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Senate Finance Committee Testimony: International Premium Cigar & Pipe Retailers Association Supports Senate Bill 1004

Mr. Chairman and members of the Committee:

Thank you for giving me the time to make some brief remarks regarding Senate Bill 1004. The International Premium Cigar & Pipe Retailers Association is made up of small retailers from across the country; here in Michigan we represent over 100 small business owners' stores that specialize in premium cigars.

As proven in other states with OTP cigar tax cap, Senate Bill 1004 will be a fiscal windfall for the state and Michigan's small businesses. The cigar tax cap will greatly reduce incentives for internet purchases by Michigan cigar consumers, keeping Michigan business in Michigan, and increasing tobacco excise and retail sales tax collections for the state. The successful partnership of business and government that started in Oregon in 2001 will be repeated in Michigan, as evidenced by cigar tax caps implemented in five other states.

In addition to Oregon, Washington (2005), Rhode Island (2006), Wisconsin (2007), and Iowa (2007), have implemented cigar tax caps with positive revenue results. In 2011, Connecticut was the latest state to implement the 50-cent cigar tax cap.

Capping the excise tax on premium cigars paid by retailers will encourage cigar consumers to purchase their cigars locally and not via internet or mail order operations based out of the state. These companies do not collect any applicable state taxes thereby offering the consumer a much lower price compared to in-state brick-and-mortar retailers who must charge state excise and sales tax. Competition will be restored in the marketplace; the 50-cent cigar tax cap will result in a positive economic impact for Michigan; the state will collect more excise, sales, and business income taxes from in-state businesses. ***It is important to note that this legislation does not reduce the OTP rate nor does it raise the OTP tax on other cigars*** – it just puts a cap on the amount that is collected on each cigar.

Historical Background of the 50-cent Tax Cap

In 1997, Oregon's state legislature increased the OTP excise tax rate from 35% to 65%, ranking it among states with the highest OTP excise tax rate. This regressive tax rate caused a substantial loss of business for small retailers and loss of associated tax revenues for the state. In 2001, the legislature approved the cigar tax cap, limiting the OTP excise tax rate paid by retailers to 50 cents per cigar. Following its implementation, revenues increased demonstrating that retail sales of cigars returned to in-state, small brick-and-mortar businesses. In fact, all five states that have a OTP tax cap have seen an increase in the amount of taxes collected.

Michigan retailers are losing revenue to out-of-state businesses due to the state's-excise tax on premium cigars. Implementing a 50-cent cigar tax cap will return business to the state and provide a competitive environment for small businesses.

On behalf of the members of the IPCPR, we thank you for taking this legislation up and urge you to pass Senate Bill 1004.

Respectfully,

Chris McCalla
Legislative Director

Cigar Taxes In Michigan

The Truth about Lost Revenue

Explanation of the Tax

- Box of Cigars from manufacturer costs $100.00
- Acquirer of Cigars pays $32.00 to State on 20th of month following acquisition.
- New Michigan Cost is $132.00
- Retailer sells for approximately $160.00

Explanation Internet Cigar Sales

- Out of State Company pays $100.00 for Cigars
- Out of State Company sends catalogs and emails to Michigan Cigar Smokers
- Michigan Consumers and unlawful retailers place orders from Out of State Company
- Out of State Company sells product for $120.00
- State does not collect $32.00 and Michigan Businesses lose the sale and profit opportunity
- State also loses the 6% Sales Tax

Actual Example

Name of Cigar	#/ bx	Mfg Cost	Michigan Cost w/ 32%	Average Sell Price MI	JR Cigar	Cigars Inter-national	Holt	Thompson	FAMOUS
MACANUDO PRINCE PHILLIP	10	47.90	63.23	72.00	55.78	55.78	55.78	66.00	55.99
ROMEO RESERV CHURCHILL	25	81.88	108.08	175.00	147.38* FREE 6 CIGARS	147.38	147.38	150.00* -$30.00 FREE SAMP	147.38* FREE 5 PK
Helix 542	25	50.75	66.99	85.00	58.04	58.04	58.04	N/A	63.99
Sancho Panza Dulcinea	20	54.50	71.94	110.00	72.51	72.51	72.51	101.00	72.99
Montecristo White Churchill	27	143.00	188.76	280.00	219.96* Free Watch Offer	257.40	257.40	260.00* Free Sampler	257.99
Don Diego Robusto	27	86.25	113.85	140	94.88	94.88	94.88	N/A	94.99

The Competitors of Michigan Retailers

- There are approximately 15 major Online Cigar Retailers that represent an estimated 80% of the sales into Michigan
- The remaining 20% is divided up by as many as 300+ potential mail order and internet sellers
- It is estimated that over 60% of all Premium Cigars consumed in Michigan are Non OTP and Sales Tax Paid Cigars

Consumers Reason For Purchasing Outstate

- Price-Price-Price. The consumer can start with a savings of 32% from the OTP and add another 6% for the Sales Tax
- Catalogs Soliciting Business sent to homes on a weekly basis
- Email Solicitations Daily
- No risk of getting caught as there is no enforcement

A Bigger Problem: Retailers Purchasing Out of State

- For the unethical retailer the gains are even greater as they have the opportunity to sell large quantities of untaxed cigars.
- It is too easy to do....Buy one box from a Michigan Wholesaler and you have an OTP Tax Paid Invoice in your possession. Then, simply refill that box by ordering online and not paying the tax ever again. Upon audit, the invoice shows that the cigars on the shelf are tax paid
- Average Margins for ethical retailers on Cigars are 35%...Don't pay the tax and your margins double
- Unethical retailers drive tax paying ethical retailers out of business

Another Potential Problem: Unethical Wholesalers Purchasing Out State

- The average margin for a legitimate wholesaler is 8%. If this operating margin can be increased by 32%, it does not take long for a wholesaler to generate huge profits given their volume.
- A trunk filled with cigars brought in from Pennsylvania can be worth as much as $5,000.00, a truckload...$50,000.00
- Unethical behavior puts legitimate tax collecting wholesalers out of business

FACT

- When Taxation is so great that the monetary value of an unethical transaction creates an opportunity , the criminal element will become involved.
- This is especially true if there is little or no enforcement.

Why Implement a .50 Cent Cap on Cigars

- Reduce the 32% Tax and See an Increase in OTP Revenue
- Remove the Opportunity for Unethical Businesses to prosper
- Keep the Cigar Business Here in Michigan Where it Belongs
- See an increase in SalesTax Revenue
- Create increased revenue to fund enforcement
- Create Jobs in Michigan Retail Stores as sales increase