

Legal Services Bureau
915 SW Harrison St
Topeka KS 66612-1588

Samuel M. Williams, Acting Secretary
David Clauser, General Counsel



Phone: 785-296-2381
FAX: 785-296-5213
www.ksrevenue.org

Sam Brownback, Governor

January 31, 2017

Senate Committee on Assessment and Taxation

Testimony by the Kansas Department of Revenue in Support of Senate Bill 96
by Michael Hale and Anna Landis

Senator Caryn Tyson and Members of the Committee:

The Department of Revenue respectfully submits the following testimony to the Committee in support of Senate Bill 96.

The Department has submitted this proposed legislation amending the Cigarette and Tobacco Products Act relating to definition, license and permits, license and permit fees and bonds, suspension or revocation of licenses, stamps, redemption of stamps cigarettes required to be sold in packages, certain records required of dealers, unlawful acts, penalties for unlawful acts, sale of cigarettes, license fees, administrative fines, application of certain laws to taxes.

In order to meet its obligations of diligent enforcement of the cigarette and tobacco products acts under the Master Settlement Agreement ("MSA") and the 2012 Settlement (Master Settlement) under K.S.A. 50-6a01 *et seq.*, the Department is proposing several statutory amendments to the Cigarette and Tobacco Products Act in order for Kansas to be in compliance with the MSA and the Master Settlement.

While some the amendments are "clean-up" in nature (*e.g.* deleting references to meter imprint by means of ink printing machines and water applied stamps because they are no longer used), the bulk of the proposed amendments are offered in order that the state can meet its obligations of diligent enforcement of the cigarette and tobacco products acts under the MSA and the Master Settlement. The Department firmly believes that these statutory amendments are necessary for Kansas to be in compliance with the Master Settlement.

It is noteworthy that in recent years Kansas has received approximately \$50,000,000 per year from the MSA. To help ensure that Kansas continues to receive these payments, and to militate against the possibility of Kansas having to pay back any payments previously received under the MSA, the Department believes that these amendments are required to be implemented and enforced. There can be little doubt that these statutory amendments are not only necessary for Kansas to be in compliance with the Master Settlement, but equally necessary to assure that

Kansas continues to receive future payments under the MSA, and to counteract against the prospect of repayment of deposits received.

In short, the amendments generally update tax statutes in a manner that allows the Department to better meet the original Master Settlement statutory language and amendments enacted pursuant to the 2012 Master Settlement.

Specific Section Amendments:

Section 1 New Section. Makes individuals who purchase more than 400 cigarettes (more than two cartons) without proper Kansas tax indicia liable for the tax imposed by this act.

Section 2 New section defines parameters for identifying whether a conviction is a first, second, third or subsequent conviction.

Section 3 Amends the definitions of “Dealer”, “Dealer Establishment”, “Package”, “Retail dealer”, “Sale”, “Stamps”, “Tobacco Specialty Store”, and “Electronic cigarette.” Strikes the definition of “Meter imprints” as that technology is no longer used to stamp cigarettes. Lastly adds the definition of “Conspicuous location or place”, “Contracting entity”, “Importer” and “Manufacturer”.

Section 4 Revisor’s Office addition.

Section 5 The Cigarette and Tobacco Enforcement (CATE) Unit has a contract with the FDA. Current law does not allow the KDR to fulfill certain requirements of the contract. To ensure that the KDR meets the requirements to obtain the necessary funding the contract provides, the statute must be changed to allow the Department to divulge vending machine information to contracting entities of the division.

Section 6 Authorizes the Director to deny or not renew license applications based on a list of relevant factors.

Section 7 Authorizes the Director to suspend or a person’s license based on a list of relevant factors (same list as in Section 6).

Section 8 Strikes any language of “water applied” or “meter imprints” as that technology is no longer used to stamp cigarettes in the state. In order to receive a discount on the stamps purchased, the wholesale dealers must be in good standing with the Director.

Section 9 Strikes any language of “meter imprints” and dates that no longer apply.

Section 10 Creates an exception for the retention of invoices requirement, for an outlet or fuel outlet or fuel center owned by the same entity. (For example: Dillon’s Grocery store may preserve the records at the store for the Dillon’s gas station).

Section 11 Makes it unlawful to possess, transport, import, distribute, wholesale or manufacture more than 1000 (changed from 200) cigarettes without Kansas stamps being affixed. Makes it unlawful to transport or allow to be transported into this state, cigarettes to a retailer or at retail that do not bear Kansas tax stamps. Strikes the language regarding vending machines, as vending machines are no longer allowed at the federal level. Makes it unlawful to possess, transport, import, distribute, wholesale or manufacture cigarettes or tobacco products in violation of the MSA Act.

Section 12 Substantially increases trafficking in illegal cigarette and tobacco and obstructing the enforcement of the cigarette and tobacco statutes. A first conviction bears a fine of not less than \$1,000.00, no more than \$2,500.00. Subsequent convictions result in fines of up to \$100,000.00 and possible jail time after the third conviction. Practically speaking, it would not be until a third, and most likely, a fourth conviction until a person would face the possibility of serving time in prison for trafficking in illegal cigarette and tobacco products.

Section 13 Defines cigarettes and tobacco in violation of §50-6a01 *et seq.* as contraband and subjects them and property, including vehicles, used in the trafficking of illegal cigarettes and tobacco to seizure and sale.

Further defines all packages of cigarettes bearing indicia of tax payment pursuant to compacts signed between the Governor and the Prairie Band Nation and the Iowa Tribe of Kansas and Nebraska and ratified by the Legislature as not being contraband.

Section 14 Authorizes the Department to seize illegal cigarettes, and property used in the trafficking in illegal cigarettes to seizure and sale, and provides the procedure and process to effect the sale and disbursement of said funds. This section will, in part, assist in funding the diligent enforcement as required by the Master Settlement Agreement and the 2012 Settlement.

Section 15 Enhances the Director's investigation power to request and review returns, reports and books.

Section 16 Includes the sale smokeless tobacco and roll-your-own tobacco products into the internet, telephone and mail order transactions. Previously, only cigarettes were included. Similar to Section 11, this section substantially increases trafficking in illegal cigarette (and now tobacco). A first conviction bears a fine of not less than \$1,000.00, nor more than \$2,500.00. Subsequent convictions could result in fines of up to \$100,000.00 and possible jail time after the third conviction. Broadens the reach of the Master Settlement Agreement and the 2012 Settlement. Amendments prescribed by this section follow the model applied in the recent *DMA v. Brohl*, 814 F.3d 1129, 1133 (10th Cir.), cert. denied, 137 S. Ct. 591 (2016), and cert. denied, 137 S. Ct. 593 (2016), to allow the collection of consumer sales information into the state.

Section 17 Makes it unlawful to traffic in counterfeit cigarettes, subjects counterfeit cigarettes to seizure and imposes criminal sanctions similar to those in Section 11 for trafficking in counterfeit cigarettes.

Section 18 Requires tobacco distributors to file their reports electronically on forms and in a manner prescribed by the Department. This is an accounting and auditing requirement the Master Settlement Agreement and the 2012 Settlement so that reports can be transmitted by the Department to the Attorney General and they in turn can be transmitted to a national data clearing house.

Section 19 Provides that all monies received from license fees, fines, forfeiture proceedings are used exclusively for assisting in funding the diligent enforcement as required by the Master Settlement Agreement and the 2012 Settlement.

Section 20 Changes "licensee" to "person".

Section 21 Provides for penalties and fines as well as taxes to be collected in a manner similar to sales taxes. Currently Kansas statute allows the Department to impose penalties and fines, but no practical way to collect them.

Section 22 Due to proposed amendments to KSA 79-3322, the cigarette infraction citation subsection references under this section needs to be amended to remain compatible. Nothing really substantive here, more of a compatibility amendment.

Sections 23 through 25 Revisor's changes for clarification and compatibility.