

Michigan Tobacco Enforcement

Michigan Department of Treasury

Cigarette Tax

Michigan has levied an excise tax on cigarettes since 1947. For decades the tax stayed at or below 25 cents per pack. Then, as part of the implementation of Proposal A in 1994, Michigan's Cigarette Tax was increased to 75 cents per pack. Since that time, the per-pack Cigarette Tax has been increased twice, to \$1.25 in 2002 and \$2.00 in 2004. As of January 1, 2008, Michigan's Cigarette Tax was the fourth highest in the nation.

Master Settlement Agreement

In November 1998, 46 states, including Michigan, reached an agreement with four major tobacco companies to settle lawsuits that were brought to recover the public costs of treating smoking-related illnesses. This agreement was entitled the Master Settlement Agreement or MSA. The MSA provided for annual payments from the four tobacco companies to the states, with payments totaling more than \$206 billion by 2025. Michigan received an initial payment of \$107.5 million in December of 1999. Total MSA payments through 2005 were \$1.82 billion. Annual payments will continue in perpetuity with Michigan scheduled to receive more than \$8.5 billion by 2025.

In addition to the annual payments from tobacco companies, Michigan has received two lump sum payments from selling bonds secured by future MSA payments. The Michigan Tobacco Settlement Finance Authority has distributed a total of \$815 million in bond proceeds among three funds, the 21st Century Jobs Trust Fund, the State School Aid Fund and the State General Fund. The debt service on the bonds is financed by 10.77% of the annual MSA payment in 2008 and thereafter 24.11%.

Cigarette Tax Avoidance

Higher cigarette taxes, and higher costs per pack, have led many smokers to seek alternatives to purchasing taxed cigarettes. The Michigan Department of Treasury has teamed with other state and federal agencies as well as non-government entities to educate the public about tobacco laws and to combat various forms of tax avoidance. It is a violation of the Michigan Tobacco Products Tax Act (TPTA) to purchase cigarettes that do not bear a valid Michigan stamp. Unstamped cigarettes are subject to the \$2.00 per pack cigarette tax, a 6% use tax and a 500 % penalty (\$10.00 per pack). This includes cigarettes purchased over the internet, or from any other source within or outside the state, unless the purchaser or seller is licensed under the TPTA as a stamping agent and complies with the Act by stamping each individual pack, collecting the tax due, and remitting the appropriate tax revenues to the state. Sales of unstamped cigarettes also may violate federal laws such as the Contraband Cigarette Trafficking Act and the Jenkins Act. Prior to 1994, the differential between Michigan's Cigarette Tax and rates in other states was minimal and did not lead to large-scale efforts to buy or sell untaxed cigarettes. However, the incentive to avoid taxation in Michigan became much stronger after the 1994 Cigarette Tax increase took effect. The Cigarette Tax increases imposed in

2002 and 2004 generated related increases in cigarette tax avoidance and evasion. The Department has responded by continued review and refinement of its enforcement efforts.

Enforcement Programs & Initiatives

Department of Treasury Tobacco Enforcement Actions

Michigan purchasers do not have to physically leave the state to illegally purchase cigarettes and avoid payment of cigarette taxes. A form of illegal cigarette smuggling is conducted through mail order and/or Internet sales. In these situations, the seller obtains low-tax or untaxed cigarettes and then sells and ships them to Michigan residents or businesses without the appropriate Michigan stamps and taxes. Recent growth in e-commerce has led to an increase in Internet based sellers who advertise and sell so-called "tax-free" cigarettes.

Treasury has taken several steps to curtail illegal internet sales and pursue collection of Cigarette Tax revenue from the purchasers of unstamped internet cigarettes. As part of its Tobacco Enforcement Action Plan, Treasury sent notices to all newspaper publishers in Michigan (October 2004) educating them as to the provisions of the Tobacco Product Tax Act. Treasury has also contacted specific advertisers when their advertisements have come to the attention of the Department.

Treasury has also been contacting individual purchasers in order to collect unpaid taxes and penalties. To date, over 23,000 individuals have been contacted with total liabilities exceeding \$36 million. Treasury will continue contacting individual purchasers as new information is received.

To help educate Michigan residents about tobacco laws, including restrictions on the purchase and possession of non-stamped cigarettes, Treasury has issued a number of press releases over the last several years. These releases also provide details about enforcement efforts and direct residents to Tobacco Tax information located on Treasury's Web site, www.michigan.gov/tobaccotaxes.

Michigan purchasers who have acquired unstamped/untaxed cigarettes can avoid costly penalties by paying the Tobacco and Use Taxes that are due. The cigarette taxes are paid using forms 4096A or 4096B found on the Treasury website. The use tax can be paid as part of the annual filing of the individual income tax return, form MI-1040. However, payment of the Cigarette and Use taxes does not legitimize illegal possession of cigarettes.

Department of Treasury Interaction with Michigan Indian Tribes

Cigarette sales made within a federally recognized Indian tribe's "Indian Country" pose a unique enforcement problem for states, given the attributes of sovereignty possessed by such tribes. To address this and other related issues, the Department of Treasury has committed significant time and resources toward establishing relationships with the various Michigan tribes and developing specific protocols to help guard against the

inappropriate distribution of untaxed cigarettes. These efforts, with the assistance of many of the tribes, have resulted in a significantly enhanced enforcement regime.

A specific example of such effort was the negotiations between the Department and the federally recognized tribes located in Michigan, where the State and the Tribes got together to obtain broad tax agreements that address a variety of taxes, including tobacco. This two year process resulted in agreements with eight of the twelve tribes (Bay Mills Indian Community, Grand Traverse Band of Ottawa & Chippewa Indians, Hannahville Indian Community, Little River Band of Ottawa Indians, Little Traverse Bay Bands of Odawa Indians, Nottawaseppi Huron Band of Potawatomi Indians, Pokagon Band of Potawatomi Indians, and Sault Ste. Marie Tribe of Chippewa Indians). A subsequent agreement was also signed with the Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians. These agreements cooperatively ensure the collection of Michigan tobacco taxes by providing specific protocols for sales within "Indian Country" as well as enforcement provisions enhancing the State's ability to audit and inspect within these areas.

As to those tribes which do not have an agreement with the State (Keweenaw Bay Indian Community, Lac Vieux Desert Band of Lake Superior Chippewa Indians, and the Saginaw Chippewa Indian Tribe), the Department of Treasury continues to monitor and enforce State tax laws to the extent allowed by federal law. These efforts have resulted in a number of cigarette seizures and a considerable amount of litigation. To date, the State has prevailed in all such litigation with the most recent decision coming from the United States Court of Appeals 6th Circuit specifically upholding the Department's established protocols.

Tobacco Tax Team

Since the enactment of the Tobacco Products Tax Act in 1994, the Michigan State Police Tobacco Tax Team has worked with the Michigan Department of Treasury, Michigan Attorney General, and Michigan Department of Community Health to enforce the law. The Team has made more than 668 arrests and has seized more than 291,160 cartons of cigarettes, with an estimated value of \$ 6.8 million. Taxes and penalties on the seized cartons have totaled more than \$10.4 million. In connection with the seizure of illegal cigarettes, more than \$1 million in contraband cash and 50 vehicles have also been seized.

The Tobacco Tax Team also has seized more than 93,141 units of other tobacco products. The wholesale value of the seized products was more than \$2.3 million.

Non-Participating Manufacturer (NPM) Enforcement

The Master Settlement Agreement (MSA) allows Participating Manufacturers to reduce their payments to the states *if* they lose market share to Non-Participating Manufacturers. The lost market share must be related to a state's failure to enact and diligently enforce a Model Statute designed to neutralize "cost disadvantages" a Participating Manufacturer experiences in relation to NPMs. In December 1999, Michigan joined other states in addressing this issue by enacting Public Act 244. This law requires NPMs to establish and maintain a qualified escrow fund, if they sell cigarettes (including roll-your-own tobacco) for ultimate consumption in Michigan. Escrow funds are maintained for 25

years to pay judgments or settlements on claims against the NPM, brought by the state or "releasing parties" as defined in the MSA. Shortly after enactment of PA 244, the Treasury identified potential NPMs and mailed them notice of the new law and its escrow requirements.

To ensure that NPMs escrow the required funds, Michigan law also requires licensed tobacco wholesalers and unclassified acquirers to report to Treasury all transactions involving NPM products. NPMs that fail to comply with the escrow requirements are referred to the Michigan Attorney General for civil action against the NPM.

Enforcement of Requirements for Non-participating Manufacturers

Sales Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
Contact with known or suspected NPMs	41	86	108	98	49	11	11	11	10
*NPMs whose products were reported as sold in MI	35	27	46	44	28	8	8	8	6
NPMs depositing funds in qualified escrow accounts for MI	11	15	23	20	18	8	7	6	5
Total annual deposit into qualified escrow MI accounts	\$267,756	\$342,439	\$1,007,888	\$1,633,704	\$922,484	\$1,508,664	\$1,336,185	\$558,215	\$425,144
**Cases referred to MI Attorney General	6	6	10	15	4	0	2	2	1

* Some NPMs included in this number may later have been found to be incorrectly reported. This number can vary.

**These numbers may include multiple years for a single NPM and for certain years additional investigations may be pending.

Michigan escrow accounts hold more than \$7.5 million. For sales in calendar years 2000 through 2008, Treasury sent more than 400 letters to known or suspected NPMs whose cigarettes and "roll-your-own" tobacco may have been sold for consumption in Michigan. To date, Treasury has referred 46 cases to the Attorney General for legal action. Of the completed cases, at least 18 have resulted in judgments against NPMs, some of which cover multiple years.

Continuing NPM/Tobacco Tax Enhancements

Treasury is continually looking for ways to improve its tax systems and other areas of responsibility. Given the disparity in state tax rates and the MSA responsibilities, the administration and enforcement of the TPTA and the various issues related to NPMs are of particular importance. Current and future initiatives are outlined below:

- Effective July 18, 2002 the Tobacco Products Tax Act requires certain tobacco licensees to report NPM products to the Department.

- Under the Tobacco Products Tax Act, NPMs must file an annual certification attesting to their compliance with escrow requirements as well as provide important information including brand identification. Enforcement was further strengthened by prohibiting acquisition or sale of non-compliant NPM product, and extending fines, penalties, and seizure provisions to NPM products.
- Effective January 8, 2004, the Tobacco Products Tax Act requires NPMs to pre-pay an Equity Assessment fee of at least \$10,000 prior to commencing tobacco sales for consumption in Michigan.
- Effective January 8, 2004, NPMs must report the brand names of cigarettes and roll-your-own tobacco that they intend to sell for consumption in Michigan
- Treasury maintains a directory on its Web site listing the NPMs that have complied with our laws and are able to have their approved tobacco product brands shipped into Michigan. Likewise, the purchase for consumption in Michigan of tobacco product brands not found on the list, or any tobacco product manufactured by a NPM that is not found on the list, is a violation of the TPTA by the seller and the purchaser and subjects them both to fines, penalties, and other State action.
- A listserv was established after receiving feedback from licensees. Treasury uses the listserv to communicate information about changes to the directory, notice of judgments, and other useful information. Anyone may sign up for the listserv by sending a request to Treas_TobaccoTaxes@michigan.gov. Treasury also mails notices of judgments and updates to the directory to certain tobacco products tax licensees.
- The web site www.michigan.gov/tobaccotaxes provides licensees with the latest tobacco tax information. Links are provided to the Tobacco Products Tax Act, PA 327 of 1993, and other tobacco tax laws. The Web site houses the directory of NPMs and their brands that are authorized for sale and consumption in Michigan. A link to the Web site of the National Association of Attorneys General, www.naag.org is also provided so that tobacco licensees can identify participating manufacturers in good standing and from whom they may buy tobacco products.
- The biggest deterrent to counterfeit cigarette sales in Michigan is the State's tobacco tax stamp program which makes it much easier to identify contraband cigarettes. To help ensure the effectiveness of this program, various security features incorporated into the stamps (including color) are changed routinely.
- A Tobacco Tax Tip Hot Line allows concerned taxpayers to submit anonymous information regarding tobacco tax violations. These tips are forwarded to the Treasury Enforcement Team, whose primary duty is the enforcement of the Tobacco Products Tax Act.

- System improvements have increased efficiency and accuracy regarding tobacco related record keeping and processing (including those associated with non-participating manufacturer information). Additional staff has been assigned to this area.
- Treasury works closely with the Michigan State Police and the Office of Attorney General to provide for more effective tobacco inspections and other necessary enforcement activities.
- Section 11 of the Tobacco Products Tax Act (MCL 205.431) was amended in 2004, making **it illegal to sell or solicit a sale of a tobacco product to be brought into Michigan to anyone other than a licensed person (manufacturer, wholesaler, unclassified acquirer, etc.)**, The new provisions aid the State's enforcement efforts by requiring packages containing tobacco products to be properly marked and by requiring detailed seller information on invoices and related documents,
- Treasury offers ongoing education to tobacco tax licensees to help assure compliance with the State's tobacco laws.
- Treasury implemented an Automated Tobacco Products Tax System which has improved monitoring of the distribution of tobacco products at all levels. The system also improves inventory monitoring for both tobacco and cigarette stamps at the wholesale level resulting in more accurate reconciliation of usage and sales. Finally, this system allows Treasury to administer Michigan tobacco tax laws quickly and efficiently by improving identification of TPTS violations

Conclusion

The State of Michigan has taken extensive action to administer and enforce the Tobacco Products Tax Act as well as PA 244 of 1999 which ensures that tobacco product manufacturers participating in the Master Settlement Agreement are not put at a cost disadvantage. The State is committed to the enforcement of its tobacco laws and will continue to review and modify its efforts as new information and circumstances present themselves.

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