Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE
Revised

House Bill 88 (Chair, Economic Matters Committee and Chair, Ways and Means Committee)(By Request - Departmental - Comptroller)

Economic Matters and Ways and Means Budget and Taxation and Finance

Other Tobacco Products Licenses

This departmental bill requires licensure of other tobacco product (OTP) retailers, wholesalers, storage warehouses, and "tobacconists" that operate in the State as well as any manufacturers that produce OTPs in Maryland. The bill also specifies that OTP wholesalers are generally responsible for paying the OTP tobacco tax, institutes a bond requirement for wholesalers to secure their tax payments, prohibits certain types of OTP sales (*e.g.*, Internet sales), and requires the Comptroller to adopt regulations to carry out the bill's provisions.

These provisions in the bill take effect May 1, 2011, contingent on the successful securing of funding to implement the bill. A requirement to certify a funding source takes effect July 1, 2010.

Fiscal Summary

State Effect: General fund expenditures increase by $72,000 in FY 2011 for one-time expenses to upgrade the Judiciary's e-licensing software. General fund revenues increase by $17,800 in FY 2011 and future years due to license fees collected by the Comptroller. Potential general fund revenue increase beginning in FY 2011 due to increased OTP tax compliance. Potential minimal increase in general fund revenues and expenditures due to the bill's penalty provisions.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	$17,800	$17,800	$17,800	$17,800	$17,800
GF Expenditure	$72,000	-	-	-	-
Net Effect	($54,200)	$17,800	$17,800	$17,800	$17,800

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Minimal increase in revenues due to the issuance of licenses by clerks of the circuit courts. Potential minimal increase in revenues and expenditures due to the bill's penalty provisions from cases heard in the circuit courts.

Small Business Effect: The Comptroller's Office has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: OTPs are cigars or any rolled tobacco (other than a cigarette), that is intended for consumption either by smoking, chewing, or as snuff.

Licensure Requirements for OTP Wholesalers, Manufacturers, Storage Warehouses, and Retailers

The bill requires OTP retailers, wholesalers, storage warehouses, and tobacconists that operate in the State to be licensed. OTP manufacturers must be licensed if they produce OTPs in the State; out-of-state OTP manufactures are not required to be licensed in the State to have their products sold in Maryland. Wholesalers and storage warehouses must maintain an established place of business; wholesalers must also maintain equipment and vehicles necessary for the storage and distribution of OTPs. Licenses for manufacturers, storage warehouses, and wholesalers are issued by the Comptroller; retailers and tobacconists must obtain county licenses, through the appropriate circuit court clerk, for each place of business.

The bill specifies the authorized uses of each type of license. In general, a manufacturer may (1) sell untaxed OTPs to tobacconists or wholesalers inside or outside the State; (2) distribute samples to consumers; (3) store products in a storage warehouse; (4) sell premium cigars or pipe tobacco to a licensed retailer; or (5) on approval from the Comptroller, act as an agent of a Maryland wholesaler for the distribution of OTPs. A wholesaler's license allows the holder to buy, hold, transport, sell, and store OTPs in a specified manner. Licensed storage warehouses may store untaxed OTPs on behalf of a manufacturer, and – if licensed concurrently as a wholesaler – the storage warehouse license authorizes the holder to store products on which the State, or another state's, tobacco tax has been paid. A retailer's license allows a merchant to (1) purchase OTPs from a licensed wholesaler and sell these products to consumers; and (2) purchase untaxed premium cigars or pipe tobacco from manufacturers. A tobacconist is an OTP business that derives at least 70% of its revenues from the sale of OTP and tobacco-related accessories; a tobacconist license authorizes the licensee to buy OTPs from a manufacturer.

License terms are for one year and, unless renewed by the licensee, expire on the first April 30 after the effective date. The annual fee for a wholesaler's license is $250. Manufacturers and storage warehouse licenses are $25, and a retailer's license is $15. Wholesaler and retailers with similar licenses for cigarette sales must still obtain the OTP license, but they are exempt from the license fee. If a licensed business comes under new ownership, a license may be re-assigned in some cases.

Responsibilities of License Holders

Wholesalers must file a tobacco tax return with the Comptroller by the twenty-first day of the month following a month in which the wholesaler possessed OTPs on which the tobacco tax has not been paid. Licensed tobacconists or OTP retailers who purchase specified untaxed OTPs from manufacturers must pay the OTP tobacco tax by filing quarterly tax returns. Licensed OTP manufacturers and storage warehouses must file an information return as required by the Comptroller.

The bill authorizes the Comptroller to require an OTP wholesaler to post a security for payment of taxes equal to $5,000 plus the amount, if any, by which the tobacco tax due for the month exceeds $5,000. The Comptroller may exempt a person from posting security if for the past five years, the person: (1) has been a licensed wholesaler; and (2) has been in continuous compliance with applicable tobacco tax laws and security requirements.

Wholesalers must retain an invoice for each OTP purchase and must keep a record of all OTPs received. For each OTP sale to a retailer or tobacconists, the wholesaler must keep a record of the retailer's or tobacconist's name and address and prepare an invoice that shows the political subdivision where the OTP retailer or tobacconist is located. Wholesalers must make an inventory record each month of all OTPs under the control of the wholesaler and must keep records of all out-of-state sales of OTPs. These records must be kept for six years and are subject to inspection by the Comptroller. A retailer that purchases premium cigars or pipe tobacco from an OTP manufacturer or tobacconist must retain invoices and sales records for two years.

Disciplinary Action and Judicial Process

The Comptroller may deny a license to an applicant, reprimand a licensee, or suspend or revoke a license under certain circumstances, as specified by the bill. The Comptroller may suspend a license for between 5 and 20 business days for a first offense, and up to six months for a subsequent offense. Licenses may be revoked if the licensee engages in acts or omissions that are grounds for disciplinary action as identified by the bill. A licensee may make an offer of compromise, consisting of a sum of money in lieu disciplinary action. Offers of compromise are capped at $2,000 for retailers and $50,000 for other licensees. The Comptroller may only accept an offer of compromise if the payment achieves the desired disciplinary purpose and the public welfare is not impaired by allowing the licensee to continue operation. Money paid in lieu of suspension or revocation is distributed to the general fund.

The bill establishes that licensees have an opportunity for an administrative hearing, before the Comptroller, prior to any final disciplinary action being taken against a licensee. Parties aggrieved by the outcome of the administrative hearing are entitled to a judicial review by the appropriate circuit court and may ultimately appeal to the State court of special appeals.

Other Provisions

Persons in the business of selling or distributing OTPs may not sell or ship any OTP that is ordered or purchased by mail, over the telephone, Internet, or other electronic network to unlicensed recipients. Persons that sell or distribute OTPs in this manner are guilty of a felony, may be fined up to $50 per package of OTPs illegally sold, and/or imprisoned for up to two years.

OTPs are considered contraband products if they (1) are possessed or sold in a manner that is not consistent with the licensing requirements established by the bill; or (2) are transported by vehicle in the State by a person who does not have the records required by the bill. The bill establishes various requirements for the shipment, import, and sale of OTPs. Only OTP brand owners, importers, or their designated agents (in addition to OTP license holders) may participate in these activities. Persons who violate the bill's provisions related to shipment, importation, or sale of OTP are subject to disciplinary action, fines, and imprisonment as specified by the bill.

Transporters of OTPs must have a delivery ticket or invoice in the vehicle that states the quantity and brand of the OTP being transferred as well as the name and address of the seller and the authorized buyer. The Comptroller may require a carrier who transports OTP into the State to submit a copy of any freight bill relating to the OTP shipment.

In general, and unless otherwise specified, violations of the bill are misdemeanor offenses and may result in fines of up to $1,000 and/or imprisonment for up to 30 days. The Comptroller is required to adopt regulations to carry out the provisions of the bill.

The Comptroller and the Administrative Office of the Courts must certify to specified committees of the General Assembly on or before January 1, 2011, that the agencies have entered into a memorandum of understanding specifying a funding source to implement the bill.

Current Law: OTPs are taxed at a rate equal to 15% of the wholesale price. The wholesale price is the price for which a wholesaler buys OTPs, exclusive of any discount, trade allowance, rebate, or other reduction.

The tobacco tax on OTPs is paid by the wholesaler who sells the OTPs to a retailer or consumer. If a retailer or consumer possesses untaxed OTPs, the retailer or consumer is responsible for paying the tax. If the OTP tax is paid by a retailer or consumer, a tax factor is applied to the purchase price of OTPs. The tax factors are established by the Alcohol and Tobacco Tax Bureau on an annual basis. The tax factors are determined on the basis of average markups of OTPs at the wholesale and retail levels and approximate the same tax liability as if the OTP tax were paid by the wholesaler.

An OTP wholesaler is a person who (1) holds OTPs for sale to another person for resale; or (2) sells OTPs to another person for resale. An OTP consumer is a person who (1) possesses OTPs for a purpose other than selling or transporting the OTPs.

The tax on OTPs does not apply to (1) OTPs that a wholesaler is holding for sale outside the State or to a U.S. armed forces exchange or commissary; or (2) a person transporting OTPs by vehicle in the State has records required under Section 16-219 of the Business Regulation Article; or (3) OTPs that a consumer brings into the State if the quantity does not exceed specified amounts.

An OTP wholesaler is required to file a tobacco tax return as specified by regulation. Current regulations require a wholesaler to file a monthly tax return no later than the twenty-first day of each month following the report month, regardless of whether OTPs were sold or not. The return must include all sales of OTPs to retailers and consumers during the report month. A retailer or consumer who is responsible for remitting the OTP tax is required to file quarterly returns. Each return is required to state the wholesale price of OTPs sold during the period that the return covers.

Statute requires the Comptroller to establish, by regulation, a system of administering, collecting, and enforcing the tobacco tax on OTPs.

OTP revenues accrue to the general fund. In addition, the State sales tax of 6% is imposed on the final retail price of OTPs.

While no State OTP licensure requirement currently exists in Maryland, in many cases, wholesalers, retailers, and manufactures of OTPs located in the State must be registered with the Comptroller. All in-state wholesalers and manufacturers must register in order to conduct business in the State, but registration is not required of out-of-state manufacturers and wholesalers. However, retailers – for whom registration is also not mandatory – must register with the Comptroller if they purchase OTPs from out-of-state manufacturers or wholesalers.

Background: Pennsylvania and the District of Columbia do not tax OTPs; all other states require some type of licensure, registration, or permit for OTPs. In some cases an OTP license is separate from other licenses; in other cases the license is a general tobacco products license. The following states require a registration or certificate: New Jersey, Indiana, West Virginia, and New Mexico. All other states require a license or permit for OTPs.

The Comptroller advises that a common scheme of OTP tax evasion is for a wholesaler to purchase untaxed OTPs from an outside source in another state for sale to in-state retailers at a discounted rate. These wholesalers under report taxes owed to the State. Retailers also purchase untaxed OTPs directly from out-of-state wholesalers. Untaxed OTPs are often purchased over the Internet. In 2006, federal alcohol and tobacco enforcement agents uncovered a large mail fraud scheme of distributors selling OTP to retailers and consumers in Illinois and then diverting the money to Florida.

State Revenues: The bill establishes licensing requirements and requires that wholesalers remit all OTP taxes. Under current law, untaxed OTPs can be shipped to retailers and consumers under certain circumstances. Retailers and consumers who receive OTPs on which the tax has not been paid are responsible for paying the OTP tax. The Comptroller's Office advises that requiring wholesalers to remit the OTP tax, except as specified by the bill, will improve tax compliance and OTP tax revenues will increase by a minimum of $100,000 annually. Legislative Services concurs that requiring OTP wholesalers to remit the tobacco tax will likely increase tax compliance beginning in fiscal 2011. The amount of increase in OTP taxes, however, cannot be reliably estimated at this time. Although OTP tax compliance is likely to increase, requiring cigarette wholesalers to remit the tobacco tax has not eliminated the incidence of untaxed cigarettes in the State.

The Comptroller's Office projects that it will issue 120 wholesaler's licenses each year beginning in 2011. Of these wholesalers, it is estimated that 70 do not currently have a comparable cigarette license in the State and are required to pay the $250 licensing fee. The exact number of storage warehouses in the State is not known; Legislative Services assumes that 10 or fewer storage warehouse licenses will be issued beginning in fiscal 2011. The Comptroller's Office advises that there are currently no in-state OTP manufacturers. Further, the Comptroller advises that, although nearly 7,000 retail businesses currently sell cigarettes and OTPs, all such retailers must obtain an OTP license in addition to a cigarette license. However, under the bill, these businesses do not have to pay the OTP retail license fee. The Comptroller's Office expects that 40 tobacconists will be licensed beginning in fiscal 2011. Therefore, Legislative Services assumes 40 tobacconists and only 25 retailers pay the $15 retail OTP license fee beginning in fiscal 2011; the county that issues the license keeps 97% of the revenue from retailer licensing fees and 3% reverts to the general fund. Legislative Services assumes no annual growth in the number of licenses issued by the Comptroller or the counties.

Due to the collection of license fees, general fund revenues increase by $17,750 in fiscal 2011 and in future years. Legislative Services anticipates that 130 wholesalers and storage warehouses establish their licensure in order to be in compliance by May 1, 2011. The general fund also benefits negligibly ($29) from the fee paid by 40 tobacconists and 25 retailers that do not already hold a cigarette retailer license.

General fund revenues also increase due to accepted offers of compromise and criminal penalties from cases heard in District Court. The resulting amount of revenue cannot be reliably estimated but is expected to be minimal.

State Expenditures: In fiscal 2011, general fund expenditures for the Judiciary (Administrative Office of the Courts) increase by approximately $72,000 to update the electronic licensing software used by the agency to meet the bill's requirement that the clerks of the circuit courts issue OTP licenses to local retailers. The Judiciary advises that its electronic licensing system is administered and maintained through a contractual agreement with the Science Applications International Corporation (SAIC). In order to comply with the bill's requirement to issue retail licenses, SAIC must adjust and reanalyze its program and perform initial testing to ensure that the electronic licensing system is functional and capable of registering the new licensees. Instead of using special funds for this purpose, the Comptroller's Office advises that it has identified funds to implement the bill within the Comptroller's existing fiscal 2010 general fund appropriation, which would otherwise be reverted at the end of the fiscal year.

General fund expenditures increase minimally as a result of the bill's incarceration penalties due to more people being committed to Division of Correction (DOC) facilities and increased payments to counties for reimbursement of inmate costs. The number of people convicted of this proposed crime is expected to be minimal.

Persons serving a sentence longer than 18 months are incarcerated in DOC facilities. Currently, the average total cost per inmate, including overhead, is estimated at $2,750 per month. This bill alone, however, should not create the need for additional beds, personnel, or facilities. Excluding overhead, the average cost of housing a new DOC inmate (including variable medical care and variable operating costs) is $409 per month. Excluding all medical care, the average variable costs total $182 per month.

Persons serving a sentence of one year or less in a jurisdiction other than Baltimore City are sentenced to local detention facilities. For persons sentenced to a term of between 12 and 18 months, the sentencing judge has the discretion to order that the sentence be served at a local facility or DOC. Prior to fiscal 2010, the State reimbursed counties for part of their incarceration costs, on a per diem basis, after a person has served 90 days. Currently, the State provides assistance to the counties for locally sentenced inmates and for inmates who are sentenced to and awaiting transfer to the State correctional system. A $45 per diem grant is provided to each county for each day between 12 and 18 months that a sentenced inmate is confined in a local detention center. Counties also receive an additional $45 per day grant for inmates who have been sentenced to the custody of DOC but are confined in a local facility. The State does not pay for pretrial detention time in a local correctional facility. Persons sentenced in Baltimore City are generally incarcerated in DOC facilities. The Baltimore City Detention Center, a State-operated facility, is used primarily for pretrial detentions.

Local Fiscal Effect: As mentioned above, the Comptroller estimates that roughly 40 tobacconists and 25 retailers in the State that do not hold retail cigarette licenses pay the $15 license fee to the appropriate jurisdiction. Therefore, local revenues increase minimally, by about $946, due to the bill. Even so, the Comptroller estimates that nearly 7,000 retailers in the State must obtain an OTP retailer's license. Although these businesses do not have to pay a fee if they hold a cigarette retailer's license, the circuit court clerks must issue a license to every retailer and tobacconist that sells OTPs.

Local revenues increase minimally as a result of the bill's monetary penalty provisions from cases heard in the circuit courts. Expenditures increase minimally as a result of the bill's incarceration penalties. Counties pay the full cost of incarceration for people in their facilities for the first 12 months of the sentence. Per diem operating costs of local detention facilities are expected to range from $57 to $157 per inmate in fiscal 2011.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Judiciary (Administrative Office of the Courts), Department of Legislative Services

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Other Tobacco Products Licenses

BILL NUMBER: HB 88

PREPARED BY: Comptroller of Maryland

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__X__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

___ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

The proposed legislation will have no impact on small business in Maryland.