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2021 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

House Bill 1324

(Delegate P. Young)

Ways and Means and Economic Matters

Budget and Taxation

Tobacco Tax and Sales and Use Tax - Out-of-State Sales of Premium Cigars and Pipe Tobacco and Tobacco Smoking Devices

This emergency bill establishes licensure requirements for remote (out-of-state) tobacco sellers. Accordingly, a person located outside of Maryland must be a licensed remote tobacco seller in order to sell premium cigars or pipe tobacco to consumers in the State. An applicant for a remote tobacco seller license must identify the premium cigars and pipe tobacco that the applicant intends to sell and ship into the State, utilize third-party age verification for purchases and deliveries, and consent to being subject to the State tobacco tax. The bill also alters the definition of an “out-of-state seller” as it applies to the tobacco tax and makes various other modifications to tobacco tax provisions as they apply to out-of-state sellers of premium cigars and pipe tobacco. Finally, the bill modifies the definition of “other tobacco products” (OTP), as it applies to OTP licensing and tobacco tax provisions, to exclude tobacco pipes, and specifies that the sales and use tax rate for tobacco pipes is 12% of the taxable price. **The bill’s provisions related to out-of-state sales and their tax rates take effect July 1, 2022.**

Fiscal Summary

State Effect: General fund revenues are not materially affected in FY 2021 or 2022 but increase minimally beginning in FY 2023, as discussed below. General fund expenditures may increase minimally to the extent that penalties are imposed. The Comptroller’s Office and the Alcohol and Tobacco Commission (ATC) can implement the bill with existing budgeted resources.

Local Effect: Local government expenditures may increase minimally to the extent that penalties are imposed. Local government finances are not otherwise directly affected.

Small Business Effect: Minimal; the bill primarily affects businesses located outside of the State.

Analysis

Bill Summary: A person located outside the State must have a remote tobacco seller license before the person may sell premium cigars or pipe tobacco to a consumer in the State. A remote tobacco seller license authorizes the licensee to sell premium cigars and pipe tobacco through a common carrier or private delivery service to a consumer in the State by receiving and filling orders that the consumer transmits by electronic means.

License Issuance and Renewal

The Executive Director of ATC must issue a license to each applicant who meets the requirements for licensure as specified under the bill. An applicant must pay to the executive director a fee of \$25 or an amount set by regulation. The executive director must pay all license fees collected under the bill into the State general fund. The bill further specifies that the General Assembly intends that these license fees be used to administer the bill's licensure provisions.

Unless renewed, the license expires June 30 after its effective date. The issuing official must mail a specified renewal notice to the licensee at least one month before the expiration of the license. The licensee may renew the license for an additional one-year term if the licensee is otherwise entitled to be licensed, submits a renewal application, and pays to the issuing official the \$25 license fee. The issuing official must renew the license of each licensee who meets the applicable requirements. A licensee may not assign the license.

Before the issuance or renewal of any license, the executive director must conduct an investigation with regard to the applicant, the business to be operated, and the facts set forth in the application.

Authorized Disciplinary Actions

Subject to specified hearing provisions, the executive director may deny a license to an applicant, reprimand a licensee, or revoke a license if the applicant or licensee commits specified acts of fraud, is convicted of specified crimes, violates specified laws or regulations relating to the sale of tobacco, or fails to utilize third-party age verification for purchases and deliveries. The executive director must deny a license to any applicant who has had a license revoked under the above circumstances until one year has passed since the revocation and the executive director is satisfied that the applicant will comply with relevant State laws and regulations.

The bill further specifies administrative procedures for the revocation of a license by the executive director. A party to a proceeding before the executive director who is aggrieved

by a final decision of the executive director in a contested case is entitled to judicial review as provided under Maryland's Administrative Procedure Act.

Prohibited Acts and Penalties

A person who acts, attempts to act, or offers to act as a licensed remote tobacco seller without an appropriate license is guilty of a misdemeanor and is subject to a fine of up to \$1,000 and/or imprisonment for up to 30 days. Each day that a violation continues is a separate offense. Similarly, a person who violates any other specified provision of the bill related to remote tobacco sellers is guilty of a misdemeanor and subject to a fine of up to \$1,000 and/or imprisonment for up to 30 days.

Adoption of Regulations by the Executive Director

The executive director must adopt regulations to implement the bill's provisions applicable to the licensure of remote tobacco sellers. The regulations must include minimum standards for third-party age verification services that a remote tobacco seller must use, as well as minimum standards for the types of delivery services a tobacco seller is authorized to use.

Tobacco Tax for Out-of-state Sellers

The bill expands the definition of an "out-of-state seller" as it applies to Title 12 of the Tax General Article (Tobacco Tax) to mean a person (1) located outside of the State that sells, holds for sale, ships, or delivers premium cigars or pipe tobacco to consumers in the State, if specified minimum sale thresholds are met (as provided under current law) and (2) *who is required to hold a remote tobacco seller license* as provided under the bill. Any person who meets the definition of an out-of-state seller as modified by the bill must pay the State tobacco tax on pipe tobacco and premium cigars on which the tobacco tax has not been paid.

The bill further specifies that, for premium cigars and pipe tobacco sold by an out-of-state seller, the tobacco tax rate applies to the actual price paid by an out-of-state seller for a stock keeping unit or, if the actual price paid by an out-of-state seller for a stock keeping unit is not available, the average of the actual price paid by an out-of-state seller for a stock keeping unit over the 12 calendar months before January 1 of the year in which the sale occurs. (Under current law, the tax applies to the wholesale price of the product.) The Comptroller must adopt regulations to implement these provisions.

An out-of-state seller must file an information return required by the Comptroller. The Comptroller must adopt regulations that (1) require an out-of-state seller to maintain records of the cost of premium cigars and pipe tobacco acquired for sale into the State and (2) specify the period for which an out-of-state seller must maintain these records. An

out-of-state seller must allow the Comptroller to examine records maintained in accordance with the bill.

An out-of-state seller must pay the tobacco tax on pipe tobacco and premium cigars by filing a tax return with any supporting schedules on forms provided by the Comptroller by the twenty-first day of the month after a sale of premium cigars or pipe tobacco is made or on dates specified by the Comptroller by regulation. For the covered period, the return must state (1) the stock keeping unit number for any premium cigars and pipe tobacco sold and (2) for each stock keeping unit, the quantity and price of premium cigars and pipe tobacco sold.

The Comptroller may require an out-of-state seller to post security for the tax in the amount of \$5,000 plus the amount, if any, by which the tobacco tax due for any reporting period exceeds \$5,000. The Comptroller may exempt a person from posting security for the tobacco tax if the person is and has been licensed to act as a remote tobacco seller for the past five years and is in continuous compliance with tobacco tax laws and the conditions of the person's posted security. However, a person is not in continuous compliance with the tobacco tax laws for a period if the person has violated specified provisions of the bill with respect to remote tobacco sellers.

Other Changes to Tobacco Taxes

The bill defines "tobacco pipe" to mean a pipe made primarily of meerschaum, wood, or porcelain with a bowl designed to be used without a screen or filter and modifies the definition of OTP to exclude tobacco pipes. Thus, these products are not subject to the OTP excise tax. (Under current law, as enacted by Chapter 37 of 2021, the OTP tax rate for all products other than cigars and pipe tobacco is 53% of the wholesale price.) Instead, the bill specifies that tobacco pipes are subject to the 12% sales and use tax rate that, under current law (as enacted by Chapter 37), generally applies to electronic smoking devices (ESD). These provisions of the bill take effect upon enactment and apply retroactively to any tax imposed on OTP on or after March 14, 2021. The Comptroller must issue a refund to any person who paid the higher tobacco tax on tobacco pipes in the intervening period and applies for a refund.

Current Law: In the State, a person must be licensed under Title 16.5 of the Business Regulation Article (Other Tobacco Products) in order to act as an OTP manufacturer, storage warehouse, wholesaler, retailer, or tobacconist in the State. Chapter 37 of 2021 expanded the definition of OTP to mean a product that is intended for human consumption or likely to be consumed, whether smoked, heated, chewed, absorbed, dissolved, inhaled, or ingested in any manner that is made of, derived from, or contains tobacco or nicotine, with specified exclusions. OTP (1) includes cigars, premium cigars, pipe tobacco, snuff, snus, filters, rolling papers, pipes, and hookahs and (2) excludes cigarettes, ESD, or a drug,

device, or combination product authorized for sale by the U.S. Food and Drug Administration (FDA) under the federal Food, Drug, and Cosmetic Act. (Prior to the enactment of Chapter 37, OTP was defined as any cigar or roll for smoking, other than a cigarette, made in whole or in part of tobacco or any other tobacco or product made primarily from tobacco, other than a cigarette, that is intended for consumption by smoking or chewing or as snuff.)

Section 16.5-217 of the Business Regulation Article generally prohibits a person from selling or shipping OTP, ordered or purchased by mail or through a computer network, telephonic network, or other electronic network by a consumer or unlicensed recipient, directly to a consumer or unlicensed recipient in the State. The provisions of Title 16.5 do not apply, however, to a seller located outside the State when selling, holding for sale, shipping, or delivering premium cigars or pipe tobacco to consumers in the State.

Collection of Tobacco Taxes from Out-of-state Sellers

Chapter 735 of 2019 required out-of-state sellers to pay the tobacco tax on pipe tobacco and premium cigars on which the tobacco tax has not been paid. The Act defined “out-of-state seller” as a person located outside the State that sells, holds for sale, ships, or delivers premium cigars or pipe tobacco to consumers in the State if, during the previous calendar year or the current calendar year, (1) the person’s gross revenue from the sale of premium cigars or pipe tobacco in the State exceeds \$100,000 or (2) the person sold premium cigars or pipe tobacco into the State in 200 or more separate transactions. The enactment of Chapter 735 followed the U.S. Supreme Court’s ruling in *South Dakota v. Wayfair, Inc.* 585 U.S. __ (2018), which upheld South Dakota legislation requiring online sellers with annual sales of over \$100,000 or with more than 200 different transactions to residents in the state to collect the state’s sales tax.

Tobacco Tax for Other Tobacco Products

The tobacco tax rate for pipe tobacco and premium cigars is 30% and 15% of the wholesale price, respectively. For non-premium cigars, the tobacco tax rate is 70% of the wholesale price. These revenues accrue to the general fund. Chapter 37 of 2021 increased the tobacco tax rate for OTP other than cigars and pipe tobacco from 30% to 53%. The Comptroller may require a person subject to the tobacco tax to post security for the tax, as specified.

“Premium cigars,” as defined under State law, means cigars that (1) have hand-rolled wrappers made from whole tobacco leaves where the filler, binder, and wrapper are made of all tobacco, and may include adhesives or other materials used to maintain size, texture, or flavor or (2) are designated as premium cigars by the executive director by regulation. “Pipe tobacco” is defined as any tobacco that, because of its appearance, type, packaging,

or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to smoke in a pipe.

In addition, the State sales tax rate of 6% is imposed on the final retail price of OTP.

Monitoring and Enforcement

Pursuant to Chapter 12 of 2019 and Chapters 359 and 360 of 2020, alcohol and tobacco enforcement duties are transferred from the Comptroller's Field Enforcement Division to ATC effective January 1, 2021. Thus, ATC is responsible for monitoring and enforcement activity related to tobacco licenses. The Comptroller's Office, however, retains duties related to enforcement of tobacco taxes.

Non-Face-to-face Sale of Tobacco Products

The federal Tobacco Control Act (TCA), enacted in June 2009, requires FDA to, among other things, issue regulations regarding the sale and distribution of tobacco products that occur through means other than a direct, face-to-face exchange between a retailer and a consumer in order to prevent the sale and distribution of tobacco products to individuals who have not attained the minimum age for purchase of such products, including requirements for age verification. In a June 2020 report to Congress, FDA advised that it has yet to issue rules contained in TCA related to non-face-to-face sales.

State Revenues: Committee narrative in the 2020 *Joint Chairmen's Report* requested that the Comptroller's Office study ways in which to solve difficulties in properly calculating the correct amount of the excise tax owed for online premium cigar sales. In response, the Comptroller's Office issued a [report](#) on cigar excise tax application for out-of-state sellers. According to the report, the difficulties out-of-state sellers experience in calculating the appropriate excise tax seem to arise from identifying where in the purchasing chain the tax applies. In addition, the report recommends that, for out-of-state sellers, the tobacco tax be calculated by applying the tax rate to (1) the "actual cost" of each stock keeping unit sold online directly to Maryland consumers or (2) the cost established for each stock keeping unit in the out-of-state seller's "actual cost list."

The bill makes various clarifying changes to tobacco tax provisions as they apply to out-of-state sellers that generally reflect the recommendations of the Comptroller's report. In addition, the bill establishes a licensure requirement for remote tobacco sellers located outside of the State. To the extent that the bill results in increased compliance with the tobacco tax as it applies to the remote sale of premium cigars and/or pipe tobacco, general fund revenues increase minimally beginning in fiscal 2023, which reflects the bill's July 1, 2022 effective date for these provisions. Any such impact cannot be reliably estimated but is nonetheless expected to be minimal.

The bill also modifies the definition of OTP as it applies to the tobacco tax to exclude tobacco pipes and specifies that tobacco pipes are subject to an enhanced State sales and use tax rate of 12%. As discussed above, Chapter 37 of 2021 expanded the definition of OTP to include tobacco pipes (as well as filters, rolling papers, pipes, and hookahs) and, thus, subjected these products (which were not previously subject to the OTP tax) to an OTP tax rate of 53%, in addition to the 6% State sales and use tax. The March 2021 Board of Revenue Estimates forecast incorporated estimated additional general fund revenues generated by the Chapter 37 modifications to tobacco tax rates but did not account for any revenue increase from the imposition of the OTP tax on tobacco pipes (which, as noted above, were not previously subject to the tax). Accordingly, it is assumed that State revenues are not materially impacted by the above-described changes made by the bill, particularly since those provisions are retroactive to March 14, 2021.

General fund revenues for ATC increase negligibly beginning in fiscal 2023 due to the collection of license fees under the bill. The annual license fee established by the bill for the remote tobacco seller license is \$25. It is unknown how many sellers will be subject to the bill's licensure requirements and the associated fee; however, the number is expected to be minimal.

General fund revenues increase further to the extent that monetary penalties are imposed for violations under the bill. Any such impact cannot be reliably predicted but is likely to be minimal.

State Expenditures: General fund expenditures potentially increase due to the bill's incarceration penalty. Any such impact, however, is anticipated to be minimal.

The Comptroller's Office advises that it can implement the bill's provisions with existing budgeted resources. ATC can also handle its responsibilities under the bill with existing budgeted resources.

Additional Information

Prior Introductions: None.

Designated Cross File: SB 883 (Senator Guzzone) - Budget and Taxation and Finance.

Information Source(s): Judiciary (Administrative Office of the Courts); Office of Administrative Hearings; Comptroller's Office; Alcohol and Tobacco Commission; U.S. Food and Drug Administration; Department of Legislative Services

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