

SUBJECT: Regulating domestic sales of cigarettes manufactured for export

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 7 ayes — Oliveira, McCall, Bonnen, Y. Davis, Heflin, Keffer, Ritter
0 nays
4 absent — Craddick, Hartnett, Hilbert, Ramsay

WITNESSES: None

BACKGROUND: In 1999, the 76th Legislature enacted SB 1122 by Armbrister, making it illegal to sell cigarettes in Texas that are manufactured in the United States and designated for export. The Tax Code requires distributors to buy stamps from the comptroller and affix them to each pack of cigarettes, domestic or imported, to show payment of the state's 41-cent excise tax per pack of 20 cigarettes. Violations are punishable by a maximum \$2,000 fine. The federal excise tax is 34 cents per 20-cigarette pack. Tax Code, sec. 154.0415 prohibits affixing tax stamps to cigarettes labeled for export.

DIGEST: CSHB 2378 would make it a felony to deal in or import cigarettes that do not comply with all applicable federal law and regulations or to which tax stamps may not be affixed. Knowing violators would commit a felony punishable by a maximum \$5,000 fine and/or up to five years in prison. The bill would exempt duty-free cigarettes or those imported for personal use.

The bill would prohibit state tax stamps on packages of cigarettes that did not comply with federal laws or regulations, including ingredients, importation, and previous exportation. Violations would have to be made knowingly. Sellers, distributors, and manufacturers could seek court injunctions if they believed they were being harmed economically or commercially.

The comptroller would have to use tax stamps permitting identification of the person affixing them and to maintain ID data at least four years. Distributors would have to retain copies of U.S. customs certificates for all imported

cigarettes they tax-stamped.

This bill would take effect September 1, 2001, and would apply to offenses and violations committed on or after that date.

**SUPPORTERS
SAY:**

CSHB 2378 would make needed changes and additions to the act of the 76th Legislature regulating “gray market” cigarettes. It represents a negotiated compromise between regulators and the tobacco industry.

The gray market exists because cigarettes made in the United States for sale overseas are not taxed. Typically, they are less expensive and have different ingredients. Unscrupulous importers buy them, pay lower import taxes, and sell them domestically at a sizable profit compared to more expensive and more heavily taxed domestic cigarettes. Consequently, the state loses tax revenue. It also receives less in tobacco-settlement money because those payments are based in part on legitimate domestic sales.

CSHB 2378 would make gray marketing a felony, while adding important exceptions for personal use and duty-free purchases that were overlooked or rendered invalid by previous bills. It would bring state law into compliance with applicable federal statutes and regulations. It would provide better means of tracking illegal exports through the existing tax stamp and customs certificates procedures. This would strengthen the law and make it more difficult to place tax stamps on illegally exported cigarettes.

Allowing injunctive relief would address competitors’ chief concern — putting a quick stop to unfair business practices. Court orders often can be obtained faster than regulatory action or prosecution.

**OPPONENTS
SAY:**

Creating a felony for gray marketing of cigarettes would be too draconian. At most, this offense should be a misdemeanor.

The provision prohibiting state tax stamps on cigarettes not complying with federal law would be too broad. Instead of enhancing enforcement, it would make it more difficult for the comptroller to determine which of the myriad federal statutes and regulations an importer might be violating.

OTHER
OPPONENTS
SAY:

Merely allowing injunctive relief would not go far enough to deter and punish gray marketeers. Honest distributors should be able to sue for damages as well. The bill should require more reporting by distributors.

NOTES:

The bill as filed did not allow for the comptroller's current practice of using colored tax stamps. It would have required the comptroller to maintain tax-stamp ID data for three years and would have allowed disclosure of the names. The original bill contained no provisions about the kinds of cigarettes on which stamps could not be placed. It did not specify that offenses must be committed knowingly; would not have allowed injunctive relief; and did not include the duty-free and personal-use exemptions. It would have provided for destruction of seized and forfeited cigarettes and required monthly distributor reports on importation.

A related bill, SB 937 by Armbrister, would require monthly importation reports by cigarette distributors, allow lawsuits for actual damages from commercial injury or economic loss, and provide for seizure, forfeiture, and destruction of contraband cigarettes. SB 937 was considered in a public hearing by the Senate Finance Committee on April 2 and left pending.