

Department of Legislative Services
 Maryland General Assembly
 2007 Session

FISCAL AND POLICY NOTE

Senate Bill 594 (Senator Garagiola, *et al.*)
 Finance and Budget and Taxation

Maryland Biomedical Product Development Fund

This bill establishes the Maryland Biomedical Product Development Fund to support the research and development of innovative treatments, therapies, diagnostics, and medical devices that address a smoking-related disease. The Maryland Technology Development Corporation (TEDCO), in consultation with the Department of Health and Mental Hygiene (DHMH), must administer the fund. The bill increases the tobacco tax rate for cigarettes and changes the distribution of tobacco tax revenues to make tobacco tax revenue contributions into the biomedical fund the third priority.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: Tobacco tax revenues increase by a total of \$32.5 million in FY 2008 from raising the tobacco tax. Tobacco tax revenues of \$38.5 million go to TEDCO for the biomedical fund in FY 2008. General fund revenues from tobacco taxes decline by \$2.5 million in FY 2008 due to diversion of revenues to the fund as required by the bill. No effect on general fund expenditures. Future years reflect a gradual decrease in TEDCO special fund revenues and expenditures for the biomedical fund and progressively less tobacco tax revenues deposited into the general fund due to declining tobacco tax revenue from fewer cigarette pack sales.

| (\$ in millions) | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|------------------|---------|---------|---------|----------|----------|
| GF Revenue | (\$2.5) | (\$5.3) | (\$8.1) | (\$11.0) | (\$14.0) |
| SF Revenue | 38.5 | 34.6 | 33.2 | 31.8 | 30.4 |
| SF Expenditure | 38.5 | 34.6 | 33.2 | 31.8 | 30.4 |
| Net Effect | (\$2.5) | (\$5.3) | (\$8.1) | (\$11.0) | (\$14.0) |

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Significant increase in small business revenues beginning in FY 2008 for those awarded grants from the biomedical fund. Decrease in revenues for small businesses that sell cigarettes, which are projected to see a decline in cigarette pack sales beginning in FY 2008.

Analysis

Bill Summary:

Maryland Biomedical Product Development Fund

The special, nonlapsing fund consists of tobacco tax revenues distributed to the fund and any other money from any other source accepted for the fund's benefit. Money in the fund may only be spent to • award grants for research and development of innovative treatments, therapies, or diagnostics that address one or more smoking-related diseases; and • pay necessary administrative costs.

TEDCO, consulting with DHMH, must evaluate grant applications and award grants to qualified applicants. Grant applications will be evaluated on • the proposed project's scientific and technical merit; • the extent to which the proposed project would address an unmet medical need for a smoking-related disease; • the proposed project's innovation and novelty; and • the anticipated economic impact for the State.

A grant awarded must be between \$150,000 and \$1.5 million. If a grant of more than \$250,000 is awarded, TEDCO must pay the grant in phases based on the grantee achieving negotiated technical and scientific milestones. A grant may be awarded for a period between six months and three years. A qualified applicant or its commonly owned or controlled affiliates may not receive more than \$1 million in a year or \$3 million over five years from the fund.

An awarded grant is contingent on a memorandum of understanding (MOU) between the grantee and TEDCO that establishes the scope of the State's ownership or other financial interest in the commercialization and other benefits of the results, products, inventions, and discoveries of funded projects. The MOU also must reflect the grantee's intellectual property policies, to the extent that they are consistent with federal and State law.

Annually by January 1, TEDCO must report to the Governor and the General Assembly on the grants awarded. The report must identify each grantee receiving funding, the amount of funding awarded to each grantee, and a description of the grantee's project.

Tobacco Tax

The Comptroller must distribute \$275.0 million from tobacco tax revenues to the State's general fund after first distributing the amount necessary to pay refunds relating to the tobacco tax to a refund account; and second, distributing the amount necessary to administer the tobacco tax laws to an administrative cost account.

After making these distributions, the Comptroller must distribute the remaining tobacco tax revenues to the biomedical fund.

The bill increases the tobacco tax rate for cigarettes in the following manner: • from 50 to 58 cents for each package of 10 or fewer cigarettes; • from \$1.00 to \$1.15 for each package of at least 11 and not more than 20 cigarettes; • from 5 to 6 cents for each cigarette in a package of more than 20 cigarettes; and • from 5 to 6 cents for each cigarette in a package of free sample cigarettes.

Any cigarettes used, possessed, or held in the State on or after July 1, 2007, by any person for sale or use in the State must be subject to the full tobacco tax of \$1.15 on cigarettes imposed by the bill. Revenue attributable to this requirement must be remitted to the Comptroller by September 30, 2007. Except as otherwise provided on or after July 1, 2007, no Maryland stamp must be used except the Comptroller-issued stamp to evidence the tobacco tax on cigarettes of \$1.15 imposed by the bill.

Current Law:

TEDCO

TEDCO is a public instrumentality of the State that assists in transferring to the private sector and commercializing the results and products of scientific research and development conducted by colleges and universities. It also assists in commercializing technology developed in the private sector and fosters the commercialization of research and development to create and sustain businesses throughout all regions of Maryland.

Tobacco Tax Revenue

From the tobacco tax revenue, the Comptroller must distribute the amount necessary to pay refunds relating to the tobacco tax to a refund account. After making this

distribution, the Comptroller must distribute the amount necessary to administer the tobacco tax laws to an administrative cost account. After making this distribution, the Comptroller must distribute the remaining tobacco tax revenue to the State's general fund.

The tobacco tax rate for cigarettes is • 50 cents for each package of 10 or fewer cigarettes; • \$1.00 for each package of at least 11 and not more than 20 cigarettes; • 5 cents for each cigarette in a package of more than 20 cigarettes; and • 5 cents for each cigarette in a package of free sample cigarettes.

The tobacco tax rate for other tobacco products is 15% of the wholesale price of the products.

Background: The Centers for Disease Prevention and Control advise that the adverse health effects from cigarette smoking account for an estimated 438,000 deaths, or nearly one of every five deaths, annually in the United States. Cancer is the second leading cause of death and was among the first diseases causally linked to smoking. Smoking causes about 90% of lung cancer deaths in women and almost 80% of lung cancer deaths in men. Smoking also causes other types of cancers such as bladder, oral cavity, pharynx, larynx, kidney, pancreas, and stomach cancers. Smoking also causes cardiovascular diseases, such as coronary heart disease, which is the leading cause of death in the United States. In addition, cigarette smoking causes respiratory disease and has other adverse health effects. Cigarette smoking is associated with a 10-fold increase in the risk of dying from chronic obstructive lung disease and has many adverse reproductive and early childhood effects.

State Revenues: The bill increases the tobacco tax rate from \$1.00 to \$1.15 per pack and imposes a floor tax on cigarettes used, possessed, or held in the State effective July 1, 2007. As a result, fiscal 2008 total tobacco tax revenues could increase by \$35,026,000 (\$32,520,000 tobacco tax increase on cigarettes sold, plus an additional \$2,506,000 from the floor tax imposed). The floor tax would only be imposed in fiscal 2008. **Exhibit 1** details the fiscal impact of the bill in fiscal 2008 through 2012.

Future year tobacco tax revenues would gradually decrease as it is assumed that the increased tobacco tax rate would discourage more people from smoking. Legislative Services projects that cigarette pack sales would decrease by 3% in fiscal 2008 as a result of the increased tax. Future years assume a slight decrease in cigarette pack sales as opposed to the slight increase that is currently projected to occur without the bill.

The bill would require that in fiscal 2008 through 2012, \$275 million in tobacco tax revenues would be transferred annually to the general fund and the remaining revenues

would be transferred to the biomedical fund. Under current law, however, it is projected that tobacco tax revenues would exceed \$275 million annually in fiscal 2008 through 2012. As a result, the bill would have a negative impact on the general fund as shown in Exhibit 1.

TEDCO special fund revenues for the biomedical fund could increase by \$38,482,000 in fiscal 2008 which reflects the diversion of tobacco tax revenues into the fund. Future years assume a slight decrease in special fund revenues deposited into the biomedical fund, which reflects the projected decrease in cigarette pack sales as a result of the increased tobacco tax.

Exhibit 1
Effect of Tobacco Tax Increase and Change in Tax Distributions on the
Maryland Biomedical Product Development Fund and the General Fund
(\$ in Millions)

| | <u>FY 2008</u> | <u>FY 2009</u> | <u>FY 2010</u> | <u>FY 2011</u> | <u>FY 2012</u> |
|--|----------------|----------------|----------------|-----------------|-----------------|
| <u>Current Law</u> | | | | | |
| Tobacco Taxes General Fund | \$278.5 | \$280.8 | \$283.1 | \$285.5 | \$287.9 |
| <u>Bill's Effect</u> | | | | | |
| Tobacco Taxes | 311.0 | 309.6 | 308.2 | 306.8 | 305.4 |
| Floor Tax | 2.5 | | | | |
| Tobacco Taxes to General Fund | 275.0 | 275.0 | 275.0 | 275.0 | 275.0 |
| Tobacco Taxes to MBPDF | 38.5 | 34.6 | 33.2 | 31.8 | 30.4 |
| Impact of Increased Tobacco Taxes on Sales Tax Revenue | 1.0 | 0.5 | 0.0 | (0.5) | (1.1) |
| Total General Funds (Tobacco and Sales Tax Revenues) | 276.0 | 275.5 | 275.0 | 274.5 | 273.9 |
| Net Impact on General Fund | (\$2.5) | (\$5.3) | (\$8.1) | (\$11.0) | (\$14.0) |

State Expenditures: TEDCO special fund expenditures could increase by an estimated \$38,482,000 in fiscal 2008, which reflects the bill's effective date. This estimate includes \$38,124,424 in biomedical grants and \$357,576 for administrative costs. The administrative costs reflect four new positions (one physician, two program administrators, and one secretary) with no start-up delay to facilitate the review of funding applications and award grants, conduct annual follow-up of research grants, and

provide financial fund management. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

| | |
|---|---------------------|
| Biomedical Fund Grants | \$38,124,424 |
| Salaries and Fringe Benefits | 328,821 |
| Operating Expenses | <u>28,755</u> |
| Total FY 2008 State Expenditures | \$38,482,000 |

Future year expenditures reflect (1) all of the special fund revenue not spent on administrative costs awarded in grants; (2) full salaries with 4.5% annual increases and 3% employee turnover; and (3) 1% annual increases in ongoing operating expenses. This estimate does not reflect the additional expenses of any interest the fund earns or other deposits that may be made into the fund. However, Legislative Services assumes the total amount of money in the fund will be completely spent by the end of each fiscal year.

Existing DHMH staff can consult with TEDCO regarding the biomedical fund.

Legislative Services advises that it did not receive a fiscal estimate from TEDCO.

Additional Information

Prior Introductions: None.

Cross File: HB 659 (Delegate Feldman, *et al.*) – Economic Matters and Ways and Means.

Information Source(s): Department of Business and Economic Development; Department of Health and Mental Hygiene; Office of the Comptroller; Health Effects of Cigarette Smoking, December 2006, Centers for Disease Control and Prevention; Department of Legislative Services

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mll/rhh

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