

DEPARTMENT OF TAXATION

2004 Fiscal Impact Statement

1. **Patron** John H. Chichester

3. **Committee** House Finance

4. **Title** State Cigarette Tax; Rates

2. **Bill Number** SB 465

House of Origin:

☐ **Introduced**

☐ **Substitute**

☐ **Engrossed**

Second House:

☒ **In Committee**

☐ **Substitute**

☐ **Enrolled**

5. **Summary/Purpose:**

This bill would increase the state cigarette tax rate from 2.5 to 20 cents per pack from July 1, 2004 through June 30, 2005, and 35 cents per pack thereafter. Beginning September 1, 2004, this bill would impose an excise tax on other tobacco products at a rate of 10% of the wholesale price. All state cigarette and tobacco tax revenues would be deposited in a new "Virginia Health Care Fund" to be appropriated for the provision of health care services, including Medicaid payments.

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> |
|---------------------------|-----------------------|-------------------------|--------------------|
| 2003-04 | \$42,500 | 0 | GF |
| 2004-05 | \$1,259,455 | 8 | GF |
| 2005-06 | \$579,116 | 8 | GF |
| 2006-07 | \$592,489 | 8 | GF |
| 2007-08 | \$610,091 | 8 | GF |
| 2008-09 | \$628,368 | 8 | GF |
| 2009-10 | \$647,329 | 8 | GF |

6b. **Revenue Impact:**

| <i>Fiscal Year</i> | <i>Dollars</i> | <i>Fund</i> |
|---------------------------|-----------------------|--------------------|
| 2003-04 | \$3.1 million | GF |
| | \$0 | Local |
| | \$0 | TTF |
| 2004-05 | \$109.9 million | GF |
| | \$0.5 million | Local |
| | \$0.3 million | TTF |

| | | |
|---------|---|--------------------|
| 2005-06 | \$224.0 million \$1.2 million \$0.6 million | GF Local TTF |
| 2006-07 | \$224.3 million \$1.4 million \$0.7 million | GF Local TTF |
| 2007-08 | \$225.3 million \$1.4 million \$0.7 million | GF Local TTF |
| 2008-09 | \$226.3 million \$1.4 million \$0.7 million | GF Local TTF |
| 2009-10 | \$227.3 million \$1.4 million \$0.7 million | GF Local TTF |

7. Budget amendment necessary: Yes.

Item(s): Page 1, Revenue Estimates.
284 and 286, Department of Taxation

8. Fiscal implications:

Administrative Costs

Assuming the requested amendment is adopted, the Department would incur administrative costs of \$42,500 in FY 2004, \$1,259,455 in FY 2005, \$579,116 in FY 2006, \$592,489 in FY 2007, \$610,091 in FY 2008, \$628,368 in FY 2009, and \$647,329 in FY 2010 for systems modifications, forms revisions, the printing and distribution of updated forms and 8 additional FTE's for tobacco tax enforcement purposes.

Some of the administrative costs that the Department would incur as a result of this bill are similar to the costs for the cigarette tax changes in the Governor's tax reform plan that are assumed in the Executive Budget. The Executive Budget assumes costs of \$50,619 in FY 2004, \$803,354 in FY 2005, \$471,200 in FY 2006, \$471,200 in FY 2007, \$485,340 in FY 2008, \$499,900 in FY 2009, and \$514,900 in FY 2010 to implement the cigarette tax increase proposed in the Governor's tax reform proposal.

Revenue Impact

Compared to current law, this bill is estimated to increase state and local revenues by \$3.1 million in FY 2004, \$110.7 million in FY 2005, \$225.8 million in FY 2006, \$226.4 million in FY 2007, \$227.4 million in FY 2008, \$228.4 million in FY 2009 and \$229.4 million in FY 2010. This estimate does not reflect the impact of the bill's provision allowing dealers to obtain cigarette tax stamps prior to paying for them by posting a bond or letter

of credit. The tobacco products tax portion of these revenues is \$18.9 million in FY 2006, \$21.7 million in FY 2007, \$22.6 million in FY 2008, \$23.7 million in FY 2009, and \$24.7 million in FY 2010. The tobacco products tax estimate assumes the requested amendment is adopted.

The Executive Budget assumes the passage of the Governor's tax reform proposal. The Governor's tax reform proposal contains provisions that would increase the state cigarette tax rate to 25 cents a pack. The following chart compares the state and local revenue effects of the cigarette tax increase contained in this bill on current law with the changes to the state and local revenue forecast, assumed in the Executive Budget, caused by the proposed cigarette tax increase in the Governor's tax reform proposal.

| Fiscal Year | Effect of SB 465 on State and Local Revenue | State and Local Revenue Effects of Similar Provisions in the Governor's Tax Reform Proposal | Difference Between SB 465 and Similar Provisions in the Governor's Tax Reform Proposal |
|--------------------|--|--|---|
| 2004 | \$3.1 million | \$4.0 million | <\$0.9 million> |
| 2005 | \$110.7 million | \$146.5 million | <\$35.8 million> |
| 2006 | \$206.9 million | \$145.8 million | \$61.1 million |
| 2007 | \$204.7 million | \$145.8 million | \$58.9 million |
| 2008 | \$204.8 million | \$143.8 million | \$61.0 million |
| 2009 | \$204.7 million | \$143.8 million | \$60.9 million |
| 2010 | \$204.7 million | \$143.8 million | \$60.9 million |

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

The Department is unable to implement the tobacco products tax provisions of this bill by September 1, 2004. To allow the Department sufficient time to implement the tax on tobacco products, the following amendment is requested:

Page 4, Line 232, at the end of the line

Insert: 4. That the provisions of this act adding Article 2.1 to Chapter 10 of Title 58.1 shall be effective on July 1, 2005.

11. Other comments:

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 \$2.05 per pack in New Jersey to a low of 2.5 cents per pack in Virginia. The median state cigarette tax in the U.S. is 60 cents per pack. The table below shows the cigarette tax rates in states bordering Virginia.

| State | Per Pack |
|----------------------|-----------------|
| District of Columbia | \$1.00 |
| Kentucky | \$0.03 |
| Maryland | \$1.00 |
| North Carolina | \$0.05 |
| Tennessee | \$0.20 |
| West Virginia | \$0.55 |

Recent Trends in the State Taxation of Cigarettes

Eighteen states increased cigarette tax rates during 2002, and seventeen states have increased cigarette tax rates during 2003. 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

Forty-seven 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 47 states that tax other tobacco products, 35 of these states use the wholesale price of the product as the base of the tax. The 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 | 6.6% of wholesale price |
| West Virginia | 7% of wholesale price |

Proposal

This bill would increase the state cigarette tax rate from 2.5 to 20 cents per pack from July 1, 2004 through June 30, 2005, and 35 cents per pack thereafter. Cigarette wholesalers that hold a permit issued by the Department would be allowed to obtain cigarette stamps from the Department prior to paying for them by posting a bond or letter of credit amounting to twice the wholesaler's anticipated average monthly Virginia revenue stamp purchases, as determined by the Department. The bond or letter of credit would be conditioned on the payment of the tax, less the dealer discount, within 30 days of the issuance of the stamps. With good cause, the Department would be authorized to require any cigarette wholesaler to pay for stamps at the time of receipt.

Beginning September 1, 2004, this bill would impose an excise tax on other tobacco products at a rate of 10% of the wholesale price. "Tobacco products" would be defined as cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco, as those terms are defined in § 5702 of the Internal Revenue Code. The tax would be paid on a monthly basis by all wholesale dealers located in the Commonwealth and all retail dealers located in the Commonwealth that obtain cigarettes from wholesale dealers in other states.

All state cigarette and tobacco tax revenues received after July 1, 2004 would be deposited in a new "Virginia Health Care Fund" to be appropriated for the provision of health care services, including Medicaid payments. Additionally, 40 percent of the funds from the Master Settlement Agreement with tobacco product manufacturers would be deposited in the Fund. The Fund would also receive any Medicaid program expenditures from a prior fiscal year recovered by the Commonwealth.

cc : Secretary of Finance
Date: 2/24/2004 JEM