

DEPARTMENT OF TAXATION

2003 Fiscal Impact Statement

1. Patron: Darner

2. Bill No: HB 1712

3. Committee: House Finance

House of Origin:

 X Introduced

 Substitute

 Engrossed

4. Title: Retail Sales and Use Tax: Reduce
Sales and Use Tax on Food
Cigarette Tax: Increase Tax

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would replace the current Food Tax Reduction Program and reduce the state sales and use tax rate on food purchased for human consumption to 1½%, effective July 1, 2003. This bill requires that revenues from the tax on food at the rate of ½% be deposited in the Transportation Trust Fund and revenues from the tax at the rate of 1% be distributed to the localities for educational purposes based on school-age population.

This bill would increase the tax on cigarettes from 2.5 cents to 50 cents per pack. The effective date of the cigarette tax rate increase is not specified.

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

6a. Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2002-03	\$401,000	0	GF
2003-04	\$726,000	8	GF
2004-05	\$474,000	0	GF

6b. Revenue Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2002-03	\$24.6 million	GF
2003-04	\$148.8 million	GF
2003-04	\$768,000	TTF
2003-04	\$1.5 million	Local

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2004-05	\$127.2 million	GF
2004-05	\$832,000	TTF
2004-05	\$1.7 million	Local

7. Budget amendment necessary: Yes.

Page 1, Revenue Estimates

Items 283 and 285, Department of Taxation

8. Fiscal implications:

Administrative costs

TAX would incur administrative costs of \$401,000 in fiscal year 2003, \$726,000 in fiscal year 2004 and \$474,000 in fiscal year 2005 and thereafter for systems modifications, processing, forms revisions, the printing and mailing of updated forms and coupon books, 8 additional FTE's for tobacco tax enforcement purposes and the design and production of new cigarette stamps.

Revenue impact

The provisions of this bill would generate a net increase in General Fund revenues of \$24.6 million in fiscal year 2003, \$148.8 million in fiscal year 2004 and \$127.2 in fiscal year 2005. The estimates are based on a July 1, 2003 effective date. The Department would difficulty implementing this bill in such a short timeframe and would prefer an effective date of September 1, 2003. The impact of each provision is discussed below.

Food Tax Reduction

The reduced sales tax rate on food would have a negative impact on revenues dedicated to the General Fund for unrestricted use by the Commonwealth. This provision would decrease General Fund revenues by \$149.0 million in fiscal year 2004 and \$169.0 million in fiscal year 2005. Food tax receipts used to generate these estimates are derived from data maintained by the Department of Accounts. This data has been adjusted for the dealer discount. Therefore, the revenue estimates assume an adjustment for the dealer discount.

Cigarette Tax

The cigarette tax increase would offset the decrease resulting from the reduced tax rate on food and increase revenues dedicated to the General Fund for unrestricted use by the Commonwealth. This provision would generate additional revenues for the General

Fund of \$24.6 million in fiscal year 2003, \$293.3 million in fiscal year 2004 and \$291.3 million in fiscal year 2005. These revenue estimates assume an

effective date for the cigarette tax increase of July 1, 2003, and that cigarette stamps would be purchased one month before use.

The increase in the price of a pack of cigarettes would result in an increase in sales tax revenues, as the price on which the sales tax is based would increase. While it is assumed that the Commonwealth would lose some sales tax revenue due to a drop in the consumption of cigarettes because of the increased price, it is estimated that the Commonwealth would gain sales tax revenues due to the increased cigarette tax revenue. It is estimated that the increased sales price on a pack of cigarettes would generate additional sales tax revenue for the General Fund of \$4.5 million in fiscal year 2004 and \$4.9 million in fiscal year 2005. In addition, this would increase Transportation Trust Fund revenues by \$768,000 in fiscal year 2004 and \$832,000 in fiscal year 2005. Local revenues would increase by \$1.5 million in fiscal year 2004 and \$1.7 million in fiscal year 2005.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

The following technical amendments are suggested to apply the cigarette tax increase on a per cigarette basis because a pack is not uniform and may contain a number of cigarettes from 10 to 25. The amendments apply the tax on the basis that a standard pack contains 20 cigarettes.

Page 2, Line 82, after: mills

Strike: 50

Insert: 2.5

Page 2, Line 82, after: each

Unstrike: such cigarette

Page 2, Line 82, after: cigarette

Strike: pack of cigarettes.

11. Other comments:

Reduced Sales Tax Rate on Food

This bill does not affect the imposition of the local sales and use tax. Therefore, consumers would pay a reduced sales and use tax rate of 2½% (1½% state; 1% local) on purchases of food for human consumption.

Food Stamp Definition

Under the current Food Tax Reduction Program, “food purchased for human consumption” means food as defined under the federal Food Stamp Program.

This bill does not change the definition. The definition is broad and includes any food or food product for home consumption, except alcoholic beverages, tobacco, and hot foods or hot food products ready for immediate consumption. Hot meals for immediate consumption are generally excluded from the food stamp definition.

In utilizing the food stamp definition, the reduced sales tax rate applies to purchases of a wide variety of grocery and staple items such as meats, fruits and vegetables, cereals, beverages, snack and bakery foods, and dietary and health foods. In addition, cold prepared foods and beverages packaged for home consumption qualify as “food purchased for human consumption” under the federal definition.

Excluded from the definition of “food” is food sold by any retail establishment that derives more than 80% of its total gross receipts from the sale of food prepared for immediate consumption. This exclusion applies primarily to fast food establishments and restaurants.

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 1½% 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 ½% tax rate, and the remaining 1% represents the local option sales and use tax revenues. Effective July 1, 2003, this bill would eliminate the General Fund 1½% tax rate share of the revenues for unrestricted use. 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.

Other States' Food Exemptions

Generally

Of the 45 states that impose sales and use taxes, 31 currently provide an exemption of some type for food for human consumption. These exemptions range from full exemptions, some with phase-out provisions, to partial exemptions applying reduced rates on food. Some states fully tax food sales and allow an income tax credit or grant a refund for sales and use tax paid on food. Illinois, North Carolina and South Carolina, along with Virginia, currently provide a reduced sales and use tax rate on food for human consumption. (Source: Survey by Federation of Tax Administrators.)

Border States

The border states that provide an exemption of some type for food are the District of Columbia, Kentucky, Maryland, and North Carolina.

- The District of Columbia provides an exemption for all food and drink with the exception of food or drink sold through vending machines or prepared for immediate consumption, and snack food. The District of Columbia does not follow the food stamp definition of “food.”
- Kentucky does not follow the food stamp definition of “food,” but instead provides an exemption for food products deemed to be a “nutritional necessity.” Taxable items include candy, confectionery, chewing gum, soft drinks, sodas and similar beverages, water, meals served on or off the premises, and food sold through vending machines.
- Maryland provides an exemption and follows the food stamp definition of “food” with exceptions for soft drinks or carbonated beverages, candy and confectionery. These items, however, are exempt when sold by grocers and markets and through vending machines. Maryland also exempts milk, fresh fruit, fresh vegetables and yogurt sold through vending machines.
- North Carolina provides a reduced sales and use tax rate (local tax applies) on food for human consumption and follows the food stamp definition of “food” with no exceptions. The reduced rate does not apply to sales of food for immediate consumption and food sold through vending machines.

Tennessee and West Virginia currently impose the sales and use tax on food and food products.

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.

Other Legislation

Cigarette Tax

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

House Bill 1566 would impose a tax on cigarettes of 50 cents per pack and 5 cents per cigar, and it would allow localities to impose a tax of 25 cents per pack and 3 cents per cigar.

House Bill 2247 would increase the state cigarette tax from 2.5 cents to 25 cents per pack and allow 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 835 would impose a tax on the manufacturers of cigarettes equal to 4 cents per pack.

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

Sales Tax on Food

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

cc: Secretary of Finance

Date: 1/13/03/VHM

Document: S:\2003leg\WorkInProgress\OTPwork\HouseBills\HB1712F161.DOC