

Department of Legislative Services
Maryland General Assembly
2002 Session

FISCAL NOTE

Senate Bill 343

(Senator Van Hollen, *et al.*)

Budget and Taxation

Tobacco Tax - Rate

This bill increases the cigarette tax from \$.66 per pack to \$1.36 per pack. The bill also reduces the licensed wholesaler discount from .82% to .4%.

The bill takes effect July 1, 2002.

Fiscal Summary

State Effect: General fund revenues would increase by approximately \$147.8 million in FY 2003. Future year revenues reflect a 1.1% decline in consumption, a 3% annual increase in cigarette pack prices, and increased sales tax collections.

(\$ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	\$147.8	\$123.3	\$125.5	\$127.7	\$129.9
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$147.8	\$123.3	\$125.5	\$127.7	\$129.9

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Current Law: Cigarettes are taxed at a rate of \$.66 per pack. The discount rate on the purchase price of tobacco tax stamps offered by the State Comptroller to cigarette wholesalers is 0.82%.

Background: Chapter 121 of 1999 increased the cigarette tax from \$.36 to \$.66 and also lowered the licensed wholesaler discount from 1.36% to .82%. In addition, Chapter 121 imposed a 15% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco.

Tobacco tax increases have recently been proposed by the Governors of several states: Connecticut -- a \$.61 increase to the state's per-pack tax of \$.50; New York -- \$.39 increase to the state's per-pack tax of \$1.11; Oregon -- \$.09 increase to the state's per-pack tax of \$.68; Kansas -- \$.65 increase to the state's per-pack tax of \$.24; Minnesota -- \$.29 increase to the state's per-pack tax of \$.48; and Indiana -- \$.395 increase to the state's per-pack tax of \$.15.

Washington State has the highest cigarette tax in the country at \$1.425 per pack. Virginia has the lowest tax at \$.025 per pack. The nationwide average is \$.45 per pack.

Cigarette wholesalers do not file a return for cigarettes purchased. Instead, the tax is paid by the purchase of tax stamps. Cigarette wholesalers purchase tobacco stamps (to pay the tax) in bulk from the Comptroller based on the inventory of cigarettes they expect to have in their warehouses. The stamps are then attached to the packs of cigarettes. The stamp affixed to a pack of cigarettes is a visual verification that the tax has been paid. Because stamps are purchased in large volume, wholesalers are given a discount on the price of the stamp.

State Revenues: State revenues will be affected in three ways: the tobacco excise tax; the floor tax; and the sales and use tax.

The Tobacco Excise Tax

Increasing the tobacco tax by \$.70 to \$1.36 will increase revenues by \$118.7 million in fiscal 2003. This estimate reflects the following assumptions:

- Inflation will increase the price of cigarettes by 3% annually.
- Based on the change in revenues from fiscal 1999 to fiscal 2000 (\$.30 cigarette tax increase led to a 16.2% decline in consumption), it is estimated that cigarette pack consumption will decrease from fiscal 2002 to fiscal 2003 by approximately 22% due to cross border sales (elasticity of -1.23%). Revenues will decline by approximately 1.1% annually thereafter.
- 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.

- The estimated base price per pack of cigarettes will be \$4.06 for fiscal 2003, including all sales and excise taxes.

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. Based on the floor tax from fiscal 2000, it is assumed that 10.9% of inventories would be held for resale and subject to the tax. These revenues amount to \$23.1 million fiscal 2003.

Sales and Use Tax

Maryland imposes a 5% sales tax on the price and tax of cigarettes. Therefore, any excise tax increase will also effect sales and use tax revenues. Sales and use tax revenues are estimated to increase by \$5.9 million in fiscal 2003 and fiscal 2004.

Total Revenue Increase: FY 2003-2004

<u>(\$ in Millions)</u>	<u>Excise Tax</u>	<u>Floor Tax</u>	<u>Sales and Use Tax</u>	<u>Total Revenue Increase</u>
FY 2003	\$118.7	\$23.1	\$5.9	\$147.8
FY 2004	\$117.4		\$5.9	\$123.3

The Licensed Wholesaler Discount

Under current law the licensed wholesaler receives a discount of .82% of the purchase price of the tax stamps. The bill adjusts this discount to .40% in fiscal 2003, 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 smaller discount rate in proportion to the cigarette tax rate. However, the increase or decrease in general fund revenues are assumed to be minimal.

State Expenditures: The Comptroller’s Office currently employs 16 field enforcement agents who are sworn police officers to enforce anti-smuggling regulations. The Comptroller’s Office indicates that it will require six additional alcohol and tobacco agents with necessary equipment (vehicles, guns, cell phones, etc.) at a cost of \$350,459 in fiscal 2003 to help control the anticipated increase in smuggling as a 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 from out of state 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.

Small Business Effect: According to the 1998 Survey of U.S. Business by the U.S. Census Bureau, over 92% of general merchandise stores, food and beverage stores, and gas stations (places where individuals may purchase tobacco products), have fewer than 20 employees.

Cigarettes are major sources of sales revenue in these stores. Any reduction of cigarette sales would have an impact of these businesses.

Additional Information

Prior Introductions: None.

Cross File: HB 988 (Delegate Frush, *et al.*) – Ways and Means.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Maryland Citizens Health Initiative, *New York Times*, Department of Legislative Services

Fiscal Note History: First Reader - February 11, 2002
lsc/cer

Analysis by: Michael Sanelli

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510