

**DESCRIPTION OF PRESENT LAW AND PROPOSALS
RELATING TO TOBACCO TAX AND TRUST FUND
AND OTHER PROVISIONS**

Scheduled for Consideration

by the

SENATE COMMITTEE ON FINANCE

on May 14, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

May 14, 1998

JCX-35-98

CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
I. TOBACCO REVENUE AND TRUST FUND PROVISIONS RELATED TO S. 1415, AS REPORTED BY THE SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TECHNOLOGY	2
A. Present-Law Tax and Trust Fund Provisions	2
B. Description of the National Tobacco Proposed Resolution	5
C. Description of S. 1415, as Reported by the Senate Committee on Commerce, Science and Technology	9
D. Description of Proposed Finance Committee Amendment Relating to Tobacco Taxes and Trust Fund	13
II. OTHER PROVISIONS	17
A. Deductions for Health Insurance Expenses	17
B. Trade Provisions	20
1. Ban on distribution of tobacco products produced by child labor	20
2. Limits on the authority to promote the exportation of tobacco	20
3. Report on impact on U.S. international obligations	21
4. Anti-smuggling Provisions/Prohibition on imports except under a permit	21
5. Prohibition against sales of tobacco products in duty-free shops or forwarding through or manufacture in foreign trade zones	21
C. Medicaid Provision	22

INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of present law and proposals relating to tobacco tax and trust fund and revenue-reduction provisions to be considered by the Senate Committee on Finance ("Finance Committee") on May 14, 1998. The Finance Committee is considering a committee amendment to be offered to S. 1415, as reported by the Senate Committee on Commerce, Science and Technology ("Commerce Committee").²

Part I of this document is a description of present-law tobacco revenue and trust fund provisions and the proposed Finance committee amendment to S. 1415 relating to tobacco taxes and trust fund provisions. Part II is a description of present law and proposals relating to certain other provisions.

¹ This document may be cited as follows: *Description of Present Law and Proposals Relating to Tobacco Tax and Trust Fund and Other Provisions* (JCX-35-98), May 14, 1998.

² S. 1415 was reported by the Senate Committee on Commerce, Science, and Technology on May 1, 1998 (S. Rept. 105-180).

**I. TOBACCO REVENUE AND TRUST FUND PROVISIONS RELATED TO S. 1415,
AS REPORTED BY THE SENATE COMMITTEE ON COMMERCE, SCIENCE,
AND TECHNOLOGY**

A. Present-Law Tax and Trust Fund Provisions

Excise taxes on tobacco products

Excise taxes are imposed on cigarettes, cigars, chewing tobacco and snuff, pipe tobacco, and cigarette papers and tubes (Code sec. 5701). In addition, tax will be extended to "roll-your-own tobacco" at the same rates as pipe tobacco, effective on January 1, 2000. These taxes are imposed upon removal of the taxable tobacco products by the manufacturer, or on importation into the United States.³ The current tax rates are shown in the table below.

<u>Tobacco product</u>	<u>Tax rate</u>
Cigarettes:	
Small cigarettes ⁴	\$ 12.00 per thousand (24 cents per pack of 20 cigarettes)
Large cigarettes	\$ 25.20 per thousand
Cigars:	
Small cigars	\$ 1.125 per thousand
Large cigars	12.75% of manufacturer's price, up to \$30 per thousand
Chewing tobacco	\$ 0.12 per pound
Snuff	\$ 0.36 per pound
Pipe tobacco	\$ 0.675 per pound
Cigarette papers	\$ 0.0075 per 50 papers
Cigarette tubes	\$ 0.15 per 50 tubes

Effective on January 1, 2000, the tax rate on small cigarettes is scheduled to increase by \$5 per thousand (to 34 cents per pack of 20 small cigarettes), and the tax rates on other taxable tobacco products are scheduled to increase by proportionate amounts. Effective on January 1,

³ The term United States includes the 50 States and the District of Columbia.

⁴ A significant majority of taxable cigarettes, and of taxable tobacco products, is small cigarettes.

2002, a further increase of \$2.50 per thousand (to 39 cents per pack of 20 small cigarettes) is scheduled to become effective. (Tax rates on other taxable tobacco products will increase proportionately on that date as well.)

Generally, excise taxes on tobacco products that are removed during any semimonthly period must be paid by the 14th day after the last day of such semimonthly period. Late payment of tobacco excise taxes is subject to interest charges and penalties in the same manner as the late payment of other types of taxes. In addition, a failure to pay penalty equal to 5 percent of the tax due but unpaid is assessed under section 5761(b).

Revenues from the current tobacco products excise taxes are deposited in the General Fund of the Treasury.

Tobacco occupational excise tax

An annual excise tax of \$1,000 per premise generally is imposed on manufacturers of tobacco products, manufacturers of cigarette papers and tubes, and export warehouse proprietors (Code sec. 5731). The occupational tax is \$500 per premise for taxpayers with gross receipts less than \$500,000. Revenues from the occupational tax are deposited in the General Fund of the Treasury.

Penalty excise taxes

In addition to excise taxes imposed primarily to raise revenue, the Internal Revenue Code (the "Code") includes several excise taxes imposed as penalties for taking (or failing to take) certain required actions. Examples of these excise taxes include taxes on excess lobbying expenditures by charitable organizations, certain "self-dealing" activities by officers and others involved with private foundations, failures by private foundations to distribute required percentages of income, and numerous regulatory excise taxes imposed with respect to specified activities of qualified pension plans. Present law does not establish any underage smoking reduction goals or impose any penalty excise tax with respect to such goals.

Overview of Internal Revenue Code Trust Funds

Most Trust Funds that are financed with dedicated excise tax revenues are established in the Code (secs. 9501 et. seq.). Examples of these Trust Funds are the Airport and Airway Trust Fund, the Highway Trust Fund, the Black Lung Trust Fund, the Aquatic Resources Trust Fund, the Inland Waterways Trust Fund, the Hazardous Substance Superfund, the Leaking Underground Storage Tank Trust Fund, the Oil Spill Liability Trust Fund, and the Vaccine Injury Compensation Trust Fund. Each of these Trust Funds includes provisions dedicating specified

revenues to the Trust Fund and provisions approving expenditure purposes of the Trust Fund (generally as those purposes are in effect on the date of enactment of specific authorizing legislation). The Code also contains general provisions relating to the management of these Trust Funds. Under present law, there is no Federal Tobacco Trust Fund.

B. Description of the National Tobacco Proposed Resolution

Payments required of tobacco manufacturers

In general

The National Tobacco Proposed Resolution, dated June 20, 1997, (the "Proposed Resolution") is a draft document advanced by a number of State Attorneys General, members of the public health community, and a number of large tobacco manufacturers to resolve litigation between tobacco manufacturers and the States, to establish a framework for the regulation of tobacco, to fund various initiatives related to tobacco cessation and control, and to establish limits on the civil liabilities of tobacco manufacturers. The Proposed Resolution is intended to be formalized in a Master Settlement Agreement and implemented through legislation and the execution of a binding, enforceable Protocol.

The Proposed Resolution provides for a number of payments to be made by tobacco manufacturers. These include an initial, first-year payment of \$10 billion, annual payments having an aggregate nominal amount of as much as \$358.5 billion over 25 years, and a "look-back surcharge" of as much as \$2 billion per year if targets in the reduction of underage smoking are not achieved.

These payments would be liabilities of those cigarette and smokeless tobacco manufacturers that join in the resolution. An alternative system of payments is required from manufacturers that do not join in the resolution. In general, a nonparticipating manufacturer would be required to escrow an amount equal to 150 percent of what would otherwise be its share of the annual payment if it were a participating manufacturer. The escrowed funds would be available for liability claims against such manufacturers.

All payments made under the Proposed Resolution are proposed to be currently deductible in the year of payment. The Proposed Resolution specifically provides that all payments made pursuant to its terms will be deemed to be ordinary and necessary business expenses for the year of payment, and that no portion will be treated as a fine or penalty or the cost of a tangible or intangible asset.

First-year payments

The Proposed Resolution would require a lump sum cash payment in the amount of \$10 billion to be made on the "Statute Signing Date," the date legislation enacting the National Tobacco Settlement Agreement is signed into law. Allocation of the \$10 billion among the various tobacco manufacturers is not provided in the Proposed Resolution.

Annual payments

The Proposed Resolution would require participating manufacturers to make annual payments for each calendar year beginning after the date of enactment in the following nominal amounts:

<u>Year</u>	<u>Nominal amount</u> (billions of dollars)
1	8.5
2	9.5
3	11.5
4	14.5
5 and thereafter	15.0

Beginning with the first payment, the nominal amount of each annual payment would be increased annually for inflation at a rate equal to the greater of 3 percent or the increase in the Consumer Price Index (the "CPI"). The amount of each annual payment further would be adjusted to reflect changes in sales volume compared to a sales volume in a base year of 1996. Up to 25 percent of any reduction in an annual payment to reflect reduced sales volume would be disregarded to the extent of any increase in industry net operating profits for a similar period.

A credit against the annual payment equal to 80 percent of any amounts paid as a result of a participating tobacco manufacturer's civil liability for past conduct would be provided. As the annual cap on payment of such civil liability is 33 percent of the annual payment, the maximum credit available against any annual payment would be 26-2/3 percent.

Rules allocating liability for the annual payments among the various tobacco manufacturers are not provided in the Proposed Resolution.

Annual payments under the National Tobacco Proposed Resolution would be required to be made by February 15 of the year following the year to which the payments relate. If, for example, legislation implementing the Proposed Resolution were to be enacted in September of 1998, the first annual payment would be made with respect to 1999, and would be due on February 15, 2000.

Look-back surcharge

The Proposed Resolution provides for a look-back surcharge to be assessed against the participating manufacturers if certain targets for the reduction of underage smoking are not met. The targets are as follows:

<u>Year after enactment</u>	<u>Reduction in underage use of cigarettes</u>	<u>Reduction in underage use of smokeless tobacco</u>
5 and 6	30%	25%
7, 8 and 9	50%	35%
10 and thereafter	60%	45%

In each case, the underage usage of the tobacco product would be measured by the results of the University of Michigan's National High School Drug Use Survey "Monitoring the Future." The rate of reduction is measured compared to the rate of usage in 1996. The surcharge is to be calculated by the Food and Drug Administration ("FDA").

In the case of underage usage of cigarettes, the surcharge would equal \$80 million times the number of percentage points by which the reduction in teen usage fails to achieve the target. The surcharge could not exceed \$2 billion for any year. The surcharge is reduced to prevent double counting of persons whose smoking has already resulted in an imposition of the surcharge in previous years. In the case of smokeless tobacco, the surcharge would be determined through a comparable procedure. Abatement of up to 75 percent of the surcharge would be possible if a manufacturer demonstrates that it acted in good faith, pursued all reasonable available measures to attain the targeted reductions and there was no evidence of an action taken by the manufacturer that served to undermine the achievement of the targeted reductions.

Under the Proposed Resolution, the lookback surcharge would be a joint and several liability of all of the participating manufacturers. Primary liability would be allocated among the various manufacturers based on their relative sales, as measured by Federal excise tax payments.

Overview of expenditure provisions

The Proposed Resolution includes recommendations regarding the use of a portion of the payments received from the participating manufacturers. Generally, these recommendations involve the designation of monies to Trust Funds or specific agencies for purposes related to smoking cessation and tobacco related research. The bulk of the funds remaining after satisfaction of the recommendations will be paid over to the States. However, no specific dollar amount of payments to be made to the States is provided in the Proposed Resolution.

Other provisions of the Proposed Resolution

Regulation of the tobacco industry

The Proposed Resolution would mandate a significant restructuring of how tobacco products are manufactured, marketed, and distributed in the United States.

Civil liability

The Proposed Resolution would limit any participating manufacturer's exposure to civil liability arising from the manufacture and sale of tobacco products. All suits brought by the States and all Castano Civil Actions would be settled legislatively. Other legal actions would be limited to those brought by individual plaintiffs. No class action suits would be allowed. Punitive damages would not be allowed in individual tort actions. An annual aggregate cap on the amount that could be required to be paid by all participating manufacturers in any one year would be established equal to 33 percent of the annual payment. Judgments in excess of \$1 million would be satisfied only if all other judgments can be accommodated under the annual cap. As noted above, 80 percent of any payments made to tort claimants could be used as a credit against the annual payment.

C. Description of S. 1415, as Reported by the Senate Committee on Commerce, Science and Technology

Payments required of tobacco manufacturers

In general

S. 1415, as reported by the Senate Commerce Committee, would provide for a number of payments to be made by tobacco manufacturers. These include an initial, first-year payment of \$10 billion, annual payments having an aggregate nominal amount of as much as \$564.1 billion over 25 years, and a "look-back assessment" of as much as \$3.5 billion per year if targets in the reduction of underage smoking are not achieved. Additional payments would be required to be made to a Tobacco Community Revitalization Fund and an International Tobacco Control Trust Fund.

These payments would be liabilities of those cigarette and smokeless tobacco manufacturers that join in a Master Settlement Agreement with the States implementing the June 20, 1997 Proposed Resolution. An alternative system of payments would be required from nonparticipating manufacturers, those that do not join in the Agreement. In general, a nonparticipating manufacturer would be required to make payments equal to pay an amount equal to 150 percent of what would otherwise be its share of the annual payment if it were a participating manufacturer.

All payments made under S. 1415, as reported, are proposed to be currently deductible as ordinary and necessary business expenses, except for the look-back assessment. The look-back assessment would be specifically made nondeductible by the bill.

First-year payments

S. 1415, as reported, would require a lump sum cash payment in the amount of \$10 billion to be made to the National Tobacco Settlement Trust Fund within 30 days of the date of enactment. The allocation of this amount between the participating manufacturers is specified in the bill, and generally follows the relative capitalization of the participating manufacturers.⁵ Interest on late payments would be assessed at the rate of prime plus 10 percent.

⁵ The specified payments are Phillip Morris Incorporated, \$6.58 billion; Brown and Williamson Tobacco Corporation, \$1.73 billion; Lorillard Tobacco Company, \$710 million; R.J. Reynolds Tobacco Company, \$660 million; and United States Tobacco Company, \$320 million.

Annual payments

S. 1415, as reported, would require participating manufacturers to make annual payments to the National Tobacco Settlement Trust Fund for each calendar year beginning after the date of enactment in the following nominal amounts:

<u>Year</u>	<u>Nominal amount</u> (billions of dollars)
1	14.4
2	15.4
3	17.7
4	21.0
5 and thereafter	23.6

The nominal amount of each annual payment would be increased annually for inflation at a rate equal to the greater of 3 percent or the increase in the CPI, beginning with the fourth year after enactment. Beginning with the seventh year after enactment, the amount of each annual payment would be further adjusted, either up or down, to reflect changes in sales volume compared to a sales volume in a base year of 1996.

S. 1415, as reported, would not provide for a credit against the annual payment for amounts paid as a result of a participating tobacco manufacturer's civil liability.

Annual payments under S. 1415, as reported, would be required to be made in three equal installments on March 1, June 1, and September 1 of the year to which the payments relate. If, for example, S. 1415 were to be enacted in September of 1998, the first annual payment would be made with respect to 1999. One-third of the payment would be due from the industry on March 1, 1999; one-third would be due on June 1, 1999; and one-third would be due on September 1, 1999.

Each payment would be allocated between the participating manufacturers in proportion to their share of tobacco products sold in the domestic market for the most recent available calendar quarter, as determined by the Secretary of the Treasury not more than two months, and not less than one month, before the payment is due. A civil penalty equal to \$100,000 for each day any annual payment is delinquent would be assessed if the payment was not made within 60 days of the date it was due.

Any participating manufacturer that manufactures and distributes to consumers less than 3 percent of cigarettes in any calendar year, that had resolved tobacco-related civil actions with more than 25 States before 1998, and that provided to all other States the opportunity to enter into similar agreements would be exempt from making any annual payment. Only one manufacturer is able to meet these standards.

Look-back assessment

S. 1415, as reported, provides that a look-back assessment would be imposed on the participating manufacturers if certain targets for the reduction of underage smoking are not met. The targets are as follows:

<u>Year after enactment</u>	<u>Reduction in underage use of cigarettes</u>	<u>Reduction in underage use of smokeless tobacco</u>
3 and 4	15%	12.5%
5 and 6	30%	25%
7, 8 and 9	50%	35%
10 and thereafter	60%	45%

In each case, the underage usage of the tobacco product would be measured by the results of the University of Michigan's National High School Drug Use Survey "Monitoring the Future." The rate of reduction would be measured compared to the rate of usage in 1996.

The assessment to the industry would be determined by the Secretary of Health and Human Services ("HHS") and would be based on a sliding scale that depends upon the number of percentage points by which the targeted reduction in underage use is not achieved. In the case of cigarettes, the assessment would be \$80 million for each of the first 5 percentage points, \$160 million for each of the next 5 percentage points, and \$240 million for each percentage point in excess of 10, subject to an annual maximum of \$3.5 billion. These amounts would be indexed for inflation beginning in the fourth year after enactment. The assessment would be allocated by the Secretary of HHS among the manufacturers by market share. Any manufacturer with less than 1 percent of market share would be exempt from payment unless HHS determined that such manufacturer's brands were used by underage individuals at a rate equal to or greater than the manufacturer's total market share. In the case of smokeless tobacco, the surcharge would be determined through a comparable procedure. Additional penalties, including removal of the annual aggregation payment limitation, may apply if the District Court for the District of Columbia determines that a manufacturer has failed to comply substantially with the terms of the legislation or has taken any material action to undermine achievement of the targets.

The surcharge would be assessed by May 1 of the subsequent calendar year and would have to be paid by July 1 of the year in which it is assessed. HHS would be authorized to establish an interest rate of up to three times the prevailing prime rate for late payments. S. 1415, as reported, does not provide for the abatement of any portion of the surcharge, nor does it provide for adjustment of the surcharge to prevent double counting persons whose smoking has already resulted in an imposition of the surcharge in previous years.

S. 1415 specifically provides that the surcharge is not deductible, as an ordinary and necessary business expense or otherwise, for Federal income tax purposes.

Other payments

S. 1415, as reported, would require additional payments to be made to the Tobacco Community Revitalization Fund and the International Tobacco Control Trust Fund.

Industry payments to the Tobacco Community Revitalization Fund would equal \$2.1 billion for each of fiscal years 1999 through 2008 and \$500 million for each of fiscal years 2009 through 2023. An amount sufficient to offset certain Department of Agriculture costs related to tobacco would be required to be paid in later years. The industry payment would be allocated among tobacco product manufacturers and importers according to market share. Participating manufacturers would be allowed a credit equal to the amount of their annual payment.

A licensing fee equal to \$1.00 per thousand cigarettes manufactured or distributed for sale by a domestic concern either directly or through its foreign affiliates would be assessed to fund the International Tobacco Control Trust Fund.

Overview of expenditure provisions

S. 1415, as reported, includes provisions requiring the use of a portion of the payments received from the participating manufacturers. Generally, these provisions involve the designation of moneys to trust funds or specific agencies for various purposes. Payments of \$196.5 billion would be required to be made to the States in installments over 25 years. After that time, one-half of all annual payments would be transferred to the States. Certain additional amounts, including a portion of all surcharge payments, would also be transferred to the States. States that do not choose to resolve their civil actions in accordance with the legislation, or to enter into the Master Settlement Agreement, would not be eligible to receive their share of these payments.

Other provisions of S. 1415, as reported by the Commerce Committee

Regulation of the tobacco industry

S. 1415, as reported, would mandate a significant restructuring of how tobacco products are manufactured, marketed, and distributed in the United States.

Civil liability

S. 1415, as reported, would limit any participating manufacturer's exposure to civil liability arising from the manufacture and sale of tobacco products. All suits brought by the States, and all Castano Civil Actions, would be settled legislatively. An annual aggregate cap of \$6.5 billion on the amount that could be required to be paid by all participating manufacturers would be established. All settlements, judgements and payments are required to be registered with the Secretary of the Treasury. A mechanism to allocate payments between claimants in years where the total payment would otherwise exceed \$6.5 billion would be established by regulation.

**D. Description of Proposed Finance Committee Amendment
Relating to Tobacco Taxes and Trust Fund**

Increase in tobacco products excise tax rates

In lieu of the payments (including the initial \$10 billion payment) required of tobacco manufacturers under S. 1415, as reported by the Commerce Committee, the current Federal excise tax rate on small cigarettes would be increased by \$1.10 effective on January 1, 1999.

The tax rates on all other taxable tobacco products would be increased proportionately to the increases specified for small cigarettes. In addition, the effective date for imposition of tax on "roll-your-own" tobacco and of certain compliance provisions regarding exported cigarettes enacted in 1997 would be accelerated to January 1, 1999, and the compliance provisions would be modified as necessary to conform to similar anti-smuggling provisions of S. 1415, as reported.

On each January 1 beginning in calendar year 2000, all tobacco excise tax rates would be adjusted for inflation, as measured by changes in the CPI occurring during the 12-month period ending on the preceding August 31.

Floor stocks taxes comparable to those imposed when tobacco excise tax rates previously have been increased would be imposed on each tax increase date. Floor stocks taxes would be required to be paid no later than July 1 of the year of tax increase.

As stated above in the description of present law, the current tobacco products excise taxes apply to tobacco products manufactured in, or imported into, the United States. Solely for purposes of these increased tax amounts, the term United States would include U.S. possessions as well as the 50 States and the District of Columbia. Accordingly, no amount of the increase would be covered-over to U.S. possessions under Code section 7652.

Impose penalty excise tax for failure to meet underage smoking reduction goals

Both the Proposed Resolution and S.1415, as reported by the Commerce Committee, would establish goals for the reduction of underage smoking and would impose lookback "surcharges" or "assessments" on tobacco manufacturers if these goals are not met. In lieu of the lookback surcharges or assessments, the Finance Committee amendment would impose a non-deductible penalty excise tax on all manufacturers and importers of cigarettes and smokeless tobacco.

All manufacturers and importers of cigarettes and smokeless tobacco would be subject to the penalty excise tax. Imposition of this penalty excise tax would be governed by the smoking reduction goals and imposed at the rates specified in S. 1415, as reported by the Commerce Committee. In addition, the determination of whether underage smoking goals are met would be determined under rules prescribed by the Secretary of the Treasury (in consultation with the

Public Health Service).⁶ Beginning in that year, the Secretary of the Treasury would be directed to publish by February 15 of each calendar year the amount of tax allocated to each cigarette and smokeless tobacco manufacturer and importer based on their prior year's excise tax liability.

The penalty excise tax would be payable in full no later than April 1 of each calendar year. Cigarette manufacturers and importers would be jointly and severally liable for payment of this tax imposed with respect to cigarettes, as provided in the Proposed Resolution and S. 1415, as reported. Smokeless tobacco manufacturers and importers similarly would be jointly and severally liable for payment of tax attributable to smokeless tobacco. Other Code administrative and enforcement provisions applicable to excise taxes generally would apply to this tax.

Deletion of Federal requirements relating to "pass through" of payments

Those provisions in S. 1415, as reported by the Commerce Committee, requiring that tobacco manufacturers use their best efforts to pass through to consumers the amount of any payments on a per unit basis would be deleted.

Deletion or modification of miscellaneous "fees" contained in S. 1415

The provisions of S. 1415, as reported by the Commerce Committee, that impose separate "fees" to support the Tobacco Community Revitalization Trust Fund programs, the "fees" and operative Trust Fund provisions related to international tobacco control, and the "fees" and "assessments" on nonparticipating manufacturers would be deleted from the bill.

The Finance Committee amendment would provide that, notwithstanding any other provision of law, all charges or user fees imposed under the titles of the bill other than the revenue title must be set in amounts that recover only costs attributable to providing services to the party paying the fees (i.e., must be true, or cost-based, user fees rather than disguised taxes).

Establishment of National Tobacco Trust Fund

In lieu of the four separate Trust Funds provided for under the Commerce Committee titles of S. 1415, as reported, a National Tobacco Trust Fund (the "Tobacco Trust Fund") would be established in the Treasury Department pursuant to provisions enacted into the Trust Fund provisions of the Code. Amounts equal to the net revenues⁷ from the changes made by this

⁶ These rules could be, but would not be required to be, based on the University of Michigan's National High School Drug Use Survey, "Monitoring the Future."

⁷ The term "net revenues" means the gross payments received less an income tax offset.

amendment would be deposited in the Tobacco Trust Fund.⁸ That is, the amounts deposited in the Tobacco Trust Fund represent monies received by the Treasury after accounting for the provisions relating to health insurance tax benefits. The balance of the net revenues from the Finance Committee amendment would remain in the General Fund of the Treasury. The Tobacco Trust Fund further would receive amounts equal to all penalties imposed under S. 1415. Amounts in the Tobacco Trust Fund would be available for expenditure as provided in subsequently enacted appropriations Acts.⁹

Amounts in the Tobacco Trust Fund generally would be available for expenditure for the programmatic purposes established in S. 1415, as reported by the Commerce Committee. A separate account, the State Share Account, would be established in the Tobacco Trust Fund to administer distribution of Trust Fund monies to States. The State Share Account would receive revenues equal to 40 percent of the total net revenues from the tobacco tax increases. These revenues would not be available to finance any other Trust Fund expenditure purposes. States would be eligible for payments from the State Share Account and the Tobacco Trust Fund generally only if they waived their rights to any State settlements with the tobacco manufacturers or importers.

Each State would be eligible to receive the portion of the monies appropriated from the State Share Account shown in the table entitled "Distribution of Funds to States" below. In general, there would be no requirements or restrictions on the use of funds appropriated to the States from the Tobacco Trust Fund; however, the Medicaid cost recovery provisions would apply to States that use Tobacco Trust Fund payments in their Medicaid programs. Cost recovery would be waived for States that use Tobacco Trust Fund monies for other purposes.

Expenditures for all of the referenced purposes would include those purposes as in effect on the date of the Finance Committee amendment's enactment. Provisions further would be included ensuring that no tax revenues are deposited into the Tobacco Trust Fund if any monies are spent other than as authorized under these provisions.

General administrative provisions applicable to Code Trust Funds would apply to the Tobacco Trust Fund, except no interest would accrue on unspent balances in the Tobacco Trust Fund. As with other Code Trust Funds, the Tobacco Trust Fund would not be permitted to borrow from the General Fund.

⁸ These amounts would be reduced by any refunds or tax previously paid that were properly allocable to revenues deposited into the Tobacco Trust Fund.

⁹ As reported by the Commerce Committee, S. 1415 provides that spending for certain programs is to be direct spending. This provision in the Finance Committee amendment supersedes those direct spending provisions.

Distribution of Funds to States

<u>State</u>	<u>Percentage</u>
Alabama	1.237
Alaska	0.400
Arizona	1.709
Arkansas	0.954
California	8.695
Colorado	0.990
Connecticut	1.548
Delaware	0.400
D.C.	0.474
Florida	4.768
Georgia	2.735
Hawaii	0.800
Idaho	0.400
Illinois	3.930
Indiana	1.490
Iowa	0.932
Kansas	0.800
Kentucky	1.664
Louisiana	1.723
Maine	0.800
Maryland	1.425
Massachusetts	3.802
Michigan	3.586
Minnesota	1.246
Mississippi	1.701
Missouri	1.701
Montana	0.400
Nebraska	0.400
Nevada	0.400
New Hampshire	0.400
New Jersey	3.755
New Mexico	0.800
New York	12.812
North Carolina	1.977
North Dakota	0.400
Ohio	4.205
Oklahoma	0.800
Oregon	1.353
Pennsylvania	4.421
Rhode Island	0.800
South Carolina	1.090
South Dakota	0.400
Tennessee	2.851
Texas	5.930
Utah	0.400
Vermont	0.400
Virginia	1.348
Washington	1.726
West Virginia	0.782
Wisconsin	1.841
Wyoming	0.400

II. OTHER PROVISIONS

A. Deductions for Health Insurance Expenses

Present Law

In general

Under present law, the tax treatment of medical insurance expenses depends on whether the individual is self employed, an employee with employer-provided health coverage, or an employee without employer-provided health coverage. For purposes of the tax provisions relating to medical insurance expenses, subject to certain dollar limits, premiums for long-term care insurance generally are treated the same as premiums for health insurance.

Deduction for health insurance expenses of self-employed individuals

Under present law, self-employed individuals (i.e., sole proprietors, partners in a partnership, and more than 2-percent shareholders of S corporations), are entitled to deduct a portion of the amount paid for medical insurance for the self-employed individual and the individual's spouse and dependents. Self-employed individuals may deduct the amount paid for health insurance as follows: 45 percent in 1998 and 1999, 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and all years thereafter.

The deduction is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. This rule is applied separately to long-term care insurance and health insurance. In addition, no deduction is available to the extent that the deduction exceeds the taxpayer's earned income from the trade or business with respect to which the health insurance is provided. Expenses for health insurance in excess of the deductible amount may be taken into account in determining whether the individual is entitled to an itemized deduction for medical expenses. The deduction does not apply for self-employment tax purposes.

Exclusion from income and wages for employer-provided health care

Under present law, employer contributions to an accident or health plan, including employee salary reduction contributions under a cafeteria plan, are excludable from an employee's income. This exclusion for employer-provided health coverage also generally applies to coverage provided to former employees. In the case of a self-insured medical reimbursement plan, the exclusion is conditioned on the coverage being provided under a plan meeting certain nondiscrimination requirements. Insured health plans are generally not subject to nondiscrimination rules. Employer-provided accident or health coverage is generally excludable

from wages for employment tax purposes without regard to whether the coverage is provided on a nondiscriminatory basis.

Itemized deduction for medical expenses

Under present law, individuals who itemize deductions may deduct amounts paid during the taxable year, including expenses for medical insurance (if not reimbursed by insurance or otherwise) for medical care of the taxpayer, the taxpayer's spouse, and dependents, to the extent that the total of such expenses exceeds 7.5 percent of the taxpayer's adjusted gross income ("AGI").

Description of Proposal

The proposal would permit all individuals (including self-employed individuals) who are not eligible to participate in an employer-subsidized health plan to deduct 100 percent of the amount paid for insurance which constitutes medical care for the individual, the individual's spouse and dependents. The deduction would not apply to amounts paid by the individual for Medicare Part B premiums. The deduction would apply to premiums for long-term care insurance (subject to the present-law limits).

As under the present-law self-employed health deduction, the deduction would not be available for any month in which the individual is eligible to participate in an employer-subsidized health plan maintained by an employer (or former employer) of the individual or the individual's spouse. This rule would be applied separately to long-term care insurance and health insurance. An employer subsidy would include pre-tax contributions through salary reduction. An individual with health care continuation coverage (under sec. 4980B of the Code) would not be considered to be receiving employer subsidized health care if the employee is charged at least 100% of the applicable premium as defined in section 4980B.

Any amount taken into account for purposes of this deduction could not be taken into account for purposes of the itemized deduction for medical expenses. The deduction would not apply for self-employment tax purposes.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1998.

10
20

B. Trade Provisions

1. Ban on distribution of tobacco products produced by child labor.

Present Law: Section 307 of the Tariff Act of 1930 prohibits the import of products produced by forced or indentured workers.

Settlement: None.

Commerce Committee Bill: Section 1107 would amend Section 307 to prohibit imports of tobacco products produced in a foreign country by child labor.

Proposed Finance Committee Mark: Modify language in Commerce Committee bill to prohibit imports of tobacco products produced by forced or indentured child labor.

2. Limits on the authority to promote the exportation of tobacco.

Present Law: FY98 Commerce, State, and Judiciary Appropriations Act include a rider which prohibits the President from promoting the sale or export of tobacco products and from seeking the reduction or removal of trade barriers relating to tobacco exports.

Settlement: None.

Commerce Committee Bill: Section 1133 would prohibit the use of appropriated funds to promote or encourage the exportation of tobacco. Allows President to seek elimination of barriers that are applied in an unjustifiable and arbitrary manner and that have been certified by the Department of Health and Human Service as not being a reasonable means of protecting public health.

Proposed Finance Committee Mark: Codify the current appropriations rider, clarifying that no ministerial functions performed by agencies (e.g., processing customs documentation on exports at a port) are prohibited and that the President may seek the reduction of discriminatory barriers to U.S. tobacco exports.

3. Report on impact on U.S. international obligations.

Present Law: None.

Settlement: None.

Commerce Committee Bill: Section 1134 would require USTR to report within 90 days of enactment of the legislation on any provisions that it deems to be inconsistent with our international obligations, such as the NAFTA and the WTO.

Proposed Finance Committee Mark: Strike.

4. Anti-smuggling Provisions/Prohibition on imports except under a permit.

Present Law: None.

Settlement: None.

Commerce Committee Bill: Section 1141-47 create a broad licensing scheme that would apply to all sales of tobacco. Section 1145(a) expressly prohibits the importation of tobacco products except under a permit.

Proposed Finance Committee Mark: Clarify that licensing requirements in the bill apply to all sales of tobacco products, including imports to avoid allegations that provisions violate WTO obligations.

5. Prohibition against sales of tobacco products in duty-free shops or forwarding through or manufacture in foreign trade zones.

Present Law: None.

Settlement: None.

Commerce Committee Bill: Section 1147 would ban the sale of any tobacco products in duty-free stores or the use of any foreign trade zone for the distribution or manufacture of tobacco products.

Proposed Finance Committee Mark: Clarify that the sale of tobacco products in duty free stores and through FTZs are subject to all applicable U.S. laws, including laws relating to sales of tobacco products to minors.

C. Medicaid Provision

Present Law

States have the authority to exclude certain drugs or restrict coverage for them. Among these are agents when used to promote smoking cessation.

S. 1415, as reported, removes “agents when used to promote smoking cessation” from the list of drugs which may be subject to state restriction. S. 1415 also prohibits states from excluding or restricting nonprescription drugs when used to promote smoking cessation.

Description of Proposal

The proposal deletes the provision in S. 1415. Federal reimbursement for these agents are allowed under current law.

ERRATA

"DESCRIPTION OF PRESENT LAW AND PROPOSALS RELATING TO TOBACCO TAX AND TRUST FUND AND OTHER PROVISIONS"

1. On page 15, the word "generally" should be inserted into the last sentence of the paragraph that begins at the bottom of page 14 and ends at the top of page 15 before the words "would be available".

2. On page 15, the first full paragraph should read as follows:

Amounts in the Tobacco Trust Fund generally would be available for expenditure for the programmatic purposes established in S. 1415, as reported by the Commerce Committee. A separate account, the State Share Account, would be established in the Tobacco Trust Fund to administer distribution of Trust Fund monies to States. The State Share Account would receive revenues equal to 30 percent of the total net revenues produced by the tobacco tax increases during the five calendar years, 1999 through 2003. In calendar year 2004 and thereafter, this percentage would increase to 45 percent. These revenues would not be available to finance any other Trust Fund expenditures. States would be eligible for payments from the State Share Account and the Tobacco Trust Fund generally only if they waived their rights to any State settlements with tobacco manufacturers or importers.

3. On page 15, footnote 9 should read as follows:

As reported by the Commerce Committee, S.1415 provides that spending for certain programs is to be direct spending. This provision in the Finance Committee amendment supersedes those direct spending provisions (except with respect to the provisions for payments to tobacco farmers).