

**DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement**

1. **Patron** H. Russell Potts, Jr.

2. **Bill Number** SB 5026

3. **Committee** Senate Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Cigarette Tax and Tobacco Products Tax;
Rate Increase

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would increase the state cigarette tax rate on cigarettes from 30 cents to \$1.05 per pack. This bill would also increase the state cigarette tax rate on roll-your-own tobacco from 10% to 30% of the manufacturer's sales price. Additionally, this bill would increase the rate of the tobacco products tax from 10% to 15% of the manufacturer's sales price. The net revenues resulting from these tax increases would be deposited into the Transportation Trust Fund. This bill would also limit the local cigarette tax rates in Fairfax and Arlington Counties to 30 cents per pack.

Under current law, revenues from the cigarette and tobacco products taxes are deposited into the Virginia Health Care Fund. Fairfax and Arlington are currently authorized to impose local cigarette taxes at a rate that does not exceed the state cigarette tax rate of 30 cents per pack.

This bill would be effective July 1, 2007.

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

6a. Expenditure Impact:

Fiscal Year	Dollars	Positions	Fund
2006-07	\$136,000	0	GF
2007-08	\$336,000	5	GF
2008-09	\$341,000	5	GF
2009-10	\$346,000	5	GF
2010-11	\$351,000	5	GF
2011-12	\$356,000	5	GF

6b. Revenue Impact:

Fiscal Year	Dollars	Fund
2006-07	\$6.0 million	GF
	\$0.9 million	TTF
	\$1.7 million	Local
	\$15.3 million	HCF
2007-08	(\$6.6 million)	GF
	\$327.1 million	TTF
	(\$1.9 million)	Local
	(\$44.7 million)	HCF
2008-09	(\$6.6 million)	GF
	\$327.1 million	TTF
	(\$1.9 million)	Local
	(\$44.7 million)	HCF
2009-10	(\$6.6 million)	GF
	\$327.1 million	TTF
	(\$1.9 million)	Local
	(\$44.7 million)	HCF
2010-11	(\$6.6 million)	GF
	\$327.1 million	TTF
	(\$1.9 million)	Local
	(\$44.7 million)	HCF
2011-12	(\$6.6 million)	GF
	\$327.1 million	TTF
	(\$1.9 million)	Local
	(\$44.7 million)	HCF

7. Budget amendment necessary: Yes.

Item(s): Page 1, Revenue Estimates.
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8. Fiscal implications:Administrative Costs

TAX would incur administrative costs of \$136,000 in FY 2007, \$336,000 in FY 2008, \$341,000 in FY 2009, \$346,000 in FY 2010, \$351,000 in FY 2011, and \$356,000 in FY 2012 for system changes and 5 additional FTE's for tobacco tax enforcement purposes. If the cigarette and tobacco products taxes are increased to the extent provided for by this bill, TAX anticipates the smuggling of cigarettes and tobacco products into Virginia will

increase. The 5 additional full time employees would be necessary to combat cigarette and tobacco products smuggling.

Revenue Impact

This bill would increase the Health Care Fund and other state and local revenues in FY 2007 as purchasers of cigarettes and tobacco products increase their purchases prior to the July 1, 2007 effective date of the tax increase provided for by this bill. As all cigarette tax and tobacco products tax revenues are currently deposited into the Health Care Fund, it is estimated that this bill would increase revenue to the Health Care Fund by \$15.3 million in FY 2007. Revenue from the retail sales and use tax would also increase. It is estimated that there would be an increase in General Fund, Transportation Trust Fund and local revenue of \$8.6 million in Fiscal Year 2007.

This bill would increase Transportation Trust Fund revenues and decrease Health Care Fund and other state and local revenues in FY 2008 and following years. As the revenues from the cigarette tax and tobacco products tax rate increases provided for by this bill would be deposited into the Transportation Trust Fund, it is estimated that this bill would increase revenue to the Transportation Trust Fund by \$327.1 million in FY 2008 and following years. As demand for cigarettes and tobacco products decrease due to the increased price of cigarettes and tobacco products, revenues from the portions of the cigarette tax and tobacco products tax that would continue to be deposited into the Health Care Fund would decrease by \$44.7 million in FY 2008 and following years. Revenues from the retail sales and use tax would also decrease because of decreased demand. It is estimated that there would be a decrease in General Fund and local revenue of \$8.5 million in Fiscal Year 2008 and following years.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

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. The tax on cigars was repealed in 1966. The cigarette tax increased to 20 cents per pack on August 1, 2004 and again on July 1, 2005 to 30 cents per pack. Virginia, Kentucky and North Carolina are currently ranked as having the 45th lowest state cigarette taxes in the nation.

The cigarette tax is paid by wholesaler dealers who have obtained a stamping agent permit from the Department of Taxation through the purchase of stamps, which must be affixed to each container from which cigarettes are sold. A discount equal to two percent of the purchase price of the cigarette stamps is available to stamping agents.

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 \$2.46 per pack in Rhode Island to a low of 7 cents per pack in South Carolina. The median state cigarette tax in the U.S. is 80 cents per pack. The table below shows the cigarette tax rates in states bordering Virginia.

State	Per Pack
District of Columbia	\$1.00
Kentucky	\$0.30
Maryland	\$1.00
North Carolina	\$0.30
Tennessee	\$0.20
West Virginia	\$0.55

Recent Trends in the State Taxation of Cigarettes

Twelve states, including Virginia, North Carolina and Kentucky increased cigarette tax rates during 2005, and seven states, including Virginia, increased cigarette tax rates during 2004. Maine and Montana enacted the largest increases of \$1.00 per pack. Hawaii enacted the smallest increase at 10 cents per pack.

Virginia Tobacco Products Tax

Under current law, a tobacco products tax is imposed on cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco. Cigarettes are not subject to the tax on tobacco products. Tobacco products include the following:

- Cigars -- any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco that is a cigarette).
- Smokeless tobacco --
 - Snuff -- any finely cut, ground, or powdered tobacco not intended to be smoked.
 - Chewing tobacco -- any leaf tobacco not intended to be smoked.
- Pipe tobacco -- any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe.

- Roll-your-own tobacco -- any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes.

The tax is imposed at the rate of 10% on the "manufacturers sales price," which is defined as the actual price for which a manufacturer, manufacturers' representative, or any other person sells tobacco products to an unaffiliated distributor. For the purpose of compensating distributors for accounting for the tobacco products tax, distributors are allowed to deduct two percent of the tax otherwise due when filing the monthly return and paying the tax if the amount due was not delinquent at the time of payment.

Effective July 1, 2007, roll-your-own tobacco will be subject to the state cigarette excise tax instead of the tobacco products tax. The cigarette tax on roll-your-own tobacco, however, will be imposed at the rate of 10% of the manufacturer's sale price and the tax would be administered much like the tobacco products tax.

Cigarette and Tobacco Products Taxes Revenue

Under current law, all of the revenue from the state cigarette and tobacco products taxes and 40% of Virginia's allocations from the Master Settlement Agreement are deposited into the Virginia Health Care Fund. Moneys deposited to the fund are used solely for the provision of health care services as appropriated in the state budget. Health care services include, but are not limited to, Medicaid payments, disease diagnosis, prevention and control and community health services.

Transportation Trust Fund

The Transportation Trust Fund was established in 1986 as a permanent fund and receives all the revenue generated as a result of the ½% retail sales and use tax increase effective January 1, 1987. Moneys in this fund are dedicated to transportation needs in the Commonwealth.

Local Cigarette Taxes

All cities and towns with general taxing powers are currently authorized to impose a local cigarette tax with no rate limitations. Thirty cities and twenty-nine towns currently impose a cigarette tax. Only two counties, Arlington and Fairfax, are authorized to impose a local cigarette tax, which is limited to the state cigarette tax rate of 30 cents per pack.

Proposal

This bill would increase the state cigarette tax rate from 30 cents per pack to \$1.05 per pack. This bill would also increase the state cigarette tax rate on roll-your-own tobacco from 10% to 30% of the manufacturer's sales price. Additionally, this bill would increase the rate of the tax on tobacco products from 10% to 15% of the manufacturer's sales price. The increased net revenues resulting from these tax increases would be deposited into the Transportation Trust Fund. This bill would also limit the local cigarette tax rates in Fairfax and Arlington Counties to 30 cents per pack.

cc : Secretary of Finance

Date: 09/22/2006 JEM

09/22/06