

# OTP MARKET OVERVIEW AND TAX ENFORCEMENT SOLUTIONS

Presentation to: Tobacco Taskforce

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Title/Department: COO

Company: SICPA/Meyercord

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Confidentiality level: **CONFIDENTIAL**



Enabling trust

Meyercord Revenue Inc.

A SICPA company



# AGENDA

- Introduction to SICPA/Meyercord
- Introduction to SICPATRACE®
- OTP Market Overview
- Tools to Combat Tax Evasion and Illicit Activities around OTP

# A BRIEF HISTORY

- Leading provider of **security inks and integrated solutions**
- Portfolio of products extending to **banknotes, value documents** and **brand protection**
- Proven solutions targeting **excise tax control with 10+ years of solution deployments**
- US: SICPA acquired Meyercord Revenue in 2010 – **merging more than 130 years of combined tax stamp industry experience**



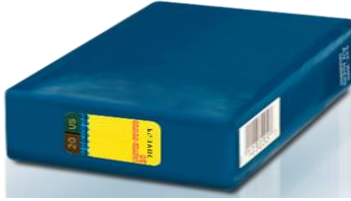
140 BILLION BANKNOTES  
SECURED WITH SICPA  
INKS PER YEAR

76 BILLION PRODUCTS  
INDIVIDUALLY MARKED  
PER YEAR

CLIENTS IN 180  
COUNTRIES

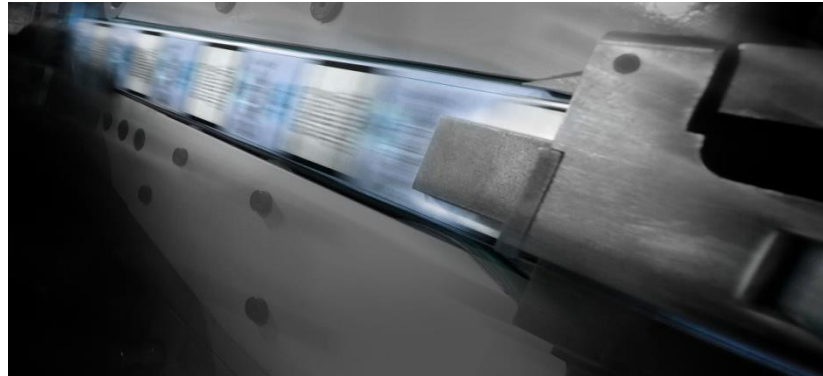
3,000 STAFF

# SICPA/MEYERCORD REVENUE AT A GLANCE (US)



More than **59 years of experience** providing heat-applied cigarette tax stamps to 45 U.S. states

**NASPO Class II Security Assurance Certificate** issued in 2005 and **ISO 14298 Certificate** issued in 2015



**Proven track-and-trace systems** in CA and MA with **10+ years** of runtime success



Enables the collection of more than **\$17 billion** in tobacco tax revenue annually



Prints **12 billion** tax stamps annually



## INTRODUCTION TO SICPATRACE®





# FOUNDATIONS OF SICPATRACE® (2004 – 2009)



 Tobacco

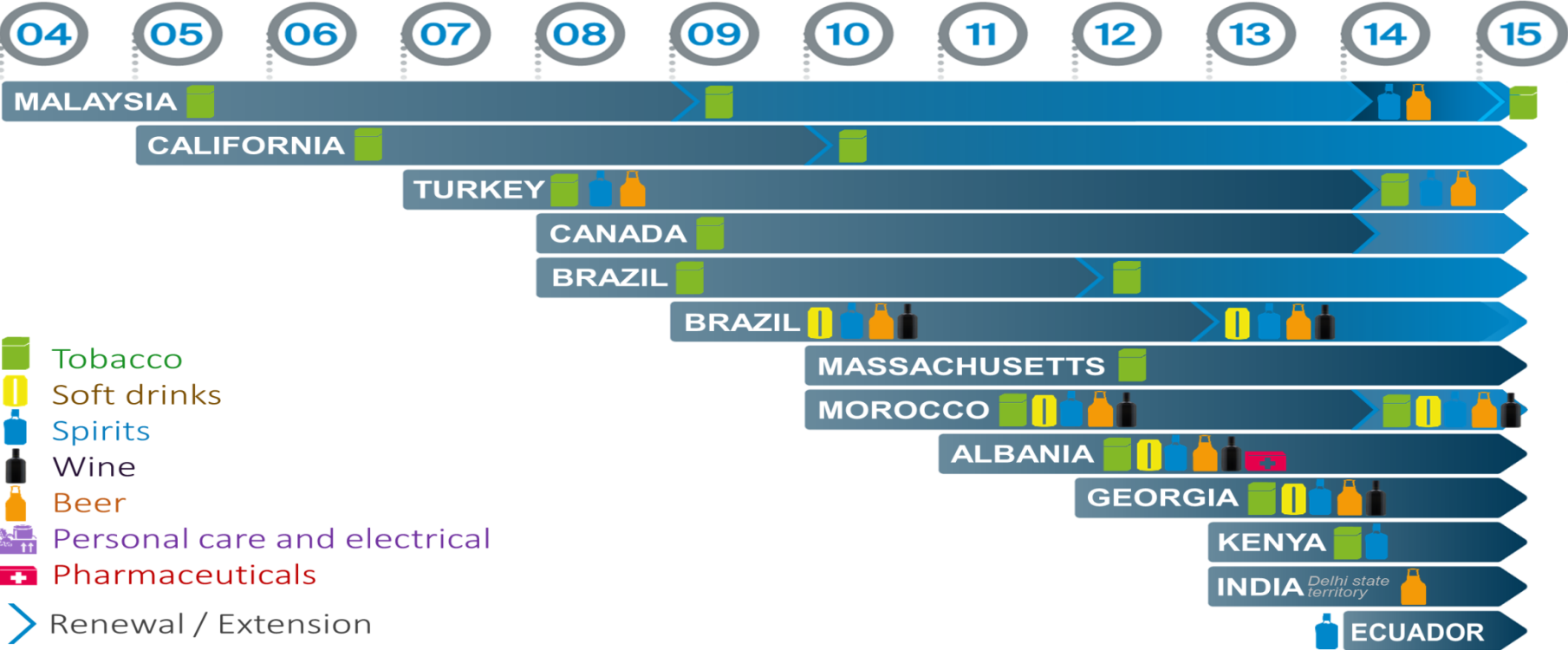
 Spirits

 Beer

 Renewal / Extension

- Platforms largely built around a tax stamp for tobacco excise tax control and production monitoring
- Established industry standards and credibility
- Demonstrated efficiency and capability, but, with each new deployment, a better understanding of customer needs and applications

# EXPANSIONS OF SICPATRACE®



# SICPATRACE® IN MASSACHUSETTS

- Feb. 2010: MA DOR awarded SICPA a contract for the implementation of a State Tax Revenue Collection Platform
- The Encrypted Cigarette Excise Stamp Program distributes and tracks 180 million tax stamps per year.
- Each stamp leverages self-adhesive stamps carrying overt, semi-covert, covert and forensic security features
- System enables validation of Distributor names, date of stamp application, brand variance and other fields





# Protecting MSA Payments

- Illegal Tobacco Sales could have an impact on the MSA payments to the Commonwealth (Currently approx. \$250MM – 4% share)
- Payments are based on the Federal Excise Taxes Paid when products are transferred to licensed distributors
- A requirement of the MSA is to have records available upon request
- This platform protects MSA payments through controls integrated within the Stamping process (Tobacco Product Directory) as well as through enforcement



## OTP MARKET OVERVIEW

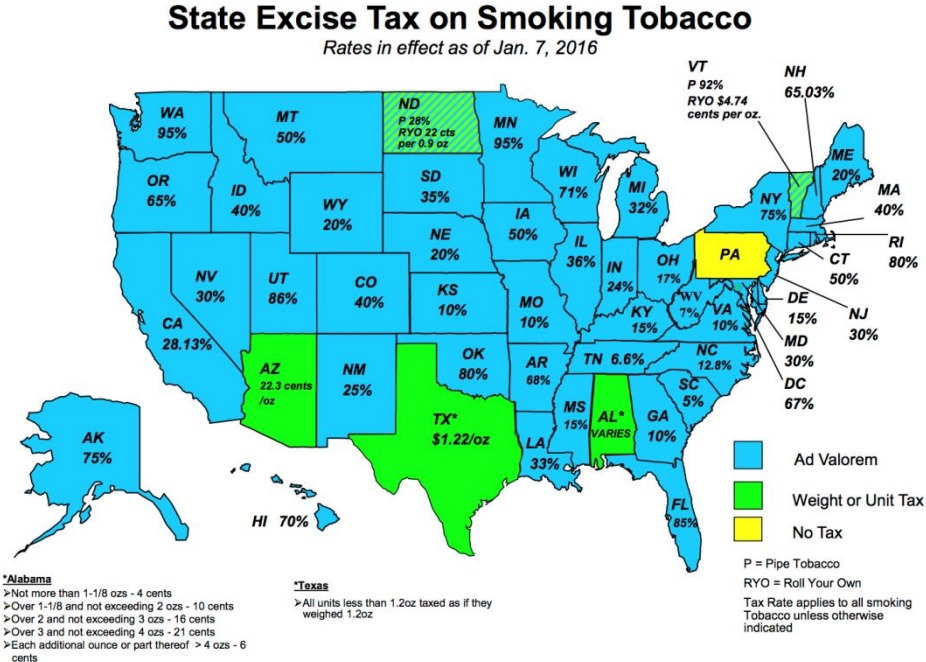


# MARKET OVERVIEW

- OTP is often marketed as safer, cheaper and more “discreet” means for nicotine delivery than cigarettes
- Price increases on cigarettes, economical downturn and “low/non-homogenous” tax rates on OTP has helped shift the demand on OTP products in the US and other regions
- In 2014, the OTP market grew by 6.6%, and in the last decade by an average of **4% per year**, vs. an 3% average decline for the cigarette market
- According to TMA, OTP represented about 8% of the tobacco revenue in the US in 2010, by 2014 that number was up to **17%**

# TAX CHALLENGES

- As is, compliance activity on product set is voluntarily reported and assessed
- Tax authorities lack reconciliation information to confirm reporting
- There are no visible markings of product to assist in enforcement



# THE OTP MARKET – TAX CHALLENGES

- OTP's biggest challenge is an even wider variation in tax rates between states and also among tobacco product types
  - For example: MA has a flat 210% tax rate on top of wholesale price, NY has a 75% tax on chewing tobacco and a \$2/oz tax on snuff and PA has NO OTP tax - All 3 are neighboring states



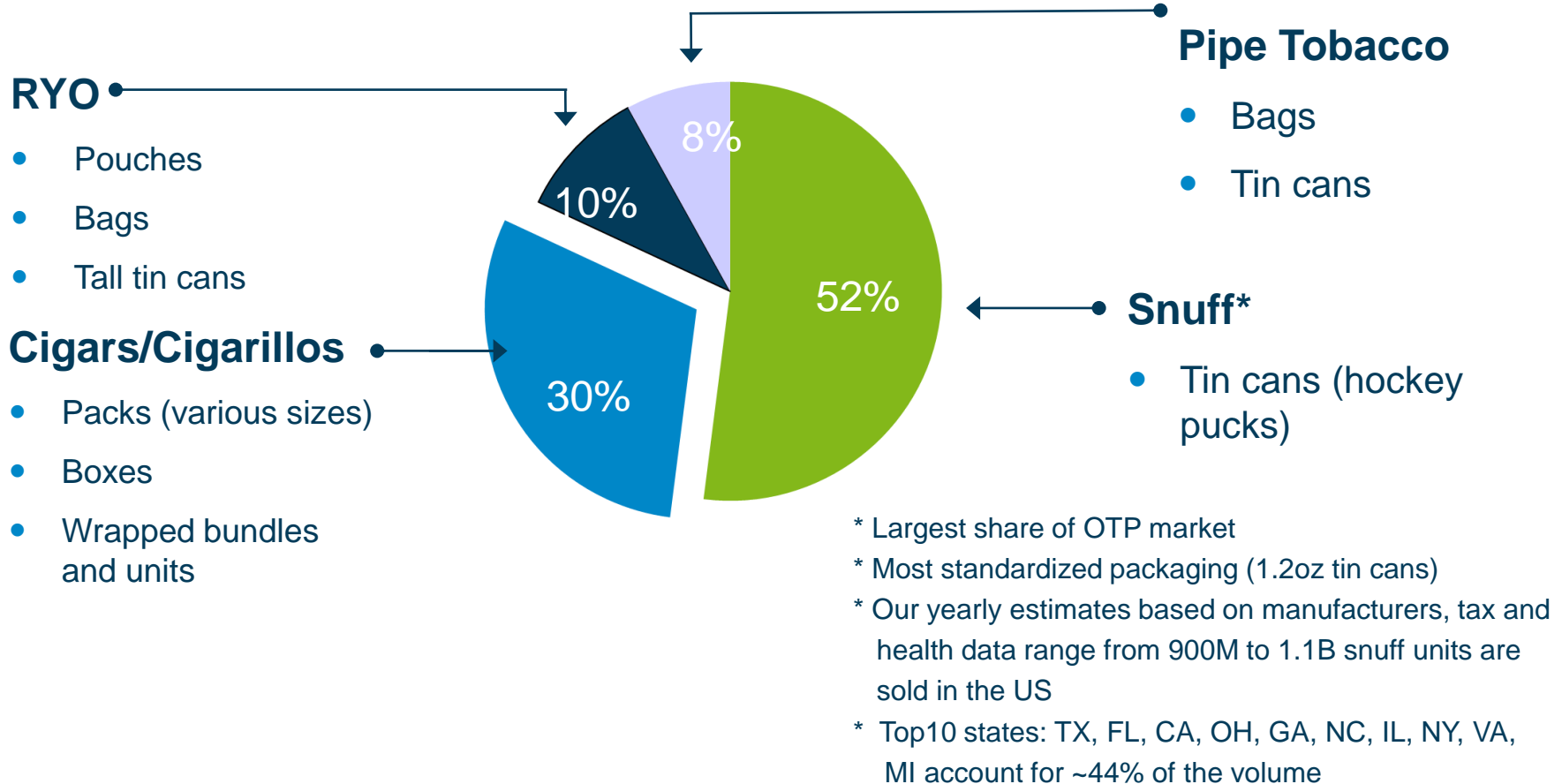
# SMOKELESS OTP ESTIMATES (lower) - Massachusetts

	Factors		Source
Massachusetts Demographics	Population	6,646,144	2012 US census
	Adult population %	78.30%	2012 US census
	Smokeless Tobacco Usage (% of total adult population)	1.10%	CDC, 2009 (lowest estimate)
	Smokeless usage (people)	57,243	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	82,474.50	TMA report, 2014 minus margin of error Cross checked with Euromonitor 2010 +4% CAGR
	Part of Massachusetts	0.666%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	549	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 21	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 44.30	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 17.10	DOR, Fiscal year 2014
	<b>Delta</b>	<b>\$ 27.20</b>	

# SMOKELESS OTP ESTIMATES - Massachusetts

	Factors		Source
Massachusetts Demographics	Population	6,646,144	2012 US census
	Adult population %	78.30%	2012 US census
	Smokeless Tobacco Usage (% of total adult population)	1.50%	CDC, 2009
	Smokeless usage (people)	78,059	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	109,966	TMA report, 2014
	Part of Massachusetts	0.908%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	999	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 38	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 80.54	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 17.10	DOR, Fiscal year 2014
	<b>Delta</b>	<b>\$ 63.44</b>	

# OTP MARKET SEGMENTATION





DELIVERING VALUE THROUGH INNOVATIVE  
SOLUTIONS



# SICPA STATUS 2012-2015

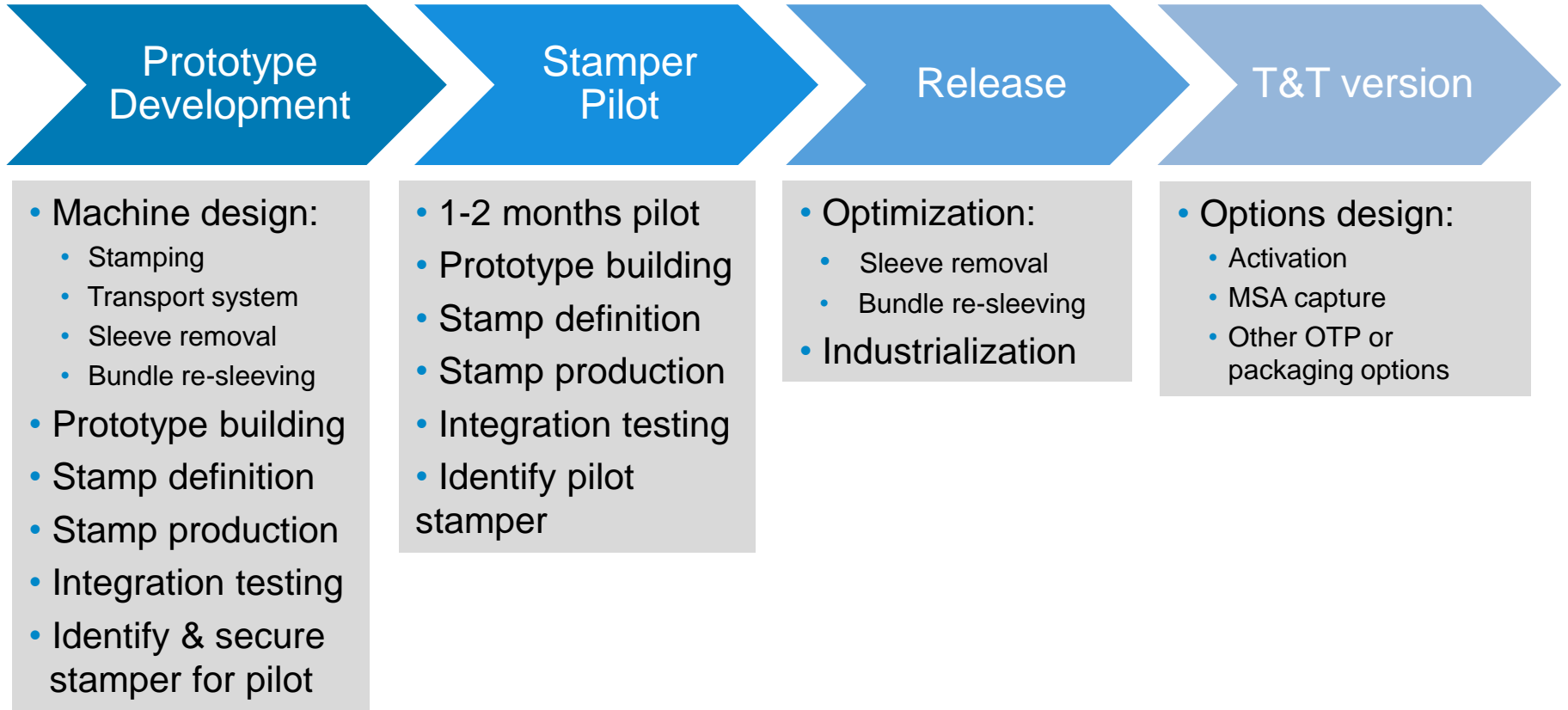
- Conducted site visits in Alabama and Massachusetts (2012)
- Developed a self-adhesive stamp for OTP
- Identified an affordable, flexible, and off-the-shelf solution for stamping that could:
  - Stamp other type of OTP such as RYO as well
  - Be integrated within a Track and Trace platform with activation and SKU check cameras
- Tested the feasibility on actual 1.2 Oz tin cans with self adhesive stamps
- Engaged with industry to develop a all-in-one 1.2Oz tin can stamping machine as well as multi-product stamping option



# STRATEGY TO MAXIMIZE MARKET COVERAGE AND FACILITATE ADOPTION

- Because the market is very fragmented in various dimensions:
  - Product packaging types & various tax rates
  - Sizes of licensed tobacco license holders ranging from large nationwide group to small wholesalers (without equipment today)
  - Stamp to order vs. Stamp to stock
- SICPA considered pursuing a multi-option, flexible approach:
  - Manual Stamping
  - Add-on carriers for existing stamping machines
  - COTS label applicator solutions
  - Single purpose, integrated equipment

# GO-TO MARKET ROADMAP



# REMAINING CHALLENGES WITH STAMPING

- For an automated solution to be compelling (i.e. efficient) for stampers, it needs to eliminate the most time consuming manual operations:
  - Stamping (and data capture)
    - Ensure current solutions meet the performance and price requirement
  - De-sleeving 5-can bundles into individual tin cans
  - Re-sleeving into bundles
- Some off-the-shelf slitting & shrink-wrapping solutions may exist but need to be investigated, adapted, and integrated
- Solution Need to be cost effective with an effective ROI



# INVOICE CAPTURE – SOFTWARE APPROACH TO COMPLIANCE

# REVENUE PROTECTION PROPOSAL

- Modular system that can be scaled up over time, bringing additional levels of benefits, and fully leveraging the initial investment:
  - **Invoice Capture:** Forms capture of product data reported by wholesalers to MSAi integrated with DOR's existing data warehouse and reporting capabilities for query and analysis
  - **Visual Reporting & Business Analytics:** Enhanced comparative analytics to drive audit and compliance identification of illicit purchases by retailers and associated excise tax and sales tax evasion
  - Leveraging of this platform within **the SICPATRACE® Platform currently deployed by DOR**
- All modules leverage common architecture and data management solution enabling the to add capabilities as needed

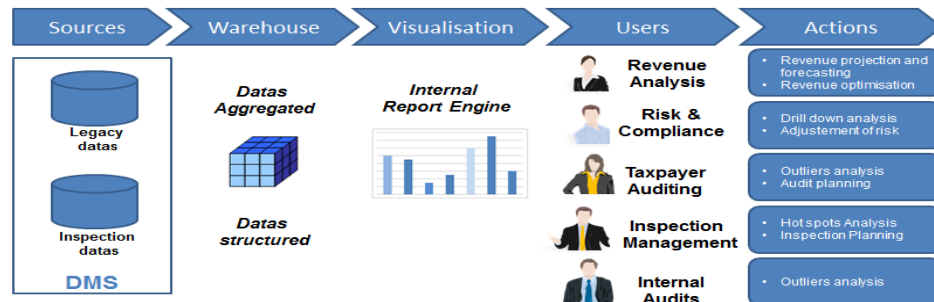


# INVOICE CAPTURE OVERVIEW

- Flexible **Invoice Data Capture Interfaces** enabling wholesalers to upload invoice content using the existing MSAi extracts i.e. bill to party, date, SKUs, quantities into the capture system
- Enables capture of Cigarette, OTP, e-Cigarette or Consumer Packaged Good ('CPG') product distribution from wholesaler to retail to support tax compliance and reconciliation.
- Supports capture of wholesaler shipments received from manufacturers to provide reconciliation of wholesaler reported inventory and activity.
- BOE access to data repository through SICPATRACE® solution

# VISUAL REPORTING & BUSINESS ANALYTICS

- Data warehouse **Infrastructure Layer** utilizes **SICPATRACE® Data Management System** for import, extract, and storage of all the Invoice capture related data – and compatible with future services
- **Versatile Reporting Platform** integrated with **SICPATRACE® reporting architecture** supporting a standard set of reports developed and maintain by SICPA for DOR, or DOR's access to drill-down capabilities
- The platform features a wide range of **visual chart and dashboard elements**, and built-in **geo-mapping & business analytics** tools and capabilities



# Data Driven Compliance – Texas success (HB-11)

- The Comptroller's office identified the following taxes due to the state following implementation of their invoice capture e-reporting system:
  - Almost \$90M due to the state in fiscal 2009
  - More than \$102M in fiscal 2010
  - More than \$84M identified in fiscal 2011
  - An additional \$123M million in taxes was identified in fiscal 2012
    - 4-year total of \$398.9M

*• Since House Bill 11 took effect, it has helped uncover more than \$230 million in potentially unreported sales tax...In the Javaid case, our investigators also discovered tobacco tax violations that might have gone undetected if House Bill 11 reporting requirements hadn't drawn our attention to this particular store.*

**- Texas Comptroller Susan Combs**



NEXT STEPS



# NEXT STEPS with TASKFORCE/DOR

- Can DOR or the Taskforce act unilaterally on this?
  - Does MA DOR (or the Taskforce) have general statutory authority to promulgate rules and regulations as required to administer taxes the legislature has given them authority to collect or is specific legislative guidance necessary?
- Alignment with stakeholders
  - In the form of a pilot or some limited deployment
- Application
  - Stamp placement, de-sleeving and re-sleeving need to be addressed



THANK YOU  
FOR YOUR ATTENTION

Meyercord Revenue Inc.

A SICPA company  SICPA