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POINT-COUNTERPOINT: RYO MACHINES

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Point: RYO Cigarette Shops on a Roll

Shops say tobacco companies, c-stores, others trying to extinguish competition

A new generation of roll-your-own (RYO) cigarette machines has been spreading across the country at tobacco shops capitalizing on tax loopholes to deliver low-priced products, reported the Wall Street Journal.

Now lawmakers, backed by tobacco companies and convenience store chains, want to declare such shops to be manufacturers, said the report. That would subject them to the same taxes and regulations as the broader cigarette industry, which the newspaper said would be likely to put them out of business.

Instead of buying ready-made cigarettes, the shops' customers purchase loose tobacco and pour it into an ATM-sized machine that rolls 200 cigarettes in less than 10 minutes.

The cigarettes typically are made with leaves labeled "pipe tobacco'' and can sell for half what major brands cost, depending on state taxes, the report said.

Hundreds of such shops--mostly or entirely focused on the RYO machines--have opened since 2009, when Congress increased the federal excise tax on a carton of 200 cigarettes to $10.066 from $3.90 and hiked the tax on a pound of RYO cigarette tobacco to $24.78 from $1.0969. The tax for a pound of pipe tobacco rose only to $2.8311 from $1.0969.

Under a Senate bill passed Wednesday, any retailers making RYO machines available to customers would be treated like mainstream cigarette manufacturers. The provision was included in a rural school financing amendment tucked inside the federal surface transportation bill, which still needs House approval.

"[RYO] cigarette machines take advantage of an unintended tax loophole, and that isn't right,'' said Senator Max Baucus (D-Mont.), who chairs the Senate Finance Committee and sponsored the amendment. Representative Diane Black (R-Tenn.) introduced a separate bill earlier this month classifying the shops as manufacturers.

Richmond, Va.-based Altria Group Inc. and the National Association of Convenience Stores (NACS) have lobbied for such measures, which are finding support on both sides of the aisle. Governors in Virginia, South Dakota and Wyoming have signed similar bills this month, and legislatures in approximately 20 other states are weighing action.

In New York, state and city authorities filed lawsuits this week against a handful of RYO retailers for allegedly circumventing taxes and regulations. Ready-made cigarettes still have a market share of more than 95%, according to industry estimates cited by the Journal.

RYO Machines LLC, the largest maker of the machines, has hired its own lobbyists and lawyers to try and turn the tide. The company and affected tobacco shops say they have no way of complying with the regulatory requirements of being a cigarette manufacturer. They say they have not broken any laws and that large tobacco companies are trying to extinguish competition.

"I'm David fighting Goliath,'' Phil Accordino, part-owner of Girard, Ohio-based RYO Machines, told the newspaper. The company began manufacturing the machines in 2008. It has sold about 1,900 machines to tobacco shops in more than 40 states, including approximately 1,000 last year.

Stores pay a bit more than $30,000 for each machine, which takes two to three seconds to roll a cigarette. That is several times faster than smaller table-top versions, but still about 1,000 times slower than machines at big cigarette manufacturing plants.

The Alcohol & Tobacco Tax & Trade Bureau declared in 2010 that retailers with the machines are manufacturers, but RYO Machines secured a preliminary injunction in a federal court in Ohio. Oral arguments in that case are expected to begin next month. It also has won injunctions in a handful of states, including Connecticut and Wisconsin.

In the meantime, RYO shops continue to spread in places like Smyrna, Ga., where Tobacco Road opened its doors last November with four machines in a converted KFC fast-food restaurant. A steady stream of smokers filed in this week, drawn by signs touting cigarette cartons for $23.80, which includes the fee to use a machine, said the report.

Critics say such shops unfairly avoid hefty taxes and fees levied on cigarette manufacturers. They also say shops use cigarette tobacco that has been mislabeled as pipe tobacco to gain a further price advantage. Pipe tobacco traditionally is moister than cigarette tobacco with a wider cut.

"We want to see a level playing field,'' Ronald Bernstein, CEO of Mebane, N.C.-based Liggett Group LLC, part of Vector Group Ltd., a large U.S. cigarette company, told the Journal.

Sales of pipe tobacco that end up in pipes have been declining for decades, shrinking by about two-thirds between 1990 and 2008, according to industry estimates cited by the report.

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Counterpoint: Back Taxes Eventually Will Bite Retailers
By Corey Fitze
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NACS outlines its position on RYO machines

In response to a recent Wall Street Journal article regarding roll-your-own (RYO) tobacco manufacturers, I am writing to rebut the false claims being made by the RYO tobacco machine companies.

First and foremost, the company RYO Machine Rental, or more commonly known as RYO Filling Station, promotes the use of pipe tobacco in their machines rather than RYO, or loose tobacco. They do this to take advantage of a tax loophole that saves the customer roughly $20 for a carton of cigarettes.

The convenience-store industry is always looking for the next "greatest thing." We are entrepreneurs to the core; however, we can only act with market certainty. We have reason to believe that in the next three-to-five years, once a federal lawsuit is resolved, all retailers who possess these machines will have to pay back-taxes on every cigarette their machines have produced. More than 20 states have come out with either regulatory or legislative language deeming retailers who own these machines to be tobacco manufacturers. The uncertainty in the marketplace makes it harder for small business owners to plan for the future.

Second, RYO-machine companies compare a machine that manufactures a carton of cigarettes in less than 10 minutes to a coffee grinder in a grocery store that customers can use; however, grocery stores are not evading taxes when customers make their own coffee vs. purchasing coffee already ground up. The more appropriate comparison is a buffet: Just because a restaurant has a buffet, that doesn't mean the customers are "cooking" their own food. The restaurant still has to be treated like a restaurant, thus they have to pay the applicable taxes and follow all FDA regulations and local restrictions.

The RYO-machine companies claim their opposition is led by "big tobacco"; however, they seem to have missed the fact that more than 75 associations and companies (none of them being tobacco manufacturers) have gone on record supporting legislation deeming retailers who own machines to be tobacco manufacturers. They also ignore the fact that the National Fire Protection Agency sent a letter to all state fire marshals stating that retailers who on RYO machines should be treated as manufacturers for purposes of fire-safety laws.

Finally, the RYO-machine companies claim that treating them as manufacturers is "anti-competitive." This is plainly false. The c-store industry is the most competitive market in the country. We are the only industry in America that advertises prices on 20-foot signs in front of our stores. We are the only industry in America where someone will drive 5 miles out of their way to save 3 cents on products we sell (fuel). We know what competition is because our industry lives and dies by it every day; however, the current state of uncertainty surrounding the regulatory treatment of retailers who own RYO machines makes the market inherently uncompetitive and demands immediate congressional intervention.

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MARYLAND HOUSE COMMITTEE VOTES TO RAISE TAX ON SOME TOBACCO PRODUCTS

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Maryland's House Ways and Means Committee voted on Monday to approve tax hikes on several tobacco products, reported the Baltimore Business Journal. It supported the Senate's approved 55-percent tax hike on cigarillos, but did not go along with the Senate's recommendations on other items.

The committee approved a 50 percent tax rate on smokeless tobacco and upheld the current 15 percent tax rate on premium cigars. Last week the Senate voted to raise wholesale tax rates to 70 percent for cigarillos and 20 percent for smokeless tobacco and premium cigars, according to the report.

Gov. Martin O'Malley previously suggested a 70 percent tax rate for all three products, comparable to the tax rate for cigarettes. The conference committee set to merge the House and Senate votes could still choose the higher rate.

"What the House passed is a great public health victory and will save the lives of thousands of Maryland young people," said Vincent DeMarco, president of the Maryland Citizens' Health Initiative, which supported the bill. "But, we strongly urge the General Assembly to raise the tax on smokeless tax to 70 percent of wholesale to save as many lives as we can."

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