tobacco sales or a reduction in the market share held by the OPMs could reduce the amount given to the states.

Before the MSA was signed, OPMs manufactured an average 700 billion cigarettes a year, with a peak in 1996 of 754 billion. In addition, the overall consumption of cigarettes declined by 50 billion from 1997 to 2000. Since the MSA was signed, OPMs have begun to lose their dominance over the market. Their market share reduction, which can be attributed to many factors, has been just under 4% over the last three years.

The decline of the OPMs control in the tobacco market has enabled NPMs to garner greater control of the market share. OPMs have been forced to raise the price of their cigarettes to accommodate for the payments to the states, while NPMs that do not pay into escrow accounts have not. Therefore, NPMs have gained those consumers whose preferences are driven by finances.

Currently, states are actually receiving less money than previously forecasted. Reductions to the MSA payments are attributed to a reduction in cigarette sales by OPMs and SPMs, which was a desired result of the MSA, and an NPM adjustment based on the failure to enforce the model NPM statute provided in Exhibit T of the MSA. The MSA payments received by the states as of April 2001 were 10.7 percent below the originally estimated payments. Twelve percent of this reduction (approximately $200 million according to the Kentucky Legislative Research Council), or just over 1 percent of the total estimated payment is due to the NPM adjustment, while the rest can be attributed to the decline in volume shipped by the OPMs. Thus, the majority of the reduction in settlement payments is a direct reciprocation of the decline in smokers in the United States, as well as a drop in a volume of cigarettes sold. If the trend continues states will not receive all of the money once thought to be guaranteed based on the MSA.

If current trends continue, the states could suffer $14 billion in lost revenue over the next 9 years. According to a United States General Accounting Office report, states have received $1.6 billion less than originally projected under the Master Settlement Agreement (MSA). Based on MSA projections states are
expecting to receive nearly $70 billion from the tobacco industry through 2010, but latest estimates show a 20% reduction in these payments. The decrease is attributed to continuing decline in the consumption of cigarettes at a rate of 1.5% each year, and NPMs garnering a 0.8% greater share of the market each year. By gaining market share at their current pace the NPMs could cost the states $2.4 billion dollars. In an effort to stop NPMs from gaining market share, some states are proposing legislation that would levy an additional tax on the cigarettes sold by NPMs, e.g., South Dakota Senate Bill 21, 2002.

Submitted as:
South Dakota
SB 21 (enrolled version)
Status: enacted into law in 2002.

Suggested State Legislation

(Title, enacting clause, etc.)

Section 1. [Short Title.] This Act may be cited as “An Act to Prohibit Tax Stamping or Payment of Taxes on Cigarettes or Roll-Your-Own Tobacco Products Produced by Certain Nonparticipating Manufacturers and to Provide for the Creation of a Directory for Compliant Nonparticipating Manufacturers.”

Section 2. [Conditions for Affixing a Cigarette Tax Stamp.] No distributor or wholesaler may, directly or indirectly, affix the [state] cigarette tax stamp or imprint to a package of cigarettes, or pay the [state] cigarette tax on roll-your-own tobacco product, manufactured or sold by a tobacco product manufacturer unless:

(1) The manufacturer is a participating manufacturer as that term is defined in [insert citation]; or

(2) The manufacturer is a nonparticipating manufacturer in compliance with [insert citation].

Section 3. [Directory of Complying Manufacturers.] The [secretary of revenue] shall annually, no later than [insert date], transmit to all licensed distributors and wholesalers, and post on the [department of revenue’s] website, a directory of nonparticipating tobacco product manufacturers determined by the [secretary] to be in compliance with [insert citation]. The [secretary of revenue] shall amend the directory on the [department of revenue’s] website, as necessary, to include any nonparticipating tobacco product manufacturer determined to be in compliance with [insert citation] after [insert date], or to remove any nonparticipating tobacco product manufacturer subsequently determined not to be in compliance with [insert citation]. The [secretary of revenue] may require distributors, wholesalers, and nonparticipating tobacco product manufacturers to submit such information as the [secretary] may determine is necessary to enable the [secretary] to determine whether a nonparticipating tobacco product manufacturer is in compliance with [insert citation].

Section 4. [Exclusions and Removals from Directory.] Any nonparticipating tobacco product manufacturer excluded or removed from the directory may request a contested case hearing before the [secretary]. A request for hearing shall be made within [sixty (60)] days of the exclusion or removal or the date the manufacturer determined it was in full compliance with this Act and [insert citation], and shall contain the evidence supporting the manufacturer’s compliance with [insert citation]. At the hearing, the [secretary] shall determine whether the nonparticipating tobacco product manufacturer is in compliance with [insert citation], and whether the manufacturer should be listed in the directory.

Section 5. [Violations.] Any stamped cigarettes or roll-your-own tobacco on which taxes have been paid in violation of this Act are contraband goods and may be legally seized, without a warrant, by the [secretary of revenue], [department] agents or employees, or by any law enforcement officer of this state if
directed by the [secretary] to do so. Any tobacco products seized and forfeited under this Section shall be
destroyed. The [department of revenue] may allow a credit for tax paid on contraband cigarettes and roll-
your-own product returned to the manufacturer or distributor from which they were purchased. An Act to
prohibit tax stamping or payment of taxes on cigarettes or roll-your-own tobacco products produced by
certain nonparticipating manufacturers and to provide for the creation of a directory for compliant
nonparticipating manufacturers.

Section 6. [Severability.] [Insert severability clause.]

Section 7. [Repealer.] [Insert repealer clause.]

Section 8. [Effective Date.] [Insert effective date.]