

MINNESOTA • REVENUE

CIGARETTE AND TOBACCO TAXES Rate Changes Little Cigars Classified as Cigarettes

February 6, 2013

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue

Analysis of H.F. 91 (Lenczewski) As Proposed to be Amended (H0091A2)

	Fund Impact			
	<u>F.Y. 2014</u>	<u>F.Y. 2015</u>	<u>F.Y. 2016</u>	<u>F.Y. 2017</u>
	(000's)			
Cigarettes				
Excise Tax Rate Increase	\$321,100	\$352,600	\$354,800	\$356,500
Floor Stocks Tax	\$30,400	\$0	\$0	\$0
In-Lieu Cigarette Sales Tax 6.875%	(\$1,400)	(\$1,600)	(\$1,900)	(\$2,100)
Nonsettlement Fee	\$30	\$30	\$30	\$30
Other Tobacco Products				
Excise Tax Rate Increase and Minimum	\$19,600	\$21,400	\$22,400	\$23,500
Sales Tax	\$600	\$600	\$600	\$600
Little Cigars				
Cigarette Excise Tax	\$9,700	\$10,500	\$10,300	\$10,200
Other Tobacco Products Excise Tax	(\$1,900)	(\$2,100)	(\$2,100)	(\$2,100)
Sales Tax on Other Tobacco Products	(\$800)	(\$800)	(\$800)	(\$800)
In-Lieu Cigarette Sales Tax	\$1,500	\$1,700	\$1,700	\$1,700
Nonsettlement Fee	\$1,400	\$1,500	\$1,500	\$1,500
Cigarette and Other Tobacco Refunds	(\$200)	(\$200)	(\$200)	(\$200)
Appropriation to Commissioner of Revenue	<u>(\$100)</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
General Fund Total	\$379,930	\$383,630	\$386,330	\$388,830
Cigarettes – Repeal of Health Impact Fee	(\$156,700)	(\$169,200)	(\$167,200)	(\$165,200)
Other Tobacco Products – Repeal of Fee	<u>(\$25,900)</u>	<u>(\$29,500)</u>	<u>(\$30,600)</u>	<u>(\$31,900)</u>
Health Impact Fund Total	(\$182,600)	(\$198,700)	(\$197,800)	(\$197,100)
Sales Tax on Other Tobacco Products	\$30	\$30	\$30	\$30
Sales Tax on Little Cigars	<u>(\$40)</u>	<u>(\$40)</u>	<u>(\$40)</u>	<u>(\$40)</u>
Natural Resources and Arts Funds	(\$10)	(\$10)	(\$10)	(\$10)
Total – All Funds	\$197,320	\$184,920	\$188,520	\$191,720

Effective July 1, 2013

EXPLANATION OF THE BILL

Cigarettes

The bill repeals the 75¢ per pack cigarette health impact fee. The cigarette tax increases from the current rate of 48¢ per pack to \$2.83 per pack. This is an increase of \$1.60 per pack from the current total tax and fee of \$1.23 to a tax of \$2.83 per pack. *As proposed to be amended*, the cigarette tax is indexed based on the in-lieu sales tax rate calculations. The proposal includes a floor stocks tax on current inventories of \$1.60 per pack on cigarettes.

The cigarette sales tax is adjusted for retail price changes due to the excise tax rate change. The cigarette sales tax rate is changed from 6.5% to 6.875%.

Also, the nonsettlement fee increases from 35¢ per pack to 50¢ per pack.

Tobacco Products

The bill repeals the 35% tobacco products health impact fee. The tobacco products excise tax increases from the current rate of 35% of the wholesale price to 95% of the wholesale price. The previous total tax and fee on tobacco products of 70% changes to a tax of 95% of the wholesale price.

The bill creates a minimum tax for each container of moist snuff equal to the rate imposed on a pack of cigarettes. *As proposed to be amended*, the minimum tax would not also apply to loose or other types of tobacco.

Little Cigars

The proposal expands the definition of cigarettes to include any roll for smoking made wholly or in part of tobacco that weighs 4.5 pounds or less per thousand wrapped in any substance containing tobacco, however labeled or named, which, because of its appearance, size, the type of tobacco used in the filler, or its packaging, pricing, marketing, or labeling, is likely to be offered to or purchased by consumers as a cigarette, unless it is wrapped in whole leaf tobacco and does not have a cellulose acetate or other cigarette-like filter. Little cigars are removed from the definition of tobacco products. The primary effect of the wording changes is to tax little cigars as cigarettes. The tobacco products excise tax and fee on the wholesale price and the sales and use tax on other tobacco products would be replaced with the cigarette excise tax of \$2.83, the cigarette in-lieu of sales tax, and the cigarette non-settlement fee of 50¢.

Tobacco Tax Collection Report

The bill requires that the Commissioner of Revenue report to the 2014 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 for fiscal year 2014.

REVENUE ANALYSIS DETAIL

Cigarettes

- The cigarette collection amounts are from November 2012 forecast.
- For fiscal year 2014, sales of 226,670,000 packs of cigarettes are estimated. For the \$1.60 per pack net increase, an elasticity factor of -0.950 is applied and reduces the number of packs sold by 64,790,000 to 161,880,000.
- A weighted average retail price per pack of \$6.12 (including the in-lieu sales tax) is estimated for fiscal year 2014. An annual growth factor of 2% is used to estimate the weighted average price in subsequent years.
- The cigarette floor stocks tax is based on 19 million packs.
- The cigarette tax is indexed at an estimated 2% annually, with no elasticity adjustments.

Tobacco Products – Excise Tax Rate Increase to 95% and Minimum Tax for Moist Snuff

- The tobacco products collection amounts are from the November 2012 forecast. For fiscal year 2014, tobacco tax and fee collections of \$57,200,000 are forecast.
- For fiscal year 2014, it is estimated that there will be 25,247,000 tins of moist snuff sold in Minnesota at an average wholesale price of \$2.00 (excluding the state excise tax) for total excise tax collections of sales of moist snuff are estimated at \$35,345,800.
- The estimate includes a reduction for little cigars that were previously taxed in the other tobacco products category that will now be taxed as cigarettes.
- The balance of other tobacco products revenues (\$18,941,100 net of little cigar revenues) are received from a variety of products including cigars, chewing tobacco, pipe tobacco, roll-your-own tobacco, lozenges, e-cigarettes, etc.
- An elasticity factor of -0.60 was applied for changes in consumption for both moist snuff and all other tobacco products.

Little Cigars

- November 2012 forecast amounts are used. National data indicate that little cigar production is about 3% of cigarette production. It is estimated that 6,800,000 packs of little cigars would be sold in fiscal year 2014.
- The wholesale price of little cigars is assumed to be 85¢ per pack of 20 in fiscal year 2014.
- Little cigar prices are assumed to grow at 2% annually (consistent with cigarette price growth).
- Little cigars are currently being produced at a weight of over three pounds per thousand and are subject to a federal excise tax at the large cigar rate of 52.75% of the sales price. For little cigars that are three pounds per thousand or less, the federal tax rate is \$1.01 per pack (equal to the federal cigarette rate). It is assumed that the industry would continue to sell little cigars that are over three pounds per thousand, so the federal tax is 52.75% and the state tax rate would be \$5.66 under the proposal.

REVENUE ANALYSIS DETAIL (Cont.)

- For this proposal, little cigars would be considered cigarettes since they weigh 4.5 pounds or less per thousand. The tax rate is \$2.83 for cigarettes that are not more than three pounds per thousand, but \$5.66 for cigarettes over three pounds per thousand.
- The proposal would increase the price per pack of little cigars to be closer to the average price per pack of cigarettes. The significant increase in product price limits the use of elasticity factors.
- It is assumed that the little cigar market would be reduced to 10% of the current market, 35% of the market would substitute cigarettes for little cigars, and 55% of the little cigar retail market would be lost due to consumption reductions.
- It is assumed that little cigars, now defined as cigarettes, would be subject to the increased non-settlement fee of 50¢ per pack.

All Estimates

- The fiscal year 2014 sales and excise tax estimates are adjusted for 11 months of collections.

Number of Taxpayers: There are approximately 175 wholesalers of other tobacco products and 50 wholesalers of cigarettes in Minnesota. Also, there are about 9,000 retailers of tobacco products.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.revenue.state.mn.us/research_stats/Pages/Revenue-Analyses.aspx