

Department of Legislative Services
 Maryland General Assembly
 1999 Session

FISCAL NOTE

Senate Bill 143 (The President. *et al.*)
 (Administration)

Budget and Taxation

Tobacco Tax

This Administration bill increases the cigarette tax from \$.36 to \$1.36 per pack phased-in over 2 years (\$.50 in fiscal 2000 and another \$.50 in fiscal 2001). The bill also alters the licensed wholesaler discount from 1.36% to .57% in fiscal 2000 and to .36% in fiscal 2001, and imposes a 25% 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 October 1, 1999.

Fiscal Summary

State Effect: General fund revenues would increase by \$149.4 million and expenditures would increase by \$68,000 in FY 2000. Future year revenues reflect the increase in the tobacco excise tax rate in FY 2001 and changes in consumption. An appropriation of \$8.0 million to the Dedicated Purpose Fund is contingent upon enactment of this bill.

(\$ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
GF Revenues	\$149.400	\$236.600	\$219.800	\$215.900	\$214.000
GF Expenditures	0.068	0.059	0.061	0.063	0.066
Net Effect	\$149.300	\$236.100	\$219.700	\$215.800	\$213.900

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 4 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 \$.50 to \$.86 will increase revenues by \$128.7 million in fiscal 2000. Increasing the tobacco excise by another \$.50 to \$1.36 will increase excise tax revenues by \$218.5 million in fiscal 2001. 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 \$14.7 million and \$10.8 million in fiscal 2000 and fiscal 2001, respectively.

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 25% of the wholesale price of these products. The revenues from this tax are estimated at \$4 million on an annualized basis. Since the tax is only applicable to these products sold on or after October 1, 1999, fiscal 2000 revenues will increase by about \$3 million.

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 \$3.0 million in fiscal 2000 and by \$3.3 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	\$128.7	\$14.7	\$3.0	\$3.0	\$149.4
FY 2001	\$218.5	\$10.8	\$4.0	\$3.3	\$236.6

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 .57% in fiscal 2000 and to .36% in fiscal 2001 to maintain the discount as a constant percentage of the tax per pack. Therefore, this adjustment will have no impact on State revenues.

Budget Issues

The proposed fiscal 2000 budget assumes \$154.8 million in tobacco tax revenues from the \$.50 increase in the tobacco tax rate proposed by this bill for fiscal 2000. Of this amount, \$8 million is directed to the Dedicated Purpose Fund of the State Reserve Fund and is

contingent upon the passage of this bill. The remainder are general funds.

The Department of Legislative Services (DLS) estimates that the proposed \$.50 increase in the tobacco tax rate will generate \$149.4 million in additional tobacco tax revenues in fiscal 2000. This reduces the assumed fiscal 2000 unappropriated general fund balance of \$9.1 million by \$5.4 million. Based on the Governor's budget submission, this results in a \$3.7 million unappropriated general fund balance in fiscal 2000.

The bill also specifies that in fiscal 2001 and in each year thereafter, the Governor is to include in the budget capital appropriations for education facilities an amount equal to the estimated revenue increase from the second \$.50 tobacco tax increase in fiscal 2001. Correspondingly, the Governor's long term fiscal projection for fiscal 2001-2003 includes \$97 million annually for higher education facilities contingent on the tobacco tax funding. The following table shows the DLS' estimated revenues from the second \$.50 tobacco tax increase.

Estimated Long-Term Revenues from the Second \$.50 of the Tobacco Tax Increase

<u>\$ in Millions</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>
Estimated Revenues from Second \$.50	\$101.3	\$99.4	\$97.9	\$96.8

State Expenditures: General fund expenditures could increase by an estimated \$68,000 in fiscal 2000, which accounts for the bill's October 1, 1999 effective date. This estimate reflects the cost of hiring 2 revenue examiners to conduct audits of new smokeless tobacco and cigar accounts and expended audits of current cigarette distributors who also distribute smokeless tobacco and cigars. This estimate includes salaries of \$40,900, 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 9 tax agents to enforce anti-smuggling regulations and advises that it will require 12 additional alcohol and tobacco agents with necessary equipment (vehicles, guns, cell phones, etc.) at a cost of \$620,400 in fiscal 2000 to help control the anticipated increase in smuggling as result of this bill.

DLS 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 2 packs of cigarettes at 1 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 1 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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