

Department of Fiscal Services
 Maryland General Assembly

FISCAL NOTE

House Bill 457 (Delegate Frush, *et al.*)
 Ways and Means

Tobacco Tax

This bill raises the cigarette excise tax from 36 cents to \$1.36 per pack, alters the cigarette vendor discount from 1.36% to 0.36%, and imposes a 35% 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 \$1.36 tax.

The increased cigarette tax is effective on July 1, 1997.

Fiscal Summary

State Effect: General fund revenues would increase by \$136.5 million, including one-time cigarette floor tax revenues, and general fund expenditures would increase by \$55,700 in FY 1998. Future year revenues reflect a decline in cigarette consumption and future year expenditures reflect inflation and salary adjustments.

(in thousands)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	\$136,500	\$102,100	\$99,300	\$96,600	\$94,000
GF Expenditures	56	59	61	63	66
Net Effect	\$136,444	\$102,041	\$99,239	\$96,537	\$93,934

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

Local Effect: None.

Small Business Effect: This bill would have a meaningful effect 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 \$1.36 and decrease the vendor discount allowed to wholesalers from 1.36% to 0.36%. 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 1%.

A \$1.00 increase in the excise tax would cause a 50.9% decline in cigarette pack sales in fiscal 1998, to 174.0 million packs. As seen in **Exhibit 1**, revenues from the increased tax, including the decreased vendor discount, would increase by an estimated \$109.9 million. The anticipated reduction in cigarette sales would decrease the total amount of the 5% sales tax collected by approximately \$8.9 million in fiscal 1998.

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 \$32.7 million would be gained in fiscal 1998 only.

The total estimated increase in cigarette excise tax revenues, including the decrease in sales tax revenues, is \$133.7 million in fiscal 1998. Future year estimates reflect declining cigarette sales.

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 35% of the products’ wholesale price. The revenue estimates that are discussed below are based on the following assumptions:

- sales of these tobacco products are increasing at a rate of 3% per year;
- fiscal 1998 sales will decrease by 20% due to imposition of the tax;

- 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;
- the price mark-up by wholesalers to retailers is approximately 10%; and
- revenue generated from this tax would remain relatively stable in future years.

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 35% tax generating \$3.0 million in fiscal 1998. This tax would generate an estimated \$4.0 million annually in future years. The anticipated reduction in sales of these products would decrease the total amount of the 5% sales tax collected by approximately \$149,000 in fiscal 1998.

**Exhibit 1
Revenue Change from HB 457**

(In millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Excise Tax Revenue Increase	\$109.9	\$107.2	\$104.5	\$101.9	\$99.3
Cigarette Floor Tax	\$32.7	\$0	\$0	\$0	\$0
Other Tobacco Products Tax	\$3.0	\$4.0	\$4.0	\$4.0	\$4.0
Overall Sales Tax Revenue Change	(\$9.1)	(\$9.1)	(\$9.2)	(\$9.3)	(\$9.3)
Total Revenue Change	\$136.5	\$102.1	\$99.3	\$96.6	\$94.0

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. Future year estimates reflect 3.5% annual salary increases, 3% employee turnover, and 2% annual increases in ongoing operating expenses.

Small Business Effect: This bill could significantly affect small businesses. The majority of tobacco producers, wholesalers, and retailers in Maryland are small businesses. The \$1.00 tobacco tax increase and new tax on other tobacco products as proposed in this bill would reduce the sales of tobacco products. The revenue loss from reduced sales, while partially offset by increased profits per pack, would decrease the overall profits that businesses realize

from tobacco product sales.

Information Sources: Comptroller of the Treasury (Alcohol and Tobacco Tax Unit),
Department of Fiscal Services

Fiscal Note History: First Reader - February 17, 1997

ncs

Analysis by: Ryan Bishop

Reviewed by: John Rixey

Direct Inquiries to:

John Rixey, Coordinating Analyst

(410) 841-3710

(301) 858-3710