

POSITION PAPER PREPARED BY TOBACCO DISTRIBUTORS
Concerning Encrypted Tax Stamping
REVISED 10/23/2007 1:15 PM

The Issue: Private manufacturers of cigarette stamping equipment are proposing to state legislatures that the states mandate a change to the manner in which tax stamps are applied to cigarettes. The stated rationale for the proposed change is primarily to allow states to recover excise tax revenue lost due to inadequate tracking and authentication capabilities of current systems. (States currently considering a change to encrypted stamps include: Alabama, Arizona, Georgia, Illinois, Michigan, New York, and Texas.)

Global concerns: We have two over-arching or “global” concerns and a number of operational concerns. Our two global concerns are:

1. No one has yet been able to quantify the extent of the problem that encrypted stamping proposes to fix. Neither the companies proposing the change, nor the various Departments of Revenue can quantify the problem objectively.
2. The states’ ability to realize the revenue recovery promised depends, not upon the system proposed, as much as it does the Departments’ of Revenue ability to police the industry. Changing to the new system without any increase in funding for policing activity would greatly reduce the effectiveness of the new system to the point that it would not be worth the cost of implementation.

Operational Concerns: Beyond the over-arching “global concerns” we have a number of operational concerns and questions that distributors and states need to take into consideration when evaluating a change to the current system.

- 1) Chief among our operational concerns is the problem of neighboring taxing jurisdictions. There are very few distributors left that stamp cigarettes for one state only. Most distributors are stamping cigarettes for sale in more than one state. For example: Alabama allows state and local municipalities to charge tobacco excise tax for which stamps have to be applied. It is not uncommon for a pack of cigarettes intended for sale in Alabama to carry up to 4 different stamps. Changing to the new system in Georgia will mean that distributors will have to maintain dual stamping lines, equipment, maintenance agreements, etc. In addition to increased personnel costs to service and operate, audit and maintain the additional equipment.
 - a. Question to Ask: What is the plan, timeline, target states and order of priority for promoting this initiative in other states?
- 2) Cost recovery for existing equipment is a very real issue for those distributors that do only stamp for product within one state and who may have purchased stamping equipment in the last few years.
 - a. Question to Ask: In other words what does a distributor do with a \$100,000 piece of equipment that has been made obsolete by action of the state legislature?
- 3) We understand that the companies proposing the change are encouraging states to provide distributors with the new equipment in anticipation of the new system recovering more than adequate lost revenue to offset the equipment investment.
 - a. Question to Ask: Who will pay for the new equipment?
- 4) Another concern would be ensuring that, at a minimum, those distributors currently possessing stamping machines be provided new machines. Preliminary discussions raised the issue of smaller distributors being left out because it would be too expensive to provide every distributor with a machine. It was suggested that smaller distributors would have to go to a larger distributor to get their product stamped. We would be **strongly opposed** to this type of arrangement.
- 5) There are currently two providers of digital stamping technology: Authentix and Sicpa. If this initiative is to be considered, we recommend that (provided they both meet performance guidelines) both providers have



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the opportunity to operate in each state. There are two primary manufacturers of stamping equipment: Meyercord Revenue (aligned with Sicpa) and Red Stamp (aligned with Authentix). Distributors need competition in the marketplace to keep technology up to date, costs down, and service levels adequate.

- 6) Referencing concerns 1 & 5 above, it is not unlikely that a distributor serving multiple states could actually have to own and maintain not two...but actually as many as *three* different stamping machines. For example: suppose Georgia decides to approve Authentix for digital stamping, South Carolina decides to approve Meyercord for digital stamping, and Alabama decides that they like the system that they are currently using. In this scenario the distributor would have to own, operate and maintain *three different machines*.
- 7) Any state mandated change requiring new equipment would need to allow adequate time for the manufacturers of this unique equipment to ramp up to meet the demand.
- 8) Any distributor considering purchasing new stamping equipment in a state where a change is being considered would be well advised to either wait and see what the outcome of the initiative is, or contractually ensure with the manufacturer of the stamping equipment that should a change be approved, the distributor would be “made whole”.
- 9) Should this initiative gain traction we would **STRONGLY RECOMMEND** an implementation date no sooner than three years out. This would give adequate time to allow manufacturer’s to ramp up, neighboring states to consider implementing complimentary legislation, distributors to make plans to implement the new system, and DoR to implement new policies, procedures, personnel and systems to support it.
- 10) Any new system is going to have “bugs”. We are concerned that there is only one other state in the country (California) that has made the transition to this new technology.
 - a. Question to Ask: Do you want your state to serve as the “guinea pig” upon which this new system is tested.

Our Position

We acknowledge the limitations and problems with the equipment and system we currently have to work with. We are not opposed to new technology. As the tobacco tax collectors for state governments, no one knows the challenges of the current system as well as we do. However, our organization is interested in proactively seeking an *industry-wide* (rather than a state-specific) solution to this issue.

Our Commitment

Representatives of our organization met recently with representatives of both digital stamping equipment companies. We are available to communicate with *all* of the stakeholders in this issue: state departments of taxation (in those states currently using or considering digital stamping), wholesalers, manufacturers, retailers, stamping equipment manufacturers, etc. to attempt to work through all of the details involved and perhaps develop a model that might be implemented across the country.

Digital stamping may well deliver everything it promises. However, we would hope that any change to the current system be well thought-out, well researched, and take into account the concerns we have enumerated herein.

For more information, see attached fact sheet and/or contact: Greg Martin, Executive Director at 770-932-5810.

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