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Revenue Committee  
January 24, 2013

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[LB25 LB26]

The Committee on Revenue met at 1:30 p.m. on Wednesday, January 24, 2013, in Room 1524 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB25 and LB26. Senators present: Galen Hadley, Chairperson; Paul Schumacher, Vice Chairperson; Tom Hansen; Burke Harr; Charlie Janssen; Beau McCoy; Pete Pirsch; and Kate Sullivan. Senators absent: None.

SENATOR HADLEY: We have a quorum, so we'll get started. My name is Galen Hadley, I'm a senator from Kearney. To my left is Senator Schumacher from Columbus; to his left will be Senator Pirsch from Omaha; and to his left is Senator Sullivan from Cedar Rapids. On my far right is Senator Burke Harr, who will be here; and next to him is Senator Janssen from Fremont and then Senator McCoy from Omaha and Senator Hansen from that great city of North Platte. Our committee counsel is Mary Jane Egr Edson. We want to welcome her again to the committee. This is her second meeting that she is giving us legal advice. And our research analyst is Bill Lock, who is in the office. Matt Rathje decided since his wife had a baby yesterday, he might want to stay home, (laughter) so Laurie is handling the clerking duties for us today. We appreciate that very much, Laurie. And I have a note here on the pages, Nathan Funk from Norfolk, right? And Evan Schmeits from Columbus. Got it right. If you'd please turn off your cell phones or put on vibrate while in the hearing room. The sign-in sheets for testifiers are on the tables by both doors and need to be completed by everyone wishing to testify. If you're testifying on more than one bill, you need to submit a form for each bill. Please print and complete the form prior to coming up to testify. When you come up to testify, hand your testifier sheet to the committee clerk. There are also clipboards in the back of the room to sign if you do not wish to testify but would like to indicate your support or opposition to a bill. These sheets will be included in the official record. We will follow our agenda posted on the door. The introducer or a representative will present the bill followed by proponents, opponents, and neutral. Only the introducer will have the option for any closing remarks. As you begin your testimony, state your name, and spell it for the record. If you have handouts, please bring ten copies for the committee and staff. If you only have the original, we will make copies. Give the handouts to the page to circulate. It is possible that you will see people either gone right now or senators that do get up and leave; we are in the process of introducing bills, so senators have to introduce bills in other committees, so please do not feel offended if they get up and walk out. It has nothing to do with the bill or your testifying, on doing that. And lastly, I assume one of these days I'll get to chair the committee I'm Chair of, but that will not happen again today. (Laughter) So my maiden voyage of being Chair is still being postponed to a later date. Senator Schumacher, I'm turning it over to you, but if you wouldn't mind screwing up a little so they don't think I'm replaceable. (Laughter)

SENATOR SCHUMACHER: Okay. Let's open the hearing on LB25. Senator Jones, if you want to...oh, I mean Hadley. (Laughter) [LB25]

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SENATOR HADLEY: Vice Chair Schumacher, members of the Revenue Committee, my name is Galen Hadley, and I represent the 37th Legislative District. Today I introduce LB25, a bill that would require Nebraska license cigarette wholesalers, or, as we commonly refer to them, stamping agents, to pay for cigarette taxes on or before the 15th day of each month rather than prior to or at the time of sale, gift, or delivery to the retail dealer. Very simply, this bill is making a minor adjustment in the stamp procurement process that addresses a roughly \$64 million cash flow problem for our stamping agents. Stamping agents are charged with attaching cigarette stamps to each cigarette package sold by retailers. To accomplish this stamping, agents pay the Tax Commissioner up-front for the stamps. Stamping agents must estimate the volume of stamps needed because they are only able to deliver cigarettes when the retail orders...retailers order them. This usually results in the purchase of more stamps than required and carrying those stamps in inventory until the next time they purchase stamps. Additionally, stamping agents cannot recoup their stamp cost until such time as a retailer places cigarette orders. That period of time can be often be weeks, and that is the cash flow problem. LB25 significantly remedies the problem by requiring that stamping agent pay for their stamps on or before the 15th day of every month. To ensure that the state is paid, LB25 requires stamping agents to file surety bonds with the Tax Commissioner or to deposit money or other security with the Tax Commissioner in a form and an amount as the Tax Commissioner deems necessary. A second provision in LB25 would change the filing date when stamping agents must file their monthly returns with the Tax Commissioner from the 10th day of each month to the 15th day. The current ten-day reporting deadline is sometimes difficult for stamping agents to meet, and the extra five days would provide sufficient time for their response. Thank you, and there are testifiers behind me that will be able to answer any questions you might have. I would also be willing to answer any questions that you might have that I can help with. [LB25]

SENATOR SCHUMACHER: Questions for Senator Hadley? Seeing none, any proponents? [LB25]

SENATOR HADLEY: Thank you, Mr. Vice Chair. [LB25]

MICK MINES: Senator Schumacher, members of the committee, for the record, my name is Mick Mines, M-i-c-k M-i-n-e-s. I'm a registered lobbyist for the Nebraska Grocery Industry Association, and I'm here today in support of LB25. The Nebraska Grocery Industry Association is a membership organization, and we include as members the Nebraska Licensed Wholesale Cigarette Dealers, who for generations have been stamping the cigarettes throughout Nebraska. I'd like to thank Senator Hadley for bringing the matter of stamping to your attention because it is truly a cash flow issue that we believe is easily remedied by LB25. As the senator explained, cigarette wholesalers purchase those 60...each package, each stamp is 64 cents retail.

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As a commission or discount to the wholesaler for stamping those cigarettes, we buy that 64 cent stamp for roughly 63...or 63.2 cents. We get a discount of about 1.2 cent per stamp for affixing the stamp and all the process that goes into it. When we...it's by statute now, we are required to pay either in advance or at time of delivery for those stamps. And when we do that, there is a time frame, as Senator Hadley mentioned; it usually meant it's days, but very often it's weeks in time. And our members in that time period, first of all, they pay for the stamps, they then have to secure the stamps to the cigarettes. They prepare the packages, they segregate, and maintain an inventory of the stamped cigarettes. They collect the stamp fee from the retailer. So there's a long process between the time they pay the Tax Commissioner for the stamp and the time they're able to recoup that stamp cost back from the retailer. What we're asking in the bill is that we be allowed to pay on the 15th day of each month for the stamps. We're going to pay the same amount, the revenue stream should be the same. And I might give you a little bit of history on the cigarette stamps and how that has changed over time. Since the 1960s, cigarette sales, obviously, have declined, and in 2003, it was...it was kind of a steady decline. And in 2003, LB759 increased the price of that cigarette stamp from 34 cents to 64 cents. And that resulted in a 14 percent decline in cigarette sales that next year, so it had a dramatic effect. And since then, cigarette sales have continued to decline. As an example, in 2000, sales of cigarettes or cigarette stamps, there was a total of 129.4 million cigarette packages were sold. Ten years later that dropped to about 100,000...100,200,000 cigarettes. So cigarette sales are dropping. We all know that. Conversely, the revenue from cigarette stamp tax is dropping for us as well. In fact, in 2002, the year before the increase went in, cigarette wholesalers, our 1.85 percent discount that we get for performing the stamping duties...in 2002, all wholesalers received about \$4.3 million for performing those functions. Today, we're receiving...not only did the price of the cigarette stamp go up, but the Legislature, rightly, lowered the percentage of the stamping tax from 3.4 percent to 1.85 percent, which it is today. When that happened, it was almost revenue neutral, but after ten years, today, cigarette wholesalers, at a 1.85 percent discount, have gone from \$4.4 million to about \$1.85 million, so our revenues have declined. Granted, cigarettes...we aren't stamping as many cigarettes because of the decline in the cigarette sales. However, you know, we do have business functions that have increased, just like every other business. We have labor for the preparation of the products for stamping and affixing the stamps, and, as I mentioned before, segregating and maintaining inventory controls. We have stamping machine maintenance and/or lease, and we have floor space where we have to maintain the cigarettes. We have, you know, insurance and maintenance of facilities, stamping supplies. We also have...these are very valuable. We have theft, we have shrinking, shrinkage because the machines will eat the stamps sometimes. So we have business costs that have continued to increase while our revenues have decreased. We've got fixed assets that just won't go away. We simply ask that LB25 provides us with a fair compensation for what we do. Our revenues have declined for doing the same job that we've done, and we would ask that you advance this bill on to General File. Thank you. And I'd be glad to answer any questions. [LB25]

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SENATOR SCHUMACHER: Any questions for Mr. Mines? Senator Pirsch. [LB25]

SENATOR PIRSCH: So LB25...with respect to the language in here that's crossed out regarding MIRF, that doesn't have any substantive, right, effect? Is that just that the bill drafter happened to open up that section and is updating... [LB25]

MICK MINES: Right, right. [LB25]

SENATOR PIRSCH: So, so just ignore the MIRF stuff in here then. [LB25]

MICK MINES: Yeah (laugh). Right, there is no more MIRFs. [LB25]

SENATOR PIRSCH: There's not a tie to the substantive nature of your bill. [LB25]

MICK MINES: That's correct. [LB25]

SENATOR PIRSCH: I don't have any other questions. [LB25]

SENATOR SCHUMACHER: Any other questions? Thank you, Mr. Mines. [LB25]

MICK MINES: Thank you. [LB25]

SENATOR SCHUMACHER: Any other proponents? Seeing none, any opponents? None of those either? Any neutrals? [LB25]

DOUG EWALD: (Exhibit 1) Vice Chair Schumacher, members of the Revenue Committee, my name is Doug Ewald, E-w-a-l-d, Tax Commissioner of the Nebraska Department of Revenue. I appear before you today in neutral capacity with regard to LB25. Nebraska licensed resident and nonresident stamping agents have always required...have always been required to prepay the cigarette tax at the time they purchase the cigarette tax stamps. That has been required since the cigarette tax was first imposed back in 1947. There have only been a couple of cases where the department has not received proceeds from the tax, even though the stamping agents were only required to provide a surety bond back then of \$1,000. This method of prepaying the cigarette tax when the stamps are purchased is also required in at least 45 states that have a cigarette tax, and all six states adjacent to Nebraska require this prepayment. In 2012, resident and nonresident cigarette stamping agents prepaid approximately \$5 million per month in cigarette taxes, while the largest out-of-state stamping agent in 2011 paid approximately \$672,000 in cigarette taxes each month. I would also note that prepayment significantly reduces the risk of insufficient-fund checks being received by the state. Today, stamping agents are required to provide a \$10,000 surety bond. However, if prepayment of cigarette tax is eliminated, then I

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anticipate the department would implement significantly increased bonding requirements. If LB25 advances, I would strongly recommend that the effective date be changed to January 1, 2014. It would be simpler to administer for several reasons: First, the department did not need to make significant changes to electronic filing requirements associated with monthly cigarette tax reports filed by stamping agents. The requirement was adopted in LB590, which was in the last, 2011 legislative session; it became effective January 1 of this year. LB590 allows us to track every "stick in the state." So every cigarette is tracked in conjunction with the Master Settlement Agreement, which is a nationwide agreement. Second, new bonding amounts would also coincide with the license renewal of cigarette wholesalers. Today, every cigarette wholesale license expires on December 31. A new one is granted January 1 each year. And lastly, split periods make it difficult for auditing purposes. If you're going to change something one way and then change it another way midstream, creates some difficulty for us from an auditing perspective as well as the requirements when we give stuff to the AG's Office for Master Settlement reports. We provide them to them on an annual basis. So there's a couple of things there, so that's the extent of my testimony today with respect to a little bit of the history, in a neutral capacity, and I'd be more than happy to address any questions you might have. [LB25]

SENATOR SCHUMACHER: Senator Pirsch. [LB25]

SENATOR PIRSCH: So I am just trying to understand what's happening now, right, with respect to when the stamping agent pays, that's a prepay at the...either before or at the time of receiving the stamps, right? [LB25]

DOUG EWALD: Correct. [LB25]

SENATOR PIRSCH: And then they take those stamps and process them or do whatever they do. [LB25]

DOUG EWALD: Exactly. So anyone stamps you, you order 30,000 stamps, it costs us \$31.50 to process those 30,000 stamps. You buy those, you pay the state the 64 cents a stamp, and then you're free to adhere those, affix those to each pack of cigarettes. [LB25]

SENATOR PIRSCH: So the proposed change, then, in this bill would say, when prepay or at the time, but when might you pay for those stamps? [LB25]

DOUG EWALD: Well, this basically changes it to the 15th of the month following the month in which you actually...the wholesaler would have delivered those to the retailer. So the fiscal note is basically drive-by. It's a timing issue. You get \$5 million a month, you lose a half month of float, so, basically, you do the math, it's pretty straightforward. [LB25]

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SENATOR PIRSCH: So what is, and I apologize, you said of the total it would be 2.2, is that what you're estimating in terms of the float? [LB25]

DOUG EWALD: Correct. Yes. [LB25]

SENATOR PIRSCH: Thank you. [LB25]

SENATOR SCHUMACHER: Any other questions? I have just one question. If an equal amount of cigarettes are going to be sold and the tax doesn't change, how do we end up losing \$2 million? I mean, the interest isn't worth anything these days, so how do we end up \$2 million short? [LB25]

DOUG EWALD: Well, it's a timing issue. You will receive that last payment in the fiscal year, for this first current fiscal year that you would normally get paid in, I'll say, in June, you won't get that until July of the following year. So, as far as the fiscal year goes, you're basically losing the first year. You lose one...a half of a month from a reporting standpoint. [LB25]

SENATOR SCHUMACHER: So this is a loss on paper but it's not a loss in reality. [LB25]

DOUG EWALD: Well, it's a timing issue between fiscal years. That's why it's a hit in the first fiscal year, but then after the first fiscal year, that's the recurring standard. [LB25]

SENATOR SCHUMACHER: And if we were ever to completely outlaw cigarettes, we'd have a payment coming in at the end that we wouldn't have gotten otherwise. Basically, we'll make up...whatever we delayed, we'll pick up at the end. It's not...we're not losing \$2 million. [LB25]

DOUG EWALD: In the current fiscal year, you would. [LB25]

SENATOR SCHUMACHER: Okay. All right. I don't have any other questions. Anyone else? Thank you, Commissioner. [LB25]

DOUG EWALD: Thank you. [LB25]

SENATOR SCHUMACHER: Any other neutral testimony? Senator Hadley. Senator Hadley waives. Open the hearing on LB26, Senator Hadley. [LB25]

SENATOR HADLEY: Vice Chairman Schumacher, members of the Revenue Committee, my name is Galen Hadley. I represent the 37th District. I'm here today to introduce LB26, a bill that will return the discount provided on the sale of cigarette tax

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stamps to cigarette wholesalers. The tax on cigarettes in Nebraska is defined as a special privilege tax paid by every person engaged in distributing or selling cigarettes at wholesale. The current cigarette tax, established in 2003 by LB759, is 64 cents per package of 20 cigarettes, and 80 cents per package of 25 cigarettes. Each package of stamps sold at retail in Nebraska must have a cancelled stamp affixed to the bottom of the package. Nebraska licensed cigarette wholesalers perform this function for the state, and as compensation for this service they receive 1.85 percent discount upon the purchase of stamps from the Nebraska Tax Commissioner. That discount translates into less than 1.2 cents per package. In 2003, LB759, the Legislature increased the cigarette tax from 34 cents to 64 cents per pack. Additionally, the bill reduced the cigarette wholesaler's discount from 3.4 percent to the current 1.85 percent in order to eliminate an unnecessary windfall to the wholesalers. As you know, cigarette sales decline each year. To cigarette wholesalers, this translates to a higher stamping expense because their fixed assets, like stamping machines, floor space, labor, have not. So, too, has the wholesaler stamping discount declined. Specifically, 2002, the year before passage of LB759, the cigarette discount was 3.4 percent. Wholesalers' gross discount for the year was \$4,399,000. As a result of reducing the stamp discount to 1.85 percent and the reduction in packages of cigarettes sold today, their gross discount is \$1.853 million. It's less than half of what it was in 2002. LB26 proposes that we return the stamping discount to 3 percent, resulting in about a \$3 million annual gross discount. There are other testifiers behind me who will provide more specific information about cigarette wholesalers. I would be happy to answer any questions you might have. [LB26]

SENATOR SCHUMACHER: Any questions for Senator Hadley? Seeing none, thank you, Senator Hadley. [LB26]

SENATOR HADLEY: Thank you. [LB26]

SENATOR SCHUMACHER: Any proponents on LB26? [LB26]

MICK MINES: Vice Chairman Schumacher, members of the committee, for the record, my name is Mick Mines, M-i-c-k M-i-n-e-s. I'm a registered lobbyist for the Nebraska Grocery Industry Association here today in support of LB26. And I would again like to thank Senator Hadley for bringing this to your attention. In 2003 when the Legislature advanced LB759, the cigarette tax went from 34 cents per stamp to 64 cents per stamp. At the same time, the commission paid to stamping agents was reduced from 3.4 cents per stamp to 1.85 percent per stamp. As Senator Hadley outlined, our revenue...our revenue...the revenue that is paid to stamping agents for performing the duties of stamping cigarettes reduced from about \$4.4 million to \$1.85 million. Granted, the cigarette sales have declined. Our abilities and our capabilities, we don't stamp as many cigarettes, but it's a matter of being fairly compensated. We have inherent costs that we have to maintain and we would just simply like fair compensation for the service we render to the state of Nebraska in stamping cigarettes. So I echo Senator Hadley's

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testimony. We would ask your consideration to increase the tax on the...or, excuse me, the commission on the cigarette stamps from 1.85 percent to 3 percent. I'd be happy to answer any questions. [LB26]

SENATOR SCHUMACHER: Any questions from the committee? I have a couple questions. How many of these stamping companies are there? [LB26]

MICK MINES: There are about 117 licensed Nebraska cigarette wholesalers, so they have licenses to stamp. About half are stamped in Nebraska, are Nebraska-based, and half are outside Nebraska. An outside example might be Farner-Bocken. Farner-Bocken is located in Carroll, Iowa, but they have distribution throughout Nebraska. So there are about 117 companies. [LB26]

SENATOR SCHUMACHER: Are there any shortages...I mean, any going out of business, can they consolidate to get their margins back up? [LB26]

MICK MINES: You know, that's the perfect question, so how come they're still in business? It's kind of like cattle...raising cattle. You're either in or you're out, and they're willing to...the small ones, in particular, that, you know, they don't do...they do less than half a million stamps a year. It's more for convenience for themselves and their customers that they're in the business and lose money. The very large ones likely are making it, they're not losing money. But I think if you took a poll of all 117,000 (sic), most are not making ends meet just on the stamps. They're covering that loss with any profits they make on the product. [LB26]

SENATOR SCHUMACHER: And this stamping mechanism has been around for a long time? [LB26]

MICK MINES: Yes, it has. [LB26]

SENATOR SCHUMACHER: So, I mean, it's...what do they get, a roll of stamps or some kind of a rubber stamp thing or...? [LB26]

MICK MINES: Books of stamps and they're in them. They put them in stamping machines and they'll stamp a carton at a time. But you have to open the carton, you have to prepare the surface. It's quite a process of stamping. [LB26]

SENATOR SCHUMACHER: Well, that seems to be kind of an old-fashioned way to do...to collect a tax. Any states figured out a way to do this with modern computers, scanners, something like that to eliminate these things? [LB26]

MICK MINES: There is electronic stamping, right. There's electronic stamping and we don't do that in Nebraska. We're not required to. It's very...it's quite expensive, and most

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states that require that have tremendous volumes of stamping to help cover those costs. Some states stamp for themselves as well, so the state of Nebraska could stamp cigarettes if you chose to. [LB26]

SENATOR SCHUMACHER: I don't have any more. Senator Pirsch. [LB26]

SENATOR PIRSCH: Just to clarify what I thought I heard you say. Did you say there was 117 licensed wholesalers in Nebraska? [LB26]

MICK MINES: Registered in Nebraska, right. [LB26]

SENATOR PIRSCH: Okay. And then another, you said, about equal amount outside the state? [LB26]

MICK MINES: No, that...we have 117 total licensees. [LB26]

SENATOR PIRSCH: Oh. [LB26]

MICK MINES: Approximately half of those are Nebraska corporations and half are outside Nebraska. [LB26]

SENATOR PIRSCH: I see. It's about 55 of each, then, so... [LB26]

MICK MINES: Just about, yeah. [LB26]

SENATOR PIRSCH: Okay. Nothing further. [LB26]

SENATOR SCHUMACHER: Any other questions from any other members of the committee? Thank you, Mr. Mines. [LB26]

MICK MINES: Thank you, Senator. [LB26]

SENATOR SCHUMACHER: Any other proponents? Any opponents? Seeing none, any neutral parties? Seeing none, Senator Hadley. Senator Hadley is waiving again, and returning to the helm of the Starship Enterprise. [LB26]

SENATOR HADLEY: I hope the committee appreciates these quick hearings, because it's going to change. (Laughter) I just thought I would let you know that this is not going to be the norm as time goes on. With that, we will close the hearing. I appreciate people coming, and we'll see you tomorrow, same time, same place. Thank you.