Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 617 (Delegate Tarrant, *et al.*)
Economic Matters

Cigarette - Definition

This bill alters the definition of "cigarette" to include any specified tobacco product that is • wrapped in paper containing tobacco and weighs less than three pounds per one thousand cigarettes; or • is likely to be purchased by consumers due to its resemblance to a cigarette.

The bill takes effect July 1, 2008.

Fiscal Summary

State Effect: General fund revenues would increase $1.9 million annually beginning in FY 2009 due to the increased net taxes on specified tobacco products. Transportation Trust Fund revenues would decrease minimally due to decreased sales tax revenues assessed on tobacco products. Any additional revenue related to licensing and fire safety performance standard certifications would be minimal. Likewise, any increased regulatory activity could be handled with existing resources.

($ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	$1.9	$1.9	$1.9	$1.9	$1.9
SF Revenue	(-)	(-)	(-)	(-)	(-)
Expenditure	$0	$0	$0	$0	$0
Net Effect	$1.9	$1.9	$1.9	$1.9	$1.9

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

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill alters the definition of a cigarette to include any size or shaped roll for smoking that is made of tobacco or tobacco mixed with another ingredient and either • is wrapped in paper containing tobacco and, with the wrapper, weighs less than three pounds per thousand cigarettes; or • contains tobacco, in any form, that is functional in the product and is likely to be purchased or offered as a cigarette because of its appearance, the type of tobacco used in the filler, or its packaging.

The bill subjects these tobacco products to any statute governing the manufacture, distribution, and sale of cigarettes beginning July 1, 2008. The bill retains the current definition of cigarettes for the fire safety performance standard established by Chapter 497 of 2007 through fiscal 2009; beginning in fiscal 2010, the new definition would also apply to that standard.

Current Law: The Business Regulation Article defines a "cigarette" as any size or shaped roll for smoking that is made of tobacco or mixed with another ingredient and wrapped in paper or in any other material except tobacco. The Commercial Law and Tax-General articles contain the definition above and also explicitly exclude cigars from the definition.

Chapter 497 of 2007 prohibits cigarettes from being manufactured, sold, or offered for sale in Maryland unless the cigarettes have been tested and meet specified performance standards and the manufacturer has filed written certification with the Comptroller that each cigarette has been tested. Chapter 497 remains effective until a federal reduced cigarette ignition propensity standard is adopted and becomes effective.

Cigars, pipe tobacco, chewing tobacco, and snuff (other tobacco products or OTPs) are taxed at 15% of their wholesale price. Cigarettes are taxed at a rate of $2.00 per pack. The discount rate on the purchase price of tobacco tax stamps offered by the State Comptroller to cigarette wholesalers is 0.82%. The State sales tax of 6% is imposed on the final retail price of OTPs and cigarettes.

Only entities licensed by the Comptroller may act as a cigarette manufacturer, retailer, storage warehouse, subwholesaler, vending machine operator, or wholesaler.

The federal government imposes a tax of $0.39 per package of 20 cigarettes. Cigars are classified by the federal government as either large (weighing more than three pounds per thousand) or small (not more than three pounds per thousand). Small cigars are taxed at a rate of $0.04 per pack of 20 or $1.828 per 1,000 units. Large cigars are taxed at a maximum of $0.05 per pack of 20 or 20.719% of the sales price, not to exceed $48.75 per 1,000 units.

Background: Cigars are generally wrapped in tobacco while cigarettes are typically wrapped in paper. A subset of little cigars has been manufactured to resemble cigarettes in size and shape (except that they are wrapped in tobacco instead of paper) and have been advertised and marketed to consumers as cigarette alternatives. These cigars are often packaged like cigarettes and contain a filter. Due to the differences in federal and State tax rates on cigars and cigarettes, the retail price of these cigars can be substantially lower than cigarettes. Despite a continued decline in the consumption of cigarettes, sales of little cigars have more than doubled in the last 10 years.

Exhibit 1 illustrates an example of the difference in the retail price and taxes collected from a pack of 20 little cigars, based on whether the State classifies it as a cigarette or cigar. Although cigarettes and little cigars are not perfect substitutes, tax differentials provide an incentive for consumers to purchase little cigars relative to cigarettes.

Exhibit 1
Effects of Imposing the OTP Tax and Cigarette Tax on a Pack of 20 Little Cigars

	State Tax Applied	
	Cigarette	**OTP**
Wholesale Price	$2.28	$2.28
Markups	0.59	0.59
Federal Excise Tax	0.39	0.04
State Excise Tax	2.00	0.34
State Sales Tax	0.32	0.20
Final Retail Price	**$5.58**	**$3.45**

In 2006 Attorneys General from 40 states, including Maryland, requested that the U.S. Department of the Treasury reverse decades-old rules that permit products of the same size, shape, and weight as cigarettes, but which have brown rather than white wrappers, to be labeled as little cigars. In its petition, the Attorneys General also state that little cigars are exempted from the health and advertising restrictions reached under the Master Settlement Agreement. To date, no final determination has been issued by the department. Several states, including Connecticut, Vermont, and Iowa, tax these little cigars as cigarettes.

State Revenues: The bill would tax specified tobacco products as cigarettes beginning July 1, 2008. As a result, general fund revenues would increase $1.9 million in fiscal

2009. TTF revenues would decrease minimally in fiscal 2009. This estimate is based on the following facts and assumptions:

- an estimated 52% of the OTP tax was collected from cigars in fiscal 2007;
- 48% of all cigars sold nationwide in 2007 were little cigars;
- the elasticity of tax-paid little cigars is estimated to be -0.8; and
- based on the estimated difference in the price and estimated elasticity of affected tobacco products, sales tax revenues would decrease by a little less than $200,000 in fiscal 2009.

Legislative Services advises that the final determination of which tobacco products would be classified as cigarettes under the bill would substantially alter the estimated fiscal impact of the bill.

Additional Information

Prior Introductions: SB 23/HB 20 of the 2007 special session, similar bills, were not reported from the Senate Budget and Taxation and House Ways and Means committees, respectively.

Cross File: None.

Information Source(s): Comptroller's Office, Federation of Tax Administrators, U.S. Department of Treasury (Alcohol and Tobacco Tax Trade Bureau), Department of Legislative Services

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