



The Effect of the 2012 Federal Transportation Reauthorization Bill on State and Local Regulation of Roll Your Own Tobacco Retailers

The 2012 federal transportation reauthorization bill classifies as tobacco manufacturers those retailers who make roll your own (RYO) tobacco machines available to consumers. Although significant, the provision's classification solves only part of the combustible, loose tobacco product problem. This fact sheet describes some of the implications of this policy on state and local regulation of roll your own tobacco retailers.¹

Q: What does the federal transportation reauthorization bill have to do with tobacco?

A: Signed into law on July 6, 2012, the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21) is an amendment to reauthorize the federal highway aid program through September 2014.² It consolidates existing federal transportation programs and is intended to strengthen transportation infrastructure. Most policy provisions took effect on October 1, 2012.



Among the “riders” in MAP-21 that are unrelated to transportation is Section 100122, which revised a subsection of the Internal Revenue Code. The prior version of this tax code subsection defined a tobacco product manufacturer as “any person who manufactures cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco.”³ The relevant section of MAP-21 added that the term manufacturer “shall include any person who for commercial purposes makes available for consumer use (including such consumer’s personal consumption or use . . .) a machine capable of making cigarettes, cigars, or other tobacco products. . . .”⁴ The effect of this provision is that store owners who “rent” roll your own tobacco machines to customers are now considered tobacco manufacturers.

Q: What is the significance of defining store owners with RYO tobacco machines as manufacturers?

A: RYO tobacco products represent a significant loophole in tax law because retailers who sell RYO products and customers who buy them avoid paying the higher taxes associated with cigarettes. Taxes on conventional cigarettes are higher than the taxes on

a corresponding amount of loose tobacco, so using a RYO machine can be significantly cheaper for a customer as compared to buying conventional cigarettes. In addition, a 2009 law substantially increased taxes on many types of loose tobacco⁵ but not on loose pipe tobacco. Since then, the discrepancy in tax rates between loose pipe tobacco and other loose tobacco has led many RYO customers to use loose tobacco falsely branded as pipe tobacco to make cigarettes in RYO machines, because doing so is even less expensive for customers than using loose tobacco.⁶ A sharp increase in shipments of so-called pipe tobacco and concomitant decrease in shipments of other loose tobacco suggests that most of the products branded as pipe tobacco are being used in RYO machines.⁷

Low-tax or tax-free tobacco products undermine the documented public health benefits of high tobacco taxes,⁸ and many public health advocates have long considered RYO machines as creating a tax loophole that allows retailers to avoid the financial consequences of manufacturing cigarettes on their premises. The transportation bill closes that loophole and recognizes that RYO cigarettes, like conventional cigarettes, have serious health consequences. Now that RYO retailers are considered manufacturers, they are required to pay federal fees and excise taxes, a change that will raise the price of RYO cigarettes.

Q: What is the controversy surrounding the RYO provision in the transportation bill?

A: Despite their long history of opposing tobacco control measures meant to protect public health, large tobacco manufacturers supported the transportation bill provision, presumably because they believed that the provision would reduce or eliminate competition from retailers with RYO machines.⁹ If RYO machines become prohibitively expensive for retailers, or if RYO cigarettes become as expensive as conventional ones, large manufacturers hope to gain from increased sales of conventional cigarettes. Many retailers believe that the political motivation behind Section 100122 was really to benefit Big Tobacco.¹⁰ In any case, increased taxation of tobacco products has been shown to positively impact public health,¹¹ and the RYO provision in the transportation bill should help in that respect. Retailers have argued that Section 100122 will cause their operating costs to become unsustainable and will result in lost jobs,¹² but they have not acknowledged the public health consequences of using RYO machines to evade cigarette taxes.

Q: How will the federal law affect state and local regulation of RYO tobacco machines?

A: State taxes and revenues. Federal and state tobacco taxes are legally distinct. Federal and state taxes do not affect each other but instead are cumulative. The increase in federal tobacco taxes will increase the price of RYO products in every state by the same amount, but each state determines its own rate of taxation, which is imposed along with federal taxes on tobacco products. In states in which localities impose their own tobacco taxes, local taxes are another distinct and additional layer of taxes imposed.

Therefore, states and localities will increase revenue if they work to close the RYO tobacco loophole at the state and local level by also choosing to designate RYO retailers as manufacturers, mirroring the federal provision, or by raising taxes on RYO products. As discussed in detail in the Consortium's *Regulating Roll Your Own Tobacco Machines* Tips & Tools guide, states and localities have several other options for addressing the proliferation of RYO machines. These methods include prohibiting RYO machines, requiring retailers with RYO machines to obtain a permit, and using self-service access laws or fire-safe cigarette laws to regulate RYO machines and RYO products.

Public health. Because an increase in federal tax will raise prices nationwide, all states and localities are likely to experience a public health benefit as a result of the federal law. The extent of this benefit will depend on how many RYO customers smoke fewer RYO cigarettes or quit. If states impose their own RYO taxes, they could receive an additional public health benefit by spending the increased tax revenue on tobacco control.

Litigation. The federal law may have an impact on legal challenges related to the regulation of RYO machines.

Federal

MAP-21 will impact federal litigation relating to RYO machines. For example, in *RYO Machine Rental v. U.S. Dep't of Treasury*, a trial court temporarily set aside a Tobacco, Tax and Trade Bureau (TTB) ruling requiring RYO retailers to obtain a permit and pay applicable taxes.¹³ This case centered on whether the TTB (an agency) had the authority to issue such a ruling, but now that the federal transportation bill (enacted by Congress) mandated a similar requirement, the case is likely to be only of academic interest.

State

The law's effect on state cases will be less direct but still potentially significant.

- First, if the federal definition makes RYO machines prohibitively expensive or drives RYO retailers out of business, they are much less likely to invest resources in challenging similar state regulations. Given that some retailers have already concluded that state litigation is not worth the cost,¹⁴ it seems likely that even more retailers will decide not to challenge similar state regulations, due to the existence of the federal law. For example, in *Henne v. Flaherty*,¹⁵ a Washington state court ruling temporarily halted a new state excise tax on RYO cigarettes.¹⁶ However, the plaintiff retailer didn't post a required bond because the federal transportation bill was pending. The Washington Supreme Court allowed the tax to go into effect,¹⁷ and the lawsuit was dismissed.¹⁸ Although the main question in this case was whether the new state law violated another existing state law requiring that two-thirds of the legislature approve any tax increase, the expanded federal definition was apparently enough to dissuade the plaintiffs from further pursuing the

litigation (even though the plaintiffs had won in the lower court). The federal law may impact other technically unrelated state cases such as this one.

- The federal law may also influence substantive decisions in state court cases. For example, in *Connecticut v. Tracey’s Smoke Shop & Tobacco*, the court recognized that a retailer acted as a manufacturer when it assisted customers with RYO machines and offered cartons of machine-rolled cigarettes for sale.¹⁹ However, the court declined to temporarily order that no RYO machines could be used because it was possible for the retailer to act in a way that did not make it a manufacturer. Instead, the court prohibited employees from assisting customers with the machines and prohibited the retailers from advertising or offering for sale cigarettes made on the premises. Although this case turned on the wording of state law, the broad federal definition of “manufacturer,” which now includes RYO retailers, may influence the interpretation of state laws in future cases.
- It is possible that a large tobacco manufacturer will argue that the new federal definition of manufacturer would preempt – or prevent – states or localities from having laws that do not include RYO retailers in the definition of manufacturer. Prevailing on this argument seems unlikely, however, because local, state, and federal taxation schemes are legally distinct. The federal government may choose to tax retailers in a way that states or localities do not, and it is unlikely that the federal definition was intended to override states’ or localities’ own definitions.

Table I. Potential Impact of the Federal Transportation Bill

Issue Affected	Predicted Impact
State or local taxes and revenues	None, unless states or localities implement their own RYO taxes
Public Health	Positive impact due to national increase in prices, although the magnitude will depend on consumer response
Federal Litigation	Likely will resolve or render moot any cases concerning the classification, under federal law, of RYO retailers
State Litigation	May discourage retailers from challenging state regulation and/or may influence courts’ treatment of RYO retailers when interpreting vague state manufacturer laws

Q: What are the limitations of the provision in the federal transportation bill?

A: The tax treatment of loose tobacco products based on how they are labeled has led to manufacturer manipulation. The tobacco tax disparity of nearly \$22 per pound between loose cigarette tobacco and loose pipe tobacco led manufacturers to re-label loose cigarette tobacco as pipe tobacco and then market this so-called pipe tobacco for RYO use.²⁰ While the provision in the federal transportation bill is an important step, it did not change federal excise tax rates. At this point, it is not entirely clear what impact the classification of RYO operators as manufacturers will have on the tax disparity between pipe tobacco and RYO tobacco, nor what new ways tobacco manufacturers will continue to exploit that disparity. The Government Accountability Office recommends modifying federal tobacco taxes to definitively eliminate the large tax differential between RYO and pipe tobacco.²¹ Compounding this problem is the fact that loose tobacco of all types remains grossly under-taxed under many current state tobacco excise tax laws.

In addition, pipe tobacco is still not regulated by the U.S. Food and Drug Administration (FDA). The FDA currently regulates cigarettes, RYO tobacco, and smokeless tobacco,²² and has not yet extended its jurisdiction to pipe tobacco. Because current FDA regulations do not apply to pipe tobacco, it can be produced with flavorings, labeled with misleading descriptors such as “light” and “low-tar,” and generally marketed and sold with fewer restrictions.

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Notes

¹ The information contained in this document is not intended to constitute or replace legal advice, and we encourage you to consult with local legal counsel before attempting to implement any measures described here. For more details about roll your own policy considerations, please contact the [Tobacco Control Legal Consortium](#).

² Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21), Pub. L. No. 112-141 (codified as amended in scattered sections of 23 U.S.C.).

³ Internal Revenue Code, 26 U.S.C. § 5702(d).

⁴ MAP-21 § 100122, available at <http://www.govtrack.us/congress/bills/112/hr4348/text>.

⁵ Children’s Health Insurance Reauthorization Act of 2009, tit. vii, § 701(g), 123 Stat. 106 (2009) (codified at 26 U.S.C. § 5701).

⁶ U.S. DEP’T OF TREASURY, ALCOHOL AND TOBACCO TAX AND TRADE BUREAU, TTB S 5210-12-2010, STATISTICAL REPORT - TOBACCO (2011), available at <http://www.ttb.gov/statistics/2010/201012tobacco.pdf>.

⁷ *Id.*

⁸ See, e.g., Kenneth E. Warner, *Smoking and Health Implications of a Change in the Federal Cigarette Excise Tax*, 255 J. AM. MED. ASS’N 1028 (1986); Frank J. Chaloupka & Rosalie Liccardo Pacula, *The Impact of Price on Youth Tobacco Use*, 14 SMOKING AND TOBACCO CONTROL MONOGRAPHS: CHANGING ADOLESCENT SMOKING PREVALENCE 193 (U.S. Dep’t Health and Human Services et al. eds., 2001).

⁹ Emily Morris, *Roll-Your-Own Cigarette Stores Going Up in Smoke*, CHICAGO SUN TIMES, July 4, 2012, available at <http://www.suntimes.com/business/13589276-420/roll-your-own-cigarette-stores-going-up-in-smoke.html>; Lyssa Beyer & Carl Engleking, *Port's New Roll-Your-Own Cigarette Shop Hopes New Bill Blows Over*, PORT WASHINGTON-SOUKVILLE PATCH, July 9, 2012, available at <http://portwashington-wi.patch.com/articles/port-s-smoke-shack-a-ryo-cigarette-store-hopes-new-bill-will-blow-over>.

¹⁰ See, e.g., Alexis Krell, *Congress Rules on Roll-Your-Own Cigarettes*, THE NEWS TRIBUNE, June 30, 2012, available at <http://www.thenewstribune.com/2012/06/30/2200048/congress-rules-on-roll-your-own.html>; Beyer & Engleking, *supra* note 9.

¹¹ Warner, *supra* note 8.

¹² E.g., Morris; Beyer & Engleking, *supra* note 9.

¹³ RYO Machine Rental v. U.S. Dep't of Treasury, No. 4:10–CV–2462 (N.D. Ohio Dec. 14, 2010).

¹⁴ New York City Law Dep't, *Press Release: New York City Law Department Announces Consent Decree in Suit Against "Roll-Your-Own" Cigarette Businesses; "Roll-Your-Own" Stores Agree To Shut Down*, Dec. 20, 2011, available at <http://www.nyc.gov/html/law/downloads/pdf/Island%20Smokes%20Consent%20Decree.pdf>.

¹⁵ Henne v. Flaherty, No. 12-2-50512-1 (Wash. Sup. Ct. filed June 14, 2012), available at http://blog.thenewstribune.com/politics/files/2012/06/Complaint_for_Declaratory_Judgment.pdf.

¹⁶ Washington State Department of Revenue, *Update: Supreme Court Grants Temporary Stay*, June 29, 2012, available at <http://dor.wa.gov/Content/AboutUs/newsroom/2012/062912b.aspx>.

¹⁷ *Id.*

¹⁸ Washington State Department of Revenue, *The Roll-Your-Own Cigarette Case Has Been Dismissed*, July 10, 2012, available at <http://dor.wa.gov/Content/AboutUs/newsroom/2012/071012.aspx>.

¹⁹ Connecticut v. Tracey's Smoke Shop & Tobacco, LLC, CV-11-6024334S (Conn. Super. Ct. Feb. 24, 2012).

²⁰ Ctrs for Disease Control and Prevention, *Consumption of Cigarettes and Combustible Tobacco - United States, 2000–2011*, 61(30) MORBIDITY & MORTALITY WKLY REP. 565 (Aug. 3, 2012), available at <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm6130a1.htm>; Daniel S. Morris & Michael A. Tynan, *Fiscal and Policy Implications of Selling Pipe Tobacco for Roll-Your-Own Cigarettes in the United States*, 5(7) PLoS ONE e36487 (May 2012), available at <http://www.plosone.org/article/info%3Adoi%2F10.1371%2Fjournal.pone.0036487#>.

²¹ U.S. GOVERNMENT ACCOUNTABILITY OFFICE, TOBACCO TAXES: LARGE DISPARITIES IN RATES FOR SMOKING PRODUCTS TRIGGER SIGNIFICANT MARKET SHIFTS TO AVOID HIGHER TAXES, GAO 12-475, April 12, 2012, available at <http://www.gao.gov/assets/600/590192.pdf>.

²² Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776–1858 (2009).