

Department of Legislative Services
 Maryland General Assembly
 2003 Session

FISCAL AND POLICY NOTE

Senate Bill 324 (Senator Ruben, *et al.*)
 Budget and Taxation

Tobacco Tax - Rate

This bill increases the tobacco tax from \$1.00 per pack to \$1.36 per pack.

The bill takes effect July 1, 2003.

Fiscal Summary

State Effect: General fund revenues would increase by approximately \$85.0 million in FY 2004, which includes \$10.5 million from the floor tax. Future year revenues reflect a 1.3% decline in consumption, a 3% annual increase in cigarette pack prices, and increased sales tax collections.

(\$ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	\$85.0	\$73.6	\$72.6	\$71.7	\$70.7
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$85.0	\$73.6	\$72.6	\$71.7	\$70.7

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 \$1.00 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 288 of 2002 increased the cigarette tax from \$.66 to \$1.00 per pack. 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.

Exhibit 1 shows the cigarette tax in all 50 states and the District of Columbia.

The U.S median cigarette tax is 48 cents 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.

The Comptroller's Office currently employs 16 field enforcement agents, who are sworn police officers, to enforce anti-smuggling regulations. 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 nonresident 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.

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 \$.36 to \$1.36 will increase revenues by \$73.9 million in fiscal 2004. This estimate reflects the following assumptions:

- Cigarette pack stamp sales will decrease by approximately 7% from fiscal 2003 to 2004 as a result of the proposed \$.36 tax increase due to reduced consumption and cross border sales (based on an elasticity of demand of -.7). Revenues will decline by approximately 1.3% annually thereafter. If the demand is more responsive to the change in price, the decrease in stamp sales could be greater.
- 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 \$4.10 for fiscal 2004, including all sales and excise taxes.
- Inflation will increase the price of cigarettes by 3% annually.

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 10.5% of inventories would be held for resale and subject to the tax. These revenues amount to \$10.5 million fiscal 2004.

Sales and Use Tax

Maryland imposes a 5% sales tax on the price and tax of cigarettes. Therefore, any excise tax increase will also affect sales and use tax revenues. Sales and use tax revenues are estimated to increase by \$1.2 million in fiscal 2004 and \$1.1 million in fiscal 2005.

Total Revenue Increase: Fiscal 2003-2004

<u>(\$ in Millions)</u>	<u>Excise Tax</u>	<u>Floor Tax</u>	<u>Sales and Use Tax</u>	<u>Total Revenue Increase¹</u>
FY 2004	\$73.9	\$10.5	\$1.2	\$85.0
FY 2005	\$73.0	0	\$1.1	\$73.6

¹Vendor discount does not change, so cigarette wholesalers will earn an additional \$600,000 from the discount. The total revenue increase does not include this amount.

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 in cigarette sales would have an impact on these businesses.

Additional Information

Prior Introductions: None.

Cross File: HB 1124 (Delegate Montgomery, *et al.*) – Rules and Executive Nominations.

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

Fiscal Note History: First Reader - March 3, 2003
ncs/jr

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Exhibit 1
Cigarette Taxes as of January 1, 2003

State	Tax per Pack (cents per pack)	Rank
Alabama	16.5	45
Alaska	100	10
Arizona	118	8
Arkansas	34	32
California	87	16
Colorado	20	39
Connecticut	111	9
Delaware	24	36
Florida	33.9	33
Georgia	12	46
Hawaii	120	7
Idaho	28	35
Illinois	98	14
Indiana	55.5	23
Iowa	36	29
Kansas	70	18
Kentucky ¹	3	50
Louisiana	36	29
Maine	100	10
Maryland	100	10
Massachusetts	151	1
Michigan	125	6
Minnesota	48	26
Mississippi	18	41
Missouri	17	43
Montana	18	41
Nebraska	64	22
Nevada	35	31
New Hampshire	52	25
New Jersey	150	2
New Mexico	21	38
New York	150	2
North Carolina	5	49
North Dakota	44	27
Ohio	55	24
Oklahoma	23	37
Oregon	68	20
Pennsylvania	100	10
Rhode Island	132	5
South Carolina	7	48
South Dakota	33	34
Tennessee	20	39
Texas	41	28
Utah	69.5	19
Vermont	93	15
Virginia	2.5	51
Washington	142.5	4
West Virginia	17	43
Wisconsin	77	17
Wyoming	12	46
District of Columbia	65	21

¹Tax rate is scheduled to increase to \$.79 on July 1, 2003.

Source: Federation of Tax Administrators