

Department of Legislative Services
 Maryland General Assembly
 1999 Session

FISCAL NOTE
Revised

House Bill 190 (The Speaker. *et al.*)
 (Administration)

Ways and Means

Tobacco Tax

This Administration bill increases the cigarette tax from \$.36 to \$.66 per pack. In addition, the bill alters the licensed wholesaler discount from 1.36% to .82% in fiscal 2000 and imposes a 15% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco.

The bill is effective July 1, 1999, and the tax on other tobacco products is applicable to products sold on or after July 1, 2000. The bill is contingent on the enactment of the Cigarette Restitution Fund legislation (SB 334/HB 751).

Fiscal Summary

State Effect: General fund revenues would increase by \$91.6 million and administrative expenditures associated with the tax increase would increase by \$68,200 in FY 2001. Future year revenues reflect changes in consumption. In addition, the Governor is required to include at least \$21 million in the annual State budget beginning in FY 2001 for Center for Disease Control and Prevention (CDC) recommended activities, thereby increasing expenditures for these activities by at least \$18 million beginning in FY 2001.

(\$ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
GF Revenues	\$91.600	\$76.000	\$72.800	\$71.200	\$70.900
GF Expenditures	0.000	0.068	0.061	0.063	0.066
Net Effect	\$91.600	\$75.900	\$72.700	\$71.000	\$70.800

Note: () = decrease; GF = general funds

Local Effect: None.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Fiscal Analysis

State Revenues: State revenues will be affected in four ways: the tobacco excise tax; the floor tax; the tax on other tobacco products (smokeless and cigars); and the sales and use tax.

The Tobacco Excise Tax

Increasing the tobacco tax by \$.30 to \$.66 will increase revenues by \$80.9 million in fiscal 2000. This estimate reflects the following assumptions:

- a federal excise tax increase of \$.10 in fiscal 2000 and another \$.05 increase in fiscal 2001 under current federal law;
- a manufacturer's price increase of \$.50 in fiscal 1999, \$.20 in fiscal 2000, and another \$.10 in fiscal 2001 for the recent tobacco settlement between the tobacco companies and the states, and the proposed farmer's settlement;
- inflation will increase the price of cigarettes by 3% each year;
- there is a price elasticity of -0.4% for cigarette sales (this means that for every 10% increase in price, there is a 4% reduction in sales);
- an estimated 2.5% decrease in sales as a result of cross-border sales for each \$.50 increase in the tobacco excise tax (reflecting 5% of the smoking population located in border counties purchasing in another state). Currently, there is an incentive for Maryland residents to travel to Delaware, Virginia, Pennsylvania, or West Virginia because of the lower tax rates in these states. Increasing the tobacco tax will further increase this incentive; and
- the estimated base price per pack of cigarettes will be \$2.36 for fiscal 2000, including the \$.50 manufacturer's price increase but excluding the current tobacco excise tax of \$.36.

The Floor Tax

The bill requires that a “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 estimates are based on the assumption that 9% of inventories would be held for resale and subject to the tax. These revenues amount to \$8.8 million fiscal 2000.

Tax on Other Tobacco Products

Under current law there is no excise tax imposed on tobacco products such as cigars and smokeless tobacco. The bill will impose a tobacco tax rate on these products equal to 15% of the wholesale price of these products. The revenues from this tax are estimated at \$2.4 million each year beginning in fiscal 2001.

Sales and Use Tax

Maryland imposes a 5% sales tax on the price and tax of cigarettes. Therefore, any excise tax increase will also increase sales and use tax revenues. Sales and use tax revenues are estimated to increase by \$1.9 million in fiscal 2000 and by \$0.5 million in fiscal 2001.

Total Revenue Increase: FY 2000-2001

<u>\$ in Millions</u>	<u>Excise Tax</u>	<u>Floor Tax</u>	<u>Other Tobacco Product Tax</u>	<u>Sales and Use Tax</u>	<u>Total Revenue Increase</u>
FY 2000	\$80.9	\$8.8	\$0.0	\$1.9	\$91.6
FY 2001	\$73.1	\$0.0	\$2.4	\$0.5	\$76.0

The Licensed Wholesaler Discount

Under current law the licensed wholesaler receives a discount of 1.36% of the purchase price of the tax stamps. The bill adjusts this discount to .82% in fiscal 2000 which is a larger percentage of the tax per pack than under current law. Depending on the number of tobacco wholesalers who remain in business after the cigarette tax increase, general fund revenues could increase or decrease as a result of the larger discount rate in proportion to the cigarette tax rate. However, the increase or decrease in general fund revenues is assumed to be minimal.

State Expenditures: The proposed fiscal 2000 budget assumed \$154.8 million in tobacco tax revenues from the \$.50 increase in the tobacco tax rate originally proposed by this bill for fiscal 2000. Of this amount, \$8 million was directed to the Dedicated Purpose Fund of the State Reserve Fund for the purpose of planning and designing higher education capital projects. This appropriation was deleted and the fiscal 2000 budget was amended to authorize the Governor to transfer an equivalent amount from the Revenue Stabilization Fund for these projects.

Beginning in fiscal 2001, the Governor is required to include at least \$21 million in the annual State budget for activities aimed at reducing tobacco use in Maryland as recommended by the CDC including: (1) media campaigns aimed at reducing smoking initiation and encouraging smokers to quit smoking; (2) media campaigns educating the public about the dangers of secondhand smoke exposure; (3) enforcement of existing laws banning the sale or distribution of tobacco products to minors; (4) promotion and implementation of smoking cessation programs; and (5) implementation of school-based tobacco education programs. In fiscal 1999 Maryland spent around \$3 million on the above activities. Assuming a constant level of funding, expenditures on these activities will increase by at least \$18 million beginning in fiscal 2001.

General fund expenditures could increase by an estimated \$68,200 in fiscal 2001, which accounts for the bill's July 1, 1999 effective date. This estimate reflects the cost of hiring two revenue examiners to conduct audits of new smokeless tobacco and cigar accounts and expanded audits of current cigarette distributors who also distribute smokeless tobacco and cigars. This estimate includes salaries of \$42,300, fringe benefits, one-time start-up equipment costs, and other operating expenses. Future year expenditures reflect full salaries with 3.5% annual increases and 3% employee turnover, and 1% annual increases in ongoing operating expenses.

The Comptroller's Office currently employs nine tax agents to enforce anti-smuggling regulations and will require three additional alcohol and tobacco agents with necessary equipment (vehicles, guns, cell phones, etc.) at a cost of \$155,100 in fiscal 2000 to help control the anticipated increase in smuggling as result of this bill.

The Department of Legislative Services advises that because there is only limited experience with a tobacco tax increase of this size, the extent to which smuggling will become a problem is unknown. However, if organized or large scale smuggling does become a problem in the future, additional tax agents may be required, perhaps on the scale envisioned by the Comptroller's Office. It should be noted that a loss from the additional cross-border sales has been incorporated in the revenue estimates.

Under current law a Maryland resident who brings in more than two packs of cigarettes at one time is considered to be smuggling tobacco products into the State. A non-resident who is traveling through Maryland is considered to be smuggling tobacco products if he/she brings more than one carton of cigarettes into the State.

Information Source(s): Department of Budget and Management, Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

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