HOUSE BILL REPORT
HB 2288

As Reported by House Committee On:
Finance

Title: An act relating to improving the administration of taxes by implementing weight-based taxation for moist snuff.

Brief Description: Implementing weight-based taxation of moist snuff.

Sponsors: Representatives Hasegawa, Santos, Buri, Cody, Condotta and Schual-Berke.

Brief History:

Committee Activity:

Finance: 3/1/07, 3/12/07 [DPS].

Brief Summary of Substitute Bill

- Changes the tobacco products tax on moist snuff from 75 percent of the taxable selling price to $2.35 per ounce.
- Modifies the distribution of overall receipts from the tax.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 5 members: Representatives Hunter, Chair; Hasegawa, Vice Chair; Conway, McIntire and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Condotta, Assistant Ranking Minority Member; Ericks and Roach.

Staff: Mark Matteson (786-7145).

Background:

Tobacco Products in General; Snuff. Aside from cigarettes, many types of tobacco products are sold on the market. These include cigars, cheroots, stogies, and periques; granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco; snuff, snuff flour, cavendish, plug and twist tobacco, fine-cut, and other chewing tobaccos. Snuff is a generic term for fine-

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ground smokeless tobacco products and, depending on its form, may be sniffed or dipped. The dipping variety of snuff, also called moist snuff, is typically sold in round tins with a net weight of 1.2 ounces.

Tobacco Products Tax. Tobacco products other than cigarettes are taxed at wholesale in the state based on the price at which manufacturers or distributors sell products to unaffiliated distributors, retailers, or consumers. Tax liability on such products is triggered by the sale, handling, or distribution of such products. The tax rate is 75 percent of the taxable sales price, in general. Cigars for which the taxable sales price is 66.7 cents or more are taxed instead by volume, at 50 cents per cigar. The tax is due when the product is first brought into the state or manufactured in the state. Taxes are reported on the combined excise tax return to the Department of Revenue (DOR).

Retail sales and use taxes are due on tobacco products when the product is sold or acquired at retail.

Receipts from the tobacco products tax are distributed as follows: 37 percent to the State General Fund, 50 percent to the Health Services Account, and 13 percent to the Water Quality Account. In fiscal 2006, $26.6 million was collected.

Modifications to the Tobacco Products Tax in Recent History. In the several years preceding calendar 2002, the aggregate tax on tobacco products was 74.9 percent of the wholesale price. In November 2001, Washington voters adopted Initiative 773, which increased the tax rate to 129.42 percent. The new rate was effective January 2002 and additional revenues were dedicated to health services.

In the 2005 legislative session, the Legislature enacted the current rate, structure, and administration of the tax. In addition to lowering the rate to 75 percent, the tax base was changed from the wholesale price to the price that manufacturers or distributors sell to unaffiliated purchasers or other distributors. The Liquor Control Board (LCB) was made the enforcement authority for the tax; previously, the DOR was legally responsible for enforcement but relied on the LCB by appointing enforcement officers as agents to engage in enforcement activities. For the first time, distributors and retailers were required to be licensed, and criminal penalties were established for failing to obtain a license, transporting tobacco products for sale without a license or prior notification to the LCB, and for several other defined offenses.

Settlement of Recent Litigation. In January 2007, a settlement was reached in litigation brought against the state by the United States Tobacco Sales and Marketing Company, Inc. (UST-Sales), a distributor and wholly-owned subsidiary of the United States Tobacco Company (UST). The litigation involved a 10-year dispute regarding the appropriate tax base that should be applied to the tobacco products tax, with respect to smokeless tobacco products. When the UST first brought the complaint, the tax was measured by the wholesale sales price. The wholesale sales price was defined at the time as the price for which a manufacturer sells product to a distributor, exclusive of any discount or reduction. An appeals court ruled that the price to which tax must be applied is the fair market value of the product.

In September 2005, the court remanded the case to superior court for further proceedings to allow the parties to provide evidence of the price a completely unaffiliated distributor would have paid to purchase the tobacco products from the manufacturing subsidiary of the UST. In June 2006, the Supreme Court granted the petition for review. In January 2007, the parties settled.

Under the terms of the settlement, the DOR has agreed to support work towards the enactment of a weight-based tobacco products tax. The DOR has publicly indicated that it is supportive of a weight-based system because it is simple to administer. The DOR has also publicly noted that the value-based measure (the current ad valorem system) has generated a high number of time-consuming and adversarial disputes between the DOR and taxpayers.

Summary of Substitute Bill:

A weight-based tax base is established under the tobacco products tax for moist snuff, defined as any finely cut, ground, or powdered tobacco not intended for smoking or sniffing. The rate is $2.35 per ounce, with fractional amounts less than an ounce taxed proportionally. The measure is the net weight listed by the manufacturer on the container. Containers with a net weight of less than 1.2 ounces must be taxed at the equivalent of 1.2 ounces: $2.82.

After the first year of implementation, the DOR is required to adjust annually the tax rate by the change in the consumer price index for the Seattle area.

The distribution of tobacco products tax receipts are modified, as follows: 28 percent to the State General Fund; 62 percent to the Health Services Account; and 10 percent to the Water Quality Account.

The DOR is directed to work with tobacco products manufacturers and wholesalers to improve administration of the tax.

Substitute Bill Compared to Original Bill:

The substitute bill increases the proposed tax rate by 25 percent and indexes the tax rate to the Consumer Price Index for the Seattle area.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) Protecting the health of our children and conserving state revenue are two primary reasons for this legislation. The intent is to cut consumption of moist snuff while maximizing state revenue.

This bill also addresses enforcement and administration issues, as well as issues in the marketplace. Because the state is effectively subsidizing cheap snuff, the companies that sell these products are capturing a significant portion of the market, resulting in less revenue to the state. The average tax per can received by the state has gone from $1.80 per can to $1.58 per can since 2003.

This legislation creates a weight-based method of taxation that provides consistency and simplicity, eliminates future litigation, and stabilizes the revenue stream to the state.

(Opposed) This bill amounts to reducing fair competition in the free market system of the United States. Moreover, this is part of a settlement to a lawsuit and should not affect tax policy. This is about a dominant player in the snuff industry that wants to affect the competition of those who are eating into its market share. The tax burden will shift from those who can afford expensive snuff to those who can only afford cheap snuff.

The change in tax policy will also negatively affect convenience stores because moist snuff consumers will return to purchasing their products from the internet, bordering states, and smoke shops.

A reduction in smokeless tobacco use will not result from this change in tax policy, and 25 percent of products will receive a tax decrease.

This legislation will cause more work and increase costs for tobacco products distributors.

Finally, this bill will also reverse legislation enacted just over one year ago.

Persons Testifying: (In support) Representative Hasegawa, prime sponsor; Mark Triplett, U.S. Tobacco Products Association; and Leslie Cushman and Steve Smith, Department of Revenue.

(Opposed) Stan Arnold, Ruth, Young & Pignettelli, Conwood Company; Catarina Wong, Core-Mark International, Inc.; Mike Leake, Washington Association of Neighborhood Stores; Ron Black, Harbor Wholesale; and Nick Federici, American Lung Association of Washington.

Persons Signed In To Testify But Not Testifying: None.