Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

House Bill 984 (Delegate Marriott, *et al.*)
Ways and Means

Tobacco Tax - Tobacco Tax Health Protection Fund

This bill raises the cigarette excise tax from 36 cents to 51 cents per pack, alters the cigarette vendor discount from 1.36% to 0.96%, and imposes a 20% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco. The bill also requires the Comptroller to establish a system for administering the tax on other tobacco products and requires wholesalers to file tobacco tax returns with the Comptroller. All unsold cigarettes held in inventory at the time the tax increase becomes effective are subject to the 51 cent tax. This bill requires that the Comptroller annually distribute portions of tobacco tax revenues to three special funds: $20 million to a health protection fund administered by the Department of Health and Mental Hygiene; $20 million to a fund for elementary and secondary school construction only; and $5 million to a crop conversion fund administered by the Department of Agriculture.

With the exception of the tobacco tax on other tobacco products, this bill is effective July 1, 1997.

Fiscal Summary

State Effect: General fund revenues would increase by approximately $4.0 million in FY 1998. General fund expenditures would increase by $55,700 in FY 1998. Special fund revenues and expenditures would increase by $45 million in FY 1998. Potential indeterminate increase in special fund administrative expenditures beginning in FY 1998 as discussed below.

(in thousands)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	$4,000	($1,400)	($2,600)	($3,700)	($4,700)
SF Revenues	$45,000	$45,000	$45,000	$45,000	$45,000
GF Expenditures	$56	$59	$61	$63	$66
SF Expenditures	$45,000	$45,000	$45,000	$45,000	$45,000
Net Effect	$3,944	($1,341)	($2,539)	($3,637)	($4,634)

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

Local Effect: None.

Small Business Effect: Meaningful impact on small businesses as discussed below.

Fiscal Analysis

State Revenues: The current estimate for cigarette sales in fiscal 1997 is 363.4 million packs; in fiscal 1998, sales are expected to decrease to 354.3 million packs. At 36 cents per pack, the cigarette tax is anticipated to generate an estimated $125.8 million in fiscal 1998. This bill proposes to raise the State cigarette excise tax from 36 cents to 51 cents and decrease the vendor discount allowed to wholesalers from 1.36% to 0.96%. The revenue estimates that are discussed below are based on the following assumptions:

- the estimated average price per pack of cigarettes, including the current 36 cent excise tax, will be $1.964 in fiscal 1998;
- regardless of a tax increase, cigarette sales are decreasing by 2.5% each year;
- the price of cigarettes will increase by 3% in fiscal 1998 due to inflation; and
- for every 1% increase in price, sales will decrease by approximately 0.8%.

A 15 cent increase in the excise tax would cause a 6.1% decline in cigarette sales in fiscal 1998, to 332.6 million packs. As seen in **Exhibit 1**, revenues from the increased tax, including the decreased vendor discount, would increase by an estimated $42.2 million. The total amount of the 5% sales tax collected from cigarette sales would increase by approximately $360,000 in fiscal 1998.

Exhibit 1
Revenue Change from HB 984

(In millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Excise Tax Revenue Increase	$42.2	$41.1	$40.1	$39.1	$38.1
Cigarette Floor Tax	$4.9	$0	$0	$0	$0
Other Tobacco Products Tax	$1.7	$2.3	$2.3	$2.3	$2.3
Overall Sales Tax Revenue Change	$0.2	$0.1	$0	($0.1)	($0.1)
Total Revenue Change	**$49.0**	**$43.5**	**$42.4**	**$41.3**	**$40.3**

The bill requires that a cigarette “floor” tax be applied on any cigarette inventories that are held for resale as of July 1, 1997; this tax must be paid to the Comptroller by September 30, 1997. Based on an estimate that 9% of inventories would be held for resale and subject to the “floor” tax, additional tax revenues of $4.9 million would be gained in fiscal 1998 only.

The total estimated increase in cigarette tax revenues, including the increase in sales tax revenues, is $47.5 million in fiscal 1998.

This bill also creates a tax to be assessed on tobacco products other than cigarettes, including cigars and smokeless tobacco. This tax would be assessed on the wholesaler at 20% of the products’ wholesale price. The revenue estimates that are discussed below are based on the following assumptions:

- º sales of these tobacco products are increasing at a rate of 3% per year;
- º a 20% decrease in sales in fiscal 1998;
- º sales made by Maryland distributors out-of-state (approximately 15% of aggregate sales) and sales to military reservations (approximately 3% of aggregate sales) would be exempt;
- º the price mark-up by wholesalers to retailers is approximately 10%; and
- º revenues generated from this tax would remain relatively stable in future years.

Aggregate sales of other tobacco products in Maryland are estimated to be $16.3 million in fiscal 1998. If this tax is enacted, sales are estimated at $12.6 million, with a 20% tax generating $1.7 million in fiscal 1998. The fiscal 1998 estimate takes into account the bill’s October 1, 1997 effective date for the tax on these products. This tax would generate an estimated $2.3 million annually in future years. The total amount of the 5% sales tax collected from these products would decrease by approximately $149,000 in fiscal 1998.

Total revenues generated from the increased cigarette tax and the new tax on other tobacco products is an estimated $49.0 million for fiscal 1998. Future year estimates reflect a continuing decline in cigarette sales.

State Expenditures: This bill would create the necessity for additional staff in the Comptroller’s Office to conduct audits of new smokeless tobacco accounts and expanded audits of current cigarette distributors who also distribute smokeless tobacco products. One Revenue Examiner and one Fiscal Clerk would be required at a total cost of approximately $55,700 in fiscal 1998.

This bill requires that the Comptroller annually distribute portions of tobacco tax revenues to three special funds: $20 million to a health protection fund administered by the Department of Health and Mental Hygiene (DHMH); $20 million to an elementary and secondary school construction fund; and $5 million to a crop conversion fund administered by the Department of Agriculture. The total distribution of revenues to these funds would be $45 million annually. The bill requires that the money provided for the health protection fund and the crop conversion fund may only be expended if an appropriation is included in the annual budget bill.

The bill requires that revenues in the health protection fund would be used to fund additional prevention and treatment services administered under the alcohol and drug abuse administration of DHMH, cancer prevention messages that discourage the use of cigarettes and tobacco products, and broadcast messages on radio and television that provide public information on the health effects of cigarettes and other tobacco products. According to the department, administration of this new fund would require a Program Administrator, four regional Community Health Educators, two Administrative Officers for processing and oversight of grants, and an Office Secretary at a total cost of $354,144 in fiscal 1998. The estimate includes salaries of $226,749, fringe benefits, equipment costs, and operating expenses as shown below.

Salaries and Fringe Benefits	$306,604
Equipment and Operating Expenses	47,540
Total FY 1998 Expenditures	**$354,144**

The remainder of this fund would be used for grants to local health departments, school based clinics, and nonprofit agencies for the funding of cancer prevention messages and programs that discourage the use of cigarettes and tobacco products as well as funding for broadcast messages on radio and television that provide public information on the health effects of cigarettes and other tobacco products.

The Department of Agriculture proposes to use the $5 million that is provided by this bill for a crop conversion fund to establish a low-interest loan program dedicated to providing tobacco farmers with financial incentives that will encourage them to shift their income base from tobacco to alternative agricultural enterprises. The department advises that it would need an Administrator, a Loan Underwriter, an Administrative Specialist, and an Office Secretary to administer this program at a total cost of $176,562 in fiscal 1998. The estimate includes salaries of $104,633, fringe benefits, one-time equipment expenditures, and operating expenses as shown below.

Salaries and Fringe Benefits	$142,987
Equipment and Operating Expenses	33,575
Total FY 1998 Expenditures	**$176,562**

The Department of Agriculture estimates that it would grant approximately $2 million in loans for fiscal 1998 with that amount increasing to just over $4 million in fiscal 1999. By fiscal 2002, the department estimates that it would grant almost $4.9 million in loans from the crop conversion fund.

The Department of Fiscal Services advises that it is assumed that both the Department of Health and Mental Hygiene and the Department of Agriculture could begin administration of these programs using existing resources. Depending upon the specific number of grants and grant amounts awarded from the health protection fund and the number of participants and loans granted in the crop conversion program, the additional staff requested by each department may be needed in future years.

The bill also dedicates $20 million of tobacco tax revenues to a fund to be used only to provide additional funding for construction of elementary and secondary schools. The Department of Fiscal Services advises that the bill does not specify whether these revenues are required to be spent entirely for new school construction or if the revenues could be used for additions or renovations to existing schools. Although it is not specified in the bill, Fiscal Services assumes that these revenues would be administered by the Public School Construction Program as overseen by the Board of Public Works.

Small Business Effect: This bill could significantly affect small businesses. The majority of tobacco producers, wholesalers, and retailers in Maryland are small businesses. The 15 cent tobacco tax increase and new tax on other tobacco products as proposed in this bill would reduce the sales of tobacco products. These taxes, while partially offset by any profit margins that the affected businesses have built into operations, could decrease the profits that businesses realize from tobacco product sales.

Information Sources: Comptroller of the Treasury (Alcohol and Tobacco Unit), Department of Health and Mental Hygiene, Department of Agriculture, Public School Construction Program, Department of Fiscal Services

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