

**Department of Legislative Services**  
Maryland General Assembly  
2006 Session

**FISCAL AND POLICY NOTE**

Senate Bill 572 (Senator Ruben, *et al.*)  
Budget and Taxation

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**Tobacco Tax - Revenues for Pension Enhancements for State Employees and Teachers**

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This bill increases the State tobacco tax from \$1.00 per pack to \$1.50 per pack of cigarettes. In addition, the bill increases from 15% to 45%, the tax rate on tobacco products other than cigarettes (cigars, pipe tobacco, chewing tobacco, and snuff). The additional tobacco tax revenues must be deposited in a special fund that can only be used to pay for pension benefit enhancements for State employees and teachers enacted after January 1, 2006.

The bill takes effect July 1, 2006.

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**Fiscal Summary**

**State Effect:** Special fund revenues could increase by \$124.7 million in FY 2007 for pension enhancements. General fund revenues from sales tax proceeds due to increased tobacco taxes could increase by \$4.7 million in FY 2007. Future years reflect the one-time floor tax revenues and a decline in tobacco consumption.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	\$4,712,000	\$4,641,000	\$4,571,000	\$4,503,000	\$4,435,000
SF Revenue	124,704,000	112,753,000	112,399,000	112,087,000	111,818,000
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$129,416,000	\$117,394,000	\$116,970,000	\$116,590,000	\$116,253,000

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

**Local Effect:** None.

**Small Business Effect:** Meaningful.

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## Analysis

**Current Law:** Cigarettes are taxed at a rate of \$1.00 per pack. The tax rate for other tobacco products, including cigars and smokeless tobacco, is 15% of the wholesale price. The State also imposes a 5% sales tax on the price of cigarettes.

**Background:** The State has increased taxes on cigarettes twice in recent years. Chapter 288 of 2002 increased the cigarette tax from \$0.66 to \$1.00 per pack. Chapter 121 of 1999 increased the cigarette tax from \$0.36 to \$0.66 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%.

### *Cigarette Taxes in Other States*

The United States median cigarette tax is \$0.80 per pack. Maryland currently has the nineteenth highest cigarette tax rate in the nation. Pursuant to this legislation, Maryland would have the tenth highest tax rate. Three neighboring states (Delaware, Virginia, and West Virginia) currently have lower cigarette taxes than Maryland; while Pennsylvania has a higher tax rate. The tax rate in the District of Columbia is the same as Maryland. The cigarette tax rate in Virginia is \$0.30 per pack with localities authorized to impose an additional \$0.15 tax per pack. In Delaware and West Virginia, the tax rate is \$0.55 per pack. The tax rate is \$1.35 per pack in Pennsylvania and \$1.00 per pack in the District of Columbia. **Exhibit 1** shows the cigarette tax in all 50 states and the District of Columbia.

### *Effects on Tobacco Consumption*

When tobacco taxes are increased, it has two effects on consumption. The first is to decrease consumption. This effect is typically estimated as a price elasticity of demand. 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 an 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.

### *Pension Benefit Enhancements*

The General Assembly has not enacted any pension benefit enhancements for State employees or teachers since January 1, 2006. However, two bills currently pending before the Senate, SB 1019 and SB 1055, would each provide pension benefit enhancements. There are no pension enhancement bills currently pending in the House of Delegates.

SB 1019 would increase the benefit accrual rate for members of the Teachers' Pension System (TPS) and the Employees' Pension System (EPS) from 1.4% of average final compensation to 1.8%, retroactive for service credit earned since July 1, 1998. It would also phase in over three years an increase in employee contributions from 2% to 5% of annual compensation. The State's actuary estimates that State pension contributions would increase by approximately \$120 million in fiscal 2007 under SB 1019.

SB 1055 would increase the benefit accrual rate for all members of TPS, the Teachers' Retirement System, and the Employees' Retirement System, and some members of EPS to 2.0%, retroactive to the beginning of membership in the systems. It would also increase employee contributions from 2% to 5% of annual compensation. The State's actuary estimates that State pension contributions would increase by at least \$345 million in fiscal 2007 under SB 1055.

**State Fiscal Effect:** Pursuant to this legislation, special fund revenues could increase by \$124.7 million in fiscal 2007 and general fund revenues could increase by \$4.7 million. **Exhibit 2** shows the revenue projections from the tobacco tax increase for both the

special and general funds. This estimate is based on an 8.4% decline in cigarette consumption and a 20.9% decline in the consumption of other tobacco products.

### *Special Fund Revenues*

The \$124.7 million increase in special fund revenues in fiscal 2007 include: \$100.9 million in additional cigarette taxes, \$12.3 million in additional taxes from other tobacco products (OTP), and \$11.6 million in one-time revenue from the floor tax. Special fund revenues in future years will total approximately \$112.8 million in fiscal 2008 and \$111.8 million in fiscal 2011. Special fund revenues can only be used to pay for pension enhancements enacted after January 1, 2006 for State employees and teachers.

### *General Fund Revenues*

The 5% sales tax on cigarettes will generate an additional \$4.7 million in fiscal 2007 and \$4.4 million in fiscal 2011. These additional funds will be deposited in the State's general fund as provided under current law.

**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.

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## **Additional Information**

**Prior Introductions:** Legislation increasing tobacco taxes has been introduced at the 2005, 2004, and 2003 sessions. SB 556 of 2005 and SB 378 of 2004 would have increased the tobacco tax rate for cigarettes from \$1.00 to \$1.50 per pack. SB 324 of 2003 would have increased the tobacco tax rate for cigarettes from \$1.00 to \$1.36 per pack. The Senate Budget and Taxation Committee did not take any action on these bills.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Federation of Tax Administrators, Milliman USA, Maryland State Retirement Agency, Department of Legislative Services

**Fiscal Note History:** First Reader - March 15, 2006  
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Analysis by: Michael C. Rubenstein

Direct Inquiries to:  
(410) 946-5510  
(301) 970-5510

**Exhibit 1**  
**State Tax Rates on Cigarettes (Rate Per Pack) – January 1, 2006**

<b>State</b>	<b>Tax Rate</b>	<b>Rank</b>	<b>Effective Date</b>	<b>State</b>	<b>Tax Rate</b>	<b>Rank</b>	<b>Effective Date</b>
Alabama	\$0.425	39	5/18/2004	Montana	\$1.70	6	1/1/2005
Alaska	1.60	7	1/1/2005	Nebraska	0.64	30	10/1/2002
Arizona	1.18	16	11/25/2002	Nevada	0.80	25	7/22/2003
Arkansas	0.59	32	6/1/2003	New Hampshire	0.80	25	7/1/2005
California	0.87	23	n/a	New Jersey	2.40	2	7/1/2004
Colorado	0.84	24	n/a	New Mexico	0.91	22	7/1/2003
Connecticut	1.51	8	3/15/2003	New York	1.50	10	4/3/2002
Delaware	0.55	35	8/1/2003	North Carolina	0.35	44	7/1/2006
Dist. of Columbia	1.00	19	1/1/2003	North Dakota	0.44	38	n/a
Florida	0.339	45	n/a	Ohio	1.25	14	1/1/2005
Georgia	0.37	41	7/1/2003	Oklahoma	1.03	18	7/1/2004
Hawaii	1.40	12	7/1/2004	Oregon	1.18	16	1/1/2004
Idaho	0.57	33	6/1/2003	Pennsylvania	1.35	13	7/1/2004
Illinois	0.98	21	7/1/2002	Rhode Island	2.46	1	7/1/2004
Indiana	0.555	34	7/1/2002	South Carolina	0.07	51	n/a
Iowa	0.36	42	n/a	South Dakota	0.53	37	3/18/2003
Kansas	0.79	27	7/1/2003	Tennessee	0.20	48	7/15/2002
Kentucky	0.30	46	6/1/2005	Texas	0.41	40	n/a
Louisiana	0.36	42	8/1/2002	Utah	0.695	29	5/6/2002
Maine	2.00	4	9/19/2005	Vermont	1.19	15	7/1/2003
Maryland	1.00	19	6/1/2002	Virginia	0.30	46	7/1/2005
Massachusetts	1.51	8	7/25/2002	Washington	2.025	3	7/1/2005
Michigan	2.00	4	7/1/2004	West Virginia	0.55	35	5/1/2003
Minnesota	1.485	11	8/1/2005	Wisconsin	0.77	28	10/1/2001
Mississippi	0.18	49	n/a	Wyoming	0.60	31	7/1/2003
Missouri	0.17	50	n/a	U.S. Median	0.80		

Note: n/a indicates that there were no reported tax increases since 2000.

Source: Federation of Tax Administrators, March 2006



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**Exhibit 2**  
**Additional State Revenues from Tobacco Tax Increase**  
**\$ in Millions**

	<u><b>FY 2007</b></u>	<u><b>FY 2008</b></u>	<u><b>FY 2009</b></u>	<u><b>FY 2010</b></u>	<u><b>FY 2011</b></u>
<b>Current Law</b>					
Cigarette Tax	\$270.2	\$267.5	\$264.9	\$262.2	\$259.6
OTP Tax	8.8	9.4	9.9	10.3	10.9
<b>Total</b>	<b>\$279.1</b>	<b>\$276.9</b>	<b>\$274.7</b>	<b>\$272.6</b>	<b>\$270.4</b>
<b>Under SB 572</b>					
Cigarette Tax	\$371.1	\$367.4	\$363.7	\$360.1	\$356.5
OTP Tax	21.1	22.3	23.4	24.6	25.8
Sales Tax	4.7	4.6	4.6	4.5	4.4
Floor Tax	11.6	0.0	0.0	0.0	0.0
<b>Total</b>	<b>\$408.5</b>	<b>\$394.3</b>	<b>\$391.7</b>	<b>\$389.1</b>	<b>\$386.7</b>
<b>Increased Revenues</b>					
Special Fund	\$124.7	\$112.8	\$112.4	\$112.1	\$111.8
General Fund	4.7	4.6	4.6	4.5	4.4
<b>Total</b>	<b>\$129.4</b>	<b>\$117.4</b>	<b>\$117.0</b>	<b>\$116.6</b>	<b>\$116.3</b>

Source: Bureau of Revenue Estimates, Comptroller's Office

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