

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

March 26, 2004

7:05 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Bruce Weyhrauch, Vice Chair
Representative Vic Kohring
Representative Dan Ogg
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE BILL NO. 538

"An Act relating to taxes on cigarettes and tobacco products; relating to tax stamps on cigarettes; relating to forfeiture of cigarettes and of property used in the manufacture, transportation, or sale of unstamped cigarettes; relating to licenses and licensees under the Cigarette Tax Act; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 538

SHORT TITLE: TOBACCO TAX; LICENSING; PENALTIES

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

03/18/04	(H)	READ THE FIRST TIME - REFERRALS
03/18/04	(H)	W&M, L&C, FIN
03/24/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/24/04	(H)	Heard & Held

03/24/04 (H) MINUTE(W&M)
03/26/04 (H) W&M AT 7:00 AM HOUSE FINANCE 519

WITNESS REGISTER

JOHANNA BALES, Excise Audit Manager
Tax Division
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Explained aspects of HB 538 and answered questions.

MIKE ELERDING, Owner
Northern Sales
Ketchikan, Alaska

POSITION STATEMENT: Testified during the discussion of HB 538.

MICHAEL BARNHILL, Assistant Attorney General
Commercial/Fair Business Section
Civil Division
Department of Law (DOL)
Juneau, Alaska

POSITION STATEMENT: Answered legal questions pertaining to HB 538.

MEGAN TACK, Member
Teens Against Tobacco Use
Juneau, Alaska

POSITION STATEMENT: Spoke in favor of HB 538.

JENNIFER APP, Advocacy Director
American Heart Association
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 538.

DORIS ROBBINS, Member
Juneau Clean Air
Juneau, Alaska

POSITION STATEMENT: Testified in support of HB 538.

VANESSA SALINAS, Coordinator
Smoke Free Anchorage Coalition
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 538.

CHRISTIE GARBE, Chief Executive Officer
American Lung Association

Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 538.

CHAD BURNETTE

Juneau, Alaska

POSITION STATEMENT: Spoke in favor of HB 538.

STEVEN PORTER, Deputy Commissioner

Office of the Commissioner

Department of Revenue

Juneau, Alaska

POSITION STATEMENT: Clarified aspects of HB 538 and answered questions.

ACTION NARRATIVE

TAPE 04-17, SIDE A

Number 0001

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at 7:05 a.m. Representatives Hawker, Samuels, Kohring, Weyhrauch, Wilson, Gruenberg, and Moses were present at the call to order. Representatives Ogg and Rokeberg arrived as the meeting was in progress.

HB 538-TOBACCO TAX; LICENSING; PENALTIES

[Contains discussion of SB 168]

Number 0100

CHAIR HAWKER announced that the only order of business would be HOUSE BILL NO. 538, "An Act relating to taxes on cigarettes and tobacco products; relating to tax stamps on cigarettes; relating to forfeiture of cigarettes and of property used in the manufacture, transportation, or sale of unstamped cigarettes; relating to licenses and licensees under the Cigarette Tax Act; and providing for an effective date.

Number 0125

JOHANNA BALES, Excise Audit Manager, Tax Division, Department of Revenue (DOR), introduced herself as the product manager for cigarette and tobacco products tax.

CHAIR HAWKER asked Ms. Bales to explain the bonding requirements in HB 538.

MS. BALES explained that the licensees who purchase tax stamps from DOR and don't wish to pay at that time are allowed to make a deferred payment. For example, if a person purchases tax stamps in January the payment would not be due until the end of February. In order to do this the licensee has to post a bond worth twice the amount of purchase. Ms. Bales gave an example of a person who wanted to purchase \$5,000 worth of tax stamps in a given month. He or she would have to post a bond for \$10,000, which would allow for a \$5,000 purchase in January and a \$5,000 purchase in February, and the January payment would not be due until the end of February and, therefore, the bond would be sufficient to cover the entire \$10,000 in tax stamps received without paying for them. If a person does not want to post a bond, he or she can pay for the tax stamps upon purchase, she added.

Number 0333

CHAIR HAWKER asked if bonding is a common procedure in Alaska.

MS. BALES replied that it is. Bonds are required in alcoholic beverage, motor fuel, and fisheries excise taxes, she said.

CHAIR HAWKER redirected his question to ask if, within the excise tobacco tax, bonding is a common procedure utilized by commercial businesses.

MS. BALES responded that about 50 percent of businesses use them.

CHAIR HAWKER asked Ms. Bales if she could characterize those who do use the deferred bond procedure.

MS. BALES characterized those who do make use of the bonds as the larger taxpayers - the smaller taxpayers just pay for the stamps.

Number 0436

REPRESENTATIVE WILSON asked how many people buy cigarettes and sell them.

MS. BALES answered that there are about 75 licensees, a combination of cigarette licensees, and other tobacco products (OTP). She noted that only the cigarette tax licensees are required to have a bond for the tax stamp.

CHAIR HAWKER asked Mike Elerding to testify as a case in point as to how the bonding process works, and to speak about his concerns regarding an increase in tax and potential consequences from it.

MIKE ELERDING, Owner, Northern Sales, related that his business is required to post a bond for the payment of the cigarette stamps purchased from the state. He said his bond at the current tax rate is \$700,000, and he has been working with his insurance agent to secure a larger bond of \$1,000,000 due to an increase in sales. However, it has been a challenging process to obtain the larger amount, and a tax rate increase would require a bond of \$2,000,000, which he predicts would be an even greater challenge. He said his other choice is to pay cash for the stamps, and the money is just not there. He called it an unintended consequence of the bill.

MR. ELERDING pointed out that he has been paying a cigarette tax for over 20 years, and his payment record with the state has been above reproach as a valuable partner helping to collect the excise taxes. He emphasized that this legislation does not seem to recognize the value of his entity's services as a partner for collecting the stamps. He questioned who would provide this service if distributors such as himself are out of the picture.

Number 0909

CHAIR HAWKER asked Mr. Elerding if he agrees with the logic applied by DOR as to how a 200 percent of monthly sales bond requirement is determined.

MR. ELERDING replied that he understands it and does not disagree with it. He mentioned talking to his insurance agent about putting a cap on the bond amount, but said he is not comfortable with that idea. He said he is looking for a creative way to solve the problem of having to come up with another \$1,000,000 bond for his company caused by the doubling of the bond amount.

CHAIR HAWKER asked that Mr. Elerding think about offering components of a solution to that problem later on in the hearing.

Number 1059

REPRESENTATIVE GRUENBERG asked where in the statutes it talks about bonding.

MS. BALES replied, AS 43.50.550.

CHAIR HAWKER indicated that copies of that citation have been distributed [to the members of the committee].

REPRESENTATIVE GRUENBERG inquired if there is a way of solving the aforementioned bonding issue. He noted that a few days ago on the House floor, there was an issue of reclamation bonds for mining, and the Department of Natural Resources (DNR) suggested a change in the wording that allowed other forms, such as letters of credit, for security. He asked for Ms. Bale's opinion of that concept.

MS. BALES replied that DOR is not opposed to that concept, and it is allowed for other types of excise tax such as the alcoholic beverage excise tax where unencumbered properties are allowed to be posted to secure the tax owed.

Number 1238

REPRESENTATIVE GRUENBERG asked for a citation on that concept.

MS. BALES said she believes that is in DOR's regulations, which is 15 AAC, Chapter 60.

REPRESENTATIVE GRUENBERG asked if there is a statute that authorizes that regulation.

MS. BALES replied she would get back to the committee with that citation.

REPRESENTATIVE GRUENBERG asked if, conceptually, [DOR] would not be opposed to that concept.

MS. BALES replied she does not believe [DOR] would be opposed to it.

REPRESENTATIVE GRUENBERG asked Mr. Elerding if he has heard the dialogue between Ms. Bales and himself.

MR. ELERDING replied that he has.

REPRESENTATIVE GRUENBERG inquired if it would be an acceptable solution.

Number 1338

MR. ELERDING, speaking from past experience as a banker, replied, "Partially." He related that he is familiar with securities that could be used, such as a letter of credit, but he opined it would be equally challenging. He explained that he already has had to boost his line of credit to pay for additional business expenses, and financing costs will increase again when the new tax is applied due to carrying more valuable inventory.

REPRESENTATIVE WILSON referred to a letter from Mr. Elerding and asked about the state charging no excise tax for mail order or Internet companies to ship OTP to Alaska, but charging tax to companies in the state. She noted that it is a problem and asked Mr. Elerding to respond.

MR. ELERDING explained that OTP are cigars and other non-cigarette products more adult in nature. All wholesale businesses in Alaska are required to pay 75 percent OTP tax. For example, if a product costs \$10, the excise tax on it is \$7.50 so the total cost of the product without markup or anything else would be \$17.50. If a mail order business from another state sells OTP to a consumer in Alaska, they are not required to pay the 75 percent excise tax, and the cost of the same product is only \$10. The consequence is that the state does not collect a lot of OTP tax from Alaska distributors because they cannot afford to sell those products. Mr. Elerding said this looks like a loophole that needs to be closed. He suggested not increasing the OTP tax to 100 percent, but rather collecting the tax from out-of-state mail order companies.

CHAIR HAWKER asked Ms. Bales to comment.

Number 1914

MS. BALES corrected a few statements made by Mr. Elerding saying that any out-of-state distributor who holds an Alaska license to sell cigarettes into the state is required to pay the OTP tax. She explained that the loophole for OTP is when an individual buys from an out-of-state retailer on-line and the distributor is not licensed in Alaska, then the individual is not required to remit the OTP tax like they would if they purchased cigarettes from an unlicensed distributor. She said the loophole is smaller, but still a legitimate concern.

CHAIR HAWKER asked if the state has the authority to require all out-of-state sellers to register with the state.

MS. BALES said no. She referred to a U.S. Supreme Court case called [Quill Corporation vs. North Dakota], a sales tax case, that states "if an out-of-state entity does not have physical presence or nexus in your state, the state cannot be required to have those companies collect excise or use tax for the state. That's why, in the cigarette tax arena, we look to the individual who imported the product to pay the tax," she said.

REPRESENTATIVE WILSON asked if there is any way this could be dealt with.

MS. BALES answered that [the legislature] could pass a statute that requires the individual who imports OTP into the state to remit the tax, similar to retail distributors, on that product.

REPRESENTATIVE WILSON asked if there already is a law in place for people who resell tobacco products.

MS. BALES replied yes, and that a new statute would have to address paying a tax for bringing OTP into the state for personal consumption, which is already in place for cigarettes.

REPRESENTATIVE GRUENBERG requested that Mr. Barnhill join Ms. Bales to testify. He noted that [Quill Corporation vs. North Dakota] and the issue of nexus are major issues dealing with sales and excise taxes. He summarized [the Quill case] by saying "to levy a tax on an out-of-state merchant, you have to show that there is a physical presence of some kind in the state." He asked Mr. Barnhill for further clarification.

Number 2430

MICHAEL BARNHILL, Assistant Attorney General, Commercial/Fair Business Section, Civil Division, Department of Law (DOL), explained that the Quill case was a case that involved the Quill pen company, a mail order company selling pens and having no physical presence in North Dakota. North Dakota attempted to get the Quill Corporation to collect a use tax on the pens, the company appealed it, and it went all the way to the U.S. Supreme Court. He explained:

In a decision that has been harshly criticized by academic commentators, the Supreme Court concluded that North Dakota did have jurisdiction over Quill

under the due process clause, because ... Quill had minimum contacts with the state. However, under the commerce clause, the U. S. Supreme Court concluded that physical presence was required. And it's that aspect of the decision that's been very controversial and there's been discussion amongst the states - that case came out in 1992 - but there's been discussion recently about finding a test case to take it back up and challenge that decision.

MR. BARNHILL mentioned that Senator Ben Stevens' sales tax bill, recently introduced in the Senate, has a provision called a "Quill provision, which extends the state's jurisdiction to collect taxes under that bill to the folks in the U. S. Constitution." He added, "If that tax is enacted the state could take a Quill test case back up."

Number 2613

REPRESENTATIVE GRUENBERG requested that Mr. Barnhill provide the location of that particular clause, and asked for his opinion if an amendment addressing that issue were to be added to [HB 538].

MR. BARNHILL replied that in the context of cigarette sales for most out-of-state sales, including Indian reservations, collectability is an issue. He opined it is probably not the best context in which to do a Quill test case.

REPRESENTATIVE GRUENBERG suggested that if DOL were to take on a test case, it should be an off-reservation distribution.

MR. BARNHILL said that type of distributor might be paying the tax already. He mentioned that several states were in the process of testing Quill.

REPRESENTATIVE GRUENBERG asked if there are other ways of meeting the Quill criteria. He said there is a provision in Alaska law that provides for a non-state resident driving in Alaska to authorize a governmental agency to be an agent for service of process if the person is sued. Those cases have survived a court challenge. He inquired if a distribution business with minimum contacts in the state could authorize DOR to be its nexus for the purpose of collecting taxes.

MR. BARNHILL replied that is almost identical to the Quill facts except an agent is being deemed for service of process. He opined, "It would not get you any further." [A case] has to go

back before the U.S. Supreme Court to be tested because 1992 was pre-Internet, the market place has changed radically, and the law has to catch up, he concluded.

REPRESENTATIVE GRUENBERG asked if any other states have come up with creative ways to [deal with this problem].

MR. BARNHILL said he did not know, but believed that way to do it is to take the same fundamental question back to the U.S. Supreme Court.

CHAIR HAWKER opened public testimony.

Number 3030

MEGAN TACK, Member, Teens Against Tobacco Use, related that her organization lets youth know about all of the harmful effects of tobacco and tries to prevent its use. She said that money motivates people and if the price of cigarettes is raised it could motivate people to stop smoking or not to start. She explained that a pack of cigarettes costs \$5, and by not smoking for four years during high school she could afford to take a trip around the world, to pay for her first year in college, or to buy a small car. She said that [HB 538] will help prevent smoking by teens.

CHAIR HAWKER asked Ms. Tack if she attends school in Juneau.

MS. TACK replied she does.

CHAIR HAWKER asked if smoking amongst her peers is fairly common.

MS. TACK said it is. She related her experience attending the Gold Medal Tournament dance where she saw many under-aged teens smoking. She shared that her parents both use tobacco products and it bothers her.

Number 3317

REPRESENTATIVE SAMUELS asked Ms. Tack how her friends get the cigarettes and whether they get older friends to buy them.

MS. TACK replied that she doesn't have many friends that smoke, but acquaintances have older friends that buy [cigarettes] for them.

REPRESENTATIVE WEYHRAUCH asked if Ms. Tack is familiar with the smoking court for youth who smoke.

MS. TACK said she is somewhat familiar with that. She mentioned she is on the Juneau Youth Court which has recently started taking tobacco cases.

REPRESENTATIVE WEYHRAUCH asked if it has had any effect to deter smoking.

MS. TACK replied that she is not sure.

CHAIR HAWKER stated his support for youth courts and mentioned the commitment by the legislature in the social services part of the budget to put extra money in for youth courts. He thanked Ms. Tack for her part in the Juneau Youth Court.

Number 3444

REPRESENTATIVE OGG thanked her for her testimony and then asked her how much she thought students would pay for a pack of cigarettes.

MS. TACK said her mom pays around \$5 to \$6 for a pack, which makes her mad because the money could be going toward buying clothes.

REPRESENTATIVE OGG wondered what students were paying for cigarettes when their older friends were buying them.

MS. TACK replied that she did not know.

REPRESENTATIVE WILSON thanked Ms. Tack for her testimony.

Number 3608

JENNIFER APP, Advocacy Director, American Heart Association, stated that this is a health issue because smoking is the leading cause of cardiovascular death in Alaska, and is responsible for one out of every five deaths. She said that this legislation will decrease that number, generate revenue, and save money. She noted that 67 percent of Alaskans like this bill. She spoke about the "red-herring", the concern that this bill would increase the tax evasion problem, mentioned by Emily Nenon in the last hearing. Every state that has significantly increased its tax rate, has received substantially more state revenue than it would have otherwise received despite

consumption declines or any increase in smuggling or tax avoidance, she pointed out.

MS. APP, referring to the discussion during the last hearing about the problems New York has encountered with smuggling, said she looked for a state that might be more similar to Alaska for comparison. She explained that Hawaii in 2001 established a stamp tax requirement like Alaska did [in 2003] and also raised the tax. They generated \$75 million last year, up from \$61 million before the increase in tax. She opined that Alaska, with the stamp tax and the proposed tax increase, as well as with the enforcement programs, has the tools in place to effectively increase the tax like Hawaii did.

MS. APP noted that only 4 percent of smokers buy their cigarettes on-line or through mail order. She said that that number is not expected to change because over 80 percent of smokers are trying to quit, which means that their smoking purchasing habits tend to be to buy one pack at a time. That population is not seeking out Internet sales to buy in bulk, she concluded. She stated her strong support for the bill.

Number 4021

REPRESENTATIVE OGG asked what the decrease of youth smoking was in Hawaii.

MS. APP said she could get that information for the committee.

REPRESENTATIVE OGG asked what the impact of advertising has on youth smoking.

MS. APP replied that from 1995 to 2003 there has been a 50 percent decrease in Alaska of high school student smoking. During that time the tobacco tax increased up to \$1 a pack in 1997, and at the same time, the money for the 1998 Master Settlement Agreement started being put towards tobacco prevention and control, a counter-marketing campaign. Because of the overlap of those two factors, it is very hard to determine what was responsible for the decline. For every 10 percent decrease in the price of cigarettes, there is about a 7 percent decrease in youth smoking, she related. Other states that have not increased the tobacco tax, but have started a prevention campaign with the money from the Master Settlement Agreement, have also seen a decrease.

Number 4300

REPRESENTATIVE OGG, referring to the increase in tax and the potential increase in bootlegging, inquired if the people who are dealing in black-market cigarettes are making a profit off of youth.

MS. APP deferred to Ms. Bales for the answer. She noted that because of the continued decrease in youth smoking it doesn't seem to be true that youth are taking advantage of bootlegged cigarettes. She pointed out that in the years that the tax was increased, 1997 to present, there has been an increase in revenue generated by the tax, about \$47 million a year, and there has not been a dip or drop that would suggest effective bootlegging.

REPRESENTATIVE OGG said the present tax seems to be doing the job of decreasing smoking.

MS. APP agreed but said that there are still some pretty high smoking statistics: 44 percent of Alaska Native youth smoke, 26-27 percent of adults smoke, which is more than most states. She mentioned that other states are increasing the tobacco tax to keep up with inflation so that it has an impact.

Number 4646

DORIS ROBBINS, Member, Juneau Clean Air, said she also volunteers for the Alaska for Tobacco Free Kids.

TAPE 04-17, SIDE B

MS. ROBBINS continued to say that she supports Teens Against Tobacco, also. Preventing kids and adults from smoking is the most important goal of this bill. She said in 1998 the cost to Medicaid from tobacco caused illnesses was \$60 million. She suggested that increasing the tobacco tax will help recover some of those costs, and she called it a pre-insurance charge for when smokers have exhausted their own funds and must go on Medicaid. She cited an example of a friend who died about a year ago who was in this situation.

CHAIR HAWKER requested that Ms. Robbins provide a copy of her written testimony for the members of the committee.

MS. ROBBINS continued saying that protection from smokers in U.S. Department of Housing and Urban Development (HUD) and Alaska Housing needs to be considered in this bill. Secondhand

smoke is a problem for the elderly, she explained, saying that she, herself, has had chronic illness caused by secondhand smoke. She concluded by saying that tobacco must begin to accept responsibility for its costs and she asked the committee to consider all that she has said and raise the tobacco tax.

Number 3905

VANESSA SALINAS, Coordinator, Smoke Free Anchorage Coalition, related that she works with youth groups in Anchorage who educate their peers on the dangers of tobacco use and secondhand smoke. She said the youth in her group are aware of advertising tactics used to make smoking attractive, as well as the consequences of smoking. The kids are telling her that the use of chew is on the rise in Anchorage. She pointed out that the more cigarettes cost, the less likely kids are to buy them and get addicted. Raising taxes will save lives, she concluded.

CHAIR HAWKER noted that Representatives Ogg, Rokeberg, and Seaton were in attendance.

Number 3630

CHRISTIE GARBE, Chief Executive Officer, American Lung Association, spoke in support of [HB 538]. She remarked that the tobacco tax increase is one strategy along with the counter marketing pieces, youth activism, community activism, and enforcement all working together to create the 50 percent reduction in youth smoking. She advocated for keeping the price of cigarettes high, because an estimated 12,000 lives have been saved because of the reduction in youth smoking. It costs the state and citizens of Alaska over \$6.38 per pack in healthcare costs and lost productivity, so even at \$2.00 per pack, this activity is still being subsidized, she noted. She stated the importance of keeping the price of cigarettes high and her appreciation for the committee's work.

REPRESENTATIVE ROKEBERG asked Ms. Garbe to describe the history of the use of the funds from the [1998 Master Settlement Agreement] for tobacco prevention and control programs, and the status of the current budget.

MS. GARBE responded that Alaska brings in about \$25 million each year from the Master Settlement Agreement and 80 percent is being used for capital projects, and 20 percent, \$4 million to \$5 million per year, could be used for tobacco prevention and control programs. The Center for Disease Control and Prevention

recommend a minimum of \$8 million a year for those programs; however, since FY 99 only \$1.4 million, a small portion of that \$20 million, has been used for that purpose. She explained that the tobacco control community works each year to get more of the \$20 million left for tobacco prevention and control programs.

REPRESENTATIVE ROKEBERG asked about the latest budget figures related to Medicaid and tobacco cessation programs.

MS. GARBE said it is her understanding that \$1,000,000 has been put into a budget amendment to be returned to the tobacco prevention and control programs, but the other \$500,000 still needs to be returned so that the full 20 percent is available for use. Only in FY 03 was the full 20 percent actually available to be used, she said.

REPRESENTATIVE ROKEBERG asked if there is a connection between those programs and this legislation.

Number 3141

MS. GARBE replied absolutely not and emphasized, "We are only in favor of the tax because its health benefits. We're not interested, nor do we expect any of the revenue for these programs." She maintained that the moral fiber of the Master Settlement Agreement funds should be the funds that are used for these tobacco prevention and control programs.

REPRESENTATIVE ROKEBERG said he wanted to make a point to the committee that this has been an on-going battle for a number of years. He said, "All of this should be weaved together in the web of our lawmaking in terms of public policy and where we are going. You folks should be aware that the Master Settlement Agreement money comes from a 45 cent tax per pack to the smoker." One of the portions of the agreement is to put money into tobacco prevention and cessation programs, which, he opined, has failed to be adequately done. He said he is concerned about going forward and increasing taxes on the smoking public, but not funding the programs that they have paid for. He stated his concern about not having control over where the money collected by the tax is going.

Number 3000

CHAD BURNETTE shared personal insights about growing up in a smoking family. He surmised that if it had cost more to smoke it is possible that members of his family might have quit or not

smoked as much. He mentioned the cost to taxpayers in terms of money and loss of income from tobacco-related illness. He said he isn't sure a tax could be created that is big enough to offset those costs. He posed the question, "What's costing us more, doing nothing about it, or perhaps, implementing a tax that could save lives and money."

Number 2715

MR. ELERDING related that even though the tobacco tax of 1997 was successful in cutting the numbers of people who smoke, every tax has unintended consequences. He urged the legislature to exercise caution and use laws already on the books to deal with underage smoking, and not "trample the rights of legitimate Alaska business interests and of Alaska's adult smokers by raising the tax to fix the problem because, invariably, it will create unintended consequences."

CHAIR HAWKER thanked Mr. Elerding for pointing out the technical aspects that would affect his business. He related that [the committee] would be working its way through [those issues] in the bill.

REPRESENTATIVE ROKEBERG asked Mr. Elerding if he is involved with vending machines in his business.

MR. ELERDING replied that he has one vending machine in Kodiak.

REPRESENTATIVE ROKEBERG said it has been suggested that the licensing fee for vending machines be increased from \$25 to \$50. He asked Mr. Elerding for his opinion on the impact this would have.

Number 2254

MR. ELERDING opined that most people who have vending machines are operating in a bar environment where there are adult consumers, and an increase would not be a large burden to them.

CHAIR HAWKER clarified that the amount is \$50 per license, not per machine.

REPRESENTATIVE ROKEBERG wondered what amount other municipal governments are charging for tobacco tax.

CHAIR HAWKER closed public testimony. He noted, with some consternation, that public testimony had been specifically

extended at the request of the [tobacco] industry who elected not to testify today.

Number 2103

MS. BALES, in response to Representative Rokeberg's question about municipal excise taxes, related that Anchorage, Juneau, and Fairbanks levy such taxes. Anchorage and Juneau levy a tax on cigarettes of 30 cents per pack, and Fairbanks charges a straight 8 percent excise or sales tax.

REPRESENTATIVE ROKEBERG asked if the local municipalities collect the tax similar to the way DOR collects it, and if DOR works with them in any way.

MS. BALES replied that DOR does not collect the tax on their behalf. She said it is her understanding that the taxpayer base is very similar to DOR's.

REPRESENTATIVE ROKEBERG asked if any city could levy a tax for tobacco products.

MS. BALES said she believes so.

REPRESENTATIVE SAMUELS inquired what the penalty is for giving tobacco products to minors.

MS. BALES deferred to Mr. Barnhill.

MR. BARNHILL replied it is a criminal law question and he does not know.

REPRESENTATIVE SAMUELS responded that he can find out.

Number 1842

REPRESENTATIVE OGG related a conversation with Steve Porter [Deputy Commissioner, Office of the Commissioner, DOR], of a discussion of page 2 [of the bill]. Representative Ogg requested clarification of whether the provision applies to an individual who imports [cigarettes] or just to a business that does.

MR. BARNHILL explained the aspects of the bill beginning on page 4. Under the Alaska State Constitution an innocent owner is protected from by a due process right and all statutes [in the bill] have been drafted to protect that right, he said.

Equipment and material used in the manufacturing, sale, offering for sale, or possession for sale, barter, or exchange of cigarettes can be seized during criminal activity such as selling unstamped cigarettes, he explained. Aircraft, vehicles, or vessels used to transport, as well as money, can be seized. The seizure process involves going to court to get a court order and showing probable cause, he said. There is a provision for seizing property without getting a court order, but it has to be incident to a valid arrest or search, subject to a prior judgment, or if there is probable cause, he noted. The courts are always involved and notice in various forms has to be given to owners after the seizure has taken place. Next is a court hearing to decide what happens to the property, he said.

MR. BARNHILL referred to page 6, subsections (e) and (f), as the provisions that protect innocent owners. Subsections (h) and (i) [on page 7] state where the property is going to go. He termed subsection (j), [page 7], as a unique section that goes beyond what Alaska constitutional law requires. If the vessel or vehicle is in a village and is the sole means of transportation for a family residing in the village, then there is an option for the court to give that property back. Great lengths have been taken to protect the rights of innocent owners, he concluded. He said this does not apply to persons ordering cigarettes through the Internet for personal consumption, only businesses that are in violation of Alaska law.

MR. BARNHILL, referring to questions from Representative Ogg about bootlegging in Alaska, said he does not know of any studies; however, he said he does have information on smuggling in other states and countries.

Number 1236

STEVEN PORTER, Deputy Commissioner, Office of the Commissioner, Department of Revenue, in response to an earlier question by Representative Ogg, clarified that the language in the bill does not apply to individuals. He cited the language on page 5, line 4, "manufactured, sold, offered for sale, possessed for sale" as evidence that applies only to businesses and not private properties.

REPRESENTATIVE OGG offered two examples of where an individual may be liable for forfeiture consequences. The first example is if someone in a village goes to the airport in their car and picks up a package of cigarettes they ordered through the mail.

Then, they barter cigarettes with a kid for salmon. He noted that that person would fit under the stipulations on [page 5, lines 3-6]. He also pointed out that on page 2, [lines 10-16], an individual who imports cigarettes is required to pay the tax. He said he doesn't see the difference between an individual and a business, as far as forfeiture is concerned, as Mr. Porter tried to point out. He voiced a concern about creating a criminal class of people who are just addicted to cigarettes.

MR. PORTER replied that [page 2, lines 10-16] applies to the liability for the tax itself. A person who imports is liable to pay the tax, and that clause only applies to those responsible for paying the tax, he explained. The forfeiture provision is the penalty side of the tax, and only those people who are liable to pay the tax, those who manufacture, sell, or resell cigarettes, are subject to forfeiture, he said. In response to Representative Ogg's first example, Mr. Porter said Representative Ogg is probably correct [in assuming the person would be liable for forfeiture] because that person has entered the next stage, which is to barter or sell.

Number 0737

REPRESENTATIVE OGG restated his concern about the forfeiture part of the bill when the price of the cigarette tax is raised above other states and a criminal element is potentially created in Alaska. "Why should we put ourselves at that height so that we have to adopt these kind of penalties?" he asked. He predicted the penalties will have an impact on villages.

MR. PORTER asked Representative Ogg if he is concerned with the commercial businesses or just the private parties.

REPRESENTATIVE OGG replied that he is more concerned with individual citizens because the tax will be aimed at addicted adult smokers creating a prohibition status on cigarettes.

MR. PORTER responded that he feels page 5, [lines 3-6] are of the most concern to Representative Ogg, and he suggested deleting six or seven words out of that section after first talking to Legislative Legal and Research Services about the legal implications of doing so.

Number 0358

REPRESENTATIVE ROKEBERG asked at what point the regulatory enforcements take place.

MS. BALES replied that last year SB 168, the cigarette Stamp Tax Act became effective on January 1, 2004. One provision states that an individual can bring five packs of cigarettes into the state each month without paying tax.

REPRESENTATIVE ROKEBERG replied that five packs is half a carton, so anyone who brings back a carton of cigarettes from Seattle is a criminal. He said that is awful. He asked if those persons would be subject to an "enforcement net."

MR. PORTER said there are many statutes on the books that people violate every day and that law enforcement looks at the more egregious elements. He compared it to child support enforcement where the worst-case violations are pursued because there is limited number of personnel in enforcement.

Number 0045

CHAIR HAWKER offered a personal observation about the interest of small businesses being protected from predatory pricing from out-of-state vendors by adding strict sidebars.

REPRESENTATIVE ROKEBERG said that this bill would put Alaskans in violation of the law. He asked, "Where do we draw the line?"

TAPE 04-18, SIDE A

MR. PORTER replied that no one is in violation of the law by bringing cigarettes into the state; they are in violation of the law by avoiding paying the tax.

REPRESENTATIVE ROKEBERG asked if that individual needs to pay tax on cigarettes bought in Washington.

MR. PORTER replied yes.

REPRESENTATIVE WILSON replied, "The law's the law. If you break the law, you pay the penalty."

REPRESENTATIVE ROKEBERG suggested not enacting bad laws with unintended consequences.

Number 0125

REPRESENTATIVE OGG pointed out that there already is a forfeiture law in place in Alaska where the cigarettes are

confiscated. He said, in the new bill, other forfeiture provisions for vehicles, boats, and bank accounts have been added, with due process. In Washington, as a result of the tax, there were increased seizures and penalties, \$650,000 from a penalty of \$10 per pack, or \$250, [upon seizure of cigarettes]. For the year 1999, there were four purchaser enforcement operations conducted and the agents issued 17 criminal citations seizing 100 cartons and six packs of cigarettes. He stated a concern that the forfeiture provision is aimed at addicted smokers.

REPRESENTATIVE WILSON replied that perhaps the amount should be changed, but that people who are going to break this law know exactly what the limit is.

MR. PORTER clarified again that the addicted person does not come under the forfeiture statute unless he or she engages in the resale of cigarettes.

Number 0435

REPRESENTATIVE SAMUELS agreed. "You're after the guy who is going to get a van load of cigarettes at a reservation, drive them to Alaska, fly them to a village, and make a whole boatload of money on them." He opined that such a person's vehicle should be confiscated, and that is the point [of the forfeiture statute].

REPRESENTATIVE GRUENBERG voiced new concerns. He suggested making Amendment 3.

REPRESENTATIVE OGG replied that public testimony is being taken and the amendment part of the meeting is yet to come.

REPRESENTATIVE GRUENBERG referred to Section 13, on page 4, line 24, and said it looks like the bill adds a provision to the forfeiture section, but that is not the case. All that the section does is move an existing section of law, AS 43.50.620, which currently has the exact same language, and changes the numbering to subsection (b) of the preceding Section 610. Section 620 becomes the new law with a change of the numbering. He asked Mr. Barnhill if that is correct.

MR. BARNHILL replied yes.

REPRESENTATIVE GRUENBERG continued to say, even if the forfeiture provisions were taken out of this bill, the language

would remain in current law. He asked the committee to look at page 7, line 12-20, where it shows what happens if someone is convicted of misconduct involving unstamped cigarettes in the first or second degree, which is cigarette smuggling, in addition to other penalties for conviction. He said that right now first degree is a Class C felony, second degree is a Class A misdemeanor, and the only difference is the amount. He asked Mr. Barnhill if that is correct.

MR. BARNHILL replied, "Under or over 1000 cigarettes."

REPRESENTATIVE GRUENBERG said even if a person is convicted of a misdemeanor, their aircraft, vessel, or vehicle are subject to forfeiture. He opined it is a very large penalty for a very small infraction. Looking at lines 17-20 he said vehicles or vessels must be forfeited in cases that have nothing to do with smuggling cigarettes. For example, if there is a prior felony conviction or probation, the vehicle is forfeited, he said. He asked why those provisions were included in the bill.

MR. BARNHILL replied that the provisions were put in at the recommendations of the criminal division of DOL. He explained that the person would have to be convicted of felony tax evasion. "These are bad guys and I would just echo Representative Samuels comments earlier - we need to have effective enforcement tools in order to interdict cigarette smuggling and deter crime," he said. He said [DOL] believes it is appropriate to have [that provision in the bill]. It is subject to the constitutional right to protect innocent owners, and to subsection (j) for a vehicle or a vessel in a village, he added.

Number 1108

REPRESENTATIVE GRUENBERG asked if it were true that a village situation would be subject to forfeiture because of a past felony conviction. He asked Mr. Barnhill if he believes it is fair to seize a vehicle or vessel for smuggling a small amount of cigarettes when there is a prior felony conviction at any time.

MR. BARNHILL said he would accept Representative Gruenberg's correction, and he thinks it is an appropriate enforcement tool because tough enforcement provisions are needed in order to deter crime.

REPRESENTATIVE GRUENBERG said that the bill does not go to House Judiciary Standing Committee and there may be constitutional problems. He asked if the forfeiture provision "increases stress on the bill."

MR. BARNHILL replied that in 1981 the Alaska Supreme Court took up and validated the issue of the constitutionality of forfeiture provisions. He opined that there is "no question that this provision is constitutional." The question of fairness is a policy issue for the legislature, he added, but the administration's perspective is that in order to adequately enforce the cigarette stamp tax and bootlegging laws there needs to be adequate tools.

Number 1342

REPRESENTATIVE WILSON said it is important to realize that when other states increased cigarette tax, some people took advantage of the situation in order to make money. She opined that [felons] are more inclined to commit this sort of crime, and the bill must have "teeth in it" in order to prevent this kind of activity. It will keep everyone on his or her toes because the law is not being changed, bootlegging is illegal now, and just the tax is being raised, she opined. She said it is worth it because lives will be saved.

MR. BARNHILL read the conclusion of the World Bank Study called "How big is the worldwide cigarette-smuggling problem?" The study hoped to answer the question about how much of an obstacle smuggling is to higher cigarette taxes, he related. After analyzing all the data, the report concluded:

Countries need not make a choice between higher cigarette tax revenues and lower cigarette consumption. Higher tax rates can achieve both objectives. Cigarette tax revenues can be enhanced still further by effective methods to reduce corruption that will result in diminished cigarette smuggling and increased tax collections. Lastly, cooperative multilateral efforts to increase cigarette tax rates on a regional basis are likely to be an effective way to combat smuggling.

MR. BARNHILL submitted the previous data as an example of the notion that increasing taxes deters the incidence of smoking, and he said that with effective enforcement tools smuggling can be combated.

CHAIR HAWKER requested that Mr. Barnhill provide the study for distribution to committee members.

MR. PORTER remarked about the importance of the fact that the legislature itself chooses the level of enforcement under any piece of legislation. He said that the Public Safety fiscal note contains "a couple hundred thousand dollars" for enforcement. If more cases were to be pursued, a substantial amount would have to be added to the fiscal note, he added.

Number 1740

CHAIR HAWKER moved to adopt Amendment 1, labeled 23-GH2116\A.1, Kurtz, 3/23/04, which read:

Page 1, following line 5:

Insert a new bill sections to read:

*** Section 1.** AS 43.50.030(a) is amended to read:

(a) For each license issued to a manufacturer, and for each renewal, the fee is \$50 [\$5].

*** Sec. 2.** AS 43.50.030(c) is amended to read:

(c) For each license issued to a vending machine operator, and for each renewal, the fee is \$50 [\$25]."

Page 1, line 6:

Delete "**Section 1**"

Insert "**Sec. 3**"

Renumber the following bill sections accordingly.

Number 1820

REPRESENTATIVE ROKEBERG objected for discussion purposes.

CHAIR HAWKER explained that the amendment addresses the disparity between licensing fees in different categories of commercial tobacco dealers. The bill raised one category from \$25 to \$50 and left manufacturers at \$5 and vending operators at \$25. This amendment makes the commercial tobacco activities in Alaska subject to a consistent \$50-a-year annual license, which is consistent with OTP sellers, he said.

REPRESENTATIVE GRUENBERG noted that currently under the bill, subsection (d) is increased. He asked if under proposed Amendment 1, subsections (b) and (c) are increased and (d) is already increased.

CHAIR HAWKER said that is correct. He noted that there is a fifth category, the buyer category - a personal use consumption license - which is left at \$25.

REPRESENTATIVE GRUENBERG stated his support of Amendment 1.

REPRESENTATIVE ROKEBERG asked for a definition of "manufacturer."

Number 2045

REPRESENTATIVE GRUENBERG said the definition is in AS 43.50.170, [paragraph] (6), "manufacturer means a person who makes, fashions, or produces cigarettes for sale to distributors or other persons."

REPRESENTATIVE ROKEBERG wondered if it includes large companies or just local manufacturers. He said he is looking for the rationale behind the \$5 [tax for manufacturers], but would not oppose the amendment.

REPRESENTATIVE GRUENBERG replied that it does not seem to exclude the big companies.

CHAIR HAWKER said that there are no commercial manufacturers in the state and his intent is to make it consistent across the board. He asked Representative Rokeberg if he has removed his objection.

REPRESENTATIVE ROKEBERG removed his objection to Amendment 1.

REPRESENTATIVE GRUENBERG also removed his objection.

CHAIR HAWKER asked if there was any further objection to the motion to adopt Amendment 1. Hearing none, it was so ordered.

Number 2222

CHAIR HAWKER moved to adopt Amendment 2, labeled 23-GH2116\A.2, Kurtz, 3/23/04, which read:

Page 8, line 23, following "report":

Insert "not later than the last day of the month in which this Act takes effect"

Page 8, line 25:

Delete "no later than 30 days after the effective date of this Act."

Insert "in six sequential monthly installments. The first installment shall be paid not later than the last day of the month in which this Act takes effect."

REPRESENTATIVE WILSON objected for discussion purposes.

CHAIR HAWKER explained that proposed Amendment 2 addresses the concern about the floor tax concept raised by Mr. Elerding and wholesale businesses. The bill, as currently drafted would impose a floor tax immediately and in its entirety. [Amendment 2] allows the tax to be assessed immediately, but payable in six sequential monthly installments.

REPRESENTATIVE WILSON asked for clarification about how the tax would work if there is an overlapping of inventory.

CHAIR HAWKER replied that the tax would be on the inventory on hand on the date that the tax changes. [The business] can pay that assessment over six months and all new purchases would be subject to the tax from that point forward, he explained.

Number 2354

REPRESENTATIVE SAMUELS asked if Chair Hawker had checked with distributors to see if six months is a good rotation time.

CHAIR HAWKER said he is not sure rotation time enters into it. Mr. Elerding indicated he believes six months is an appropriate period of time [to make the payments]. He asked Mr. Elerding to speak to the matter.

MR. ELERDING replied that six months is a big improvement over having to pay the whole tax immediately. He said he is concerned that he would have had an excess amount of inventory on hand the day before the legislation passes to accommodate consumer demand, but then the day after, due to the higher price, it would have been difficult to sell the remaining amount. The six-month time period helps solve this problem, he said.

REPRESENTATIVE WILSON asked if this amendment prevents businesses from stockpiling cigarettes before the tax is levied and then charging a higher price for cigarettes on which they've paid no tax.

CHAIR HAWKER said that is correct.

REPRESENTATIVE WILSON removed her objection to the motion to adopt Amendment 2.

CHAIR HAWKER asked whether there was any further objection to Amendment 2. There being no objection, it was so ordered.

Number 2743

REPRESENTATIVE OGG moved to adopt Amendment 3, which read [original punctuation provided]:

Page 4, line 24 through

Page 8, line 9:

Delete

Renumber the following bill sections accordingly.

CHAIR HAWKER objected for discussion purposes.

REPRESENTATIVE OGG explained that Amendment 3 keeps the status quo, whereas [HB 538] adds a new forfeiture section. The amendment would delete Sections 13 and 14 from the bill.

REPRESENTATIVE GRUENBERG stated his support for Amendment 3 because he has concerns about lines 12-20 on page 7, which state there may be additional penalties for persons convicted of previous felonies. Though he said he is in favor of the bill, he stated that he will request a referral to House Judiciary Standing Committee if the amendment fails. He opined that the issue of forfeiture should be a separate bill and that there may be constitutional problems with it. He received an opinion by DOL that a "Quill amendment" similar to the one Senator Ben Stevens put into the sales tax bill would put stress on the bill; however, he said he believes it would put very little stress on the bill and he plans to offer one like it.

Number 3109

REPRESENTATIVE SAMUELS, in response to the forfeiture discussion, opined that smuggling and its penalties are linked to the bill and should not be separate legislation. He referred to page 5, line 1, and said he has no problem with eliminating the words "barter, or exchange", and he said he agrees with Representative Gruenberg that page 7, subsection (i), on prior felonies and forfeiture may be too severe and he suggested adding a sidebar such as "within the last 10 years for a crime

against a person". He disagreed with taking away the entire tool because it would hamper law enforcement, and he referred back to his example of a person who is smuggling cigarettes for a living. He stated his opposition to [Amendment 3], which would delete the entire section.

Number 3226

REPRESENTATIVE WILSON related her opposition to [Amendment 3] because she said she couldn't imagine anyone being upset if a criminal who is on parole has to forfeit a vehicle or vessel.

REPRESENTATIVE ROKEBERG stated that while Representative Ogg has a good point, he agrees with Representative Samuel's position that there has to be some enforcement, but as the bill is written, it goes too far.

REPRESENTATIVE OGG said that the existing statutes seem to be working and he is attempting to make it simple. He voiced a concern about the bill as whole being a revenue device, which may encourage prohibition because of addictions. He opined that [HB 538] goes a step too far and that the current provision, which provides for forfeiture of tobacco products themselves is enough.

CHAIR HAWKER related that his only disagreement with Representative Ogg is whether or not this provision will make criminals out of people who are addicted to tobacco products. He said he agrees with Representative Samuels when he said that this does not penalize the addict who may seek his or her product from an illicit source; this provision pursues the illicit source.

REPRESENTATIVE WILSON said she hears what Representative Ogg is saying, but her conclusions are different than his. Raising the sales tax by a \$1 may encourage illegal activity, however, the very fact that there are high consequences serves as a deterrent.

Number 3713

REPRESENTATIVE ROKEBERG responded that he agrees with Chair Hawker's interpretation of the bill that the provision would be a force against [illegal] commercial activity, but he suggested that the testimony from DOL stated the contrary. The poor enforcement of the "five-pack rule" shows that there is a problem with too much discretion on the part of DOL. He said it

brought out "the remote but illegal opportunity for mischief to be done here to individuals." He opined that is Representative Ogg's point and it concerns him.

Number 3807

REPRESENTATIVE SAMUELS replied that the five-pack rule is the law of the land and would not be changing in this bill, and he agrees that it may need to be addressed, but the forfeitures, if the bartering and exchanging are eliminated, apply to people who are selling cigarettes. He said if [Amendment 1] fails he will offer an amendment to address Representative Gruenberg's concerns, which would fix the problem but leave the tool in place for the smuggler.

CHAIR HAWKER endorsed Representative Samuels' approach should the amendment fail. He said the bill will be held to address this issue as well as the bonding considerations previously discussed today.

REPRESENTATIVE GRUENBERG said he thought the bill was going to be passed out today.

CHAIR HAWKER said it will not be moved out today.

REPRESENTATIVE GRUENBERG requested that the criminal division testify at the next meeting and said he would not offer the Quill amendment today.

CHAIR HAWKER asked if there was any further debate on Amendment 3.

REPRESENTATIVE GRUENBERG asked if there could be an adjournment before having to finish dealing with the current amendment and take it up again at the next meeting.

CHAIR HAWKER asked Representative Ogg if he is willing to withdraw Amendment 3.

Number 4150

REPRESENTATIVE OGG withdrew Amendment 3.

REPRESENTATIVE ROKEBERG explained several conceptual amendments he will reserve for the next meeting. One concerns getting rid of the "two times bonding requirement" and going to a singular requirement, and the other is to get the methodologies into

regulation to allow the different types of securities for bonding.

CHAIR HAWKER explained that the "double-up" bonding is from the time selling is commenced to the time payment is remitted and it is actually a two-month window. He concurred with Representative Rokeberg's observations.

REPRESENTATIVE ROKEBERG said Mr. Elerding's testimony is correct in terms of insurance history, availability of the bonding, and high costs being a problem.

CHAIR HAWKER said he would be receptive to demonstrated financial responsibility being placed in statute. He said it is a discussion he would like to continue.

Number 4426

REPRESENTATIVE GRUENBERG pointed out that the statute referred to earlier by Ms. Bales is under "alcohol" and the language state that the department, in its discretion, may issue permits in place of bonds to certain people. He suggested using that as a model for this bill.

REPRESENTATIVE ROKEBERG said he will be offering an amendment to repeal the five-pack provision and one about "incidental possession resulting from interstate travel for personal consumption only of like three cartons or 30 packs of cigarettes shall not be subject to the forfeiture or other penalties." He said there needs to be a policy statement by the legislature not to make criminals out of innocent citizens. He related that he plans to offer an amendment that reserves all taxation for tobacco products to the State of Alaska, except for a broad sales tax on the part of municipalities. Those communities that have existing tax would be grandfathered in. He noted that one of the problems of the "sin tax syndrome" is that there could be multi-layers of taxation.

TAPE 04-18, SIDE B

Number 4640

REPRESENTATIVE ROKEBERG opined that currently there is a "flat line" with increasing taxes mostly at the municipal level and there is not any major decrease in consumption. He stated that it is a concern of his that the more tax is raised the fewer people smoke, as the pool gets smaller. He requested more

discussion about the level of tax saying that the \$1 is an arbitrary amount.

Number 4424

CHAIR HAWKER observed that there has been extensive testimony on the elasticity of the market, and the inhibiting value of the tax. He offered to arrange for the presentation material to be made available to Representative Rokeberg.

REPRESENTATIVE ROKEBERG stated his skepticism of the data because he opined it has not been in place long enough.

REPRESENTATIVE GRUENBERG remarked to Mr. Barnhill that he does want to pursue the "Quill issue" for the purpose of asserting the sovereignty of the state.

[HB 538 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:34 a.m.