

Department of Legislative Services
 Maryland General Assembly
 2004 Session

FISCAL AND POLICY NOTE

House Bill 1226 (Delegate Montgomery)
 Ways and Means

Tobacco Tax - Rate

This bill increases the tobacco tax from \$1.00 per pack to \$1.50 per pack.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: General fund revenue increase of approximately \$94.9 million in FY 2005, which includes \$10.0 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 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------|---------|---------|---------|---------|---------|
| GF Revenue | \$94.9 | \$83.8 | \$82.7 | \$81.7 | \$79.6 |
| Expenditure | \$0 | \$0 | \$0 | \$0 | \$0 |
| Net Effect | \$94.9 | \$83.8 | \$82.7 | \$81.7 | \$79.6 |

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 0.82%. In addition, Chapter 121 imposed a 15% tax on the wholesale price of other tobacco products such as cigars and smokeless tobacco.

After the tax increase enacted in 1999, cigarette revenues were approximately \$197.8 million in fiscal 2000, approximately \$69.3 million more than in fiscal 1999. During that same period, Maryland taxable cigarette sales decreased by approximately 16.3%. After the tax increase of 2002, fiscal 2003 cigarette revenues were approximately \$261.4 million, approximately \$58.5 million more than in fiscal 2002. Sales decreased over that period by approximately 11.6%.

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

The U.S median cigarette tax is 60 cents per pack.

When tobacco taxes are increased, it has two effects on consumption. The first is to decrease consumption. This effect is typically estimated as an elasticity. An elasticity is calculated by measuring the decrease in consumption caused by an increase in price. The Surgeon General, in a 2000 report, conducted an exhaustive analysis of research focused on estimating the price elasticity of tobacco. The Surgeon General's analysis concluded that the majority of elasticity estimates were between 0.3 and 0.5.

The Surgeon General's report cautioned, though, that estimating elasticity by calculating the change in cigarette sales in a state that has recently imposed a tax increase will understate the amount of consumption of cigarettes as individuals could be buying cigarettes in other states or in other nontaxable manners. It should be noted that a divergent range of estimates exists for the amount of contraband cigarette sales that are conducted.

The Federation of Tax Administrators conducted a recent analysis of tobacco sales in states that have increased tobacco taxes. Their analysis concluded that cigarette sales in these states were on average 21.5% higher in the three months prior to the tax increase and decreased by 8.8% after the tax increase. The analysis also raised the possibility that tax increases caused an increase in cross-border sales in an attempt to avoid the tax increase.

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 \$1.00 to \$1.50 will increase revenues by \$83.7 million in fiscal 2005. This estimate reflects the following assumptions:

- Cigarette pack stamp sales will decrease by approximately 11% as a result of the proposed \$0.50 tax increase due to reduced consumption and nontaxable sales. This estimate is based on a price elasticity of demand of 0.5 and that an estimated additional 5% of purchases will be conducted in a manner that is not subject to State taxation. 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.
- The estimated base price per pack of cigarettes will be \$4.48 for fiscal 2005, 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. It is assumed that 7.5% of inventories would be held for resale and subject to the tax, resulting in revenues of \$10.0 million fiscal 2005.

Sales and Use Tax

Maryland imposes a 5% sales tax on the price (including stamp 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 approximately \$1.2 million in fiscal 2005 and 2006.

Total Revenue Increase: Fiscal 2005 - 2006 (\$ in millions)

| | <u>Excise Tax</u> | <u>Floor Tax</u> | <u>Sales and Use Tax</u> | <u>Total Revenue Increase</u> |
|---------|-------------------|------------------|------------------------------|-----------------------------------|
| FY 2005 | \$83.7 | \$10.0 | \$1.2 | \$94.9 |
| FY 2006 | \$82.6 | | \$1.2 | \$83.8 |

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 are likely to 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: SB 324 of 2003, a similar bill, was not reported from the Senate Budget and Taxation Committee.

Cross File: SB 378 (Senator Ruben, *et al.*) – Budget and Taxation.

Information Source(s): Comptroller's Office, Federation of Tax Administrators, Department of Legislative Services

Fiscal Note History: First Reader - March 2, 2004
ncs/jr

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Exhibit 1
State Excise Tax Rates on Cigarettes

| <u>State</u> | <u>Tax Rate</u> <u>(¢ Per Pack)</u> | <u>Rank</u> |
|----------------|----------------------------------------|-------------|
| Alabama (1) | 16.5 | 47 |
| Alaska | 100 | 12 |
| Arizona | 118 | 11 |
| Arkansas (2) | 59 | 27 |
| California | 87 | 19 |
| Colorado | 20 | 43 |
| Connecticut | 151 | 3 |
| Delaware | 55 | 30 |
| Florida | 33.9 | 41 |
| Georgia | 37 | 38 |
| Hawaii (3) | 130 | 7 |
| Idaho | 57 | 28 |
| Illinois (1) | 98 | 17 |
| Indiana | 55.5 | 29 |
| Iowa | 36 | 39 |
| Kansas | 79 | 21 |
| Kentucky (2) | 3 | 50 |
| Louisiana | 36 | 39 |
| Maine | 100 | 12 |
| Maryland | 100 | 12 |
| Massachusetts | 151 | 3 |
| Michigan | 125 | 9 |
| Minnesota | 48 | 35 |
| Mississippi | 18 | 45 |
| Missouri (1) | 17 | 46 |
| Montana | 70 | 23 |
| Nebraska | 64 | 25 |
| Nevada | 80 | 20 |
| New Hampshire | 52 | 34 |
| New Jersey | 205 | 1 |
| New Mexico | 91 | 18 |
| New York (1) | 150 | 5 |
| North Carolina | 5 | 49 |
| North Dakota | 44 | 36 |
| Ohio | 55 | 30 |
| Oklahoma | 23 | 42 |
| Oregon | 128 | 8 |
| Pennsylvania | 135 | 12 |
| Rhode Island | 171 | 2 |

| <u>State</u> | <u>Tax Rate (¢ Per Pack)</u> | <u>Rank</u> |
|----------------------|----------------------------------|-------------|
| South Carolina | 7 | 48 |
| South Dakota | 53 | 33 |
| Tennessee (1) (2) | 20 | 43 |
| Texas | 41 | 37 |
| Utah | 69.5 | 24 |
| Vermont | 119 | 10 |
| Virginia (1) | 2.5 | 51 |
| Washington | 142.5 | 6 |
| West Virginia | 55 | 30 |
| Wisconsin | 77 | 22 |
| Wyoming | 60 | 26 |
| District of Columbia | 100 | 12 |
| U. S. Median | 60 | |

- (1) Counties and cities may impose an additional tax on a pack of cigarettes in AL, 1¢ to 6¢; IL, 10¢ to 15¢; MO, 4¢ to 7¢; NYC \$1.50; TN, 1¢; and VA, 2¢ to 15¢.
- (2) Dealers pay an additional enforcement and administrative fee of 0.1¢ per pack in KY and 0.05¢ in TN. In AR, a \$1.25/1,000 cigarette fee is imposed.
- (3) The HI rate is scheduled to increase to \$1.40 per pack on July 1, 2004.

Source: Compiled by FTA from various sources.
