

# MINNESOTA • REVENUE

## CIGARETTE EXCISE TAX AND FEE TOBACCO PRODUCTS TAX AND FEE Little Cigars Classified as Cigarettes

May 3, 2011

|                                  | Yes | No |
|----------------------------------|-----|----|
| DOR Administrative Costs/Savings |     | X  |

Department of Revenue

Analysis of H.F. 743 (Loon) – As Proposed to be Amended (H0743A1)

|                                               | <b>Fund Impact</b>      |                         |                         |                         |
|-----------------------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                                               | <b><u>F.Y. 2012</u></b> | <b><u>F.Y. 2013</u></b> | <b><u>F.Y. 2014</u></b> | <b><u>F.Y. 2015</u></b> |
|                                               | (000's)                 |                         |                         |                         |
| Cigarette Excise Tax – 96¢ per pack           | \$2,000                 | \$2,200                 | \$2,300                 | \$2,400                 |
| Tobacco Products Excise Tax – 35%             | (\$1,500)               | (\$1,700)               | (\$1,700)               | (\$1,700)               |
| Sales Tax on Cigarettes                       | \$700                   | \$800                   | \$900                   | \$900                   |
| Sales Tax on Little Cigars                    | (\$600)                 | (\$700)                 | (\$700)                 | (\$700)                 |
| Cigarette Non-Settlement Fee – 35¢ per pack   | \$700                   | \$800                   | \$800                   | \$900                   |
| Appropriation to Commissioner of Revenue      | <u>(\$100)</u>          | <u>\$0</u>              | <u>\$0</u>              | <u>\$0</u>              |
| <b>General Fund Net Total</b>                 | \$1,200                 | \$1,400                 | \$1,600                 | \$1,800                 |
| Cigarette Health Impact Fee – \$1.50 per pack | \$3,100                 | \$3,500                 | \$3,600                 | \$3,700                 |
| Tobacco Products Health Impact Fee – 35%      | <u>(\$1,500)</u>        | <u>(\$1,700)</u>        | <u>(\$1,700)</u>        | <u>(\$1,700)</u>        |
| <b>Health Impact Fund Net Total</b>           | \$1,600                 | \$1,800                 | \$1,900                 | \$2,000                 |
| <b>Natural Resources and Arts Funds Total</b> | (\$40)                  | (\$40)                  | (\$40)                  | (\$40)                  |
| <b>Total – All Funds</b>                      | \$2,760                 | \$3,160                 | \$3,460                 | \$3,760                 |

Effective July 1, 2011.

### EXPLANATION OF THE BILL

The bill makes changes to cigarette and tobacco definitions. The current law definition of cigarettes is any roll for smoking made wholly or in part of tobacco, the wrapper or cover of which is made of paper or another substance or material, except tobacco. Cigarettes are taxed on a per pack basis - the cigarette excise tax of 48¢ per pack, the cigarette health impact fee of 75¢ per pack, the cigarette in-lieu of sales of 34.6¢ per pack, and the cigarette non-settlement fee of 35¢ per pack. Cigarettes weighing more than 3 pounds per thousand have a cigarette excise tax of 96¢ per pack, cigarette health impact fee of \$1.50 per pack, a proportionally adjusted cigarette sales tax rate, and the 35¢ per pack non-settlement fee.

The definition of tobacco products specifically includes a variety of tobacco items including little cigars. Tobacco products other than cigarettes are subject to the tobacco products excise tax of 35% of the wholesale price and the tobacco products health impact fee of 35% of the wholesale price.

The bill expands the definition of cigarettes to include any roll for smoking made wholly or in part of tobacco weighing 4.5 pounds or less per thousand and changes the wrapper definition to include items wrapped in any substance containing tobacco which, because of the appearance, size, packaging, pricing, marketing, or labeling is likely to be offered to or purchased by consumers as a cigarette.

## **EXPLANATION OF THE BILL (Cont.)**

The primary effect of the proposal is to tax little cigars as cigarettes. The tobacco products excise tax and fee of 70% of the wholesale price and the sales and use tax on other tobacco products would be replaced with individual pack charges currently placed on cigarettes. As proposed to be amended, “little cigars” would be removed from the definition of tobacco products.

The bill requires that the Commissioner of Revenue report to the 2012 Legislature on the tobacco tax collection system. The report is to provide information and guidance to the Legislature on possible improvements to the tobacco tax collection system, including recommendations that will increase compliance. A general fund appropriation of \$100,000 is provided in the proposed amendment.

## **REVENUE ANALYSIS DETAIL**

- The February 2011 forecast amounts are used.
- National production numbers indicate that little cigar production is about 2.5% of cigarette production.
- For fiscal year 2012, sales of 235,600,000 packs of cigarettes are estimated under current law.
- An elasticity of -0.35 is assumed.
- Little cigar prices are assumed to grow at 2% per year. This is consistent with cigarette price growth.
- Wholesale brand, price, and market share information is based on wholesale distributor data provided by the Minnesota Department of Revenue – Special Taxes Division. Information on sixteen brands of little cigars was reviewed to estimate price and market share.
- The current expected weighted average Minnesota excise tax and fee on little cigars is estimated to be 57¢ per pack based on price information and the current 70% fee and tax. The weighted average retail price of the little cigar brands is estimated to be \$1.73 per pack in fiscal year 2012.
- Relative to the increased product price, elasticity assumptions indicate that the tax on 2,560,000 packs of little cigars would be affected in fiscal year 2012.
- It is assumed that producers of little cigars would continue to be subject to the federal tax of 52.75% on this product. This requires that the weight of the product be greater than 3 pounds per thousand. Cigarettes that weigh more than 3 pounds per thousand have a Minnesota tax of 96¢ per pack and a fee of \$1.50 per pack.
- It is assumed that little cigars would be subject to the 35¢ per pack non-settlement fee.
- The impact of the changes on cigarette and tobacco tax refunds is minimal.
- No adjustment is made for market behavior prior to the implementation date of July 1, 2011.
- Fiscal year 2012 is adjusted for 11 months of collections.

**Number of Taxpayers:** There are approximately 160 wholesalers of other tobacco products and 60 wholesalers of cigarettes in Minnesota. Also, about 9,000 retailers of tobacco products.

Source: Minnesota Department of Revenue  
Tax Research Division  
[http://www.taxes.state.mn.us/taxes/legal\\_policy](http://www.taxes.state.mn.us/taxes/legal_policy)