

DEPARTMENT OF TAXATION

2003 Fiscal Impact Statement

1. **Patron** Hamilton

2. **Bill Number** HB 1566

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Revenue Revitalization Act of 2002

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill, with the suggested technical amendments, would (i) eliminate the remaining 1.5% state portion of the sales tax on food, (ii) increase the state portion of the sales and use tax on alcohol, beer, and wine by 4.5%, (iii) impose a tax on all tobacco products at the rate of 50 cents per pack or 5 cents per cigar, and (iv) allow all localities to impose a local tobacco products tax at a rate not to exceed 25 cents per pack or 3 cents per cigar.

Except for the elimination of the state portion of the sales tax on food, this bill does not specify an effective date. The elimination of the state portion of the sales tax on food would be effective on July 1, 2004.

6. **Fiscal Impact Estimates are:** Tentative. (See Line 8.)

6a. **Expenditure Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2002-03	\$1,413,912	8	GF
2003-04	\$991,813	8	GF
2004-05	\$588,903	8	GF

6b. **Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2002-03	\$26.5 Million	GF
2002-03	\$0	TTF
2002-03	\$1.5 Million	Local
2003-04	\$434.7 Million	GF
2003-04	\$767,608	TTF
2003-04	\$20.1 Million	Local
2004-05	\$293.3 Million	GF
2004-05	\$832,239	TTF
2004-05	\$20.5 Million	Local

7. Budget amendment necessary: Yes.

ITEM(S): Page 1, Revenue Estimates
283 and 285, Department of Taxation

8. Fiscal implications:

These estimates assume that the technical amendments relating to the sales and use tax on alcohol, beer, and wine products and the effective date for the sales and use tax on food purchased for human consumption will be accepted.

The Department would incur administrative costs of \$1,413,912 in Fiscal Year 2003, \$991,813 in Fiscal Year 2004, \$588,903 in Fiscal Year 2005, and \$589,923 in fiscal years thereafter for systems modifications, forms revisions, the printing and distribution of updated forms and coupon books, 8 additional positions for tobacco tax enforcement purposes, and the production and design of new tobacco stamps.

This bill is estimated to increase General Fund revenues by \$26.5 million in Fiscal Year 2003, \$434.7 million in Fiscal Year 2004, and \$293.3 million in Fiscal Year 2005. Transportation Trust Fund revenues would be increased by \$767,608 in Fiscal Year 2004 and \$832,239 in Fiscal Year 2005. Local revenues would be increased by \$1.5 million in Fiscal Year 2003, \$20.1 million in Fiscal Year 2004, and \$20.5 million in Fiscal Year 2005. The local revenue estimates assume that all localities would impose a local tobacco products tax at the maximum rate allowable.

For reasons described in Part 11 below, it would be difficult for the Department to implement the provisions of this bill any earlier than September 1, 2003. If the effective date of all of the provisions of this bill, except for the provisions relating to the sales and use tax on food, was changed to September 1, 2003, General Fund revenues would increase by \$386.9 million in Fiscal Year 2004 and \$293.3 million in Fiscal Year 2005, Transportation Trust Fund revenues would increase by \$628,043 in Fiscal Year 2004 and \$832,239 in Fiscal Year 2005, and local revenues would increase by \$18.2 million in Fiscal Year 2004 and \$20.5 million in Fiscal Year 2005.

9. Specific agency or political subdivisions affected:

Department of Taxation
Local Governments

10. Technical amendment necessary: Yes.

Alcohol, Beer, and Wine Sales and Use Tax

As currently drafted, this bill would increase only the state portion of the sales and use tax on alcohol, beer, and wine products from 3.5% to 9%. Once the 1% local option portion of the sales and use tax is added to the 9% sales and use tax, consumers would be charged a total of 10% on all purchases of alcohol, beer, and wine products. All of the revenues from the 9% sales and use tax are directed by this bill to be deposited into the General Fund until such time as the Public Safety Trust Fund is created. By directing the 9% portion to be deposited into the General Fund, the Transportation Trust Fund would suffer a large negative revenue impact in each fiscal year. Also, local governments would experience a reduction in the

current appropriation from the sales and use tax for educational purposes based on school age population.

Based on the language of House Joint Resolution 555, which creates the Public Safety Trust Fund, it appears that the intent of this bill was to raise the sales and use tax on alcohol, beer, and wine products by 4.5% and to keep the current 4.5% of the sales and use tax on alcohol, beer, and wine products and its allocation mechanisms intact. Under this assumed intent, the Transportation Trust Fund would not suffer a negative revenue impact nor would local governments experience a reduction in the current appropriation from the sales and use tax for educational purposes based on school age population.

If this assumed intent is correct, the following technical amendments are suggested:

Page 1, Line 17. After: A.

Strike: Except as provided in subsection B there

Insert: There

Page 1, Line 35. After: amount of

Strike: 9

Insert: four and one-half

Page 1, Line 36. After: in

Strike: lieu of

Insert: addition to

Page 1, Line 42. After: A.

Strike: Except as provided in subsection B, there

Insert: There

Page 2, Line 68. After: amount of

Strike: 9

Insert: four and one-half

Page 2, Line 69. After: in

Strike: lieu of

Insert: addition to

State Cigarette Tax Rate

While the most common pack size of cigarettes is 20 cigarettes per pack, a few cigarette manufacturers do produce packs of cigarettes that contain either more or less than 20 cigarettes per pack. Because of the varying size of packs of cigarettes, the following technical amendment is suggested to restate the tax rate on cigarettes on a per cigarette basis:

Page 4, Line 164. After: mills

Insert: two and one-half cents on each such cigarette or

Page 4, Line 164. After: package of

Strike: such

Insert: other

Food Tax Reduction Effective Date

As currently drafted, this bill would raise the total sales and use tax on food purchased for human consumption to 4.5% on July 1, 2003. On July 1, 2004, the total sales and use tax on food purchased for human consumption would be reduced to 2.5%. The Department assumes that the increase to 4.5% on July 1, 2003 was not intended. If this assumption is correct, the following technical amendment is suggested:

Page 10, Line 494. At the end of the line.

Insert: 4. That the provisions of this act amending § 58.1-611.1 shall be effective on July 1, 2004.

11. Other comments:

PROPOSAL

This bill would (i) eliminate the remaining 1.5% state portion of the sales tax on food, (ii) increase the state portion of the sales and use tax on alcohol, beer, and wine from the current 3.5% to 9%, (iii) impose a tax on all tobacco products at the rate of 50 cents per pack or 5 cents per cigar, (iv) and allow all localities to impose a local tobacco products tax at a rate not to exceed 25 cents per pack or 3 cents per cigar.

Revenues from the state alcohol sales tax and the state tobacco products tax would be deposited in the General Fund until a Public Safety Trust Fund is created for the state alcohol sales tax and a Health Care Trust Fund is created for the state tobacco products tax.

FOOD TAX REDUCTION

Allocation of Revenues from Sales of Food

Under the current Food Tax Reduction Program, the revenue generated from the 4.0% sales and use tax is allocated to the General Fund, the Transportation Trust Fund, and the localities. The General Fund currently retains tax revenues generated by the 1.5% tax rate for unrestricted use by the Commonwealth. The tax revenue from the 1% tax rate goes into the General Fund for educational purposes and is returned to the localities based on school-age population. The Transportation Trust Fund receives sales tax revenues from the 0.5% tax rate, and the remaining 1% represents the local option sales and use tax revenues.

Proposal

Assuming the technical amendments are accepted, this bill would replace the current Food Tax Reduction Program and eliminate 1.5% tax rate retained by the General Fund for unrestricted use by the Commonwealth. Revenues from the food tax at the rate of ½% would be deposited in the Transportation Trust Fund and revenues from the tax at the rate of 1% would be distributed to the localities for educational purposes based on school age population. This is unchanged from the current distribution of sales and use tax revenues. The local option portion of the sales and use tax on food would also remain unchanged.

SALES AND USE TAX ON ALCOHOL

Current Law

Currently, alcohol, beer, and wine products are subject to the 4.5% Virginia retail sales and use tax. This also applies to all alcohol, beer, and wine products sold by Virginia ABC stores. Alcohol, beer, and wine products are not eligible for the reduced rate under the food tax reduction program.

Proposal

This bill would increase the sales and use tax on alcohol, beer, and wine products by an additional 4.5%. The total rate charged to consumers on alcohol, beer, and wine products would be 9%. The revenues from the additional 4.5% would be deposited into the General Fund until a Public Safety Trust Fund is created. Revenues dedicated to the General Fund for educational purposes, revenues dedicated to the Transportation Trust Fund, and revenues generated from the local option sales and use tax would not be affected by this bill, assuming the technical amendments are accepted.

TOBACCO PRODUCTS TAX

Virginia Cigarette Tax

Virginia first imposed a state cigarette tax in 1960, at a rate of three cents per pack. A similar tax was also imposed on cigars. The tax rate on cigarettes remained at three cents per pack until 1966, when Virginia imposed a sales and use tax and simultaneously lowered the cigarette tax to 2.5 cents per pack, where it remains today. The tax on cigars was repealed in 1966 and Virginia currently taxes no other tobacco product other than cigarettes. Virginia's cigarette tax is currently the lowest state cigarette tax in the nation.

The cigarette tax is paid by wholesale dealers through the purchase of stamps, which must be affixed to each container from which cigarettes are sold. A discount equal to 2.5 cents for a ten-pack carton of cigarettes is available to wholesalers that stamp cigarettes. Wholesalers file a monthly report with the Department of Taxation showing the quantities of cigarettes purchased and stamped.

Taxation of Cigarettes in Other States

All 50 states and the District of Columbia impose a tax on cigarettes. Six states, including Virginia, allow local governments to impose a tax on cigarettes in addition to the state cigarette tax. Current state cigarette tax rates range from a high of \$1.51 per pack in Massachusetts to a low of 2.5 cents per pack in Virginia. The median state cigarette tax in the U.S. is 48 cents per pack. The table below shows the cigarette tax rates in states bordering Virginia.

State	Per Pack
District of Columbia	\$0.65
Kentucky	\$0.03
Maryland	\$1.00
North Carolina	\$0.05
Tennessee	\$0.20
West Virginia	\$0.17

Recent Trends in the State Taxation of Cigarettes

Nineteen states increased cigarette tax rates during 2002. Three of these states have enacted additional cigarette tax increases that will become effective in either 2003 or 2004. Massachusetts enacted the largest per pack increase of 75 cents. Tennessee enacted the smallest per pack increase at 7 cents.

State Taxation of Tobacco Products Other Than Cigarettes

Currently, forty-six states tax tobacco products other than cigarettes. Other tobacco products taxed by states include cigars, smokeless tobacco, pipe tobacco, roll-your-own tobacco, snuff and chewing tobacco. The most common approach taken by states that tax tobacco products other than cigarettes is to impose a tax on the wholesale price of the tobacco product. Of the 46 states that tax other tobacco products, 34 of these states use the wholesale price of the product as the base of the tax. None of the 46 states tax other tobacco products on a per pack basis.

The following table below shows the tax rates on other tobacco products in states bordering Virginia:

State	Rate
District of Columbia	Do not tax other tobacco products
Kentucky	Do not tax other tobacco products
Maryland	15% of wholesale price
North Carolina	2% of wholesale price
Tennessee	6% of wholesale price
West Virginia	7% of wholesale price

Proposal

Assuming the technical amendments are accepted, this bill would increase the current cigarette tax from one and a quarter mills per cigarette (two and one-half cents per pack) to two and one-half cents per cigarette (50 cents per pack). Of the additional tax, one cent of the tax per cigarette would be deposited into the General Fund until a Health Care Trust Fund is created.

LOCAL TOBACCO PRODUCTS TAX

Currently, all cities and towns have the authority to impose a cigarette tax. Counties may impose a cigarette tax only if they were granted the authority to impose a cigarette tax prior to 1977. At the present time, two counties, twenty-two cities, and twenty-two towns impose a cigarette tax. The rate of the cigarette tax that can be imposed is limited only for the counties, Arlington and Fairfax, at 5 cents per pack. No county, city, or town may currently impose a tax on tobacco products other than cigarettes.

Under this bill, all localities would be allowed to impose a tax on tobacco products, not just limited to cigarettes. Any such tax would not be allowed to exceed 25 cents per pack or package or three cents per cigar. However, if a locality imposed a tax at a higher rate prior to January 1, 2003, the higher rate would be allowed to continue. A locality imposing a higher rate may not increase such rate. All rate limitations would be in effect until January 1, 2008.

EFFECTIVE DATE

The Department would encounter some difficulties implementing certain provisions of this bill by July 1, 2003. In particular, the increased tax on alcohol, beer, and wine products would be require a significant effort in a relatively short period of time to implement. It is only a small subset of dealers who sell the alcohol, beer, and wine products. However, these dealers would have to be educated on which products would be subject to the additional sales and use tax and on how to administer and remit the tax. The Department's ability to implement this legislation would be enhanced if the effective date of certain provisions could be delayed until September 1, 2003.

OTHER LEGISLATION

House Joint Resolution 555 proposes an amendment to the Constitution of Virginia that would establish the Public Safety Trust Fund. The fund would consist of revenues derived from the additional four and one-half percent tax on all retail sales of alcohol, beer, and wine. Proceeds from the Fund would be appropriated for the purposes of public safety, including law enforcement and would be in addition to revenues previously appropriated for such purposes.

House Joint Resolution 556 proposes an amendment to the Constitution of Virginia that would establish the Health Care Trust Fund. The fund would consist of revenues derived from one cent of the additional cigarette excise tax. Proceeds from the Fund would be

appropriated for the purposes of health care and would be in addition to revenues previously appropriated for such purposes.

House Bill 1453 increases the state cigarette tax from 2.5 cents to 20 cents per pack.

House Bill 2247 increases the state cigarette tax from 2.5 cents to 25 cents per pack and allows localities to impose a local cigarette tax.

House Bill 2313 would impose a tax on the manufacturers of cigarettes equal to 5 cents per pack

Senate Bill 790 would provide an exemption from the state sales and use tax on food for human consumption.

Senate Bill 835 would impose a tax on the manufacturers of cigarettes equal to 4 cents per pack.

Senate Bill 1113 increases the state tax on cigarettes from 2.5 cents to 60 cents per pack.

cc : Secretary of Finance

Date: 01/12/03 CT

Document : S:\2003leg\WorkInProgress\OTPwork\House Bills\hb1566F161.doc