

Department of Legislative Services
Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 491

(Senator Garagiola, *et al.*)

Budget and Taxation

Tobacco Tax - Tax Stamps

This bill requires a cigarette wholesaler to affix cigarette tax stamps that are capable of being read by a scanner and encrypted with the following information: (1) the name and address of the distributor affixing the stamp; (2) the date the stamp was affixed; (3) the denominated value of the stamp; (4) the cigarette manufacturer; (5) the cigarette brand; and (6) any other information required by the Comptroller. The Comptroller's Office must consult with the Attorney General regarding the use of tax stamp technology in helping the State's enforcement of the Master Settlement Agreement.

The bill takes effect October 1, 2010.

Fiscal Summary

State Effect: General fund revenues and expenditures may increase beginning in FY 2011 due to additional tax compliance. Revenue increases are not expected to be substantial in the near-term. General fund expenditures at the Comptroller's Office may increase by \$700,000 annually beginning in FY 2011 due to the use of encryption technology for the State's tax stamp program.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Except as provided, within 72 hours after receiving cigarettes in the State and before selling or attempting to sell the cigarettes, a licensed cigarette wholesaler who

first possesses the cigarettes must affix, to the smallest cigarette package, tax stamps (1) in a total amount that at least equals the tobacco tax due on the number of cigarettes in the package; and (2) in the manner that the Comptroller requires, including placing the tax stamps on the cigarette package so that the stamps are visible to a buyer. A licensed cigarette wholesaler is not required to affix tax stamps to: sample cigarettes if the cigarette package is marked as required under current law; or cigarettes that are segregated or marked to indicate that the cigarettes were received in the immediately preceding 72 hours or are being held for sale or use that is exempt under this title.

Background: State tobacco tax rate differentials provide substantial incentive to evade tobacco taxes either through organized smuggling or through individuals purchasing cigarettes over the Internet, in bordering states, or in other reduced/tax-free areas. States, including Maryland, lose substantial revenue from the consumption of cigarettes that are not taxed. In response, states have developed several initiatives to curb cigarette smuggling including increased enforcement personnel, interdiction efforts, and enforcement of authority granted to states under the federal Jenkins Act. These efforts have had mixed results.

Encryption technology can improve cigarette tax stamps by making it more difficult to produce counterfeit stamps, allowing for enhanced tracking, and providing for instant verification capabilities. California currently requires encrypted cigarette tax stamps as part of a multi-pronged approach to combat cigarette tax evasion – licensing cigarette-related businesses, increased enforcement activities including personally visiting storefronts, and implementing encryption technology. The combination of these activities has led to a decrease in the estimated amount of cigarette tax evasion in California. However, this does not mean that the stamps are impossible to counterfeit, only more difficult than ordinary stamps. News reports indicate that counterfeit California tax stamps were discovered soon after the introduction of encrypted technology. Several states are currently considering requiring the use of encrypted technology. Adopting encryption technology will address one specific type of tax evasion – the use of counterfeit stamps. Encryption technology will not prevent tax evasion from any other forms of tax evasion such as individuals purchasing cigarettes over the Internet or in bordering states.

The Field Enforcement Division of the Comptroller's Office has 6 inspectors and 16 agents who routinely inspect cigarette retailers and are trained to identify counterfeit stamps. Each agent and inspector has a pigment detector that verifies the authenticity of the stamp. The Comptroller currently expends approximately \$300,000 for the current tax stamp program. During fiscal 2008, the division conducted 5,107 cigarette retail inspections. The division also conducts criminal investigations related to illegal cigarette trading. No investigation or inspection to date has identified or seized counterfeit Maryland stamps.

State Revenues: General fund revenues may increase beginning in fiscal 2011 due to additional cigarette tax compliance. Any revenue gain in the near-term is not expected to be substantial due to the lack of documented tax stamp counterfeiting. If counterfeit tax stamps or counterfeiting becomes an issue in the future, general fund revenues may increase by between \$5 to \$10 million annually. This estimate is based on the estimated revenues from the program in California and takes into account geographic and enforcement policy differentials in the two states.

State Expenditures: General fund expenditures will increase beginning in fiscal 2011 due to encryption equipment and/or purchases at the Comptroller's Office. The Comptroller's Office estimates that requiring encryption technology will result in annual expenditures of \$1 million or about \$700,000 more than current tax stamp related expenditures.

Small Business Effect: To the extent that cigarette business licenses who are small businesses are required to purchase any encryption technology, these business will be negatively impacted through additional expenses.

Additional Information

Prior Introductions: HB 1259 of 2008 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 528 (Delegate Ross, *et al.*) - Ways and Means.

Information Source(s): Comptroller's Office, Department of Legislative Services

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