

Proposed Rules
of the
Tennessee Department of Revenue

Chapter 1320-09
Rules and Regulations Governing Tobacco Product Manufacturers and Wholesalers

Presented herein are proposed rules of the Department of Revenue submitted pursuant to T.C.A. § 4-5-202 in lieu of a rulemaking hearing. It is the intent of the Department of Revenue to promulgate these rules without a rulemaking hearing unless a petition requesting such hearing is filed within thirty (30) days of the publication date of the issue of the Tennessee Administrative Register in which the proposed rules are published. Such petition to be effective must be filed with the Department of Revenue, 6th Floor, Andrew Jackson State Office Building, 500 Deaderick Street, Nashville, TN 37242, and the Department of State, 8th Floor, William R. Snodgrass Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243, and must be signed by twenty-five (25) persons who will be affected by the rules, or submitted by a municipality which will be affected by the rules, or an association of twenty-five (25) or more members, or any standing committee of the General Assembly.

For copies of the entire text of the proposed rules, contact: Megan J. Moore, Tax Counsel, Tennessee Department of Revenue Legal Office, 6th Floor, Andrew Jackson Building, 500 Deaderick Street, Nashville, TN 37242-1099, 615-741-2348.

The text of the proposed rules is as follows:

New Rules

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1320-09-01-.01 General Provisions.

- (1) This chapter is adopted under the legal authority of Tenn. Code Ann. § 1-3-104, § 4-4-103, §§ 4-5-201 et seq., § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).
- (2) The title of this chapter is "Rules and Regulations Governing Tobacco Product Manufacturers and Wholesalers."
- (3) The purpose of these rules and regulations is to promote compliance with Tenn. Code Ann. §§ 67-4-2601, et seq., and Tenn. Code Ann. §§ 47-31-101 et seq. and to promote the public health of Tennessee citizens as follows:

- (a) By requiring quarterly escrow deposits and quarterly escrow certificates;
 - (b) To ensure compliance with Tenn. Code Ann. §§ 47-31-101 et seq.;
- (4) This chapter has the following scope and limits:
- (a) These rules and regulations govern compliance with Tennessee's Directory Statute, Tenn. Code Ann. §§ 67-4-2601 et seq., and compliance with the Tennessee Escrow Fund Act, §§ 47-31-101 et seq.;
 - (b) These rules and regulations do not affect, implement or govern the enforcement or application of any tax statute, rule or regulation, except as specifically set forth herein. This limitation includes, but is not limited to, the treatment of cigarettes which may be contraband under other tax statutes.

Authority: T.C.A. § 4-4-103, §§ 4-5-201 et seq., § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).

1320-09-01-.02 Definitions.

- (1) As used in this Chapter, the following terms shall have these meanings:
- (a) Attorney General. The Office of the Tennessee Attorney General, including, but not limited to, any attorney working on behalf of the Attorney General.
 - (b) Cigarette. Defined in Tenn. Code Ann. § 47-31-102(4) as amended. The term Cigarette includes RYO (roll-your-own) tobacco (0.09 ounces of which constitutes one individual Cigarette) and those Cigarettes that, despite being sold as little cigars, meet the definition of Cigarette set forth in Tenn. Code Ann. § 47-31-102(4) as amended. Under Tenn. Code Ann. § 47-31-102(4) Cigarette also means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains the following:
 1. Any roll of tobacco paper wrapped in paper or in any substance not containing tobacco;
 2. Tobacco, in any form, that is functional in the product, and which, either because of its appearance, the type of tobacco used in the filler, or its packaging and labeling is likely to be offered to, or purchased by, consumers as a cigarette; or
 3. Any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette, as described in Tenn. Code Ann. § 47-31-102(4)(A)(i) as amended.
 - (c) Commissioner. The Commissioner of Revenue, including, but not limited to, any employee working on behalf of the Commissioner.
 - (d) Certificate. The State's current, official form found at the Attorney General's website required for filing under the Escrow Fund Act and/or these rules.
 - (e) Directory or State Directory. The Directory of compliant Tobacco Product Manufacturers and Brands, as provided for by Tenn. Code Ann. § 67-4-2602(b) as amended and any rules

and regulations promulgated thereunder.

- (f) Escrow Fund Act or Tennessee Escrow Fund Act. The Tennessee Tobacco Manufacturers' Escrow Fund Act of 1999, Tenn. Code Ann. §§ 47-31-101, et seq. as amended and any rules and regulations promulgated thereunder.
- (g) Non-Participating Manufacturer or NPM. Any tobacco product manufacturer that is not a Participating Manufacturer.
- (h) Units Sold. Defined by Tenn. Code. Ann § 47-31-102 (10). Units sold means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the State on packs or "roll-your-own" tobacco containers bearing the excise tax stamp of the State.

Authority: T.C.A. § 4-4-103, § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).

1320-09-01-.03 Citation.

The official citation of this chapter is Tenn. Comp. R. & Regs. Chapter 1320-09, et seq.

Authority: T.C.A. § 4-4-103, § 47-31-102(10), § 67-1-102(a) § 67-4-2604(e) and § 2606(d).

Reserved Rules 1320-09-01-.05 to 1320-09-01-.99.

1320-09-02-.01 Escrow Deposits, Certificates And Disputes.

- (1) To promote compliance with Tenn. Code Ann. §§ 67-4-2601 et seq., including the requirement that NPMs comply with the Escrow Fund Act, all Non-Participating Manufacturers selling cigarettes in Tennessee must make escrow deposits required by Tenn. Code Ann. § 47-31-103(a)(2)(A) in quarterly installments, pursuant to these regulations, for a period of not less than (2) years from the effective date of these regulations or two years from the date the NPM is first certified in Tennessee, whichever is later. All Non-Participating Manufacturers selling cigarettes in Tennessee must certify their compliance with Tennessee's Escrow Fund Act on a quarterly basis during these two (2) years.
- (2) After complying with the quarterly escrow provisions of these regulations for a (2) year period, any Non-Participating Manufacturer may petition the Commissioner of Revenue to request that it be allowed to make its deposits on an annual basis. The Commissioner shall have discretion to decide whether such Non-Participating Manufacturer shall be allowed to make deposits on an annual basis, or shall remain on a quarterly basis. When making such determination, the Commissioner shall consider, among other factors the Commissioner deems relevant, the NPM's history of escrow payments and compliance; and the NPM's payment record in other states.
- (3) The Commissioner or the Attorney General may also require the production of any information or documents necessary to determine the adequacy of the amount of the installment deposit.
- (4) The Attorney General and/or the Commissioner of Revenue may provide or release to any Non-Participating Manufacturer such information necessary to calculate or determine that Non-Participating Manufacturer's quarterly deposit obligation. The Attorney General

and Department of Revenue may develop a form to be used for any Non-Participating Manufacturer to request such information.

- (5) If a Tobacco Product Manufacturer disputes the amount that it is required to deposit into a Qualified Escrow Account on a quarterly or annual basis, it must submit a written notice at the time of making its deposit. After receiving the Attorney General or Department's adjustment or release determination, or a notice of failure to make a complete escrow deposit, the Tobacco Product Manufacturer may dispute the decision. The Tobacco Product Manufacturer must file any dispute with the General Counsel of the Department of Revenue and the Tobacco Enforcement Division of the Attorney General's Office, within twenty (20) business days of the date of the decision or notice. The dispute procedure shall be pursuant to Tenn. Code Ann. §§ 4-5-223 and 4-5-225. The official mailing address, overnight delivery address, telephone and facsimile numbers of the Department and the Attorney General are set forth on the applicable official websites.
- (6) To be a valid and ripe dispute, the Tobacco Product Manufacturer shall be required to first place the full escrow deposit amount identified by the Attorney General or Department of Revenue into a Qualified Escrow Account in its Tennessee sub-account and provide proof of that deposit to the Attorney General and Department. This deposit can be made under protest. The Tobacco Product Manufacturer's written notice of dispute must include a certification that the full escrow payment demanded by the Department or Attorney General has been deposited and must state with specificity all bases or reasons for the dispute. An escrow agent is required to comply with a final order issued in a dispute proceeding pursuant to Tenn. Code Ann. §§ 4-5-223 and 4-5-225 as described herein. Such compliance shall include, but not be limited to, releasing escrow funds pursuant to the court's final order.
- (7) In any dispute, the Licensed Distributor Reports, including all information contained therein, submitted to the State of Tennessee shall be presumed correct. The Non-Participating Manufacturer shall have the burden of proving that the Licensed Distributor Reports are incorrect, incomplete or inaccurate.

Authority: T.C.A. § 4-4-103, § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).

1320-09-02-.02 Deadlines For Quarterly Escrow Deposits And Quarterly Certification.

- (1) Non-Participating Manufacturers must make their quarterly escrow deposits according to the following schedule:
 - (a) Deposits for sales occurring in the first quarter, January 1 through March 31, are due April 30 of the same year. The Non-Participating Manufacturer must file its quarterly certification with the Attorney General no later than May 15 of the same year.
 - (b) Deposits for sales occurring in the second quarter, April 1 through June 30, are due July 31 of the same year. The Non-Participating Manufacturer must file its quarterly certification with the Attorney General no later than August 15 of the same year.
 - (c) Deposits for sales occurring in the third quarter, July 1 through September 30, are due October 31 of the same year. The Non-Participating Manufacturer must file its quarterly certification with the Attorney General no later than November 15 of the same year.
 - (d) Deposits for sales occurring in the fourth quarter, October 1 through December 31, are due January 31 of the next year. The Non-Participating Manufacturer must file

its quarterly certification with the Attorney General no later than February 15 of the next year.

- (2) The quarterly escrow deposits for a given year shall be adjusted by inflation pursuant to the formula specified in the Escrow Fund Act, assuming the minimum inflation rate of three percent (3%) for the year in question. Non-Participating Manufacturers shall make a final reconciliation deposit on or before April 15 of the year following the year in which the Cigarettes are sold in order to account for the actual annual adjustment for inflation under the Escrow Fund Act. The final reconciliation deposit shall be included in the Non-Participating Manufacturer's annual certification, due on or before April 30 of the year following the year in which the Cigarettes are sold.

Authority: T.C.A. § 4-4-103, § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).

1320-09-02-.03 Penalties For Untimely Or Incomplete Quarterly Certification Or Quarterly Escrow Deposit.

- (1) If an NPM fails to timely make its quarterly escrow deposit in full, or timely file its quarterly certification with the Attorney General, the delinquent NPM and its Brand Families will be removed from the Directory until the Non-Participating Manufacturer fully complies with its obligations. Any Non-Participating Manufacturer that has not fully complied with Tennessee statutes, rules and regulations by submitting its escrow deposits and Certificates of Compliance will not be listed in the Directory or will be removed from the Directory until all past escrow deposits are made, proof of deposit is submitted to the State, all outstanding judgments are fully satisfied, and all other obligations under these Rules, the Escrow Fund Act and the Directory Statute are met.
- (2) Failure to make quarterly deposits or to file quarterly certificates shall also subject the Tobacco Product Manufacturer to the penalties for failure to place funds in escrow contained in the Escrow Fund Act or otherwise provided for under State law, regulation or rule. Such penalties shall be imposed by the court as provided for in Tenn. Code Ann. § 47-31-103(a)(3).
- (3) Each failure to make a full annual or quarterly deposit required under the Escrow Fund or rules and regulations promulgated thereunder shall constitute a separate and distinct violation.

Authority: T.C.A. § 4-4-103, § 47-31-102(10), § 67-1-102(a), § 67-4-2604(e) and § 2606(d).

1320-09-02-.04 Escrow Adjustments And Release Requests

- (1) The Escrow Fund Act authorizes the release of funds from escrow only under specified circumstances. For example, the Escrow Fund Act authorizes the release of funds from escrow to the extent that an NPM "establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the master settlement agreement payments, as determined pursuant to section IX(i) of the master settlement agreement including after the final determination of all adjustments, that such manufacturer would have been required to make on account of such units sold had it been a participating manufacturer". Tenn. Code Ann. § 47-31-103(a)(2)(B)(ii). To establish entitlement to an escrow adjustment on this ground, an NPM must calculate the total payments that it would have made as a Participating Manufacturer on account of the Units Sold in Tennessee during a particular year. The current official Tennessee Request for Release Form, located on the Attorney General's website, must be executed and filed with the Attorney General along with all required documents and information.

- (2) Adjustments to escrow accounts paid pursuant to the Escrow Fund Act, including balances due for Deposit, may occur: (a) upon a showing that the adjustment is authorized pursuant to the Escrow Fund Act in response to requests for adjustments or release; and (b) upon a showing, submitted by the Tobacco Product Manufacturer, that it is eligible for a release or adjustment under the Escrow Fund Act.
- (3) The Department or the Attorney General may require an additional deposit when additional information not known by the Attorney General or Department arises after the initial or most recent deposit was deemed sufficient or when a release from escrow was authorized and implemented.
- (4) All release requests will be governed and reviewed based upon the law, rules and regulations existing as of the date the completed Request for Release Form is filed with the Attorney General. The Attorney General will not consider release requests submitted before the time period has elapsed for which the release is requested. For example, the Attorney General will deny a release request for calendar year 2008 if it is submitted before the end of calendar year 2008.
- (5) To be eligible for consideration, a release request for an adjustment by an NPM must be made in writing on the State's current official Request for Release Form and must be accompanied by supporting documentation which establishes compliance with all other aspects of the Escrow Fund Act requirements and the basis for the escrow release request. The supporting documentation, at a minimum, must include:
 - (a) A timely filed Certification of Escrow Compliance completed on the State's current official form and executed in compliance with the State's official Instructions and Definitions for Certificate of Escrow Compliance;
 - (b) An affidavit, signed under penalty of perjury by an executive officer of the Tobacco Product Manufacturer responsible for escrow compliance, setting forth the officer's authority to bind and act on behalf of the Tobacco Product Manufacturer and demonstrating the facts which support the adjustment requested; and
 - (c) All records and/or other documentation demonstrating the facts offered in support of the requested adjustment or release, as well as documentation evidencing the timely and full deposit into escrow prior to the request for adjustment; and any legal argument or analysis in support of the requested adjustment. The NPM shall submit a proposed calculation of the annual deposit due, a proposed calculation of the refund amount and a draft letter of instructions to the Escrow Agent concerning the proposed refund. The Attorney General or Commissioner may require an NPM to provide information or documents regarding the NPM's national sales, including, but not limited to, the NPM's bi-monthly Excise Tax Returns filed with the U.S. Treasury, Tobacco Tax and Trade Bureau (TTB), formerly the Bureau of Alcohol, Tobacco & Firearms (BATF), the Importer Trade Activity (ITRAC) data, and/or U.S. Customs Forms 7501. To document its unit sales in Tennessee (as measured by excise taxes paid), the NPM shall include copies of the filed Tennessee excise tax returns for its tobacco products or arrange for equivalent excise tax payment documentation from the State of Tennessee.
 - (d) The Attorney General or Department may request such further information or documents, as is required in light of the specific facts, including, but not limited to, information on compliance with Escrow Fund requirements and the evidence or basis for any adjustment or release requested.

- (6) The Tobacco Product Manufacturer shall have the burden of proof to establish that a release or adjustment from escrow is appropriate, in whole or in part. Further, there is a presumption of correctness with regard to the calculation by the Department of the number of Units Sold in Tennessee in a particular year.
- (7) Requests for adjustments to escrow or release from escrow must use the most recent data available for Original Participating Manufacturers' aggregate percentage of the total market and the total payment due from the OPMs. The only data which will be accepted in such submissions is the data provided to the State from the Independent Auditor under the Master Settlement Agreement. An NPM submitting a request for an adjustment to escrow may obtain this information from the State but must maintain this information in a confidential manner consistent with State law and the confidentiality agreement.
- (8) The Department or the Attorney General may require, at any time, an adjustment to escrow should additional facts become available, which show that the escrow amount paid or escrow amount previously released was incorrect in any manner. Bases for adjustment include, but are not limited to, new information showing inaccurate reporting of the number of Units Sold, new information showing additional Units Sold, or a change in the OPM market share, mistake, inadvertence, or any other failure by the NPM to comply with these rules and regulations or the Escrow Fund Act.
- (9) A request for an adjustment of escrow account or release will be decided within a reasonable time of filing of all of the information necessary for its determination. The Tobacco Product Manufacturer has the burden to ensure that all necessary documents are filed with the Attorney General and Department. The Attorney General will send a copy of the adjustment or release determination to the Tobacco Product Manufacturer and, if the release request has been allowed in whole or in part, to the financial institution holding the funds in escrow. Decisions to deny escrow release requests in whole or in part, shall contain a short statement of the reason(s) for denial.
- (10) Except as provided in paragraph 13 below, when a release from escrow occurs to pay a judgment or settlement on any released claim brought against a Tobacco Product Manufacturer by the State or any releasing party located or residing in the State of Tennessee under the Escrow Fund Act, funds shall be released from escrow:
 - (a) In the order in which they were placed in escrow; and
 - (b) Only to the extent and only at the time it is necessary to make payments required under such judgment or settlement.
- (11) When a release from escrow occurs under the Escrow Fund Act due to the passage of twenty-five (25) years, funds shall be released from escrow:
 - (a) In the order in which they were placed in escrow; and
 - (b) Only if twenty-five (25) years have passed from the date on which the funds were actually placed into escrow. For example, an escrow deposit made during 2005, but related to sales of cigarettes in 1999, will not be eligible for release until 2030 (not 2024).
- (12) Upon receipt of a Request for Release form, the Attorney General or Department may elect to contact or notify other states to determine if any other states have judgments which they seek to satisfy by executing, attaching or garnishing such sub-account and to allow any other states sufficient time to take actions to attempt execution against the monies held in

the Tennessee sub-account which may be available for release from the Tennessee sub-account.

Authority: Tenn. Code Ann. § 4-4-103, § 47-31-102(10), § 67-1-102(a), §§ 67-4-2602(a)(3)(C), 67-4-2602(a)(3)(D)(i), 67-4-2602(a)(3)(D)(iv), § 67-4-2604 and § 67-4-2606(d).

Reserved Rules 1320-09-2-.05 to 1320-09-2-.99.

The proposed rules set out herein were properly filed in the Department of State on the 31st day of January, 2007, and pursuant to the instructions set out above, and in the absence of filing an appropriate petition calling for a rulemaking hearing, will become effective on the 30th day of May, 2008. (FS 01-21-08; DBID 2816-2817)

Regulatory Flexibility Act Analysis of Impact on Small Business

Pursuant to the Public Acts of 2007, Chapter 464, the Department of Revenue has considered whether the proposed rules are such that they will have an economic impact on small businesses (businesses with fifty (50) or fewer employees). The proposed rules are anticipated to have no significant economic impact affecting small businesses. The purposes of the proposed rules are three-fold. The first purpose is to promote compliance with Tennessee's Directory Statute, Tenn. Code Ann. §§ 67-4-2601 et seq., and the Tennessee Escrow Fund Act, Tenn. Code Ann. §§ 47-31-101 et seq., by requiring escrow deposits on a quarterly basis as specifically authorized by the Public Acts of 2007, Chapter 602, Section 179. The second purpose is to clarify the procedures for obtaining an adjustment or release of amounts deposited in escrow. The third purpose is to clarify the procedures for disputing the amounts deposited in escrow.

The outcome of the analysis set forth in Public Chapter 464 is as follows:

- (1) The proposed rules apply to non-participating tobacco manufacturers ("NPMs") subject to the Tennessee Escrow Fund Act. There are currently approximately 18 NPMs subject to the Escrow Fund Act, at least one of which is located in Tennessee.
- (2) The reporting and recordkeeping requirements under the proposed rules already exist on an annual basis. The proposed rules require the same reporting and recordkeeping on a quarterly basis. The additional administrative costs are projected to be minimal, and professional skills are not required. The requirement of quarterly escrow deposits will not be a burden on NPMs who are planning to fully and promptly comply with annual escrow requirements.
- (3) The effect on small businesses is a minimal amount of additional reporting and recordkeeping on a quarterly basis. Such reporting and recordkeeping is already required on an annual basis. Businesses will benefit from a clear procedure for requesting and obtaining an adjustment or release of amounts deposited in escrow. There is no probable effect on consumers.
- (4) There are no alternative methods to achieve quarterly escrow deposits other than exempting businesses based on a set of criteria.
- (5) Approximately thirty-five (35) states currently require quarterly escrow deposits. There is no federal counterpart.
- (6) The exemption of small businesses from the requirement of quarterly escrow deposits would impact the State of Tennessee's ability to defend its Master Settlement Agreement payments against claims that Tennessee has not diligently enforced the Tennessee Tobacco Manufacturer's Escrow Fund Act, Tenn. Code Ann. §§ 47-31-101 et seq.