

Department of Legislative Services
 Maryland General Assembly
 2016 Session

FISCAL AND POLICY NOTE
 First Reader

Senate Bill 514 (Senator Madaleno)
 Budget and Taxation

Tobacco Taxes - Healthy Maryland Initiative

This bill (1) increases the tobacco tax rate from \$2.00 to \$3.00 per pack of cigarettes; (2) generally increases the other tobacco products (OTP) tax rate from 30% to the greater of 74% of the wholesale price or a specified amount; and (3) imposes the OTP tax on cigarillos as defined by the bill at the same rate as cigarettes. The bill further requires the Governor to include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2018.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: Net general fund revenues increase by \$95.2 million in FY 2017 due to the increase in the cigarette and OTP tax, minus the loss of sales tax revenues. General fund expenditures increase by \$11.0 million annually beginning in FY 2018, reflecting mandated tobacco cessation program funding. Future year estimates reflect projected tax revenues and mandated general fund expenditures. **This bill establishes a mandated appropriation beginning in FY 2018.**

(\$ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	\$95.2	\$90.3	\$89.1	\$87.9	\$86.7
GF Expenditure	\$0	\$11.0	\$11.0	\$11.0	\$11.0
Net Effect	\$95.2	\$79.3	\$78.1	\$76.9	\$75.7

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

Local Effect: Local health departments may receive additional funding beginning in FY 2018 due to the increased funding for the Tobacco Use Prevention and Cessation Program.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

The bill increases the tobacco tax rate from \$2.00 to \$3.00 per pack of cigarettes and increases the OTP tax rate from 30% (70% for nonpremium cigars) to the greater of 74% of the wholesale price or the amount specified below:

- *conventional moist snuff smokeless tobacco*: \$3.00 per 1.2 ounce (or less) container (and a proportionate amount of tax for larger containers);
- *single-dose smokeless tobacco*: \$2.25 per container of 15 or fewer doses (and a proportionate amount of tax for larger containers);
- *loose smoking tobacco*: \$3.00 per 0.65 ounces; and
- *nonpremium cigars*: not less than 15 cents per cigar (for cigars with a wholesale price of less than \$20). The OTP tax rate on premium cigars is left unchanged at 15%.

In addition, the bill defines a cigarillo as a roll for smoking, however labeled or named, that is made of tobacco or tobacco mixed with another ingredient that (1) weighs no more than 4.5 pounds per 1,000 rolls and (2) is wrapped in any substance containing tobacco. Cigarillos are subject to the OTP tax at the same rate as regular cigarettes under the bill. The bill also imposes a one-time floor tax on cigarettes and OTP in fiscal 2017.

The bill requires the Governor to include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2018.

Current Law/Background: Cigarettes are taxed at a rate of \$2.00 per pack. OTPs are taxed at 30% of the wholesale price for all products, except cigars. The tax rate for cigars that are classified as premium cigars equals 15% of the wholesale price; all other cigars are taxed at 70% of the wholesale price.

Cigarette and OTP tax revenues accrue to the general fund. In addition, the State sales tax rate of 6% is imposed on the final retail price of cigarettes and OTPs. In fiscal 2016, cigarette tax revenues are projected to total \$358.6 million, and OTP tax revenues are projected to total \$33.7 million. **Exhibit 1** shows the total wholesale value of OTPs sold in fiscal 2015 and OTP tax revenues generated from each product.

Exhibit 1
OTP Wholesale Value and Taxes Imposed
Fiscal 2015
(\$ in Millions)

<u>OTP</u>	<u>Wholesale Value</u>	<u>Total Tax</u>
Premium cigars	\$13.8	\$2.1
All other cigars	30.8	21.6
Chewing tobacco	4.5	1.4
Moist snuff	23.1	6.9
Pipe tobacco	1.5	0.4
Other	2.4	0.7
Total	\$76.1	\$33.1

Source: Comptroller's Office

Exhibit 2 shows the cigarette and OTP tax rates imposed in Maryland and surrounding states as of January 1, 2016, and the tax rate for moist snuff tobacco and cigars in those states that provide for a separate tax.

Exhibit 2
Cigarette and OTP Tax Rates in Surrounding States

<u>State</u>	<u>Cigarette Tax Rate</u>	<u>OTP Tax Rate</u>	<u>Moist Snuff Tobacco (per Ounce)</u>	<u>Cigar Tax Rate Limitations</u>
Delaware	\$1.60	15%	\$0.54	None
District of Columbia	2.50	67%		Imposed only on retail price < \$2.00 ¹
Maryland	2.00	30%		15% rate for premium cigars ²
Pennsylvania	1.60	None		None ³
Virginia	0.30 ⁴	10% ⁵	0.18	None
West Virginia	0.55	7%		None

¹Little cigars, as defined in statute, are taxed as cigarettes. Premium cigars are subject to a general sales tax of 5.75%.

²The tax rate is 70% of the wholesale price for all other cigars.

³Little cigars, as defined in statute, are taxed as cigarettes.

⁴Counties and cities may impose an additional tax on cigarettes of \$0.02 to \$0.15.

⁵Tax is applied to manufacturing price.

Source: Campaign for Tobacco-Free Kids; District of Columbia Office of Tax and Revenue; Federation of Tax Administrators

According to the U.S. Centers for Disease Control and Prevention, the percentage of individuals age 18 or older who smoked cigarettes in Maryland was 19.1% in 2011. The rate across all states and the District of Columbia ranged from 11.8% to 29.0%. The percentage of adults who used smokeless tobacco in Maryland was 2.1% during that same time, with a range of 1.4% to 9.8% across all states and the District of Columbia. Maryland had the eleventh-lowest and eighth-lowest percentages across the states in cigarette and smokeless tobacco use, respectively.

In Maryland, the percentage of youth in grades 9 through 12 who used tobacco in 2011 (cigarettes, smokeless tobacco, and/or cigars) was 17.9%, with a range of 7.8% to 31.9% across 36 states. Maryland had the fourth-lowest percentage across those states.

The Tobacco Use Prevention and Cessation Program aims to reduce the use of tobacco products and to reduce the burden of tobacco-related morbidity and mortality in the State. Over the past several years, the State's fiscal difficulties have prompted reductions to the mandated funding levels for various programs funded by the Cigarette Restitution Fund. The Budget Reconciliation and Financing Act of 2010 (Chapter 484) reduced annual appropriations for tobacco use prevention and cessation activities to \$6 million in each of fiscal 2011 and 2012 and \$10 million annually beginning in fiscal 2013. Prior to these reductions, \$21.0 million was mandated for these activities annually.

State Fiscal Effect: The bill increases the cigarette and OTP tax rates and requires the Governor to include at least \$21.0 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2018. As a result, general fund revenues increase by \$95.2 million in fiscal 2017, as shown in **Exhibit 3**.

The revenue estimates are based on past cigarette tax increases in Maryland and an examination of the additional OTP revenues generated through tax increases in 11 other states in fiscal 2006 through 2010, adjusted for Maryland. Based on these experiences, the estimates assume a significant reduction in the taxable consumption of cigarettes and OTPs following the tax increases.

Future year estimates reflect estimated net increases in general fund revenues and an increase of \$11.0 million in general fund expenditures to ensure a total of \$21.0 million in annual tobacco cessation program funding. The Department of Health and Mental Hygiene (DHMH) advises that the increased funding in fiscal 2018 would be expended on contracts for statewide tobacco prevention (\$4.6 million), health communication activities (\$1.1 million), and evaluation activities (\$1.0 million). In addition, DHMH anticipates hiring additional staff (\$419,000) and providing \$3.9 million to local health departments for tobacco prevention and control activities.

Exhibit 3
Fiscal Impact of Legislation
Fiscal 2017-2021
(\$ in Millions)

	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
General fund revenues					
Cigarette tax ¹	\$84.7	\$80.1	\$78.9	\$77.7	\$76.5
OTP revenues ¹	11.4	11.1	11.1	11.1	11.1
Sales tax	(0.9)	(0.9)	(0.9)	(0.9)	(0.9)
Net general fund	\$95.2	\$90.3	\$89.1	\$87.9	\$86.7
General fund expenditures					
Tobacco cessation ²	\$0	\$11.0	\$11.0	\$11.0	\$11.0
Net impact	\$95.2	\$79.3	\$78.1	\$76.9	\$75.7

Notes: Numbers may not sum to total due to rounding.

¹Includes impact of one-time floor tax in fiscal 2017.

²Although the Tobacco Use Prevention and Cessation Program is funded by the Cigarette Restitution Fund, nearly the entirety of the fund's revenue is allocated each year to various programs under funding mandates. Therefore, it is assumed that general funds are necessary either to meet the bill's funding mandate or to backfill for funding reallocated from Cigarette Restitution Fund programs.

Small Business Impact: OTP and cigarette retailers and wholesalers who are small businesses may be negatively impacted from the proposed tax rate increases. The impact depends on the extent to which the tax increase decreases sales in these products and the extent to which the tax increase is passed on to customers.

Additional Information

Prior Introductions: Similar legislation was introduced in the 2014 and 2015 sessions. SB 37 of 2015 and SB 589 of 2014 each received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Their cross files, HB 108 of 2015 and HB 443 of 2014, each received a hearing in the House Ways and Means Committee, but no further action was taken. Similar legislation was also introduced in the 2011 through 2013 sessions.

Cross File: HB 71 (Delegates Luedtke and Frush - Ways and Means and Economic Matters) is listed as a cross file, but the bills are not identical.

Information Source(s): Comptroller's Office, Department of Health and Mental Hygiene, Federation of Tax Administrators, Tobacco-Free Kids Campaign, Department of Legislative Services

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