HB 1073

Department of Legislative Services

Maryland General Assembly

FISCAL NOTE

House Bill 1073 (Delegate Frush, *et al.*)
Ways and Means

Maryland Children's Initiative - Tobacco Tax for Children's Health and Learning

This bill increases the cigarette excise tax from 36 cents to $1.86 per pack phased-in over three fiscal years, alters the vendor discount from 1.36% to 0.57%, and imposes a 25% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco. The bill dedicates portions of tobacco tax revenues to various special funds and includes provisions addressing decreases in teen smoking and future federal cigarette excise tax increases.

This bill is effective July 1, 1998.

Fiscal Summary

State Effect: General fund revenues would decrease by $1.5 million and special fund revenues would increase by $165 million in FY 1999. General fund expenditures could increase by $43,000 and special fund expenditures could increase by $593,000 in FY 1999. Future years reflect increases in the tax rate and changes in consumption.

(in thousands)	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
GF Revenues	($1,500)	$3,800	$41,900	$19,000	$13,000
SF Revenues	165,000	259,000	285,000	285,000	283,000
GF Expenditures	43	65	67	65	67
SF Expenditures	593	578	593	615	638
Net Effect	$162,864	$262,157	$326,240	$303,320	$295,295

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

Local Effect: Potential meaningful impact on local revenues. Expenditures would not be affected.

Small Business Effect: Meaningful impact on small businesses.

Fiscal Analysis

Bill Summary: The cigarette excise tax will be increased from 36 cents to 86 cents in fiscal 1999, $1.36 in fiscal 2000, and $1.86 in fiscal 2001. This bill creates a special fund to which tobacco tax revenues would be dedicated. These funds will then be allocated to a variety of additional special funds.

Special Funds

A children's opportunity fund will provide children's opportunity grants to local jurisdictions proportionately to the number of children in each jurisdiction living below the federal poverty level. This fund would be administered by the Office for Children, Youth, and Families.

A tobacco crop conversion fund is created to provide funding for a program within the Department of Agriculture that will assist tobacco farmers in the State with the conversion of tobacco farmland to other agricultural uses.

A special fund to provide revenues for a Class Size Reduction Program is created; funding will be provided to eligible counties with the intent of achieving a student-teacher ratio of 15 students per core curriculum classroom for students in kindergarten and first grade. This fund is to be administered by the Department of Education.

A special fund to provide revenues for an early elementary reading grant program is created; this fund, also administered by the Department of Education, will provide funds to local jurisdictions for the purpose of improving the education of kindergarten and first grade students through improved reading instruction and enhanced teacher professional development. Revenues will also be provided to fund grants to local jurisdictions for after-school programs for students in grade six through eight.

A tobacco tax health protection fund to be administered by the Department of Health and Mental Hygiene (DHMH) is created; this will provide funding for additional substance abuse prevention and treatment services under DHMH's Alcohol and Drug Abuse Administration, mammography screenings, and a statewide anti-tobacco public information program involving a variety of media sources. The department is also required to contract with the State Department of Education to implement a tobacco use prevention program for elementary and secondary students, award and administer community grants for projects targeted at the prevention of tobacco-related diseases, and issue guidelines for local plans for education against tobacco use. The Department of Health and Mental Hygiene shall conduct or contract for an evaluation of this prevention and education program in conjunction with the State Department of Education. The revenues for this fund shall be dedicated in the following manner:

- 50% for additional substance abuse prevention services administered by DHMH's Alcohol and Drug Abuse Administration;
- 5% for additional substance abuse treatment services;
- 8% for mammography screening programs;
- 15% for a statewide public information program; and
- 22% for the tobacco use prevention and education programs.

Revenue Allocations

Under this bill, the first $125 million of tobacco tax revenues will go to the general fund each year. The next $165 million in tax revenues will be allocated to the aforementioned funds in the following manner:

- 30.3% to the tobacco tax health protection fund;
- 30.3% to the class size reduction program;
- 3% to the early elementary reading grant program; and
- 18.2% to grants for after-school programs.

In fiscal 1999 and 2000, 15.2% of revenues will go to the children's opportunity fund and 3% will go to the tobacco crop conversion program. For every fiscal year beginning in 2001, 18.2% of revenues will go to the children's opportunity fund.

The next $120 million of any remaining excise tax revenues will be distributed as follows:

- 16.7% to the tobacco tax health protection fund;
- 41.7% to the class size reduction program;
- 8.3% to grants for after-school programs; and
- 33.3% to the purchase of child care program.

Any additional revenues would go to the general fund.

Legislative Services advises that the "purchase of child care" program allocation is not further defined by the bill; it is assumed that the funds would be allocated to the purchase of child care program as administered by the Department of Human Resources.

Tax Contingencies and Determinations

The bill provides that, on January 1 of each year through 2003, the Secretary of Health and Mental Hygiene shall determine the number of State residents under the age of 19 who smoke cigarettes. If the Secretary determines on January 1 of any year through 2002 that the number of residents who smoke cigarettes is less than 65% of the number of residents under 19 years old who smoked as of January 1, 1998, then the maximum tobacco tax rate of $1.86 would not apply for the next fiscal year. If the Secretary determines on January 1, 2003 that the number of residents under 19 years old who smoke cigarettes is less than 65% of the number of residents under 19 years old who smoked as of January 1, 1998, then the $1.86 tobacco tax rate would not apply for fiscal 2004 or any future fiscal year. The minimum excise tax rate to be assessed in any fiscal year is 86 cents.

On January 1 of each year through 2003, the Comptroller shall make two determinations: (1) whether the federal government has enacted any cigarette tax increase or new tax on cigarettes; or (2) if the national average price of a pack of cigarettes for the previous 12 months has increased by more than 50 cents above the national average price per pack for the 12 months preceding January 1, 1998. For any fiscal year through fiscal 2003, the excise tax shall be reduced if the Comptroller determines that the federal government has enacted an excise tax increase, a new cigarette tax, or if the national average price of a pack of cigarettes for the previous 12 months has increased by more than 50 cents above the national average price per pack for the 12 months preceding January 1, 1998.

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 excise tax, imposed a new cigarette tax, or if the national average price of a pack of cigarettes for the 12 months preceding January 1, 2003 has increased by more than 50 cents above the national average price per pack for the 12 months preceding January 1, 1998.

If the State cigarette excise tax must be reduced, the rate shall be reduced by the greater of the effective federal tax increase or the amount over 50 cents by which the national average cigarette price has increased.

Floor Tax

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 tobacco tax rate increase; this tax must be paid to the Comptroller by September 30 following the date of the increase. Floor tax revenue projections are based on an estimate that 9% of inventories would be held for resale and subject to the tax.

State Revenues: At the current rate of 36 cents per pack, the cigarette tax is anticipated to generate an estimated $129.5 million in fiscal 1999. This bill proposes to raise the State cigarette excise tax from 36 cents to $1.86 over three years and decrease the vendor discount allowed to wholesalers from 1.36% to 0.57%. The cigarette excise tax would be increased to 86 cents in fiscal 1999, $1.36 in fiscal 2000, and $1.86 in fiscal 2001.

While the revenue estimates reflect a federal excise tax increase of 10 cents in fiscal 2000 and another five cent increase 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 a decrease in 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 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 $2.04 in fiscal 1999;
- regardless of a tax increase, cigarette sales are decreasing by 2.5% each year;
- inflation will increase the price of cigarettes per pack by 3% each year;
- there is an estimated 10% decrease in cigarette consumption due to the tax increase (reflecting a price increase of 24.52% and a price elasticity of -.4%); and
- an estimated 2% decrease in consumption as a result of cross-border sales (reflecting 5% of the smoking population located in border counties purchasing in another state).

Fiscal 1999 revenues with an excise tax of 86 cents would be an estimated $271 million, an increase of $142 million. Floor tax revenues would be $16.2 million, the vendor discount would decrease revenues by $1.5 million, and sales tax collections would increase by $3.3 million.

Fiscal 2000

For fiscal 2000 revenue estimates, the assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border (10%) for purchases results in a 7% reduction in consumption for the additional tax increase of 50 cents and an estimated 5% decrease in consumption as a result of cross-border sales. Fiscal 2000 revenues with an excise tax of $1.36 would be $367 million, an increase of $241 million. Fiscal 2000 floor tax revenues would increase by $14.2 million, the vendor discount would decrease revenues by $2.1

million, and sales tax collections would increase by $5 million.

Fiscal 2001

For fiscal 2001, the final year of the tax phase-in, the assumption for price elasticity (-.4%) and an increase in the smoking population crossing the border to purchase cigarettes (15%) result in a 6% reduction in consumption for the additional tax increase of 50 cents and an estimated 7% decrease in consumption as a result of cross-border sales. Fiscal 2001 revenues with an excise tax of $1.86 would be $426 million, an increase of $303 million. Floor tax revenues would increase by $12.2 million, the vendor discount would decrease revenues by $2.4 million, and sales tax collections would increase by $5.3 million.

In fiscal 2002, excise tax revenues would be an estimated $416 million, an increase of $296 million. The vendor discount would decrease revenues by $2.4 million, and sales tax collections would increase by $5 million in fiscal 2002. In fiscal 2003, revenues would be an estimated $405 million, an increase of $288 million. The vendor discount would decrease revenues by $2.3 million, and sales tax collections would increase by $5 million in fiscal 2003.

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 25% of the products' wholesale price. The revenue estimates discussed below are based on the following assumptions:

- a 1% decrease in sales in fiscal 1999 due to the imposition of the tax, 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.

Aggregate sales of other tobacco products in Maryland are estimated to be $20.1 million in fiscal 1999. If this tax is enacted, sales are estimated at $19.9 million, with a 25% tax generating $3.4 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 would generate an estimated $4.6 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.

The revenues that would be provided to the various special funds created by the bill are shown in **Exhibit 1** below:

Exhibit 1
Tobacco Tax Revenue Distributions under SB 614*
(In millions)

Year	General Fund	Tobacco Tax Health Protection Fund	Class Size Reduction Program	Early Elementary Reading Grant Program	After School Child Care Program	Children's Opportunity Fund	Purchase of Child Care Program	Tobacco Crop Conversio n Fund	Total
1999	$125.0	50.0	50.0	5.0	30.0	25.0	0	5.0	$290.0
2000	$125.0	66.0	89.0	5.0	38.0	25.0	31.0	5.0	$384.0
2001	$160.0	70.0	100.0	5.0	40.0	30.0	40.0	0	$445.0
2002	$134.0	70.0	100.0	5.0	40.0	30.0	40.0	0	$419.0
2003	$125.0	70.0	99.0	5.0	40.0	30.0	39.0	0	$408.0

*Includes revenues from sales of other tobacco products, but does not include the increase in sales taxes - (approximately $3 million in FY 1999 and $5 million annually thereafter).
Note: Numbers have been rounded.

State Expenditures: The special funds that this bill creates will be administered by a variety of State agencies. The Comptroller of the Treasury advises that it will require an additional Revenue Examiner and a Fiscal Clerk II beginning in fiscal 1999. Total expenditures for the Comptroller would increase by approximately $74,000 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 Department of Health and Mental Hygiene advises that it will require an additional Administrative Officer II and Office Secretary II to administer the additional substance abuse prevention services in the department's Alcohol and Drug Abuse Administration at a total cost of approximately $73,000 in fiscal 2000. This estimate includes salaries of $49,300, fringe benefits, one-time equipment costs, and operating expenses.

The department also indicates that it will require an additional Administrative Officer II, a Health Educator, Media Specialist I, and an Office Secretary II at a total cost of $246,000. This estimate includes salaries of $167,000, fringe benefits, one-time equipment costs, and operating expenses. These positions would be used for the development of a statewide anti-tobacco public information program as well as the tobacco use prevention program for elementary and secondary students as required by this bill.

The Department of Agriculture advises that it will require an additional Administrator III, a Loan Underwriter, an Administrative Specialist, and an Office Secretary at a cost of approximately $177,000 in fiscal 1999. This estimate includes salaries of $110,000, fringe benefits, one-time equipment costs, and operating expenses. These positions would be used 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 Governor's Office for Children, Youth, and Families advises that it will require a Technical Assistant Specialist and a Fiscal Specialist III in fiscal 1999 at a total cost of approximately $96,500. This estimate includes salaries of $85,600, fringe benefits, one-time equipment costs, and operating expenses. This office would be responsible for administering grants to local jurisdictions from the children's opportunity fund.

The State Department of Education advises that the necessity for any additional positions or expenditures to administer the programs that would be under its jurisdiction cannot be reliably estimated at this time.

The Department of Legislative Services advises that it is assumed that the Department of Health and Mental Hygiene, the Department of Agriculture, and the Office for Children, Youth, and Families could each 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.

Local Effect: Local jurisdictions would be affected to the extent that funding is provided from the special funds for the class size reduction program, children's opportunity grants, the early elementary reading grant program, and the tobacco use prevention program. Any specific revenue allocations from any of these funds depends on the amount of revenues available, and the number of local jurisdictions who apply for and receive grants for these various purposes.

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 Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates); Department of Education; Department of Health and Mental Hygiene; Governor's Office for Children, Youth, and Families; Department of Agriculture; Department of Legislative Services

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