

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

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Prepared By: The Professional Staff of the Committee on Finance and Tax

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BILL: SPB 7074

INTRODUCER: For consideration by the Finance and Tax Committee

SUBJECT: Tobacco Products other than Cigarettes or Cigars

DATE: March 27, 2015

REVISED: 04/03/15

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ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1. Fournier	Diez-Arguelles		<b>Pre-meeting</b>

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**I. Summary:**

SPB 7074 makes changes to definitions in s. 210, 25, F.S., concerning the tax on tobacco products other than cigarettes and cigars. It provides that the tax applies to the full price paid by a distributor to acquire tobacco products (including the federal excise tax paid by a domestic manufacturer) and to the federal excise tax on an imported product, if it is paid by the distributor. It amends the definition of “tobacco products” to provide that products made in whole or in part from tobacco leaves for use in chewing, smoking, or sniffing are tobacco products. It defines “affiliate” to mean “a manufacturer or other person that directly or indirectly, through one or more intermediaries, controls or is controlled by a distributor or that is under common control with a distributor.”

The bill also provides that the amendment made to s. 210.25, F.S., clarifies existing law.

**II. Present Situation:**

Tobacco products other than cigarettes and cigars are taxed under Part II of ch. 210, F.S., enacted in 1985.<sup>1</sup> Tobacco products include:

- Loose tobacco suitable for smoking;
- Snuff;
- Snuff flour;
- Cavendish;
- Plug and twist tobacco;
- Fine cuts and other chewing tobaccos;
- Shorts;
- Refuse scraps; and
- Clippings, cuttings, and sweepings of tobacco, and other kinds and forms of tobacco prepared in such manner as to be suitable for chewing;

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<sup>1</sup> Chapter 85-141, Laws of Fla.

“Tobacco products” does not include cigarettes, as defined by s. 210.01(1), F.S., or cigars.<sup>2</sup>

These products are subject to a surcharge levied at the rate of 60 percent,<sup>3</sup> and a tax levied at the rate of 25 percent,<sup>4</sup> of the wholesale sales price. The surcharge and tax are levied upon any person engaged in business as a distributor<sup>5</sup> of tobacco products at the time the distributor:

- Brings or causes to be brought into this state from without the state tobacco products for sale;
- Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- Ships or transports tobacco products to retailers in this state, to be sold by those retailers.<sup>6</sup>

The surcharge and tax are administered by the Division of Alcoholic Beverages and Tobacco (division) of the Department of Business and Professional Regulation (DBPR), which licenses distributors<sup>7</sup> and collects monthly tax returns.<sup>8</sup> The division must notify a taxpayer of any tax deficiency, stating its intention to assess the amount due. The taxpayer may protest the proposed assessment and the division must hold a hearing on the protest and issue a final assessment for the amount found due.<sup>9</sup>

Revenue produced from the surcharge on tobacco products is deposited into the Health Care Trust Fund within the Agency for Health Care Administration.<sup>10</sup> Revenue produced from the tax on tobacco products is deposited in the General Revenue Fund.<sup>11</sup> The estimate for total collections for fiscal Year 2015-2016 is \$100.5 million. The Health Care Trust Fund share is \$65.2 million and the General Revenue Fund share is \$35.2 million.

The surcharge and tax on tobacco products are based on the “wholesale sales price” which means “the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any diminution by volume or other discounts.”<sup>12</sup>

### **Legal Challenges to DBPR Administration of Tobacco Products Tax and Surcharge**

The statutory scheme for determining the correct amount of tax and the products subject to tax has remained largely unchanged since the tax was enacted in 1985. The statutes worked well when the distribution chain of the product included a manufacturer, a distributor, a retailer, and the products for sale were all covered by the statutory definition. Since 1985, however, the industry has become more diverse. Additional products have come on the market and the supply

<sup>2</sup> Section 210.25(11), F.S.

<sup>3</sup> Section 210.276(1), F.S.

<sup>4</sup> Section 210.30(1), F.S.

<sup>5</sup> “Distributor” means: (a) any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from outside the state any tobacco products for sale; (b) any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state; or (c) any person engaged in the business of selling tobacco outside this state who ships or transports tobacco products to retailers in this state to be sold by those retailers. (s. 210.25(4), F.S.)

<sup>6</sup> Sections 210.276(1)(a),(b), and (c) and 210.30(1)(a),(b), and (c), F.S.

<sup>7</sup> Section 210.45, F.S.

<sup>8</sup> Section 210.55(1), F.S.

<sup>9</sup> Section 210.55(2) and (3), F.S.

<sup>10</sup> Section 210.276(7), F.S. This trust fund is subject to the General Revenue Service Charge s. 215.20(1), F.S.

<sup>11</sup> Section 210.70, F.S.

<sup>12</sup> Section 210.25(13), F.S.

chain often includes multiple transactions. These products and supply arrangements are not clearly addressed by existing statutory language, and DBPR has been challenged over tax assessments in these situations.

### ***Definition of Wholesale Sales Price***

In 2012, Micjo, Inc., a Florida-licensed distributor of tobacco products, challenged DBPR's interpretation of "wholesale sales price." Micjo purchased hookah tobacco from non-Florida importers who purchased the product from overseas manufacturers. These importers paid the federal excise taxes on the products as well as delivery costs, and provided invoices to Micjo that itemized these costs. Micjo paid Florida taxes on the price the importers paid the manufacturers for tobacco but not on the total invoice amount, because federal excise taxes and delivery costs were paid by the importer, not by the manufacturer. The Second DCA<sup>13</sup> agreed with Micjo's position that the federal excise tax and delivery charges paid by the importer were not part of the wholesale sales price.

It is the division's position that the Micjo decision applies only to distributors of imported tobacco products, but other tobacco products distributors have challenged the division over tax assessments or refund requests related to what is included in the "wholesale sales price" of tobacco products, based on the Micjo decision. The division has also seen a change in the way tobacco product manufacturers prepare invoices, itemizing elements such as federal excise taxes and transportation costs that previously were included in the price of the product. These challenges, which seek to expand the Micjo ruling to domestic-source products, include requests for refunds of taxes paid on these separately-stated charges and could exceed \$200 million, in addition to recurring \$50 million annual reductions in excise tax revenue.

The Micjo ruling itself, although relatively small in its revenue impact, creates an unequal playing field between tobacco products manufactured outside the United States and those produced domestically, since domestic manufacturers must pay federal excise tax (included in the wholesale sales price) while these taxes must be paid by the importers of foreign-made products (and excluded from the wholesale sales price).

### ***Definition of Tobacco Products***

On February 24, 2015, an Administrative Law Judge issued a recommended order<sup>14</sup> finding that "blunt wraps" are not taxable as tobacco products and set aside the division's assessment against a taxpayer for the excise taxes and surcharges that the Department alleged were due. "Blunt wraps" are used to wrap tobacco or other products for smoking, and are made from tobacco sweepings, cellulose, and glue or are punched out of whole tobacco leaves. They were not a commercial product in 1985 when the statutory definition of "tobacco products" was created, and the judge found that:

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<sup>13</sup> *Micjo, Inc. v. Department of Business and Professional Regulation*, 78 So. 3d. 124 (Fla. 2d. DCA 2012).

<sup>14</sup> *Brandy's Products, Inc. v. Department of Business and Professional Regulation, Division of Alcoholic Beverages and Tobacco*, Case No. 14-3496 (Fla. DOAH 2015).

“DBPR’s interpretation of section 210.25(11), F.S., as including blunt wraps within the specialized definition of “tobacco products” is erroneous and unreasonably enlarges the taxing authority in contravention of the plain language of the statute.”<sup>15</sup>

The potential revenue impact of a final decision favoring the plaintiffs is a loss of \$3 million recurring and \$9 million in refunds. It also suggests that as new tobacco products are introduced into the market they may not be subject to the tax and surcharge unless they are specifically listed in the statute.

### III. Effect of Proposed Changes:

**Section 1** amends the definitions of “tobacco products” and “wholesale sales price” and creates a definition of “affiliate” in s. 210.25, F.S. It codifies the division’s current administration of these laws with respect to domestically-manufactured products, and provides that the wholesale sales price for imported products must include the federal excise tax regardless of who pays that tax. It amends the definition of tobacco products to include products that have been introduced to the market since the statute was originally enacted.

The bill defines “wholesale sales price” as the total amount paid by the distributor to obtain tobacco products. It is the sum of:

- The full price paid by the distributor to acquire the tobacco products, including charges by the seller for the cost of materials, cost of labor and service, charge for transportation and delivery, the federal excise tax, and any other charge, even if the charge is listed as a separate item on the invoice paid by the distributor, exclusive of any diminution by volume or other discounts, including a discount extended to a distributor by an affiliate.
- The federal excise tax paid by the distributor on the tobacco products, if the tax is not included in the full price under paragraph (a).

The bill defines “affiliate” to mean “a manufacturer or other person that directly or indirectly, through one or more intermediaries, controls or is controlled by a distributor or that is under common control with a distributor.” This definition is needed to ensure that the price on which the tax is based is not diminished by a discount resulting from an affiliation between the distributor and another entity.

The bill amends the definition of tobacco products to include “all other kinds and forms of products, including wraps, made in whole or in part from tobacco leaves for use in chewing, smoking, or sniffing.”

**Section 2** amends s. 951.22, F.S., to correct a cross-reference.

**Section 3** provides that the amendment made to s. 210.25, F.S., clarifies existing law.

The effective date of the bill is July 1, 2015.

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<sup>15</sup> Id. p. 20.

**IV. Constitutional Issues:**

## A. Municipality/County Mandates Restrictions:

None.

## B. Public Records/Open Meetings Issues:

None.

## C. Trust Funds Restrictions:

None.

**V. Fiscal Impact Statement:**

## A. Tax/Fee Issues:

The Revenue Estimating Conference has determined that changes made by the bill to the tobacco products tax statute are consistent with the division's current administration of the tax on domestically-manufactured tobacco products and have no tax impact with respect to those products. For distributors that buy products directly from overseas manufacturers or from out-of-state importers (as in *Micjo, Inc. v. Department of Business and Professional Regulation*) the Revenue Estimating Conference has determined that the bill will have a positive indeterminate impact on state revenue, as it will include federal excise tax and other charges paid by the out-of-state importer.

## B. Private Sector Impact:

This bill provides that distributors of tobacco products are taxed on the full price paid to acquire the tobacco product. This interpretation of the term "wholesale sales price" is the division's position as to the meaning of the term for domestically-manufactured tobacco products. For distributors operating under the same circumstances as Micjo, Inc., namely, buying products from an out-of-state importer, or for distributors importing products from overseas manufacturers, the bill will increase the tax due by including the federal excise tax in the wholesale sales price, creating parity with distributors buying domestic products.

## C. Government Sector Impact:

By amending the definitions of "tobacco products" and "wholesale sales price" this bill may reduce future litigation costs for the division. In the current fiscal year the division has spent \$61,080 for representation by the Attorney General's office in litigation related to issues this bill will clarify. Litigation of four ongoing cases is expected to cost approximately \$24,000 for each. Additional challenges have been filed.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Statutes Affected:**

This bill substantially amends section 210.25 of the Florida Statutes.

**IX. Additional Information:**

**A. Committee Substitute – Statement of Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

**B. Amendments:**

None.

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This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

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