

VIRGINIA CIGARETTE TAX RATE INCREASE GUIDELINES AND RULES

May 13, 2005

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 July 1, 2005. The cigarette tax rate increase was provided for by 2004 House Bill 5018 (Chapter 3, Acts of Assembly, 2004 Special Session I). Although TAX's implementation of the July 1, 2005 cigarette tax increase will be similar to its implementation of the September 1, 2004 cigarette tax increase, as detailed in these guidelines and rules, there will be some differences. To the extent that there is a conflict between these guidelines and rules and the guidelines and rules issued for the September 1, 2004 cigarette tax increase, 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 July 1, 2005.

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 July 1, 2005.

2004 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.*). 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.virginia.gov.

Cigarette Tax Increase

Effective July 1, 2005, the state cigarette tax rate will increase from 1 cent per cigarette (20 cents per pack of 20 cigarettes) to 1.5 cents per cigarette (30 cents per pack of 20 cigarettes).

Allocation of Revenue Stamps

During April, May and June 2005 (the "allocation months"), TAX will limit its sales of revenue stamps at the current tax rate ("old stamps") based on each stamping agent's usage of stamps during October, November and December 2004 (the "base months"). The amount of stamps that each stamping agent may purchase during each of the allocation months will be limited to its average monthly usage during the base months increased by 4% in April and May and 10% in June in order to reflect seasonal differences in usage between the allocation months and the base months and to accommodate increased demand prior to the tax increase. The purchase limit will be rounded up to the next full roll of stamps.

Upon reaching the purchasing limit for each month in the period, orders (and payments) for old stamps will be returned unfilled. Beginning inventory of unaffixed stamps as of

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April 1, 2005 and stamp purchases made after April 1, 2005 will count against each stamping agent's purchasing limits. Any stamping agent that exceeds its purchase limit must return any excess stamps to TAX.

In the event that a stamping agent does not purchase its entire allocation for the month of April, the unused April allocation will carry forward and may be used in May or June, or partly in both. Unused allocations from the month of May will not carry forward.

This allocation method differs from the allocation method used to implement the September 1, 2004 cigarette tax increase. In 2004, allocations were based on past purchases, rather than usage, of revenue stamps. Also, in 2004, the allocation method limited each stamping agent's total purchases over the four-month allocation period rather than on a monthly basis.

Example of Monthly Purchase Allocations:

In 2004, the stamping agent used 90,000 stamps in October, 80,000 stamps in November and 85,000 stamps in December. Increasing the stamping agent's average monthly usage in the base months, 85,000, by 4% results in a monthly allocation of 90,000 (rounded up from 88,400) in April and May and 120,000 (rounded up from 93,500) in June. Assume each roll is 30,000 stamps.

	<u>April</u>	<u>May</u>	<u>June</u>	<u>Period Total</u>
Monthly Allocation	90,000	90,000	120,000	300,000
Beginning Inventory 4/1/05	35,000			
2005 Purchase Orders	90,000	60,000	150,000	300,000
2005 Orders To Be Filled by TAX	60,000 (a)	60,000	120,000 (b)	240,000

Notes:

(a) As the stamping agent had an initial inventory of 35,000 stamps, the April order of 90,000 would cause the April monthly limit of 90,000 to be exceeded and therefore would not be filled. The stamping agent, however, would be permitted to submit a 60,000 April order (rounded up from 55,000) and still comply with the monthly limit.

(b) Although the stamping agent only purchased 60,000 stamps in May, the unused 30,000 allocation from May does not carry forward to June.

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"

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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.

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 affiliate during April, May and June 2005 after providing notice to TAX. Notice may be faxed to Patrick Musselwhite, Cigarette Tax Stamp Unit, Fiscal Office, Virginia Department of Taxation at (804) 786-3911.

Exceptions to Purchase Limits and Appeals

TAX may, upon application of a stamping agent, make exceptions to revenue stamp purchase limits in cases where purchase allocations based on prior stamp usage impose an undue hardship on a stamping agent 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 activity. Requests must be made to TAX in writing to:

Larry Leach
Tobacco Revenue Stamp Unit
3610 W. Broad St.
Richmond, VA 23220
Telephone: 804-367-6345
Fax: 804-367-2970
Email: larry.leach@tax.virginia.gov

TAX will provide a verbal response to written requests within five working days, followed by a written response.

In order to avoid exceeding their allocations, each stamping agent should monitor its customers' purchases and limit customer purchases to quantities that will not deplete the stamping agent's allocations prior to the end of each month. TAX will not make exceptions to the purchase limits in cases where stamping agents fail to limit customer purchases.

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Deadline for Affixing Old Stamps During the Transition Period

From June 1, 2005 through June 27, 2005, the deadline for stamping agents to affix old stamps to cigarettes will be waived. This waiver 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 June 1, 2005. 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, June 22, 2005. In the event of a hardship, stamping agents may petition TAX for an exemption from this deadline. Stamping agents should contact:

Larry Leach
Tobacco Revenue Stamp Unit
3610 W. Broad St.
Richmond, VA 23220
Telephone: 804-367-6345
Fax: 804-367-2970
Email: larry.leach@tax.virginia.gov

- Stamping agents and persons operating on their behalf may not apply old stamps to cigarette packs after 11:59 P.M. on Monday, June 27, 2005.

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 July 11, 2005, 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 July 1, 2005. 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 \$.10 multiplied by the number of packs of 20 cigarettes and \$.125 multiplied by the number of packs of 25 cigarettes in the agent's possession as of 12:01 A.M. on July 1, 2005.

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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 July 1, 2005 and the floor tax shall be an amount equal to \$.10 multiplied by the number of packs of 20 cigarettes and \$.125 multiplied by the number of packs of 25 cigarettes in the distribution area or facility.

Floor tax forms will be mailed to stamping agents not later than Friday, June 10, 2005. They will also be available on TAX's web site, www.tax.virginia.gov.

Unapplied Stamps

Unapplied old stamps must be returned to TAX at the stamping agent's expense. Stamps must be postmarked, shipped or received by TAX no later than June 30, 2005. Each stamping agent is responsible for counting and reporting to TAX the number of stamps returned. The stamping agent will only receive credit toward future stamp purchases if the old stamps are postmarked, shipped or received by TAX no later than June 30, 2005. 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 July 11, 2005.

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

Stamping agents who purchase stamps on credit by posting a bond or letter of credit should review their bond or letter of credit to insure that it will cover the increased cost of stamps due to the rate increase. The bond or letter of credit must be at least twice the stamping agent's anticipated average monthly Virginia stamp purchases at the new tax rate, as determined by TAX.

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. Effective July 1, 2004, the administrative penalties for failure to affix stamps imposed by *Code of Va.* § 58.1-1013 increased from \$25 to \$250 per 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

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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 also result in the agent having its permit revoked.

Cigarette Tax Compliance Provisions

Effective July 1, 2005, Senate Bill 876 (Acts of Assembly 2005, Chapter 28) makes several changes to the reporting requirements, penalties and other administrative provisions of the cigarette tax laws in order to increase compliance with the cigarette tax and to provide consistency with the Non-Participating Manufacturer (NPM) statute.

Senate Bill 876 allows TAX to suspend or revoke stamping agent permits in more situations. TAX is authorized to revoke a stamping agent's permit for up to one year if the stamping agent fails to file more than one of the monthly cigarette tax reports in a timely manner in a calendar year. TAX is authorized to suspend the permit of any stamping agent that refuses to allow TAX to audit its books and records, refuses TAX access to its premises, interferes with an agent of TAX or violates TAX's rules and regulations. TAX is also authorized to suspend the permit of any stamping agent who violates the cigarette tax provisions with respect to the sale of unstamped cigarettes until such time as the tax and penalties have been paid.

Senate Bill 876 allows TAX to impose civil penalties. A stamping agent that fails to file the monthly report listing all cigarettes stamped in the preceding month is subject to a penalty of \$500 for each day after the due date. Each failure to file the monthly report listing all cigarettes received in the preceding month or the quarterly NPM report is penalized by a \$250 penalty. A stamping agent selling cigarettes after its permit is revoked for failure to file these reports is subject to a penalty of \$250 per pack of cigarettes. Where willful intent is established, the penalty is \$2,500 per pack. Any person who attempts to evade the cigarette tax with respect to less than 3,000 packs is subject to a penalty not to exceed \$500 per pack. Any stamping agent who refuses to allow TAX to audit its books and records, refuses TAX access to its premises, interferes with an agent of TAX or violates the TAX's rules and regulations is subject to a penalty of \$1,000 a day. A stamping agent who violates the cigarette tax laws with respect to the sale of unstamped cigarettes is subject to a penalty of \$500 per pack.

Senate Bill 876 eliminates the unused Class 1 and 2 misdemeanor penalties for failure to file monthly reports and the Class 2 misdemeanor for persons who fail or refuse to allow an audit.

Senate Bill 876 authorizes TAX to conduct background investigations, including criminal records checks on stamping permit applicants. To offset the costs of the investigations, TAX is authorized to charge an application or renewal fee not to exceed \$750 to be applied to the costs of processing applications. Any amount collected in excess of such

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costs as of June 30 in even numbered years will be deposited into the state treasury. TAX is authorized to deny a stamping permit to an applicant that has been convicted of a felony or certain other crimes. Any person who makes a false statement in an application is guilty of a Class 1 misdemeanor.

Senate Bill 876 also extends the due date of the cigarette tax monthly returns from the tenth to the twentieth of the month. The new due date will be effective beginning with the June reports due in July.

Dealer Discount

House Bill 2625 (Acts of Assembly 2005, Chapter 925) increases the dealer discount allowed on the purchase of cigarette tax revenue stamps from 2.5 cents per carton to two percent of the amount charged by TAX for the stamps, effective July 1, 2005. The increased dealer discount will apply to stamps purchased on and after July 1, 2005. TAX will issue revised forms reflecting the new discount for periods beginning on and after July 1, 2005.

Purchasing Revenue Stamps

Stamping agents may purchase revenue stamps in person at the Virginia Department of Taxation, Customer Service Lobby, 3610 West Broad Street, Richmond, Virginia 23230. Additionally, revenue stamps may be purchased on a limited basis at the following locations:

- City of Bristol Treasurer's Office
- City of Danville Treasurer's Office
- City of Fairfax Treasurer's Office
- City Of Lynchburg Treasurer's Office
- City Of Roanoke Treasurer's Office
- City of Waynesboro Treasurer's Office
- County of Culpeper Treasurer's Office
- Virginia Department of Taxation, Norfolk District Office

Alternatively, stamping agents may contract with a courier of their choice and TAX will ship the revenue stamps at the stamping agent's expense. The contract for shipment of revenue stamps is between the stamping agent and its courier. Once a shipment is accepted by the courier, the risk of loss or damage is the responsibility of the stamping agent. It is the stamping agent's responsibility to determine the valuation or amount of insurance that should be applied to the shipment. Stamping agents may notify TAX of the desired valuation or insurance coverage by writing such instructions on the Form TT-2 Order for Virginia Cigarette Tax Stamps. Stamping agents should contact their courier to verify the costs and terms of additional valuation or insurance. TAX accepts no responsibility for loss of or damage to stamps during shipping or for failure to arrange insurance coverage or full valuation for shipped stamps.

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Please contact the Cigarette Tax Stamp Unit if you have any questions:

Virginia Department of Taxation
Cigarette Tax Stamp Unit
P.O. Box 1301
Richmond, VA 23218-1301
804-367-6345

Cigarette Tax Forms

Revised cigarette tax forms will be mailed to stamping agents not later than June 10, 2005. They will also be available on TAX's web site, www.tax.virginia.gov.

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) 367-6345.

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.

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.virginia.gov.

Approved:

Kenneth W. Thorson

Kenneth W. Thorson
Tax Commissioner

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