

VIRGINIA CIGARETTE TAX RATE INCREASE GUIDELINES AND RULES

July 30, 2004

These guidelines and rules are published by the Department of Taxation (TAX) to provide guidance to cigarette wholesalers and retailers and to the public regarding the cigarette tax rate increase that takes effect on September 1, 2004. The cigarette tax rate increase was provided for by House Bill 5018 (Chapter 3, 2004 Special Session I). House Bill 5018 provides that the development and publication of these guidelines and rules is exempt from the provisions of the Administrative Process Act (*Code of Va. § 2.2-4000 et seq.*). These guidelines and rules supplement TAX's existing Cigarette Tax Regulations (23 Virginia Administrative Code 10-370-10, *et seq.*). To the extent that there is a conflict between the existing regulations and these guidelines and rules, these guidelines and rules govern the administration of the cigarette tax during the transition from the current tax rate to the new tax rate, including the months preceding and following September 1, 2004. TAX has worked with cigarette wholesalers and retailers to develop these guidelines and rules. As necessary, additional guidelines and rules will be published and posted on TAX's web page at www.tax.state.va.us.

Cigarette Tax Increase

Effective September 1, 2004, the state cigarette tax rate will increase from 1.25 mills per cigarette (2.5 cents per pack of 20 cigarettes) to 1 cent per cigarette (20 cents per pack of 20 cigarettes). On July 1, 2005, the rate will increase again to 1.5 cents per cigarette (30 cents per pack of 20 cigarettes).

Allocation of Virginia (Cigarette Tax) Revenue Stamps

From May 1, 2004, through August 25, 2004 ("the period"), TAX will limit its sale of Virginia (cigarette tax) revenue stamps at the current tax rate ("old stamps") based on the stamping agent's purchases during the same period in 2003. The amount of stamps that each stamping agent may purchase, rounded off to the nearest roll of 30,000 stamps, during the period will be limited to the total of the following monthly purchase allocations:

- May 2004 – no more than 102% of purchases in May 2003
- June 2004 – no more than 105% of purchases in June 2003
- July 2004 – no more than 110% of purchases in July 2003
- August 2004 – no more than 110% of two-thirds of purchases in August 2003

Purchases made since May 1, 2004 and beginning inventory as of May 1, 2004 will count against each stamping agent's purchasing limit for the period. Upon reaching the period's purchasing limit, orders (and payments) for old stamps will be returned unfilled.

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Any stamping agent that exceeds its purchase limit for the period must return any excess stamps to TAX, on demand.

Example of Monthly Purchase Allocations and Period Limit:

	<u>May</u>	<u>June</u>	<u>July</u>	<u>August</u>	<u>Period Total</u>
Allowable Increase in Purchases	2%	5%	10%	2/3 x10%	
2003 Actual Purchases	\$100,000	\$80,000	\$80,000	\$90,000	
Beginning Inventory 5/1/04	\$20,000				
2004 Purchase Allocations	\$102,000	\$84,000	\$88,000	\$66,000	\$320,000 _a
2004 Purchase Orders	\$80,000	\$100,000	\$105,000	\$66,000	\$351,000
2004 Orders To Be Filled by TAX	\$80,000	\$100,000	\$105,000	\$0 _b	\$285,000

Notes:

- The sum of the monthly purchase allocations, less the beginning inventory, serves as the period limit.
- The August order of \$66,000 would cause the period limit of \$320,000 to be exceeded and therefore would not be filled. The stamping agent, however, would be permitted to submit a \$35,000 August order and still comply with the period limit.

TAX may, upon application of a stamping agent, make exceptions to these purchase limits in cases where purchase allocations based on prior-year stamp purchases impose a hardship upon stamping agents operating in good faith under the guidelines and rules. For example, purchase limits for new stamping agents could be based on measures of more recent stamping or purchase activity. Requests must be made to TAX in writing. TAX will provide a verbal response to written requests within five working days, followed by a written response.

For purposes of applying these purchase limits, TAX will consolidate the stamp purchases, stamping history and inventory of a stamping agent with the stamp purchases, purchasing history and inventory of its affiliated stamping agents. "Affiliate" means an individual or business that controls, is controlled by, or is under common control with another individual or business. A person controls an entity if the person owns, directly or indirectly, more than 10 percent of the voting securities of the entity. For the purposes of this definition "voting security" means a security that (i) confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the business or (ii) is convertible into, or entitles the holder to receive, upon its exercise, a security that confers such a right to vote. A general partnership interest shall be deemed to be a voting security.

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Code of Va. § 58.1-1009 provides that any person who sells revenue stamps not affixed to cigarettes is guilty of a Class 6 felony. Under TAX's authority to issue transitional guidelines and rules, however, TAX will allow affiliated stamping agents to transfer stamps between each other after faxing notice to Patrick Musselwhite, Cigarette Tax Stamp Unit, Fiscal Office, Virginia Department of Taxation at (804) 786-3911.

Affixing of Old Stamps During the Transition Period

From July 30, 2004 through August 27, 2004, every stamping agent in this Commonwealth will be allowed seventy-two (72) hours from the receipt of any unstamped cigarettes, to affix old stamps to the cigarettes. This extended time does not apply to the application of new stamps (see the following section). This also may not be interpreted to extend any of the deadlines mentioned below.

Sales of New Stamps

TAX will begin selling stamps reflecting the increased tax rate ("new stamps") by Monday, August 2, 2004. Purchase limits will not apply to sales of new stamps. No transitional stamps will be issued. A floor tax (see below) will apply in lieu of the use of transitional stamps.

Deadlines

The following deadlines will apply to the transition:

- TAX will not sell old stamps after Wednesday, August 25, 2004. In the event of a hardship, stamping agents may petition TAX for an exemption from this deadline.
- Stamping agents and persons operating on their behalf may not apply old stamps to cigarette packs after 11:59 P.M. on Friday, August 27, 2004.

Filing of Floor Tax Returns by Stamping Agents

Stamping agents shall pay a floor tax in lieu of the application of transitional stamps. No later than September 10, 2004, each stamping agent shall file a floor tax return with TAX setting forth the number of packs of cigarettes with an old stamp affixed to the pack in the agent's possession as of 12:01 A.M. on Wednesday, September 1, 2004. The floor tax return must be on a form specified by TAX. Accompanying the floor tax return, each stamping agent shall remit a payment to TAX in an amount equal to \$.00875 multiplied by the number of cigarettes in the agent's possession as of 12:01 A.M. on Wednesday, September 1, 2004.

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The floor tax return for any stamping agent operating as both a wholesaler and a retailer shall set forth the number of packs with an old stamp affixed to the pack that are located in its distribution area or facility as of 12:01 A.M. on September 1, 2004 and the floor tax shall be calculated using an amount equal to \$.00875 multiplied by the number of cigarettes in the distribution area or facility.

Floor tax forms will be mailed to stamping agents not later than August 16, 2004. They will also be available on TAX's web site, www.tax.state.va.us.

Unapplied Stamps

Unapplied old stamps must be returned to TAX at the stamping agent's expense no later than September 3, 2004, or on demand. The stamping agent will receive credit toward future stamp purchases for the return of old stamps postmarked or received by TAX no later than September 3, 2004. Additionally, in order to be eligible for a return credit, the stamping agent must have filed a completed floor tax return, with the requisite payment, no later than September 10, 2004.

Return credits may not be used for future stamp purchases until the floor tax return and remittance has been filed with TAX. Stamping agents may not use an anticipated return credit in calculating their floor tax remittance.

Bonds and Letters of Credit

Starting with the issuance of the new stamps, wholesale dealers will be able to obtain new stamps on credit from TAX by posting a bond or an irrevocable letter of credit:

- The bond or letter of credit must be at least twice the wholesaler's anticipated average monthly Virginia stamp purchases at the new tax rate, as determined by TAX.
- The bond or letter of credit must be conditioned on the payment of the tax for new stamps ordered and received, less the dealer discount, within 30 days of the issuance of the stamps by TAX.
- The bond must be issued by a corporate surety licensed to do business in Virginia and written so that, on timely payment of the premium thereon, it shall continue in force from year to year unless sooner terminated.
- The letter of credit must be from a bank incorporated or authorized to conduct banking business under the laws of the Commonwealth or authorized to do business in the Commonwealth under the banking laws of the United States, or a federally insured savings institution located in the Commonwealth. The bank or savings institution and the form and substance of the letter of credit must be satisfactory to TAX.

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- The bond or letter of credit shall designate the Virginia Department of Taxation, Tobacco Stamp Revenue Unit, P.O. Box 1301, Richmond, VA 23218-1301 as the beneficiary.
- The bond or letter of credit shall state how and where drafts against the bond or letter of credit may be presented.
- The bond or letter of credit shall clearly indicate the expiration date of the instrument.
- In addition to standard references to provisions of the Uniform Commercial Code, the following paragraph must appear in the bond or letter of credit:

“The purpose of this bond or letter of credit is to guarantee to the Virginia Department of Taxation payment for amounts due to it that exceed 30 days. All claims filed by the Virginia Department of Taxation against this bond or letter of credit that state a balance due that is older than 30 days will be paid against this bond or letter of credit.”

- The entity issuing the bond or letter of credit shall provide TAX with at least a 30-day notice before canceling the bond or letter of credit for any reason.

TAX will sell stamps on credit to stamping agents who post a bond or letter of credit as long as the agent's outstanding balance on credit purchases does not exceed the limits of the bond or letter of credit. Stamping agents that have posted a bond or letter of credit may use corporate checks for stamp purchases and payment of outstanding balances. If TAX must make demand upon a bond or letter of credit, it will require the stamping agent to make all future purchases on a cash basis only.

Stamping agents that currently have bonds with TAX should review their bonds to determine whether they meet these requirements.

Appeals

Taxpayers may appeal cigarette tax issues to TAX using the administrative appeals process applicable to other state taxes administered by TAX as set forth in *Code of Va.* § 58.1-1821. Appeals of cigarette tax issues are not subject to the Administrative Process Act.

Penalties for Violating Cigarette Tax Law

Under *Code of Va.* § 58.1-1003, failure by a stamping agent to follow cigarette-stamping procedures may result in the agent having its permit revoked and being found guilty of a Class 1 misdemeanor. Effective July 1, 2004, the administrative penalties for failure to affix stamps imposed by *Code of Va.* § 58.1-1013 will increase from \$25 to \$250 per

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pack and, where willful intent exists to defraud the Commonwealth of cigarette taxes, from \$250 to \$2,500 per pack. Additionally, under *Code of Va. § 58.1-1013*, second and subsequent offenses require a permit revocation of at least one year.

As the floor tax is in lieu of the application of transitional stamps, stamping agents attempting to shift product to their retail outlets, related entities or customers, or receiving any benefit other than normal payment for cigarettes purchased, from retailers for sending product to them during the transitional period to avoid the floor tax at the wholesale level, will be subject to the administrative penalties of \$250 per pack and, where willful intent exists to defraud the Commonwealth of cigarette taxes, \$2,500 per pack. TAX will seek additional assistance from the Department of Alcoholic Beverage Control and the State Police in enforcing the cigarette tax laws during the transitional period.

The failure by a stamping agent to follow these transitional guidelines and rules may result in the agent having its permit revoked.

Guidelines for the July 1, 2005 Cigarette Tax Increase

TAX will issue additional guidelines and rules regarding the July 1, 2005 cigarette tax increase.

Cigarette Tax Compliance Provisions

House Bill 862 (Acts of Assembly 2004, Chapter 1029) changed the current statutory procedures for selling cigarettes by (a) making it unlawful to purchase, possess, or affix stamps without first obtaining a permit from TAX; (b) increasing the penalties for the failure to affix stamps; and (c) requiring stamping agents to file a monthly report with TAX regarding the cigarettes to which they affixed stamps. These changes are effective July 1, 2004.

Cigarette Tax Forms

Revised cigarette tax forms will be mailed to stamping agents not later than August 16, 2004. They will also be available on TAX's web site, www.tax.state.va.us.

Additional Information

For additional information about purchasing stamps and posting a bond or letter of credit, please contact the Cigarette Tax Stamp Unit, Fiscal Office, Virginia Department of Taxation, P. O. Box 1301, Richmond, Virginia 23218-1301, or call (804) 367-8465.

For additional information about stamping permits or monthly reports, please contact the Office of Customer Services, Department of Taxation, P.O. Box 715, Richmond, Virginia 23218-0715 or call (804) 786-3503.

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These guidelines, along with other reference documents, are available on-line in the Tax Policy Library section of TAX's web site, located at www.tax.state.va.us.

Approved:

Kenneth W. Thorson
Tax Commissioner

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