



ALAN WILSON
ATTORNEY GENERAL

October 3, 2012

The Honorable James H. Harrison
Member, House of Representatives
512 Blatt Building
Columbia, South Carolina 29201

The Honorable Bruce W. Bannister
Member, House of Representatives
503A Blatt Building
Columbia, South Carolina 29201

Dear Representatives Harrison and Bannister:

You have requested an opinion from this Office concerning "certain activity," related to so-called "Roll Your Own" cigarettes. By way of background, you state the following:

[a] South Carolina customer has purchased cigarettes in Richland County in a retail establishment without the payment of any State or Federal cigarette taxes. The customer described the transaction as follows:

The customer entered a business establishment named "Palmetto Discount Tobacco", located at 7457 Patterson Road, Suite 113, in Columbia, S.C. A banner outside the establishment had a logo which read "RYO Filling Station" and the banner advertised the sale of discount cigarettes. The customer was greeted by a store employee wearing a "RYO Filling Station" shirt. The back of the shirt read "I'm a customer, not a manufacturer." The customer informed the employee that the customer was interested in cheap cigarettes. The employee asked what brand of smokes the customer wanted to purchase. The customer responded "Marlboro Lights". The employee picked out a bag of loose tobacco from ten (10) varieties on a shelf and the employee also picked up a box of empty cigarette tubes.

The customer was [led] ... by the employee to an area of the establishment that contained two (2) machines with the name "RYO Filling Station" imprinted on the machines. Both machines were initially in use by other individuals, so the customer waited his turn. The employee showed the customer how to empty the tobacco bag in the hopper of the "Filling Station" as well as how to place the hollow tubes in the machine for stuffing with tobacco. The employee also showed the customer which buttons to push in order for the machine to complete the operation.

The employee told the customer the cigarettes sold did not contain formaldehyde, described as a major lung irritant. The employee also stated that the "Fire Safe Chemical styrene" was not in the cigarettes purchased by the customer. Upon being asked why other cigarettes contained the fire safe chemical, the employee said the purpose was to "help prevent forest fires in California when people throw cigarettes out the window when they are drunk and doing drugs."

The customer reported that the entire transaction took about seven (7) minutes for which the customer paid Twenty Eight (\$28.00) Dollars for a total of two hundred (200) cigarettes in a plastic bag similar to Marlboro Lights - a number that is equal to the number contained in a standard carton of cigarettes. The employee invited the customer to buy more and to help spread the word.

The customer reports to me that a carton of Marlboro Lights ordinarily sell for approximately Fifty (\$50.00) Dollars.

Based upon these facts, you ask the following questions:

- 1- Is the transaction described above subject to the payment of cigarette taxes imposed by Sections 12-21-620(B)(1) and 12-21-625(D)(1) of the South Carolina Code of laws?
- 2- Is the transaction described above subject to the Tobacco Escrow Fund Act (Section 11-47-10 et seq.) and the Qualified [Escrow] ... Fund Enforcement Act (11-48-10 et seq.)?
- 3- Are the cigarettes in the transaction described above subject to the Reduced Cigarette Ignition Propensity Standards and Firefighter's Protection [Act] ... (23-51-20 et seq.)?

Law / Analysis
Statutory Background

Section 12-21-620(B)(1) defines a "cigarette" for purposes of taxation on products containing tobacco as (1) any roll for smoking containing tobacco or any substitute for tobacco wrapped in paper or in any substance other than a tobacco leaf" For purposes of the cigarette surtax, a "cigarette" is similarly defined by § 12-21-625(D)(1) as "(1) any roll for smoking containing tobacco or any substitute for tobacco wrapped in paper or in any substance other than a tobacco leaf"

Moreover, our Supreme Court, in *Tobacoville USA, Inc. v. McMaster*, 387 S.C. 287, 290, 692 S.E.2d 526, 528-529 (2010), described the Master Settlement Agreement between the states and tobacco companies as follows:

[i]n 1998, South Carolina was one of many states to enter into a Master Settlement Agreement (MSA) with certain tobacco companies to settle litigation brought by the

states to recover tobacco-related health care expenses. The MSA contained a Model Escrow Statute that South Carolina adopted and codified as the South Carolina Escrow Fund Act at S.C.Code Ann. § 11-47-10, *et. seq.* (Supp.2008). The Escrow Fund Act provides that a "tobacco product manufacturer" ... (TPM) that sells cigarettes to consumers within the state must either: (1) join the MSA and make settlement payments required under the MSA, or (2) remain a "non-participating member" and make payments each year to a qualified escrow fund. *Id.* § 11-47-10.

As the Supreme Court recognized, S.C. Code Ann. §§ 11-47-10 *et seq.* constitutes this State's "Tobacco Escrow Fund Act." Pursuant to § 11-47-30, "[a]ny tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer, or similar intermediary or intermediaries)" to either "become a participating manufacturer" or "place into a qualified escrow fund" a sum based upon the "units sold" within South Carolina of the tobacco products manufacturer in the previous year. The "units sold" is defined by Section 11-47-20(j) as "... the number of individual cigarettes sold in the State by the applicable tobacco 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)"

In order to deter violations and promote enforcement of the Tobacco Escrow Fund Act, the General Assembly enacted the Tobacco Qualified Escrow Fund Enforcement Act. S.C. Code Ann. §§ 11-48-10 *et seq.* Section 11-48-30(A) provides that

[e]ach tobacco product manufacturer whose cigarettes are sold in this State, whether directly or through a distributor, retailer, or similar intermediary or intermediaries shall execute and deliver on a form or in the manner prescribed by the Attorney General a certification to the Attorney General ... that, as of the date of this certification, the tobacco product manufacturer either is a participating manufacturer or is in full compliance with Section 11-47-30

Pursuant to subsection (B) of such provision,

[t]he Attorney General shall develop and make available for public inspection or publish on the office web site a directory listing all tobacco product manufacturers that have provided current and accurate certifications conforming to the requirements of subsection (A) and all brand families that are listed in the certifications

Additionally, pursuant to Subsection (C)(1),

[i] is unlawful for any person to:

- (a) affix a stamp to a package or other container of cigarettes of a tobacco product manufacturer or brand family not included in the directory if such stamp is required by law; or

- (b) sell, offer, acquire, hold, own, possess, transport, import or cause to be imported, for sale in this State cigarettes of a tobacco product manufacturer or brand family not included in the directory, or to import such cigarettes for personal consumption

Section 23-51-20 *et seq.* constitutes the "Reduced Cigarette Ignition Propensity Standards and Firefighter Protection Act." Pursuant to § 23-51-20(B), "cigarette" is defined as

- (1) any roll for smoking, made wholly or in part of tobacco or another substance, irrespective of size or shape, either flavored or unflavored, adulterated or mixed with another ingredient. The wrapper or cover must be made of or another substance or material other than leaf tobacco; or
- (2) any roll for smoking wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging or labeling, is likely to be offered to, or purchased by, consumers as a cigarette as described in subitem (1).

A "manufacturer" is defined by § 23-51-20(C) to mean

- (1) an entity which manufactures or produces cigarettes or causes cigarettes to be manufactured or produced with the intent to be sold in this State, including cigarettes intended to be sold in the United States through an importer;
- (2) the first purchaser that intends to resell in the United States cigarettes manufactured anywhere that the original manufacturer or maker does not intend to be sold in the United States or;
- (3) an entity that becomes a successor of an entity described in subitem (1) or (2).

Section 23-51-30(A) further provides that

[e]xcept as provided in subsection (O), cigarettes may not be sold or offered for sale in this State or offered for sale or sold to persons located in this State unless the cigarettes have been tested in accordance with the test method and meet the performance standard specified in this section, a written certification has been filed by the manufacturer with the State Fire Marshal in accordance with Section 23-51-40, and the cigarettes have been marked in accordance with Section 23-51-50.

Statutory Construction Principles

In responding to your questions, a number of principles of statutory construction are applicable. First and foremost, is the time-honored tenet that the primary guideline to be used in the interpretation of statutes is to ascertain and give effect to the intent of the General Assembly. *Belk v. Nationwide Mut. Ins.*

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Co., 271 S.C. 24, 244 S.E.2d 744 (1978). All rules of statutory construction are subservient to the one that the legislative intent must prevail if it can reasonably be discovered in the language used, and such language must be construed in light of the Act's intended purpose. *State v. Hudson*, 336 S.C. 237, 519 S.E.2d 577 (Ct. App. 1999). A statute as a whole must receive a practical, reasonable and fair interpretation, consonant with the purpose, design and policy of the lawmakers. *Caughman v. Columbia Y.M.C.A.*, 212 S.C. 337, 47 S.E.2d 788 (1948). The words used therein should be given their plain and ordinary meaning. *Worthington v. Belcher*, 274 S.C. 366, 264 S.E.2d 148 (1980). The interpretation should be according to the natural and obvious significance of the wording without resort to subtle and refined construction for the purpose of either limiting or expanding the Act's operation. *Greenville Baseball v. Bearden*, 200 S.C. 363, 20 S.E.2d 813 (1942).

South Carolina's Cigarette Tax

We first address the applicability of South Carolina's excise tax on cigarettes, authorized by § 12-21-610 *et seq.* A 57 cents per pack tax on cigarettes is authorized and we must determine the applicability of this tax to "Roll Your Own" cigarettes. As referenced above, § 12-21-620(B)(1) defines "cigarettes" as (1) "any roll for smoking containing tobacco or any substitute for tobacco wrapped in paper or in any substance other than a tobacco leaf" Section 12-21-610 further states that "[e]very person doing business within the State and engaging in the business of selling such articles or commodities as are named in this article shall, for the privilege of carrying on such business ... be subject to the payment of a license tax which shall be measured by and graduated in accordance with the volume of sales or acquisition of such person within the State." Based upon the literal language of the statute, and the requirement that we must give effect to the intent of the General Assembly, we cannot conclude that the offering of "Roll Your Own" cigarettes, as described above, are not included within the reach of the excise tax statute. There is no exception in the statute based upon how the cigarette is manufactured. As the federal court recently stated in *New York v. BB's Corner Inc.*, 2012 WL 2402624 (June 25, 2012), "[i]t surely elevates form over substance to credit defendants' argument that they are not in fact selling or distributing 'cigarettes' when they advertise cartons for sale, and customers walk out of their door with finished (albeit) unstamped cigarettes." In our opinion, therefore, the excise tax statute is clear and unambiguous and the offering of "Roll Your Own" cigarettes to the public, as you describe in your letter, must be included in that tax.

The Tobacco Escrow Fund Act

We next address your question concerning the Tobacco Escrow Fund Act as it relates to the offering of "Roll Your Own" cigarettes, in the manner which you describe. As noted, following the signing of the Master Settlement Agreement between the states and the tobacco companies, South Carolina enacted the Tobacco Escrow Fund Act, §§ 11-47-10 *et seq.*, requiring all tobacco product manufacturers which sell cigarettes to South Carolina consumers either to "become a participating manufacturer ... and generally perform its financial obligations under the Master Settlement Agreement" or "place into a qualified escrow fund" the specified amounts. See, § 11-47-30(a) and (b)(1). And, as noted above, the Tobacco Qualified Escrow Fund Enforcement Act, § 11-48-10 *et seq.* has as its purpose, enactment of "procedural enhancements [which] may deter potential violations and promote the

enforcement of the Tobacco Escrow Fund Act, safeguard the Master Settlement Agreement, the financial interests of the state, and the public health." Section 11-48-10(2).

The Enforcement Act, in order to enforce the Master Settlement Agreement and deter violations of the Tobacco Escrow Fund Act, provides for certification and imposes other requirements. As referenced above, each Act broadly and identically defines the term "cigarette" as

... any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains:

- (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco;
- (2) tobacco, in any form, that is functional in the product, 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 described in subitem (1) of this definition.
- (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 described in subitem (1) of this definition.

Each Act also expressly includes "roll your own" within the term "cigarette." A "roll your own" cigarette is described by § 11-47-20(d) as "any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes."

The Tobacco Escrow provisions also define the term "tobacco product manufacturer." Section 11-47-20(i) provides that a "tobacco product manufacturer" is an entity which

... after the date of enactment of this act (and not exclusively through any affiliate):

- (1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsection II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in subitem (1) or (2).

The tobacco escrow statutes, however, do not define the term "manufacturer." Where a statute is undefined, the courts usually look to the common and ordinary meaning of the word. *Richardson v. Town of Mt. Pleasant*, 350 S.C. 291, 566 S.E.2d 523 (2002). We have advised in a previous opinion of this Office that the common and ordinary meaning of the term "manufacturer" is "one who by labor, art or skill transforms raw materials into some kind of finished product or article of trade." See, *Op. S.C. Atty. Gen.*, March 15, 1982 (1982 WL 189206). Moreover, *Webster's Third New International Dictionary* (3rd ed. 2002) defines a "manufacturer" as one who is an "owner or operator of a factory."

Authorities which have addressed the question of whether the owner of a "roll your own" shop, which offers roll-your-own cigarettes in the manner which you describe, is a "manufacturer" for purposes of the escrow provisions of the Master Settlement Agreement have concluded in the affirmative. In *State of New Hampshire v. North of the Border Tobacco, LLC*, 32 A.3d 548 (2011), the Supreme Court of New Hampshire concluded that, based upon the common and ordinary meaning of the term "manufacturer," "we have no doubt that the trial court correctly concluded that Tobacco Haven was a tobacco product manufacturer selling rolled cigarettes to the consumers within the meaning of the [Non-Participating Manufacturer (NPM)] Act." In the Court's view, "[t]he scope and purpose of the NPM Act is particularly instructive on whether the legislature intended a retailer like Tobacco Haven to constitute a cigarette manufacturer under the circumstances before us. The statutory term 'tobacco product manufacturer' is broadly defined to reach entities that are directly responsible for manufacturing cigarettes and placing them in to the stream of commerce in the United States." 32 A.3d at 557. Thus, the purpose of the Act, according to the Court, is "to target commercial entities that are directly responsible for making, creating or producing cigarettes and profit from placing them into the stream of commerce for purchase by consumers in the United States." *Id.* Applying this legal analysis to the "Roll Your Own" circumstances, similar to that which you describe, the Court stated:

[t]he facts, viewed objectively, illustrate that Tobacco Haven, a commercial entity, had an organized business plan to produce in a mechanical manner and with use of industrial-type machine batches of 200 rolled cigarettes and place them into the stream of commerce for consumers to purchase. Tobacco Haven's manufacturing process included displaying various type of loose tobacco for consumer selection, along with cigarette tubes, and providing cigarette-making machines for producing rolled cigarettes with the tubes and selected tobacco. Tobacco Haven's practice of renting the use of its on-site machines does not vitiate its status as an entity that directly manufactures and sells rolled cigarettes; Tobacco Haven employees informed customers on the appropriate blend of loose tobacco for producing the desired cigarettes, instructed customers on how to use the machines, offered guidance as necessary, fixed the machines when they jammed, maintained the machines, and provided additional rolled cigarettes to complete the order of 200 cigarettes when the machines produced an incomplete batch.

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Id. at 558. See also, *State of New York v. BB's Corner, Inc.*, *supra*. Contra, Va. Op. Atty. Gen., Op. No. 11-095 (September 2, 2011), 2011 WL 4429186.

Moreover, it is also important to recognize that, since the New Hampshire case was decided, Congress enacted on June 29, 2012 HR 4348, the "Moving Ahead for Progress in the 21st Century Act." The President signed this legislation on July 6, 2012. Pursuant to HR 4348, a person who, for commercial purposes, makes available a cigarette-making machine is a tobacco product manufacturer for purposes of federal law. Section 100122 of the Act provides as follows:

(a) In general - Subsection (d) of section 5702 of the Internal Revenue Code of 1986 is amended by adding at the end of the following new flush sentence:

'Such term shall include any person who for commercial purposes makes available for consumer use (including such consumer's personal consumption or use under paragraph (1) a machine capable of making cigarettes, cigars, or other tobacco products. A person making such a machine available for consumer use shall be deemed the person making the removal as defined by subsection (j) with respect to any tobacco products manufactured by such machine. A person who sells a machine directly to a consumer of retail for a consumer's personal home use is not making a machine available for commercial purposes if such machine is not used at a retail premises and is designed to produce tobacco products only in personal use quantities.

The new federal law is an important guide in answering each of your questions. Such enactment was recently discussed and relied upon in an unpublished decision of the Sixth Circuit Court of Appeals in *RYO Machine, LLC et al. v. U.S. Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau et al.*, 2012 WL 3553504 (6th Cir. 2012) (unpublished). In that case, the Sixth Circuit vacated a preliminary injunction, granted by the District Court, which prohibited enforcement of TTB's Ruling 2010-4. 2010-4 Ruling had "deemed retailers that offer roll-your-own cigarette machines 'manufacturers of tobacco products'" within the meaning of 26 U.S.C. § 5701 *et seq.* Pursuant to 26 U.S.C. § 5703(a)(1), any manufacturer of tobacco products is liable to pay the federal excise tax on such products. However, the District Court enjoined TTB's Ruling, concluding as part of its analysis, that "[a]t this time and with the record before it, ... Plaintiffs RYO Machine and Tobacco Outlet have a colorable claim against the TTB."

The Sixth Circuit vacated the District Court's grant of a preliminary injunction on the basis of lack of jurisdiction. The Anti-Injunction Act foreclosed the District Court's exercise of jurisdiction. As the Court concluded, "[w]ith few exceptions, no court has jurisdiction over a suit to preemptively challenge a tax." (citing 26 U.S.C.A. § 7421(a)).

In the Sixth Circuit's decision, the Court also made reference to the merits:

[d]uring the pendency of this appeal, Congress passed and the President signed into law the Moving Ahead for Progress in the 21st Century Act, which authorized funding for highways and other transit programs ("the Highway Act" or "the Act") The Highway Act offset the cost of providing such funding, in part, by amending the definition of "manufacturer of tobacco products" to include retailers who make roll-your-own machines available to customers, *thereby achieving the same result as the Ruling*

(emphasis added). Further, the Court recognized that, during the pendency of the appeal, "Congress amended § 5702(d) *in a way that effectively adopts the Bureau's position* in the Ruling, prospectively mooted the controversy over how the statute should apply to roll-your-own retailers as of the date the amendment went into effect." In short, Congress has now made clear that Roll Your Own retailers are subject to the federal excise tax on tobacco because Congress deems such retailers to be "manufacturers of tobacco products." This is further support for the conclusion not only as to your second question regarding the Tobacco Escrow Fund, but also as to your first question concerning the state excise tax on cigarettes.

Reduced Cigarette Ignition Propensity Standards and Firefighter's Protection Act

Likewise, these authorities provide support for a response to your third question regarding statutes relating to fire safety standards. As noted above, South Carolina's Reduced Cigarette Ignition Propensity Standards and Firefighter's Protection Act, § 23-51-20 *et seq.* requires that cigarettes sold in the State must be tested and meet fire safety standards. A "manufacturer" is defined for the purpose of the Act by § 23-51-20(C) as

- (1) an entity which manufactures or produces cigarettes or causes cigarettes to be manufactured or produced with the intent to be sold in this State, including cigarettes intended to be sold in the United States through an importer;
- (2) the first purchaser that intends to resell in the United States cigarettes manufactured anywhere that the original manufacturer or maker does not intend to be sold in the United States; or
- (3) an entity that becomes a successor of an entity described in subitem (1) or (2).

Clearly, based upon the authorities discussed above, retail establishments offering roll your own cigarettes, as described, are "caus[ing] cigarettes to be manufactured or produced." It was the purpose of the General Assembly, in enacting the Fire Safety statutes to reduce the risks of fires which cigarettes cause and thereby protect public safety. Inclusion of Roll Your Own retailers would effectuate such purpose.

Both the Kansas and Georgia Fire Marshal appear to have reached this same conclusion. According to a letter, dated February 27, 2012, the Kansas Fire Marshal stated that Roll Your Own retailers "must be in compliance with the Kansas Fire Safety Standard and Firefighter Protection Act" continuing, the Fire Marshal wrote that "[f]or the purposes of the Fire Safety Act, a person or business

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who possesses or leases an RYO vending machine for the purpose of selling tobacco products to consumers is a cigarette manufacturer." The Kansas statute is very similar to that of South Carolina.

Likewise, a ruling by the Georgia Department of Revenue, Alcohol and Tobacco Division, dated July 24, 2012, references HR 4348. The Ruling states:

[t]his federal legislation impacts Georgia licensees that display these machines for use by the consumer. O.C.G.A. §§ 48-11-3, 48-11-4, and 48-11-8, administered by the State Revenue Commissioner, require licensing and that cigarette excise tax stamps to be affixed to the manufactured cigarettes. O.C.G.A. § 48-11-23.1 also specifies the packaging required before a stamp may be affixed.

Georgia licensees are also impacted by Title 10, Chapter 13 of the Official Code of Georgia Annotated, administered by the Attorney General concerning the Master Settlement Agreement and payments into escrow accounts. Title 25, Chapter 14 of the Official Code of Georgia, administered by the Safety Fire Commissioner, requires that all cigarette papers used must be fire safety certified and compliant. Other laws and regulations may also impact operations within Georgia.

Conclusion

Your letter describes in detail the operation of retail establishments which offer to consumers "roll your own" cigarettes through the customer's access to a machine which makes such cigarettes. Based upon the facts as you describe them, and based upon authorities in other jurisdictions which possess virtually identical or similar laws, it is our opinion that such establishments are a "manufacturer" of cigarettes for purposes of the various statutes you reference in your letter. Cf. *Op. S.C. Atty. Gen.*, January 6, 2012 (2012 WL 469994) [proprietor of a brew-on-premises facility or a home winemakers' center required to obtain DOR permit to sell beer and wine]. We believe the ruling of the New Hampshire Supreme Court, as well as the other authorities referenced herein, are persuasive, and thus we answer each of the three questions raised by your letter in the affirmative. In other words,

1. the transaction described in your letter is subject to the payment of cigarette taxes;
2. the transaction described in your letter is subject to the Tobacco Escrow Fund Act and the Qualified [Escrow] ... Fund Enforcement Act;
3. the cigarettes described in the transaction set forth in your letter are subject to the Reduced Ignition Propensity Standards and Firefighter's Protection Act.

Sincerely,



Robert D. Cook
Deputy Attorney General

RDC/an