

Department of Legislative Services
Maryland General Assembly

FISCAL NOTE

House Bill 763 (Delegate Marriott. *et al.*)

Ways and Means

Tobacco Tax - Tobacco Tax Health Protection Fund

This bill increases the cigarette excise tax from 36 cents to \$1.86 per pack phased-in at 30 cents per year over five years, sets a minimum excise tax rate of 51 cents, alters the 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 requires the Comptroller to 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; and \$5 million to a crop conversion fund administered by the Department of Agriculture.

This bill is effective July 1, 1998, except that the tax on other tobacco products is effective October 1, 1998.

Fiscal Summary

State Effect: General fund revenues would increase by \$123.7 million in FY 1999, with future year estimates reflecting changes in tax rates and decreases in consumption. Special fund revenues would increase by \$45 million in FY 1999 and in future years. General fund expenditures could increase by \$72,000 and special fund expenditures could increase by \$494,000 in FY 1999. Future year expenditure estimates reflect growth in salaries and decreases in operating expenses.

(in thousands)	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
GF Revenues	\$123,700	\$231,600	\$311,500	\$248,800	\$193,500
SF Revenues	45,000	45,000	45,000	45,000	45,000
GF Expenditures	72	65	67	69	72
SF Expenditures	494	463	479	493	510
Net Effect	\$168,134	\$276,072	\$355,954	\$293,238	\$237,918

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

Local Effect: Meaningful effect on local finances beginning in FY 1999.

Small Business Effect: Potential meaningful impact on small businesses.

Fiscal Analysis

Bill Summary: This bill increases the cigarette excise tax from 36 cents to \$1.86 per pack phased-in over five years, and imposes a 20% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco. Under this bill, on January 1 of each year through 2003, the Comptroller shall determine whether the federal government has enacted any cigarette tax increase or new tax on cigarettes. For any fiscal year through fiscal 2003, the State excise tax shall be reduced if the Comptroller determines that the federal government has enacted an excise tax increase or a new cigarette tax that will be in effect for the fiscal year.

This same reduction would be taken in fiscal 2004 or any subsequent fiscal years if the Comptroller determines that the federal government has increased the cigarette tax or imposed a new cigarette tax for any fiscal year. If the State cigarette excise tax must be reduced, the rate shall be reduced by an amount corresponding to the federal effective tax increase, but shall not be lower than 51 cents per pack.

The bill requires that a cigarette “floor” tax be applied on any cigarette inventories that are held for resale as of the effective date of any tax increase; this tax must be paid to the Comptroller by September 30 after an increase’s effective date.

State Revenues: Under the current law of 36 cents per pack, the cigarette excise tax is anticipated to generate an estimated \$129.5 million in fiscal 1999.

While the revenue estimates reflect a federal excise tax increase of 10 cents in fiscal 2000 and another five cents in fiscal 2002, the estimates assume no other changes in the federal excise tax will be made.

It is also assumed that there will be decreased Maryland sales as a result of individuals going to neighboring states, particularly Virginia and Delaware, to purchase cigarettes. It is assumed the majority of the cross-border sales will go to Virginia because of its lower excise tax rate and the greater concentration of Maryland residents near Virginia’s borders.

Fiscal 1999

The fiscal 1999 revenue estimates are based on the following assumptions:

- (1) the estimated average price per pack of cigarettes, including the current 36 cent excise tax, will be \$2.04 in fiscal 1999;
- (2) regardless of a tax increase, cigarette sales are decreasing by 2.5% each year;
- (3) the per pack price of cigarettes will increase by 3.0% each year due to inflation;
- (4) an estimated 6% decrease in cigarette consumption due to the tax increase (reflecting a price increase of 14.7% and a price elasticity of -.4%); and
- (5) an estimated 1% decrease in consumption as a result of cross-border sales (reflecting 3% of the smoking population located in border counties purchasing in another state).

Fiscal 1999 revenues with an excise tax of 66 cents will be an estimated \$286 million, an increase of \$157 million. The floor tax would increase revenues by \$9.7 million, the vendor discount would decrease revenues by \$2.7 million, and sales taxes would increase revenues by \$2.3 million.

Fiscal 2000

For fiscal 2000 revenue estimates, the assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border (6%) for purchases create an 8% reduction in consumption for the additional tax increase of 30 cents and an estimated 3% decrease in consumption as a result of cross-border sales. Fiscal 2000 revenues with an excise tax of 96 cents will be \$392 million, an increase of \$266 million. The floor tax would increase revenues by \$9.0 million, the vendor discount decreases revenues by \$3.8 million, and sales taxes would increase revenues by \$2.1 million.

Fiscal 2001

For fiscal 2001, the assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border (9%) for purchases result in a 6% reduction in consumption for the additional tax increase of 30 cents and an estimated 4% decrease in consumption as a result of cross-border sales. Fiscal 2001 revenues with an excise tax of \$1.26 will be \$471 million, an increase of \$348 million. The floor tax would increase revenues by \$7.8 million, the vendor discount decreases revenues by \$4.5 million, and sales taxes would increase revenues by \$1.8 million.

Fiscal 2002

For fiscal 2002, the assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border (12%) for purchases result in a 6% reduction in consumption for the additional tax increase of 30 cents and an estimated 5% decrease in consumption as a result of cross-border sales. Excise tax revenues with a tax of \$1.56 will be an estimated \$407 million, an increase of \$287 million. The floor tax would increase revenues by \$6.8 million, the vendor discount decreases revenues by \$3.9 million, and sales taxes would increase revenues by \$300,000.

Fiscal 2003

In fiscal 2003, the final year of the phase-in, revenues would be an estimated \$351 million, an increase of \$234 million. The assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border (15%) for purchases result in a 5% reduction in consumption for the additional tax increase of 30 cents and an estimated 7% decrease in consumption as a result of cross-border sales. Total excise tax revenues with a tax of \$1.86 will be an estimated \$351 million, an increase of \$234 million. The floor tax would increase revenues by \$5.9 million, the vendor discount decreases revenues by \$3.4 million, and sales taxes would decrease revenues by \$1.4 million.

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:

- a 1% decrease in sales in fiscal 1999, based on New Jersey's experience with a 24% 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
- revenues generated from this tax would increase by approximately 3% in future years.

If this tax is enacted, sales are estimated at \$19.9 million, with a 20% tax generating \$2.7 million in fiscal 1999. The fiscal 1999 estimate takes into account the bill's October 1, 1998

effective date for the tax on these products. This tax will generate an estimated \$3.7 million in fiscal 2000. The total amount of the 5% sales tax collected from these products would decrease by approximately \$100,000 in fiscal 1999.

State Expenditures: 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 Comptroller of the Treasury advises that it will require an additional Revenue Examiner and a Fiscal Clerk beginning in fiscal 1999. Total expenditures for the Comptroller would increase by approximately \$72,000 in fiscal 1999; this estimate includes salaries of \$43,000, fringe benefits, one-time equipment costs, and other operating expenses. These positions would be used to conduct audits of new smokeless tobacco accounts and for expanded audits of current cigarette distributors who also distribute smokeless tobacco products.

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 Health Educator, two Administrative Officers, a Media Specialist, and two Office Secretaries at a total cost of \$316,600 in fiscal 1999. The estimate includes salaries of \$215,000, fringe benefits, equipment costs, and operating expenses.

The Department of Agriculture proposes to use the \$5 million in annual revenues to be 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 \$177,000 in fiscal 1999. The estimate includes salaries of \$110,000, fringe benefits, one-time equipment expenditures, and operating expenses.

The Department of Legislative 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. The additional staff requested by each department may be needed in future years. In any event, any additional resources required could be paid for with the new funds received by each department.

The bill also dedicates \$20 million of tobacco tax revenues to a fund to be used only to provide additional money for construction of elementary and secondary schools. The Department of Legislative 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, it is assumed that these revenues would be administered by the Public School Construction Program as overseen by the Board of Public Works.

Local Effect: Local jurisdictions would be affected to the extent that \$20 million in annual tobacco tax revenues would be dedicated to provide additional funding for construction of elementary and secondary schools in the State. Any specific impact on individual jurisdictions would depend on the method used to allocate revenues.

Small Business Effect: This bill could significantly affect small businesses. The majority of tobacco producers, wholesalers, and retailers in Maryland are small businesses. The \$1.50 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 (Bureau of Revenue Estimates), Department of Health and Mental Hygiene, Department of Agriculture, Department of Legislative Services

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