HOUSE
RESEARCH
ORGANIZATION bill analysis 5/4/2013

HB 3536
Otto
(CSHB 3536 by Hilderbran)

SUBJECT: Imposing fees on sales of certain tobacco products

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 6 ayes — Hilderbran, Otto, Bohac, Button, Eiland, Strama

1 nay — N. Gonzalez

2 absent — Martinez Fischer, Ritter

WITNESSES: For — James C. Ho, Altria Client Services; Keith A Teel, Altria, RAI Services Inc, Lorillard Tobacco Company; Rob Wilkey, Commonwealth Brands; Monte Williams, Altria; (*Registered, but did not testify:* Jay Brown, McLane Company; Shannon Lucas, March of Dimes; David Reynolds, Texas Medical Association; Jack Roberts, Liggett-Vector Brands; Kandice Sanaie, Texas Association of Business)

Against — Craig Enoch, Independent Tobacco Escrow Manufacturers; Guillermo Fernandez Quincoces, Dosal Tobacco Corporation; Yolanda Nader, Dosal Tobacco Corp; Mike Walters, Global Tobacco; (*Registered, but did not testify:* Carol Boliter, Global Trading Inc., KT&G USA; Ron Hinkle, Dosal Tobacco, Global Tobacco, KT&G)

On —Pete Polite and Scott Wheat, Alabama Coushatta tribe of Texas; (*Registered, but did not testify:* John Heleman, Comptroller of Public Accounts)

DIGEST: CSHB 3536 would impose a fee on the sale, use, consumption, or distribution of cigarettes and certain other tobacco products made by certain non-settling manufacturers (NSMs) that were not part of the Comprehensive Settlement Agreement and Release of 1998 between Texas and major tobacco producers.

Fees on cigarettes and tobacco products from NSMs. CSHB 3536 would set a fee at 2.75 cents per cigarette or on each 0.09 ounces of cigarette tobacco product produced by NSMs that never participated in the 46-state Master Settlement Agreement, of which Texas was not a member. The bill would set the fee for products made by NSMs that had subsequently participated in the Master Settlement Agreement at 0.75

cents per cigarette or each 0.09 ounce of cigarette-tobacco product. The bill would raise the fee on manufacturers that subsequently participated in the Master Settlement to 2.75 cents if the Master Settlement was amended to allow them to take a credit for the payment of the bill's fee on products sold in Texas.

The bill would direct the comptroller to increase the fee annually by the greater of either 3 percent or the rate of inflation. The comptroller would grant distributors who remitted the fee a three percent discount on their purchases of cigarette stamps.

CSHB 3536 would deposit the collected revenue into the general revenue fund.

Any fees remitted by an NSM under this bill would be applied to any judgment or settlement on a claim against the NSM for costs related to the use or exposure of their tobacco products to the public.

Enforcement. CSHB 3536 would apply the normal penalty provisions provided by the Tax Code for enforcement of similar taxes and fees. The comptroller and the attorney general would be allowed to make audits or inspections of the financial records of an NSM and its distributors to ensure compliance.

Reports. CSHB 3536 would require distributors of NSM-made products to report sales data to the comptroller monthly. Exceptions would made for products sold for resale and consumption out of state or to Indian tribes.

Distributors would calculate and remit appropriate fees under the bill to the comptroller along with the monthly reporting data.

The comptroller would be required to report annually to the independent auditor of the Master Settlement the volume of cigarette sales on which the NSM fee was reported and paid. The data would be listed by manufacturer and brand family.

Chewing tobacco. CSHB 3536 would set the tax rate on chewing tobacco at 80 cents per ounce and proportionately on all fractional parts of an ounce.

Effective date. The bill would take effect September 1, 2013, and would not affect any tax liability accrued before that date.

SUPPORTERS SAY:

CSHB 3536 would help level the playing field in the cigarette marketplace by imposing an equity fee in Texas on cigarette manufacturers that were not parties to the state's tobacco settlement agreement. Forty-eight other states apply either an equity fee or an escrow payment obligation on NSM brands. Texas should join them.

Currently, tobacco manufacturers who are parties to the Texas Tobacco Settlement Agreement pay around $500 million a year to Texas. These funds are used for important programs, such as public health and higher education.

However, tobacco companies that either were not around in the late 1990s or were not present in the Texas market have now increased their market share to around 8 percent. They are able to do this because they have an unfair cost advantage in that they do not make payments to Texas under the settlement. This allows them to undercut the companies that responsibly are making payments.

By imposing an equity fee, CSHB 3536 would help to level the marketplace, allowing producers to compete on quality and value of product.

The bill would include a statement of legislative intent. Its purpose would be to:

- recover health care costs to the state imposed by non-settling manufacturers;
- prevent NSMs from undercutting competition and thus undermining the state's policy of reducing underage smoking;
- protect the tobacco settlement agreement and fund, which has been reduced by the unfair competition posed by NSMs;
- ensure even-handed treatment of manufacturers; and
- provide additional state revenue.

It is estimated that the bill would raise around $40 million a year in general revenue. These new fees would increase the cost of smoking, which would reduce the number of smokers, the frequency with which they smoke, and the amount of secondhand smoke in Texas.

CSHB 3536 would be constitutional. The constitution requires that taxes be equal and uniform. CSHB 3536 would help ensure an equal and level playing field for all tobacco manufacturers, thereby treating them with more equality and uniformity than under current law.

OPPONENTS SAY:

NSMs should not be made to pay fees relating to the Texas Tobacco Settlement Agreement because they either were not in the Texas market at that time or they were not engaging in the kind of anti-consumer behavior in which members to the agreement were allegedly engaging. NSMs should not be penalized for this through the fees CSHB 3536 would impose on them.

CSHB 3536 would crush the NSMs economically. They only way these small producers can compete with the largest tobacco producers is on price. Big tobacco, which is part of the settlement, has giant marketing budgets that little NSMs cannot hope to compete with. Imposing additional fees on them would remove this sole method of participating in the market.

The bill would not bring in the money supporters say it would. The fiscal note says it would produce an indeterminate amount. The Texas Legislature should not bank on the $40 million estimate if the Legislative Budget Board and comptroller refuse to do so.

The bill is likely unconstitutional because it would impose a tax on NSMs that other tobacco producers do not pay. Tobacco producers that are part of the settlement have agreed to make those payments to the state. Fees from CSHB 3536 would not be settled upon payments — they would be an unequal tax.