Representative Bob Herron

Rep.Bob.Herron@legis.state.ak.us

State Capitol • Juneau, Alaska 99801-1182
Phone: (907) 465-4942 • Fax: (907) 465-4589

House District 38
Kuskokwim & Johnson Rivers
Kuskokwin Bay & Nelson Island

Akiachak
Akiak
Atmautluak
Bethel
Chefornak
Eek
Goodnews Bay
Kasigluk
Kipnuk
Kongiganak
Kwethluk
Kwigillingok
Lower Kalskag
Mekoryuk
Mertarvik
Napakiak
Napaskiak
Newtok
Nightmute
Nunapitchuk
Oscarville
Platinum
Quinhagak
Toksook Bay
Tuluksak
Tununak
Tuntutuliak
Upper Kalskag

Sponsor Statement

House Bill 188: Taxation on Moist Snuff Tobacco

"An Act relating to the taxation of moist snuff tobacco, and amending the definition of 'tobacco product' in provisions levying an excise tax on those products."

HB 188 changes the state tax methodology used for smokeless tobacco products to one that is more stable for state revenues and equal across similar weighted products regardless of price. The current ad valorem tax on smokeless products has the effect of increasing the price disparity between premium and discount brands. It can be argued, therefore, that discount products gain an unfair price advantage over premium products under an ad valorem tax regime. Already the federal government and 15 states now use the weight-based method for smokeless product taxation – 13 of those states have changed to weight-based in the last 9 years.

A weight-based taxation system will produce additional state revenue. Taxing all smokeless products at the equivalent that premium products are currently assessed will result in greater tax revenue for the state government. According to the National Association of Convenience Stores, "Evidence from a 2007 analysis documented that states that had converted to a weight-based method (New Jersey, Rhode Island, and Vermont) realized immediate gains averaging nearly 32 percent."

HB 188 levels the tax playing field. Under the current ad valorem rate, discount brands pay less in taxes for each unit, which is one of the reasons discount brands have grown their share from 4% to 36% of the market in the last four years. Under HB 188, these products would be taxed at the same rate as higher priced premium products.

Additionally, according to the American Lung Association, "Increasing excise taxes on tobacco products is a proven way to reduce use, particularly among kids."

Other consumer products are already taxed by a per unit method in the state, such as gasoline, alcohol and cigarettes. HB 188 would make the taxation of smokeless products consistent with these other consumer products, and close the existing tax loophole the state provides to discount products.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM March 19, 2009

SUBJECT: Sectional summary for CSHB 188(HSS), Draft Version "S" (Work Order No. 26-LS0714\S)

TO: Representative Bob Herron
Co-chair of the House Health & Social Services Committee
Attn: Rob Earl

FROM: Donald M. Bullock Jr.
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1. Amends AS 43.50.300 to acknowledge the rates of tax are moved to AS 43.50.300(b), a new subsection added by sec. 2 of the bill.

Section 2. Provides a tax rate on moist snuff tobacco of $1.88 multiplied by the number of ounces, including fractions of an ounce. Continues the tax rate of 75 percent of the wholesale price on other tobacco products.

Section 3. Requires the monthly reporting of the number of ounces of moist snuff sold, the amount of tax imposed on moist snuff tobacco, and the amount of tax imposed on tobacco products other than moist snuff tobacco.

Section 4. Amends the definition of "tobacco product" in AS 43.50.390(4) to specifically include moist snuff tobacco.

Section 5. Adds a definition for "moist snuff tobacco" to AS 43.50.390.

Section 6. Makes secs. 1 - 5 of the Act applicable starting on the first day of the month immediately following the effective date of the Act.

DMB:ljw
09-170.ljw

HOUSE BILL NO. 188

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-SIXTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE HERRON

Introduced: 3/12/09
Referred: Health and Social Services, Labor and Commerce, Finance

A BILL

FOR AN ACT ENTITLED

"An Act relating to the taxation of moist snuff tobacco, and amending the definition of 'tobacco product' in provisions levying an excise tax on those products."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** AS 43.50.300 is amended to read:

Sec. 43.50.300. Excise tax levied. An excise tax is levied on tobacco products in the state at the **rate in (b) of this section** [RATE OF 75 PERCENT OF THE WHOLESALE PRICE OF THE TOBACCO PRODUCTS]. The tax is levied when a person

(1) brings, or causes to be brought, a tobacco product into the state from outside the state for sale;

(2) makes, manufactures, or fabricates a tobacco product in the state for sale in the state; or

(3) ships or transports a tobacco product to a retailer in the state for sale by the retailer.

* **Sec. 2.** AS 43.50.300 is amended by adding a new subsection to read:

(b) The excise tax rate on

(1) moist snuff tobacco is $1.88 multiplied by the number of ounces of moist snuff tobacco, including fractions of an ounce;

(2) tobacco products other than moist snuff tobacco is 75 percent of the wholesale price of the tobacco product.

* **Sec. 3.** AS 43.50.330(a) is amended to read:

(a) On or before the last day of each calendar month, a licensee shall file a return with the department. The return must state the number or amount of tobacco products **<u>including the number of ounces of moist snuff tobacco</u>** sold by the licensee during the preceding calendar month, the selling price of the tobacco products, [AND] the amount of tax imposed on [THE] tobacco products **<u>other than moist snuff tobacco, and the amount of tax imposed on moist snuff tobacco</u>**.

* **Sec. 4.** AS 43.50.390(4) is amended to read:

(4) "tobacco product" means

(A) a cigar;

(B) a cheroot;

(C) a stogie;

(D) a perique;

(E) snuff **<u>tobacco, including moist snuff tobacco,</u>** and snuff flour;

(F) smoking tobacco, including granulated, plug-cut, crimp-cut, ready-rubbed, and any form of tobacco suitable for smoking in a pipe or cigarette;

(G) chewing tobacco, including cavendish, twist, plug, scrap, and tobacco suitable for chewing; or

(H) an article or product made of tobacco or a tobacco substitute, but not including a cigarette as defined in AS 43.50.170;

* **Sec. 5.** AS 43.50.390 is amended by adding a new paragraph to read:

(6) "moist snuff tobacco" means any finely cut, ground, or powdered tobacco that is not intended to be

(A) smoked; or

(B) placed in the nasal cavity.

* **Sec. 6.** The uncodified law of the State of Alaska is amended by adding a new section to read:

APPLICABILITY. Sections 1 - 5 of this Act are applicable starting on the first day of the month immediately following the effective date of this Act.

Alaskans for Tobacco-Free Kids

American Cancer Society Cancer Action Network, American Heart Association, American Lung Association of Alaska, AARP

March 24, 2009

Statement for House Bill 188: Taxation on Moist Snuff Tobacco

Alaskans for Tobacco-Free Kids is a coalition of organizations committed to reducing tobacco's effects on youth. Our coalition membership includes AARP, the American Cancer Society Cancer Action Network, the American Heart Association, and the American Lung Association of Alaska. We support efforts and strategies to reduce tobacco use, especially among our youth.

Smokeless tobacco use causes serious harm, including gum disease, and a substantially increased risk of oral cancer. Even more tragic, use during youth can lead to a lifetime of addiction to smokeless tobacco, or, frequently, to cigarettes, as nicotine addiction created by smokeless use can ultimately lead to habitual smoking.

We applaud efforts to keep tobacco products away from youth and know that tobacco taxes are one of the most effective ways to reduce the number of youth who ever start using tobacco. That said, our coalition has serious concerns with the specific provisions of House Bill 188. Primarily, weight-based taxes have been shown to increase youth use and over time, will hurt state revenues.

Weight-based taxation has been promoted by manufacturers of premium moist snuff products as a strategy to reduce the effective tax on their products, particularly the new generation of ultra low-weight products. At the same time, weight-based taxation systems increase the effective tax on lower-priced brands. This is particularly harmful to Alaskans as the vast majority of youth who use smokeless tobacco use the higher-priced premium brands. By lowering the price on the smokeless tobacco products most popular with youth, shifting to a weight-based tax could increase smokeless tobacco use among youth.

Taxing by weight also provides a massive tax break to the new generation of smokeless tobacco products that can weight as little as one-tenth as much as the standard smokeless products.

Over time, shifts to a weight-based tax dramatically reduce the portion of state revenues gained from the smokeless tax. Fixing the monetary tax rate in a weight-based system will erode over time as inflation and product prices increase.

Unlike weight-based taxes, our current ad valorem tax rate automatically increases with inflation and other tobacco products price increases which protect the state's tax rate and revenue from eroding over time.

Alaskans for Tobacco-Free Kids supports and advocates the best way to tax smokeless tobacco is with our current ad valorem system. If Alaska wants more revenue from its smokeless tobacco products, we should simply raise our percentage-of-price rate.

Emily Nenon
Alaska Government Relations Director
American Cancer Society Cancer Action Network

Chris Sherwin
Director of Advocacy, Pacific Mountain Affiliate
American Heart Association

Carrie Nyssen
Senior Director of Advocacy
American Lung Association of the Northwest

Pat Luby
State Director, Advocacy
AARP

Recent MST Price Reductions Will Result in Revenue Loss in Ad Valorem States

On Tuesday, March 10, 2009, Conwood Company LLC announced a price reduction on Kodiak and Hawken. On Wednesday, March 4, 2009, US Smokeless Tobacco Company announced a price reduction on Copenhagen, Skoal and Red Seal and a price increase on Husky. The table below shows these price changes.

	Current Wholesale Price	New Wholesale Price	Price Change
Kodiak	$3.11	$2.39	($0.72)
Hawken	$3.11	$2.39	($0.72)
Copenhagen	$3.01	$2.39	($0.62)
Skoal	$3.01	$2.39	($0.62)
Red Seal	$2.02	$1.75	($0.27)
Husky	$1.35	$1.55	$0.20

In states that use an ad valorem excise tax methodology for MST, price reductions will result in an immediate reduction in MST excise tax revenues. The Alaska ad valorem rate is 75%. The annual revenue reduction is estimated in the chart below.[1]

Estimated Ad Valorem MST Tax Revenue Reduction for 2009

	Price Change Per Can	Cans Sold	Revenue Change
Kodiak and Hawken	($0.72)	183,000	($99,000)
Copenhagen and Skoal	($0.62)	1.45 million	($676,000)
Red Seal	($0.27)	12,000	($2,000)
Husky	$0.20	100,000	$15,000
Total			**($762,000)**

If Alaska converted to a weight-based taxation methodology, state revenues would not be dependent on the pricing decisions in the marketplace, including manufacturer discounts or promotions. However, because Alaska taxes MST based on price, rather than on weight, the state will lose an estimated $762,000 in excise tax revenue per year.

Weight-based taxes protect states from loss of revenue that can follow price reductions or promotional activity in ad valorem states. With an ad valorem tax, the state's revenues depend not only on the volume of sales, but also on pricing decisions of the manufacturers -- which leads to less stability in tax revenue collections. Under a weight-based methodology, every 1.2 ounce can pays the same excise tax to the state, regardless of pricing.

A weight-based MST tax methodology creates a stable and predictable stream of MST tax revenue for the state.

[1] USSTC RAD sales database. Cans sold is an estimate based on wholesaler reporting. It covers 2008. The revenue loss was estimated by multiplying the price reduction per can, the volume of cans for the affected brands and the ad valorem tax rate. We assume no changes in volume for 2009 for purposes of this estimate.

FISCAL NOTE

STATE OF ALASKA
2009 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **HB 188**
() Publish Date:

Identifier (File Name): HB188-DOR-TAX-03-23-09
Title: **Tax on Moist Snuff**
Sponsor: **Representative Herron**
Requester: **(H) Health & Social Services**

Dept. Affected: Revenue 04
RDU: **Taxation and Treasury**
Component: Taxation and Treasury
Component No. **2476**

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2010**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
Personal Services	24.2	0.0	24.2	24.2	24.2	24.2	24.2
Travel	0.5	0.0	0.5	0.5	0.5	0.5	0.5
Contractual	186.2	0.0	1.2	1.2	1.2	1.2	1.2
Supplies	0.2	0.0	0.2	0.2	0.2	0.2	0.2
Equipment							
Land & Structures							
Grants & Claims							
Miscellaneous							
TOTAL OPERATING	**211.1**	**0.0**	**26.1**	**26.1**	**26.1**	**26.1**	**26.1**
CAPITAL EXPENDITURES	**0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CHANGE IN REVENUES ( )	*	**0.0**	*	*	*	*	*

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF	211.1	0.0	26.1	26.1	26.1	26.1	26.1
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	**211.1**	**0.0**	**26.1**	**26.1**	**26.1**	**26.1**	**26.1**

Estimate of any current year (FY2009) cost: **0**

POSITIONS

Full-time	0.25	0	0.25	0.25	0.25	0.25	0.25
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

See Attached.

Prepared by: **Johanna Bales/Dan Stickel**
Division: Tax
Phone: 907-269-6628
Date/Time: 3/20/09 4:01 p.m.

Approved by:
Agency:
Date:

(Revised 9/2008 OMB)

FISCAL NOTE

STATE OF ALASKA
2009 LEGISLATIVE SESSION

BILL NO. HB 188

ANALYSIS CONTINUATION

Bill Language:
Alaska levies a tax on other tobacco products (OTP) at the rate of 75% of the wholesale cost. OTP includes any product containing tobacco that is not a cigarette. Moist snuff is one of many tobacco products upon which the OTP tax is currently levied. This bill will change the tax on moist snuff from an ad valorem tax (tax based on value) to a tax based on weight. All other tobacco products will continue to be taxed at the rate of 75% of the wholesale cost. Moist snuff will be taxed at the rate of $1.88 per ounce. Moist snuff is defined as any finely cut, ground, or powdered tobacco that is not intended to be smoked or placed in the nasal cavity.

Revenues:
If Alaska had levied a tax on moist snuff at the rate of $1.88 during fiscal year 2008 and consumption was not affected by the tax increase, total tobacco products tax revenue would have been approximately $1.1 million more than what was collected . Historically, Alaska and other states have seen a drop in consumption of taxable cigarettes and other tobacco products when the tax rate is increased. This drop is due to a decrease in consumption as product price increases (price elasticity) and a decrease in taxable consumption as consumers turn to the Internet, mail order, or other means to purchase non-taxed product. The OTP tax is not levied on tobacco products, including moist snuff, that is imported into the state for personal consumption. It is legal for an individual to purchase other tobacco products off the Internet or through the mail without paying the tobacco products tax.

Based on an analysis of tax returns, the wholesale price of the most popular lower-priced brands in FY 2008 averaged $1.03 per ounce. The average tax under the current tax structure in FY 2008 was $.77 per ounce for a total average cost of $1.80. Under the proposed weight-based tax, the total average cost would be $2.91 per ounce, a 61% increase. Lower cost moist snuff products have an approximate 35% market share in Alaska. This market share has been increasing over the last few years as consumers continually look for cheaper products. It is expected that many of these consumers will turn to the Internet for moist snuff once the price of the product increases due to the increase in tax. This will, in turn, reduce the amount of revenue expected from this tax increase. Due to price elasticity and the unknown number of consumers who will turn to tax free Internet product, it is difficult to determine the change in revenues as a result of this legislation.

Expenditures:
This bill would require the Department of Revenue to add an additional tax program requiring a new tax return and license for other tobacco products. Collections, examination and compliance can be handled using existing staff. We anticipate requiring one-quarter of an Analyst Programmer IV (Range 20) for reprogramming and maintenance of the related aspects of our tax database system. There will also be $185,000 in one-time startup expenses: $175,000 for adding the new program to our tax examination and licensing system, and $10,000 for education and communication with stakeholders as we implement the new tax program.

26-LS0714\S
Bullock
3/18/09

CS FOR HOUSE BILL NO. 188(HSS)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-SIXTH LEGISLATURE - FIRST SESSION

BY THE HOUSE HEALTH AND SOCIAL SERVICES COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE HERRON

A BILL

FOR AN ACT ENTITLED

"An Act relating to the taxation of moist snuff tobacco by weight; including moist snuff tobacco in the definition of 'tobacco product' in provisions levying an excise tax on those products; and defining 'moist snuff tobacco.'"

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** AS 43.50.300 is amended to read:

Sec. 43.50.300. Excise tax levied. An excise tax is levied on tobacco products in the state at the **rate in (b) of this section** [RATE OF 75 PERCENT OF THE WHOLESALE PRICE OF THE TOBACCO PRODUCTS]. The tax is levied when a person

(1) brings, or causes to be brought, a tobacco product into the state from outside the state for sale;

(2) makes, manufactures, or fabricates a tobacco product in the state for sale in the state; or

(3) ships or transports a tobacco product to a retailer in the state for

sale by the retailer.

* **Sec. 2.** AS 43.50.300 is amended by adding a new subsection to read:

(b) The excise tax rate on

(1) moist snuff tobacco is $1.88 multiplied by the number of ounces of moist snuff tobacco, including fractions of an ounce;

(2) tobacco products other than moist snuff tobacco is 75 percent of the wholesale price of the tobacco product.

* **Sec. 3.** AS 43.50.330(a) is amended to read:

(a) On or before the last day of each calendar month, a licensee shall file a return with the department. The return must state the number or amount of tobacco products **including the number of ounces of moist snuff tobacco** sold by the licensee during the preceding calendar month, the selling price of the tobacco products, [AND] the amount of tax imposed on [THE] tobacco products **other than moist snuff tobacco, and the amount of tax imposed on moist snuff tobacco**.

* **Sec. 4.** AS 43.50.390(4) is amended to read:

(4) "tobacco product" means

(A) a cigar;

(B) a cheroot;

(C) a stogie;

(D) a perique;

(E) snuff **tobacco, including moist snuff tobacco,** and snuff flour;

(F) smoking tobacco, including granulated, plug-cut, crimp-cut, ready-rubbed, and any form of tobacco suitable for smoking in a pipe or cigarette;

(G) chewing tobacco, including cavendish, twist, plug, scrap, and tobacco suitable for chewing; or

(H) an article or product made of tobacco or a tobacco substitute, but not including a cigarette as defined in AS 43.50.170;

* **Sec. 5.** AS 43.50.390 is amended by adding a new paragraph to read:

(6) "moist snuff tobacco" means any finely cut, ground, or powdered

tobacco that is not intended to be

(A) smoked; or

(B) placed in the nasal cavity.

* **Sec. 6.** The uncodified law of the State of Alaska is amended by adding a new section to read:

APPLICABILITY. Sections 1 - 5 of this Act are applicable starting on the first day of the month immediately following the effective date of this Act.

Alaska Tobacco Facts

January 2007 Update

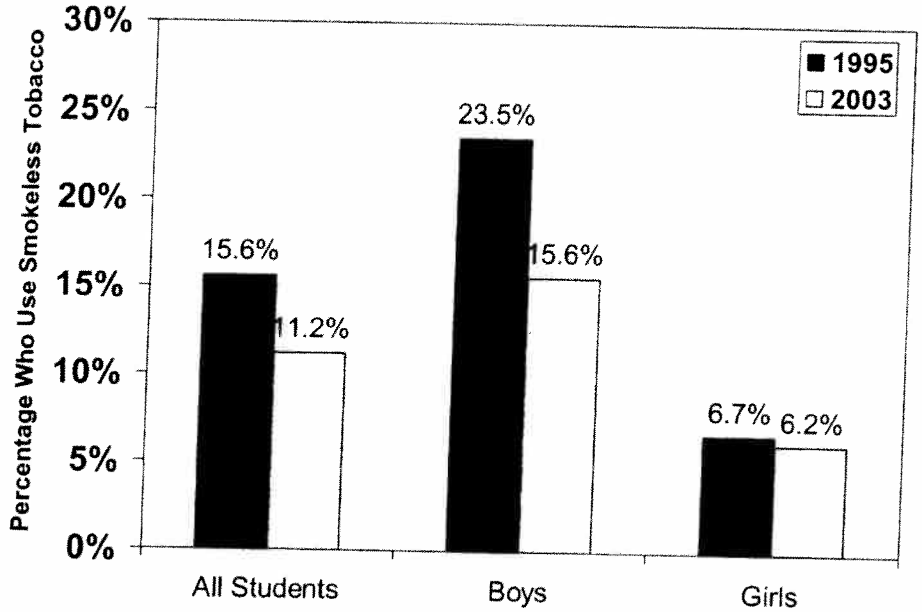
Sarah Palin, Governor
Karleen Jackson, PhD, Commissioner
Deborah Erickson, Acting Director
Tammy Green, MPH, Section Chief

Suggested Citation:
http://www.hss.state.ak.us/dph/chronic/tobacco/pdf/tobacco_facts.pdf

8. Youth Smokeless Tobacco Use

Percentage of High School Students Who Use Smokeless Tobacco, by Sex and Year

Alaska, 1995 & 2003

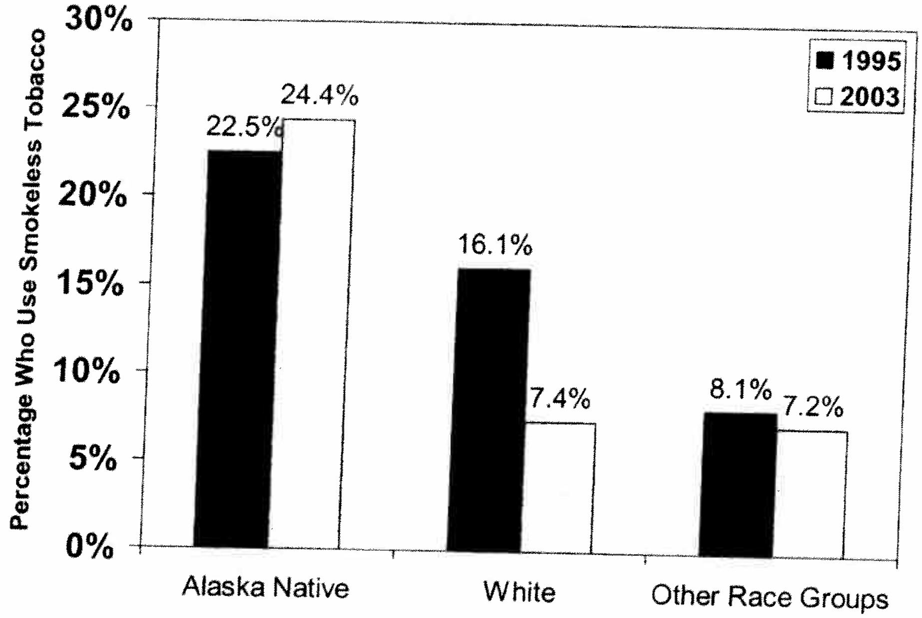


Source: Alaska Youth Risk Behavior Survey

- Overall, use of smokeless tobacco among high school students dropped from 15.6% in 1995 to 11.2% in 2003; this was largely due to the decline in boys' use of smokeless tobacco during this time.
- In 2003, nearly 4,400 high school students used smokeless tobacco.

Percentage of High School Students Who Use Smokeless Tobacco, by Race and Year

Alaska, 1995 & 2003



Source: Alaska Youth Risk Behavior Survey

- The largest drop in youth smokeless tobacco rates between 1995 and 2003 was seen among White students.

The Effect of Federal Tobacco Tax Increases on Alaska's Tobacco Taxes

Prepared by: Johanna Bales

Alaska levies an excise tax on cigarettes and on other tobacco products (OTP). The tax rates, tax calculation, and how the tax is levied differ between cigarettes and OTP. The following outlines those differences and the effect of recent federal tobacco tax increases on Alaska tobacco taxes:

Cigarette Tax

Alaska's cigarette tax is levied on each cigarette. The tax is currently 10 cents per cigarette or $2.00 per pack of twenty cigarettes. The tax is levied when cigarettes are brought into the state for sale or personal consumption. What this means is that if an individual buys cigarettes over the Internet or has friends or family ship cigarettes to them through the mail, they are liable to pay the Alaska tax. The federal tax was 39 cents per pack, but is now $1.01 per pack of twenty. The increase in the federal tax does not affect Alaska's tax rate. However, it can and probably will affect revenue as people either quit smoking or cut back due to the higher cost of cigarettes that will result from the federal increase. We also expect smuggling to increase in all states, including Alaska, which will also cut into Alaska's cigarette tax revenue.

Other Tobacco Products (OTP)

Alaska's OTP tax is levied at the rate of 75% of the wholesale price of the tobacco product. OTP includes little cigars, cigars, pipe tobacco, chewing tobacco, snuff, roll-your-own tobacco, etc. Basically, anything other than a cigarette that has tobacco in it. The tax is levied when OTP is brought into the state for sale. It is important to note, the OTP tax is not levied when OTP is brought into the state for personal consumption. The wholesale price is defined in statute as the "established price for which a manufacturer sells a tobacco product to a distributor . . . ." This is basically the manufacturer's list price.

The federal law increased many OTP products significantly. For example, the tax on little cigars increased from 4 cents per pack to $1.01 per pack of twenty. Chewing tobacco increased from 19.5 cents to 50.33 cents per pound and roll-your-own tobacco increased from $1.0969 to $24.78 per pound. The federal tax is paid by the manufacturer. Therefore, the manufacturer's list price will increase to reflect the increases in the federal tax. Even though our tax rate of 75% of the wholesale cost remains the same, the amount upon which the 75% is multiplied will be significantly higher. As such, Alaska's tax on OTP will also increase.

Will people start buying roll-your-own and other OTP from states without a tax? Most states have a tax, but if the product is exported from the state that state's tax doesn't apply. The question should be, "will people start buying roll-your-own and other OTP from Internet sellers?" The answer is, "yes." When Alaska increased the tax on OTP in 1997 from 25% to 75% of the wholesale cost, we did see an increase in people buying OTP through the mail. It is perfectly legal for them to do so since the OTP tax is only levied when OTP is imported or brought into the state for sale. With the increase in the federal tax and resultant increase in the Alaska tax, we will definitely see individuals and possibly even businesses purchasing OTP from Internet sites and through the mail. This will result in lost revenue to the state.

When Alaska increased its cigarette tax during a special legislative session in the summer of 2004, a couple of legislators tried to insert language that made it so the OTP tax was levied on individuals who imported OTP for personal consumption. Their concern was that local businesses which sell OTP were unable to compete with Internet sellers because it was legal for individuals to buy through the mail and

Internet without paying Alaska's tax, but the local retailer had to pay the tax. I think this will be even more of an issue now that the federal tax has significantly increased and the Alaska tax will be even more.

Alaska's cigarette and OTP tax rates are set in statute. The Department of Revenue has no authority to change the tax rates.

One other thing to note is that the federal law provides for a floor stock tax. What this means is that every distributor and retailer in the state must identify their inventory as of April 1, 2009 and pay the difference between the new and old federal tax rates to the federal government by August 1, 2009. Alaska does not have a floor stock tax. Even though distributors and retailers must remit the higher tax on their inventory to the federal government, the Alaska tax on OTP will be based on the manufacturer's list price at the time the product was imported into the state for sale.

Attached is the new federal language with a chart showing the changes in the federal tax rates by product.

CAMPAIGN for TOBACCO-FREE Kids

THE BEST WAY TO TAX SMOKELESS TOBACCO IS WITH A PERCENTAGE-OF-PRICE TAX

[Weight-Based Taxes Hurt State Revenues and Increase Youth Use]

The most common practice among the states is to tax smokeless tobacco, cigars, pipe tobacco, and the various other tobacco products besides cigarettes at a percentage of their wholesale price (sometimes referred to as the manufactures price). These state flat taxes on other tobacco products (OTPs) range as high as 90 percent of wholesale price (in Massachusetts), with 26 states having non-cigarette tobacco tax rates of 20 percent of wholesale price or more.

A few states tax smokeless or moist snuff tobacco products on a per-weight basis. This approach has been pushed aggressively by UST, the largest U.S. smokeless tobacco manufacture, primarily to reduce the effective tax rates on the higher-priced premium products it sells – while raising the effective tax rates on the lower-priced smokeless products primarily sold by UST's competitors.[1] But UST's best-selling premium products (Copenhagen, Skoal) are also smokeless tobacco products most popular with youth; so reducing their taxes and prices would directly increase youth smokeless tobacco initiation and use, dooming even more kids to a lifetime of tobacco addiction, related harms, and premature death.[2]

Beyond the fact that establishing a per-weight tax for smokeless tobacco would favor UST, harm its competitors, and increase youth use, taxing all OTPs or all smokeless at a percentage of price is not only easier to administer but also better for state revenues.

- A single percentage-of-price tax rate treats all OTPs the same. In sharp contrast, it is impossible to have a single weight-based tax rate that could equitably apply to all OTPs or even just to all smokeless tobacco or moist snuff because of all of the different types, sub-types, styles, and weights per dose of the products and brands in each category. Consequently, establishing a per-weight system just for smokeless tobacco or just for moist snuff smokeless still entails figuring out different tax rates by weight for each different sub-type or style – and such new rates would have to be established whenever another new type, sub-type or style of tobacco product entered the smokeless or moist snuff market.
- Failing to have different weight-based tax rates for each different type or style of product within the smokeless or moist snuff categories would end up grossly under taxing lighter-weight products. Most importantly, the newest trend in smokeless moist snuff products is toward spit-less pre-packed single-dose tablets or pouches, such as Ariva and Stonewall lozenges, RJR's Camel Snus, Philip Morris's Marlboro Snus and UST's Skoal Dry. This new generation of smokeless moist snuff tobacco products weigh as little as one-tenth per dose compared to the standard moist snuff that comes in a can. Any switch to a weight-based tax would allow these emerging products to pay to almost nothing as they gain increasingly larger shares of the smokeless moist snuff market, thereby sharply reducing state revenues.
- Weighing each product to apply a weight-based tax accurately and equitably would also entail significant new costs. Alternatively, relying on the stated weights provided by manufacturers would open the door to potential abuses – and require periodic checks to confirm the accuracy of the stated weights. In contrast, the prices used by a percentage-of-price tax are clear, publicly available, and easy to confirm quickly.

---

[1] See American Lung Association, *Taxation of Smokeless Tobacco: Percentage of Price vs. Net Weight*, April 20, 2001, http://tobaccofreekids.org/research/factsheets/pdf/0175.pdf.

[2] Substance Abuse & Mental Health Services Admin., *Results from the 2005 National Survey on Drug use and Health*, Table 7.67B, http://oas.samhsa.gov/NSDUH/2k5nsduh/tabs/Sect7peTabs58to67.pdf.

- Unlike weight-based taxes, percentage-of-price tax rates automatically increase with inflation and other tobacco product price increases, thereby protecting the state's tax rate and revenues from being eroded over time. UST often packages its weight-based proposals so that they will purportedly bring in more revenues in the next couple of years. But the fixed monetary tax rate in a weight-based system will inevitably erode over time as inflation and product prices increase, producing substantially less state revenues than a parallel percentage-of-price tax. Accordingly, if a state wants more revenue from its smokeless or OTP taxes – over both the short and long term – it should simply raise its percentage-of-price rate or establish a reasonable minimum tax to reach those tobacco products with bargain-basement or predatory prices.

- Since most states tax non-cigarette tobacco products by percentage-of-price, having such a tax system for all OTPs allows a state to make quick and accurate comparisons against other states' OTP tax rates and related revenues. In addition, a single percentage-of-price tax for all OTPs establishes and maintains tax equity by ensuring that all OTPs pay the same flat tax rate. If smokeless moist snuff pays taxes by weight while other OTPs pay by price, tax inequities are certain to develop over time if not immediately.

- The percentage-of-price tax is a flat tax that applies the exact same percentage tax rate to each and every tobacco product and brand of tobacco product other than cigarettes. Just like with sales taxes, the actual tax amount paid on higher priced products will be larger than the amount for lower priced products. But the percentage tax rate on each product will stay exactly the same. In other words, those products priced to bring in the most revenues and profits will pay more per product that cheaper versions that bring in less revenue and profits. But each will pay the same flat percentage-of-price rate.

UST argues that a change to a weigh-based system is necessary to raise the effective tax rates on cut-rate smokeless tobacco products sold by their competitors. But predatory pricing and other below-market pricing practices could be addressed more effectively and appropriately through adding a minimum tax to a percentage-of-price tax and establishing smokeless tobacco product minimum price laws.[3]

UST's only legitimate claim about operating under a competitive disadvantage comes from UST currently being the only smokeless tobacco company that has signed onto the smokeless tobacco Master Settlement Agreement (STMSA). That competitive disadvantage could be eliminated, to the benefit of the states, by new state laws that penalize non-participating smokeless tobacco manufacturers that do not sign onto the STMSA, paralleling the state laws that do the same thing regarding nonparticipating manufacturers (NPMs) and the cigarette MSA. Such laws would level the playing field and either produce new payments to the states or get more smokeless manufacturers to sign onto the STMSA and comply with its various payment requirements and other requirements designed to reduce tobacco use by kids.[4]

Campaign for Tobacco-Free Kids, February 19, 2008 / Eric Lindblom

For more information, see the Campaign factsheets at http://tobaccofreekids.org/research/factsheets/pdf/0180.pdf and http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=18.

---

[3] The Campaign for Tobacco-Free Kids has model legislative language, available upon request, to establish a minimum tax in existing state percentage-of-price tobacco tax systems – or to modify existing or proposed weight-based tax systems for smokeless or moist snuff so that (like a percentage-of-price system) they keep up with inflation and product price increases, do not fail to tax low-weight products adequately, and better protect the public health. To get any of this model legislative text, please email elindblom@tobaccofreekids.org.

[4] Model legislation to establish such a STMSA NPM fee is also available from the Campaign for Tobacco-Free Kids. To get a copy of this model legislative text, please email elindblom@tobaccofreekids.org.

From: Jack Crow [Jack_Crow@ykhc.org]
Sent: Monday, March 09, 2009 4:27 PM
To: Rep. Bob Herron
Cc: Wole Fadahunsi
Subject: YKHC's Tobacco tax review
Attachments: Smokeless Tobacco Tax Policy.doc

Hi Bob. Attached is a brief write up that our Director of Community Health and Wellness, Wole Fadahunsi draft about the potential change to the smokeless tobacco tax. Good luck.

Jack Robert

Smokeless Tobacco Tax Policy

There is a current debate as to how best to tax smokeless tobacco products and currently two policies are practiced by the different states in the US. The majority tax these tobacco products by a system referred to as ad valorem while the rest tax by a per unit basis inline with what obtains at the Federal level. Alaska as a state currently taxes Moist Snuff Tobacco (MSF) products at a rate of 75% of wholesale price -- a ad valorem tax policy.

In order to answer the question about what the appropriate practice should be regarding the tax policy to be adopted it would be better to do this within a framework. There are a couple questions to be answered to arrive at a reasonable answer and these are:

1. Should smokeless tobacco be taxed at all,
2. What method should be adopted in taxing this product,
3. What is the appropriate level of taxation?

Should Smokeless Tobacco be Taxed?

The use of tobacco products has been shown to cause harm to the individual and other people around. This is quite evident with the issue of second hand smoke (SHS). But working from the framework that government is there to protect individuals from harming one another, and not necessarily to protect an individual from harming him/herself it can be argued that government has no business taxing MSF.

However, there are other costs that tobacco use imposes on the society as a whole and the most commonly cited are: increased healthcare burden to other taxpayers, the unattractiveness of witnessing someone use chew tobacco, and message children receive viewing adults use tobacco. Therefore, to the extent that tobacco use has a burden on the society as a whole these products should be taxed.

What method should be adopted in taxing MSF?

As earlier mentioned there are two methods of taxation for MSF currently in use. The ad valorem tax system places a tax on these products based on the sale price of these products. The per unit tax system places a tax on these products based on the standard unit of the product.

Those who have worked in the area of setting tax policy for smoke tobacco products understand that a unit of cigarette (one stick) does the same amount of damage (to the individual and society) notwithstanding the cost (premium or regular) of this stick of cigarette. As a result, smoked tobacco products are taxed on a per unit basis. As with MSF, the same is true- a unit weight of this product will do the same amount of damage to the individual and society without regard to its 'premium or regular status'.

Another argument in favor of taxation on a per unit basis is: when you tax ad valorem what obtains is that premium brands get more expensive relative to the cheaper products and this can be seen as government giving undue advantage to the cheaper products because what simply happens is that consumers of the product simply shift to using the cheaper products. But with a per unit taxation all tobacco products, without regards to their premium or regular class, are taxed evenly since they will cause the same amount of damage to individual and society. True to Jefferson's core principles, states should not be in the business of picking winners and losers, but should let the market decide free of discriminatory government intervention.

What is the appropriate level of taxation?

As a tax on MSF is designed to equalize the cost differential between the societal cost of use of the product and the individual cost a per unit basis of taxation should be adopted. The appropriate tax level should balance up these costs if the societal cost is greater than the individual cost. The problem policy makers have to solve before they can set the appropriate level of taxation is figuring out what these costs are (i.e. the societal and individual cost).

Relevant articles to consult:

- What Is Proper Tax Policy for Smokeless Tobacco Products? by Gerald Prante, as downloaded from http://www.taxfoundation.org/news/show/23045.html on 03/09/09
- Tax Policy: A Fair Deal for Smokeless Tobacco by Michael Keegan, as downloaded from http://www.alec.org/am/pdf/apf/apfmst.pdf on 03/09/09
- Economics of Tobacco Control and Tobacco Tax Policy by Hana Ross, PhD. as downloaded from http://www.tobaccoevidence.net/pdf/sea_activities/Laos_WB_evidence.pdf on 03/09/09

A Weight-Based Tax on Moist Smokeless Tobacco (MST)

Alaska

$1.88/ounce

March 2009

Altria

Altria Client Services Inc. (ALCS) Supports a Weight-Based Method of Taxation for MST

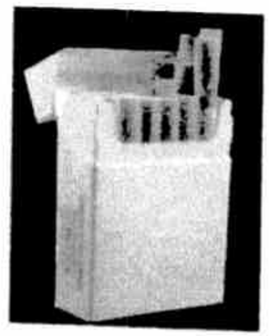
This legislation will:

- Tax MST consistently with other consumer products.
- Align Alaska's tax methodology with that of the federal government and 16 other states.
- Establish tax equity for MST products.
- Generate additional state MST tax revenues.
- Create a stable and predictable stream of MST tax revenue for the state.
- Reduce complexity and administrative burden on the state, wholesalers and retailers.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

A Weight-Based Tax is Consistent with State Excise Taxes on Other Products

MST	Cigarettes	Gasoline	Beer
		Premium  Regular	
[redacted]	Per Pack	Per Gallon	Per Barrel

An ad valorem tax method on consumer products is unusual. Unlike a sales tax, which is applied to the price of the product, an excise tax is a consumption tax. Its intent is to tax all like products uniformly. Product categories such as cigarettes, beer, wine and gasoline are taxed based upon unit, weight or volume. When taxing under a weight-based system, a state does not consider price points – the weight of the product determines the excise tax liability.

Altria

Information provided by Altria Client Services Inc. on behalf of
Philip Morris USA Inc. and US Smokeless Tobacco Company

A Weight-Based Tax Methodology Establishes Tax Equity for MST Products

An ad valorem system of taxation results in large variations in excise taxes:

- **The current ad valorem excise tax rate in Alaska is 75%.**
- **MST products of equal tobacco weight are priced differently throughout the smokeless tobacco category leading to large differences in taxes paid per unit.**
- **The current system, in effect, creates a tax break for lower-priced brands, resulting in an unfair advantage.**

A weight-based method of taxation does not favor one brand over another.

	Premium	Discount
Current Tax/1.2 oz. can	$2.39 * 75% = $1.79	$0.98 * 75% = $0.74
Weight-Based Tax/1.2 oz. can	$1.88/oz. * 1.2 oz. = $2.26	$1.88/oz. * 1.2 oz. = $2.26

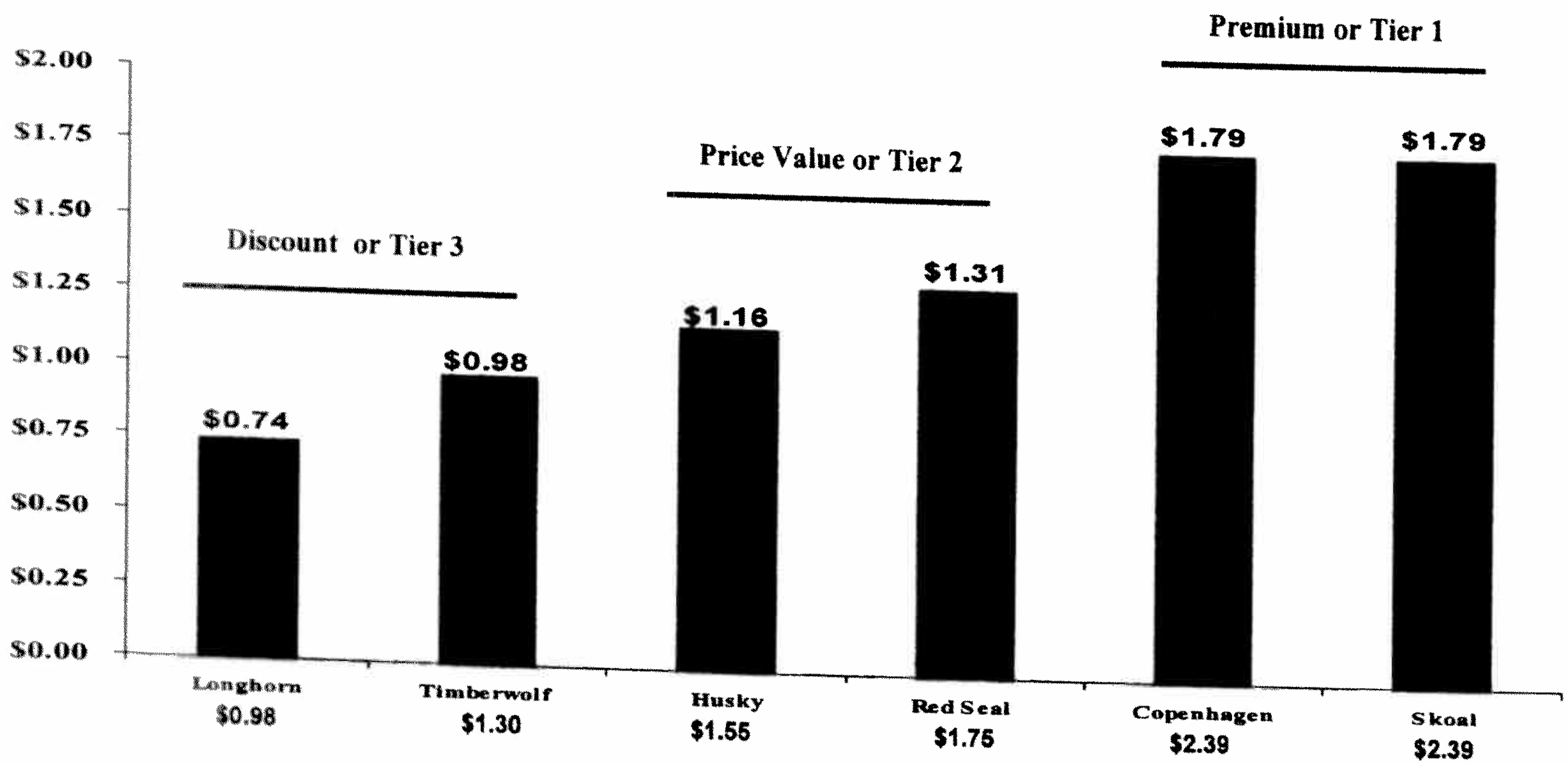
Source: Copenhagen was used as the premium brand and Longhorn was used as the discount brand. Effective March 29, 2009, the price of Copenhagen will be $2.39. As of March 11, 2009, the wholesale price of Longhorn was $0.98.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Effect of an Ad Valorem System

Equivalent products carry different tax burdens...



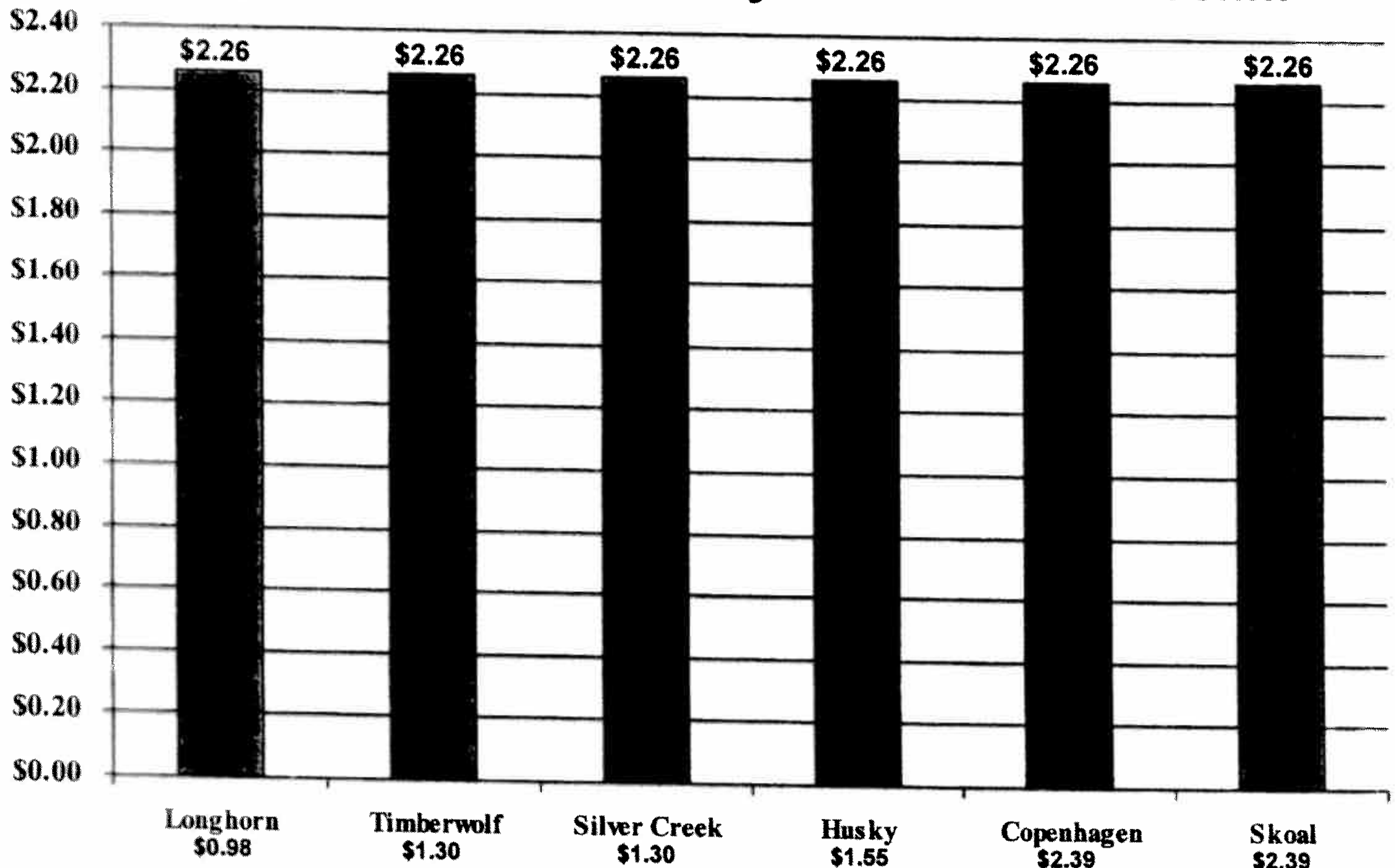
Source: Longhorn and Timberwolf pricing as of February 1, 2009 based on USSTC RAD SVT sales database; these prices are estimates and may vary. As of March 8, 2009 the price of Husky is $1.55. Effective March 29, 2009 the price of Red Seal is $1.75 and the price of Copenhagen and Skoal is $2.39.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Under a Weight-Based System

Equivalent products carry the same tax burden…



Source: Longhorn, Grizzly, Silver Creek and Timberwolf pricing as of February 1, 2009 based on USSTC RAD SVT sales database; these prices are estimates and may vary. As of March 8, 2009 the price of Husky is $1.55. Effective March 29, 2009 the price of Copenhagen and Skoal is $2.39.

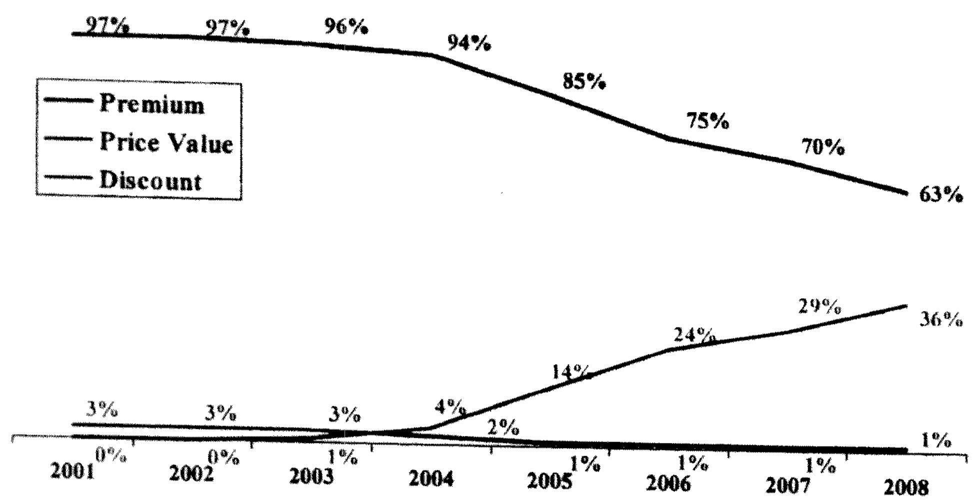
Altria

Information provided by Altria Client Services Inc. on behalf of
Philip Morris USA Inc. and US Smokeless Tobacco Company

Under an Ad Valorem Methodology, Down Trading Means Less Revenue for the State

In 2008 Tier 3 share of market continued to grow. The state receives as much as $1.05 less revenue per can every time an adult consumer down-trades from a Tier 1 MST product to a Tier 3 product under the current ad valorem system.

Alaska left an estimated $1.16 million on the table in 2008 due to down-trading.

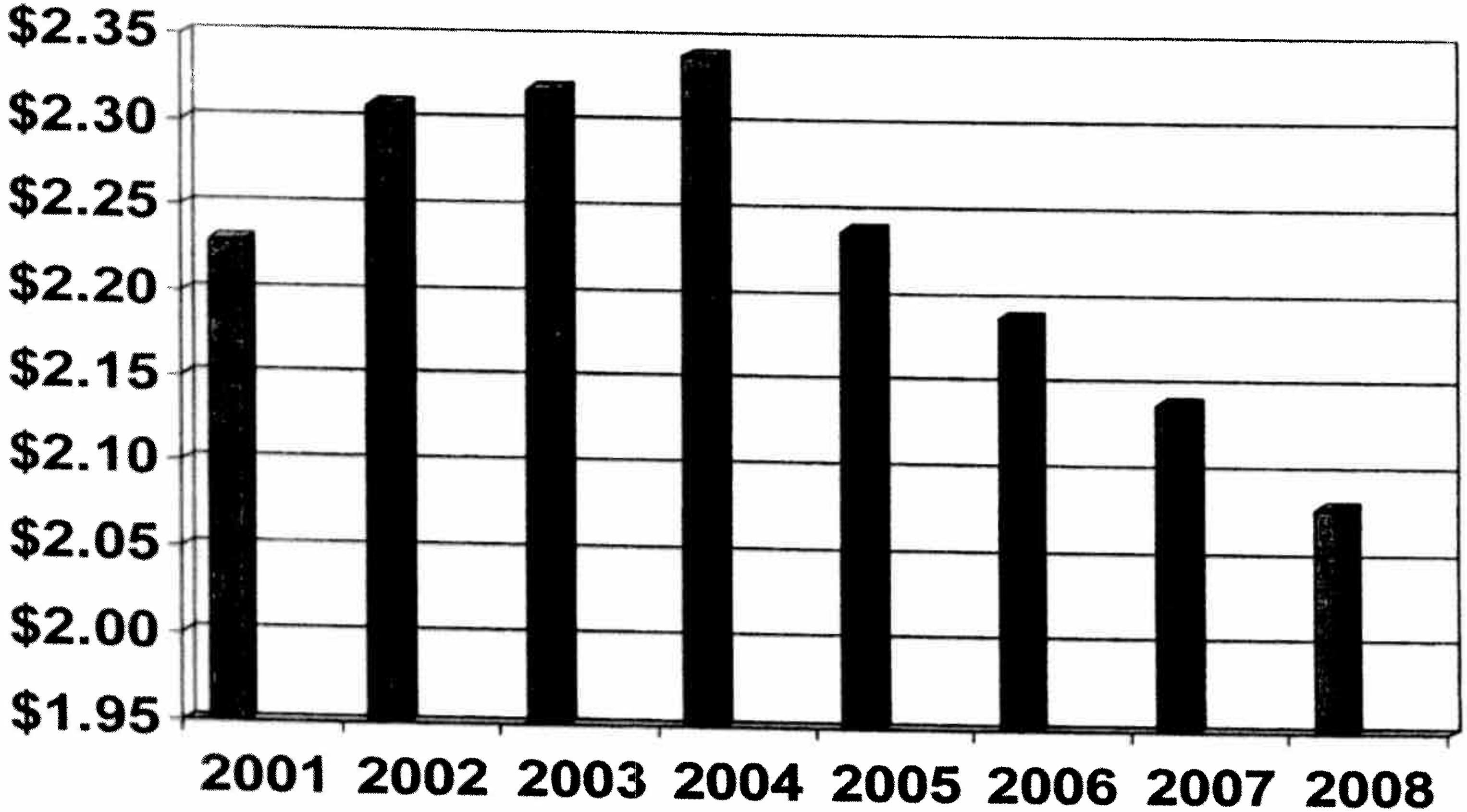


Note: $1.16 million MST excise tax revenue gain based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a rate of $1.88 per oz.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

MST National Average Wholesale Price 2001- 2008*

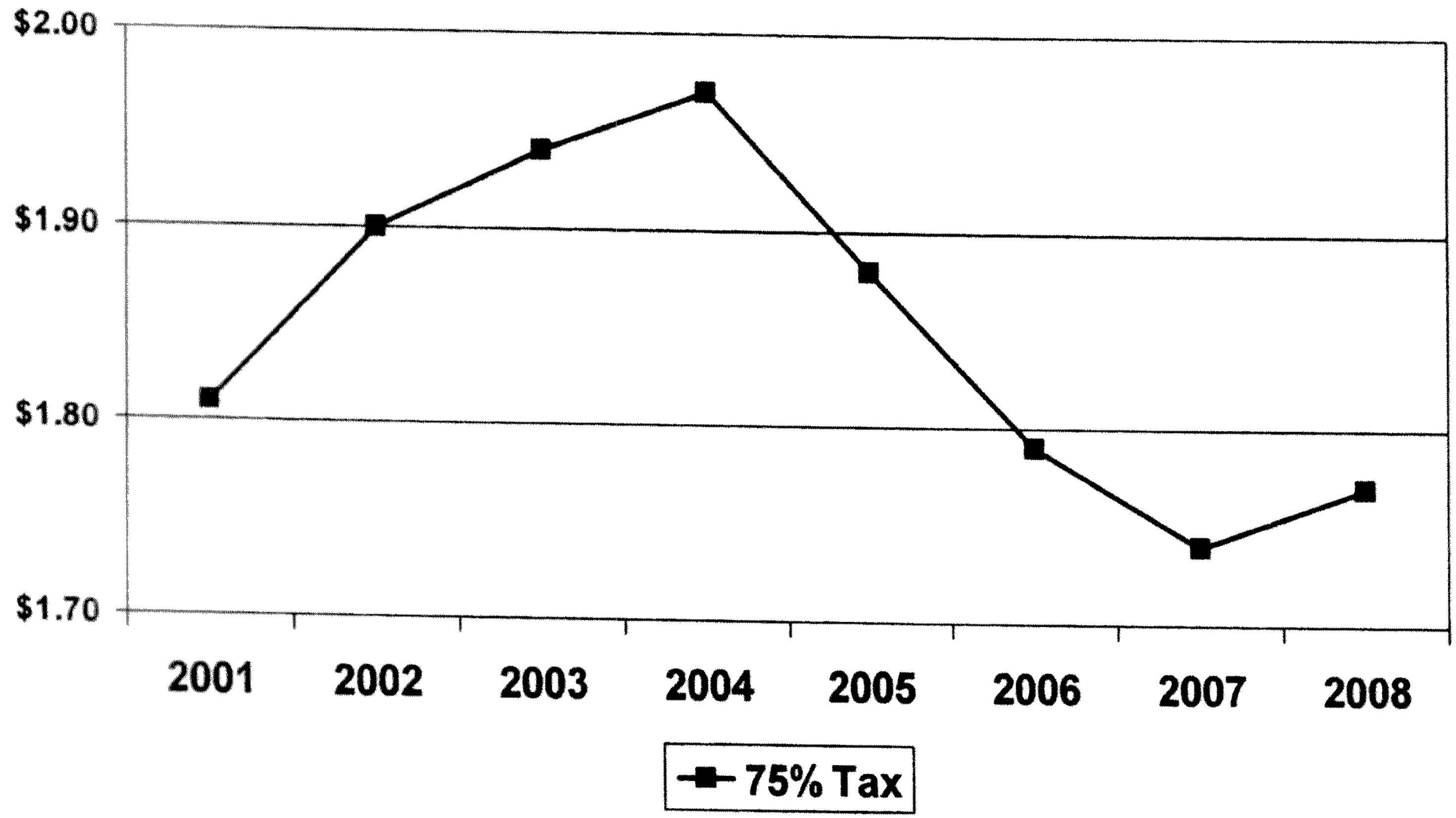


Source: Based on USSTC RAD SVT sales database as of October 31, 2008.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Alaska Weighted Average Tax Per MST Can 2006-2008



Source: USSTC RAD SVT sales database.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Weight-Based Conversion Timeline

- 1927 [redacted]
- Before 1950 [redacted]
- 2000 [redacted]
- 2001 [redacted]
- 2003 [redacted]
- 2005 [redacted]
- 2006 [redacted]
- March 2007 [redacted]
- January 2008 [redacted]
- January 2008 [redacted]
- July 2008 [redacted]
- July 2009 [redacted]
- October 2009 [redacted]

[redacted]

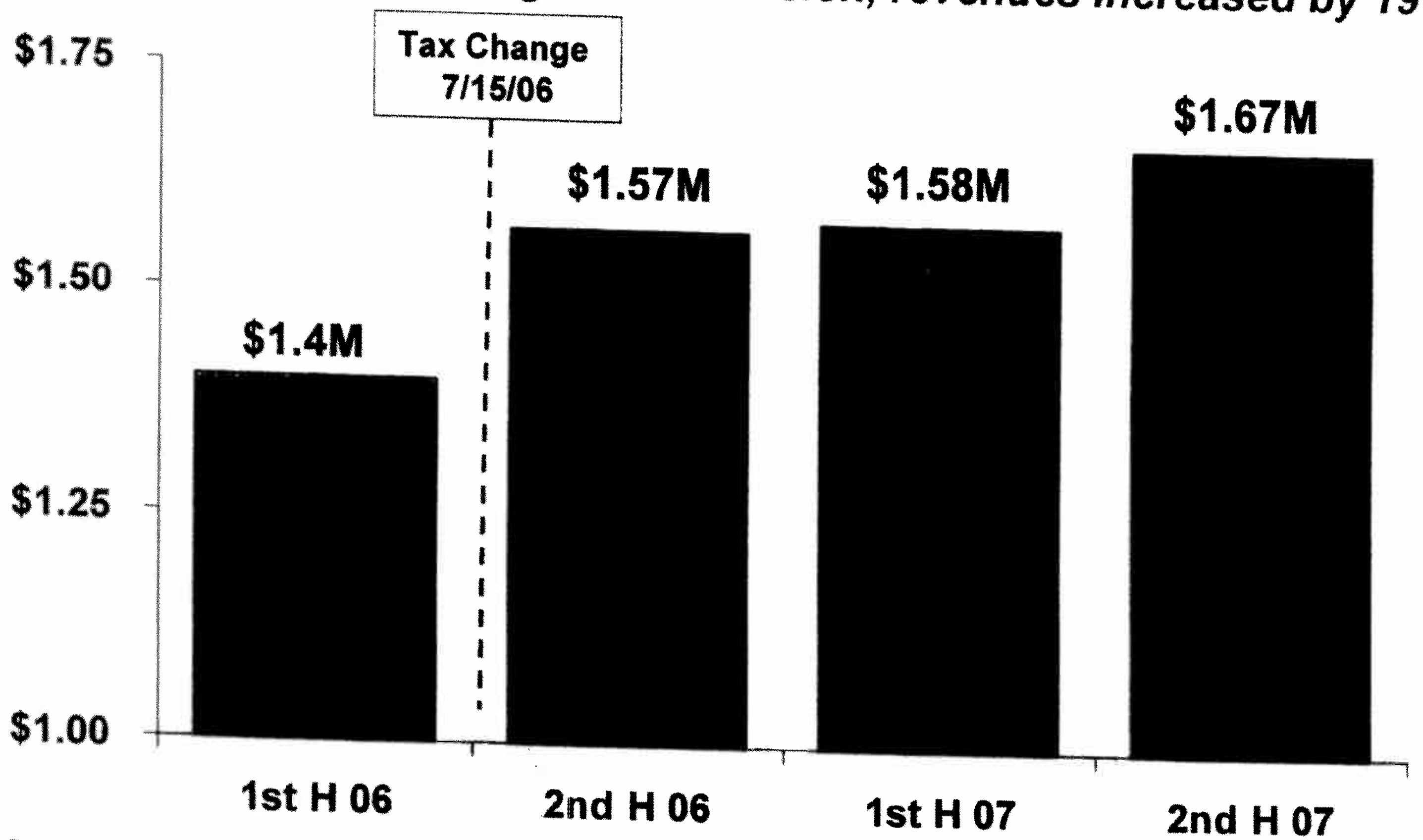
Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

New Jersey Weight-Based Conversion Case Study

In July 2006, New Jersey converted its MST tax from a 30% ad valorem rate to a 75¢/oz. weight-based Rate.

In the 18 months following the conversion, revenues increased by 19%.



Source: Based on USSTC RAD SVT System

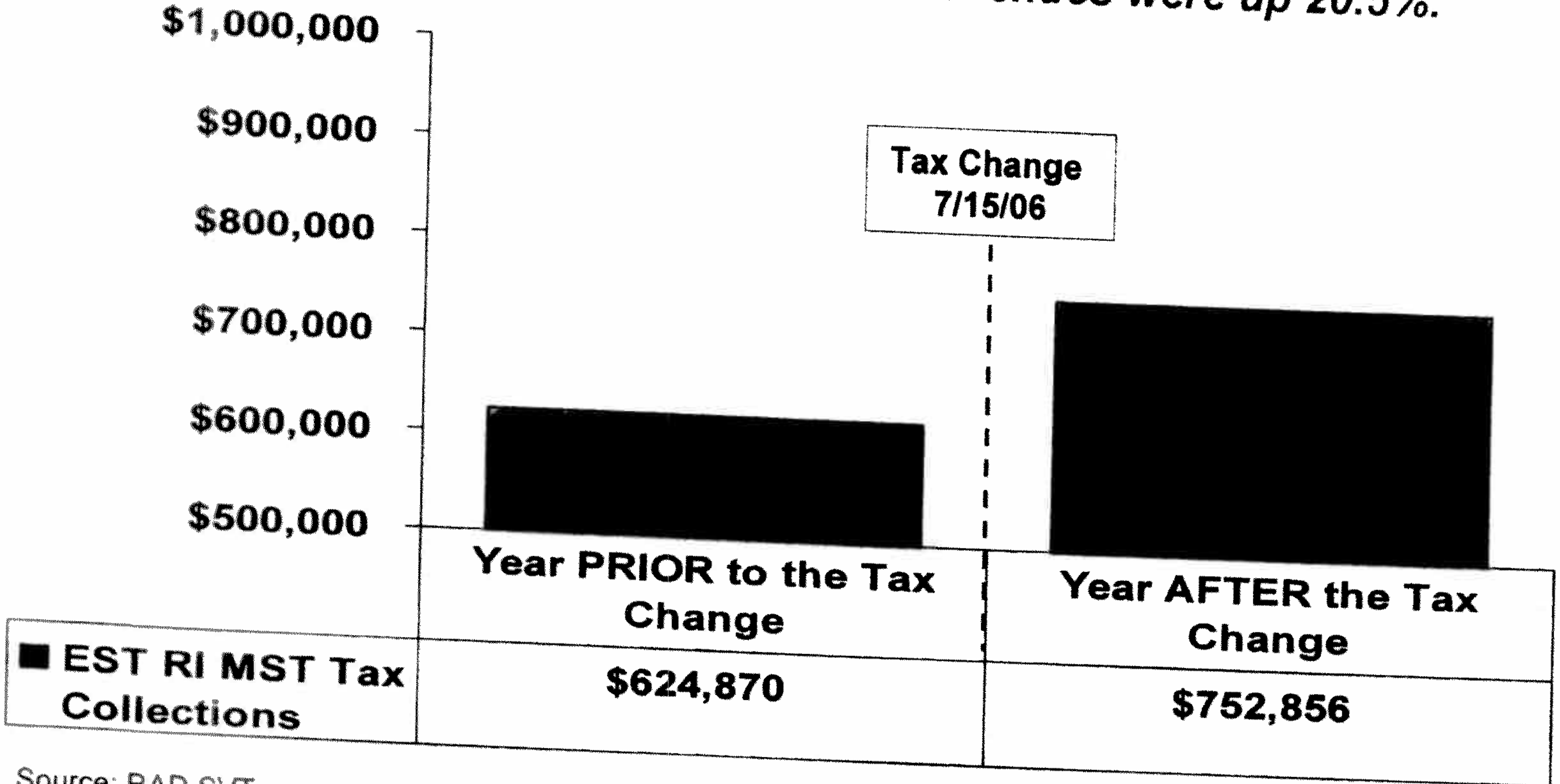
Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Rhode Island Weight-Based Conversion Case Study

In July 2006, Rhode Island converted its MST tax from a 40% ad valorem rate to a $1.00/oz. weight-based rate.

One year following the conversion revenues were up 20.5%.



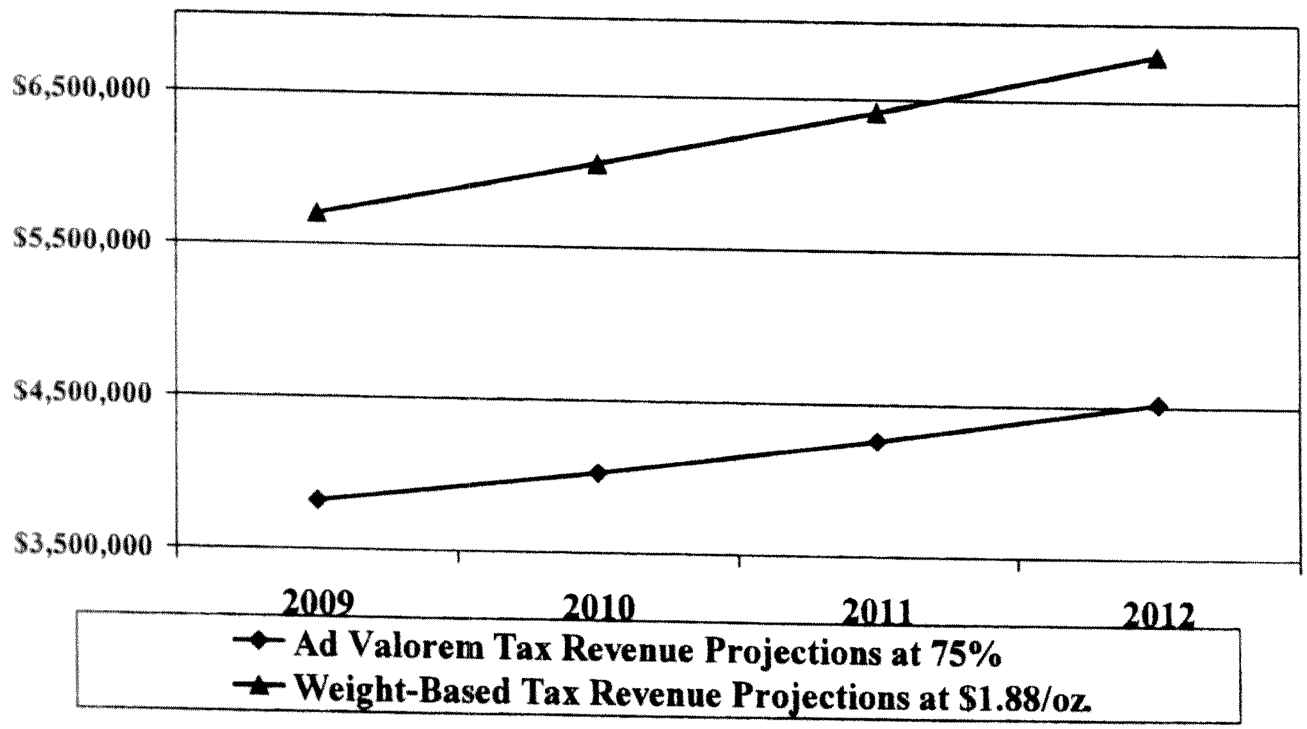
Source: RAD SVT compares time period 52 weeks prior to 7/1/06 and 52 weeks after 7/1/06

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Future MST Tax Revenue Projections

Revenues are projected to increase under a weight-based method of taxation.



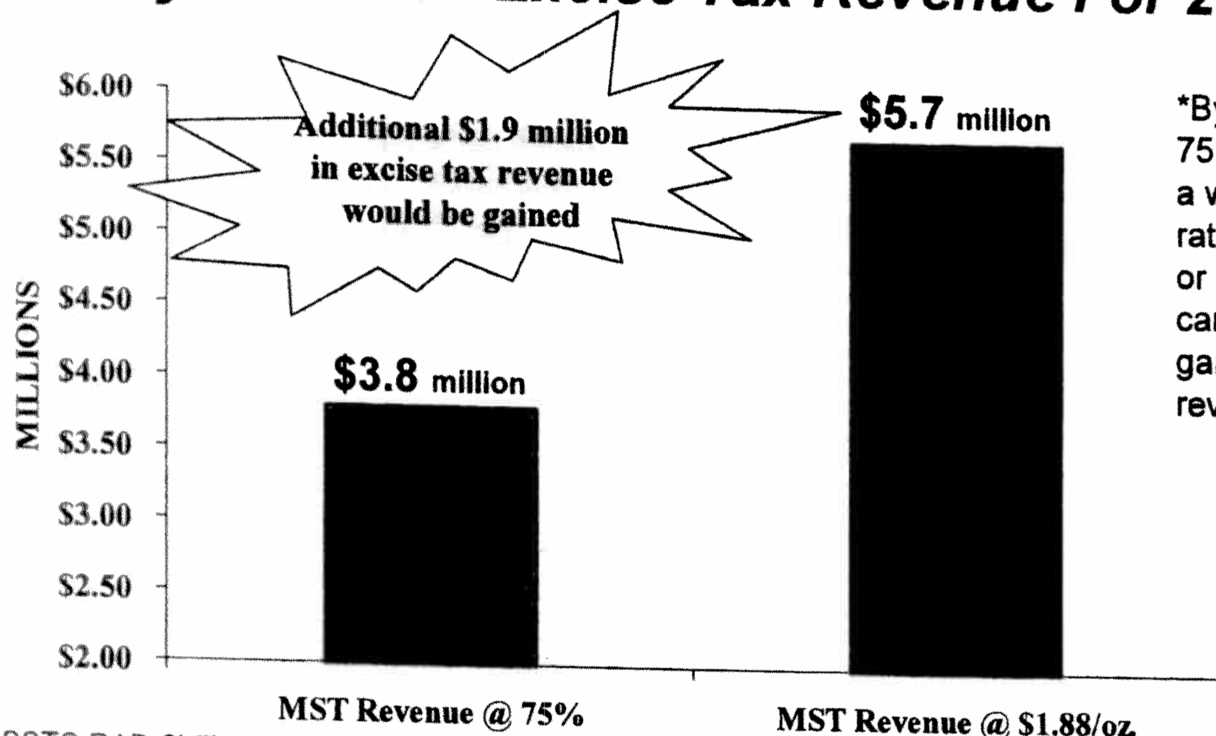
Note: Based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a rate of $1.88 per oz.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

A Weight-Based Tax Methodology Will Generate Additional Alaska MST Tax Revenues

Projected MST Excise Tax Revenue For 2009



*By switching from a 75% OTP tax rate to a weight-based tax rate of $1.88 per oz or $2.26 per 1.2 oz. can, the state would gain additional revenue.

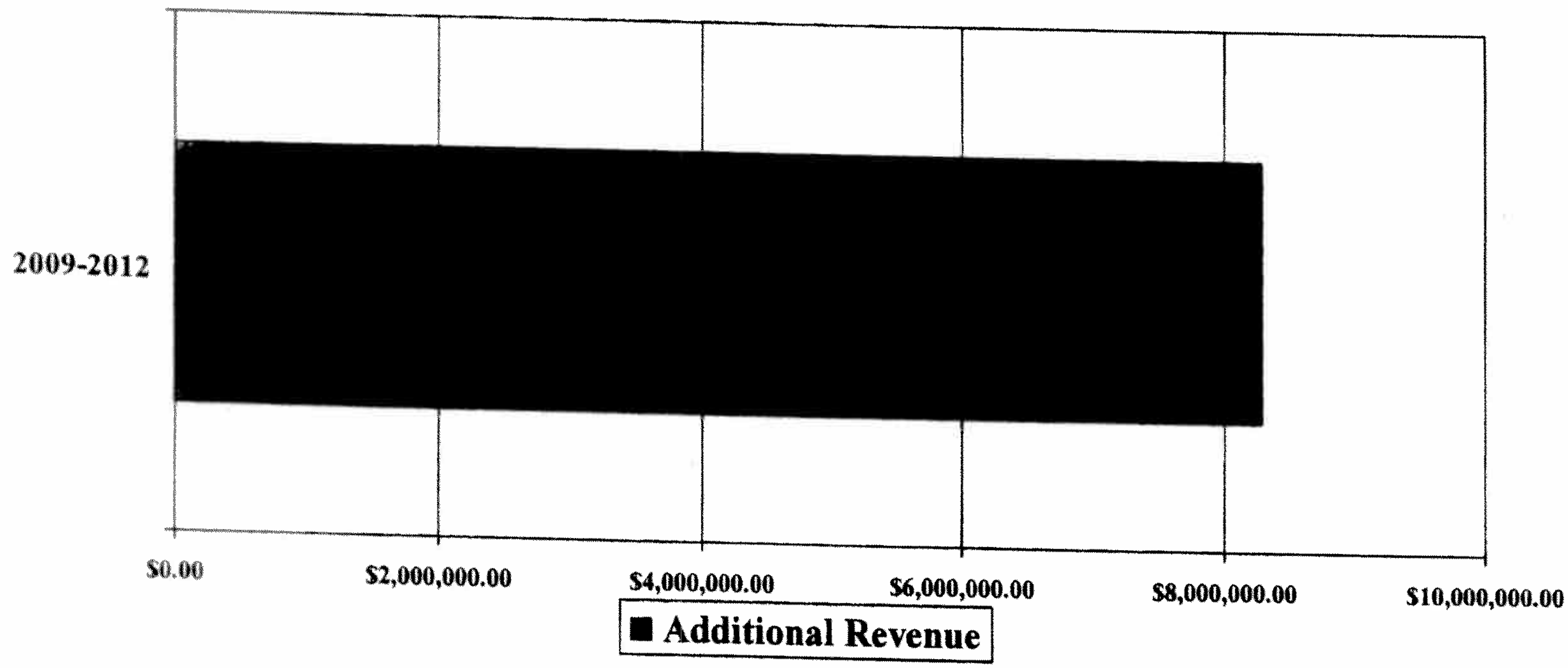
Source: USSTC RAD SVT sales database.
Note: Based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a premium equivalent rate of $1.88 per oz.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Additional Weight Based Tax Revenue 2009 - 2012

By switching to a weight-based tax, Alaska could receive over $8.3 million in additional revenue over 4 years.



Note: Based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a premium equivalent rate of $1.88 per oz.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

Wholesalers: Weight-Based Taxes Are Easier To Administer

McLANE

"A weight based system would allow us to reduce the tax administration burden that will in turn benefit our customers."
March 7, 2008 letter from Neftali Garcia, Director, Governmental Relations to the Honorable Margarita Prentice, Washington State Senate Ways and Means Committee Chair.

O.K. Distributing Co. Inc.

"Taxing moist snuff at a flat rate amount per ounce is straight forward and a lot easier to implement and report to the state."
February 7, 2008 letter to Whom It May Concern from Kelly Kaiser, Vice President, O.K. Distributing Co., Inc.

Altria

Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc. and US Smokeless Tobacco Company

ALCS Supports a Weight-Based Method of Taxation for MST

This legislation will:

- Tax MST consistently with other consumer products.
- Align Alaska's tax methodology with that of the federal government and 16 other states.
- Establish tax equity for MST products.
- Generate additional state MST tax revenues.
- Create a stable and predictable stream of MST tax revenue for the state.
- Reduce complexity and administrative burden on the state, wholesalers and retailers.

Arduin, Laffer & Moore
ECONOMETRICS

Taxing Moist Smokeless Tobacco

State excise taxes levied on Moist Smokeless Tobacco (MST) is unique amongst excise taxes levied across the United States. For most products, excise taxes are levied based on the number of units sold or quantity. Gasoline excise taxes are levied in cents per gallon. Beer, wine, and spirits excise taxes are levied in cents per gallon. Cigarette excise taxes are levied on a per pack basis. Even the federal government taxes MST based on the product's weight.

Many states (39 in all), on the other hand, tax MST based on the price of the product, see Table 1. This divergence from the standard method of levying excise taxes is inefficient and creates problems for states that tax MST on the basis of price. Consequently, MST taxation can be improved by switching MST taxation from a price-based system to a quantity-based tax system. There are two methods for taxing MST by quantity: levying the tax based on the weight of the product and levying the tax based on the number of units sold. Most states that use a quantity excise tax choose a tax on the weight of the product.

Table 1
State Tax Rate on Moist Smokeless Tobacco (MST) DIFFERENTIATE WEIGHT VERSUS UNIT BASE 2008[1]

State	Rate	Type of Tax
Alabama	$0.02 per ounce	Weight-based
Alaska	75% of wholesale price	Ad Valorem
Arizona	$0.123 per ounce	Weight-Based
Arkansas	32% of manufacturers price	Ad Valorem
California	46.76% of wholesale price	Ad Valorem
Colorado	40% of manufacturers price	Ad Valorem
Connecticut	$0.40 per ounce	Weight-based
Delaware	$0.54 per ounce	Weight-based
Florida	25% of wholesale price	Ad Valorem
Georgia	10% of wholesale price	Ad Valorem
Hawaii	40% of wholesale price	Ad Valorem
Idaho	40% of wholesale price	Ad Valorem
Illinois	18% of wholesale price	Ad Valorem
Indiana	24% of wholesale price	Ad Valorem
Iowa	$1.1 9 per ounce	Weight-based
Kansas	10% of wholesale price	Ad Valorem
Kentucky	$0.095 per unit	Per Can
Louisiana	20% of manufacturers price	Ad Valorem
Maine	78% of wholesale price	Ad Valorem
Maryland	15% of wholesale price	Ad Valorem
Massachusetts	90% of wholesale price	Ad Valorem
Michigan	32% of wholesale price	Ad Valorem
Minnesota	70% of wholesale price	Ad Valorem

[1] Based on: Prante Gerald (2008) "What Is Proper Tax Policy for Smokeless Tobacco Products?" *Tax Foundation Fiscal Fact* No. 120, March 26; including changes in MST taxes since publication.

Mississippi	15% of manufacturers price	Ad Valorem
Missouri	10% of manufacturers price	Ad Valorem
Montana	$0.85 per ounce	Weight-based
Nebraska	20% of wholesale price	Ad Valorem
Nevada	30% of wholesale price	Ad Valorem
New Hampshire	19% of wholesale price	Ad Valorem
New Jersey	$0.75 per ounce	Weight-based
New Mexico	25% of product value	Ad Valorem
New York	$0.96 per ounce	Weight-based
North Carolina	10% of wholesale price	Ad Valorem
North Dakota	$0.60 per ounce	Weight-based
Ohio	17% of wholesale price	Ad Valorem
Oklahoma	60% of wholesale price	Ad Valorem
Oregon	65% of wholesale price	Ad Valorem
Pennsylvania	No	------
Rhode Island	$1.00 per ounce	Weight-based
South Carolina	5% of manufacturers price	Ad Valorem
South Dakota	35% of wholesale price	Ad Valorem
Tennessee	6.6% of wholesale price	Ad Valorem
Texas	40% of manufacturers price	Ad Valorem
Utah	$0.75 per ounce	Weight-based
Vermont	$1.49 per ounce	Weight-based
Virginia	10% of wholesale price	Ad Valorem
Washington	75% of wholesale price	Ad Valorem
West Virginia	7% of wholesale price	Ad Valorem
Wisconsin	$1.31 per ounce	Weight-based
Wyoming	20% of wholesale price	Ad Valorem

Issues of Tax Equivalency

Price-based taxes, or ad valorem taxes, are levied as a percentage of the product's price. With respect to MST, these taxes are typically levied as a percentage of the wholesale price. For instance, in Idaho the tax on MST is 40% of the wholesaler's price. Consequently, for MST products that wholesale for $3 per can, the 40% tax would impose an excise tax of $1.20. For MST products that wholesale for $1 per can,, the 40% tax would impose an excise tax of $0.40.

From an equivalency perspective, any ad valorem tax can be set at a level such that it imposes the same burden on MST as a weight-based or unit-based tax. In other words, any ad valorem tax can be converted into a unit-based or weight-based tax with the same equivalent tax burden.

Table 2 illustrates this principle based on Florida's current ad valorem MST excise tax. Looking at the premium category, currently, the state levies a tax that is 25% of the wholesale price. Based on a wholesale price of $3.00 per 1.2 ounce can, the state could switch their ad valorem tax to a quantity tax of $0.75 per unit or $0.63 per ounce. In either scenario, the effective tax burden would be the same under all three scenarios – a 75-cent per can tax. Rows 3 & 4 illustrate the impact of the equivalency calculation on the Price Value and Deep Discount categories. While an ad-valorem tax provides a tax break for the lower-priced categories, both the unit-based and weight-based taxes levy the same dollar tax – the same dynamic that occurs when states (and the federal government) levies excise taxes on every other product subject to excise taxes.

Table 2
Premium Equivalency
Ad valorem, Per Can, and Per Ounce MST Taxes
for 1.2 ounce MST Products
In Florida
(Based on 2008 Ad valorem Tax)

Wholesale Price	Ad Valorem	Unit-Based	Weight-Based (per ounce)
Premium ($3.00/can)	$0.75	$0.75	$0.75
Price Value ($2.00/can)	$0.50	$0.75	$0.75
Deep Discount ($1.00/can)	$0.25	$0.75	$0.75

The example in Table 2 is often referred to as a "pure" weight-based method. Below is language from the 2008 Utah House Bill 356, a "pure" weight-based bill.

(4) The rate of the tax under this section is:

(a) for tobacco products except for moist snuff, 35% of the manufacturer's sales price;

(b) subject to Subsection (5), for moist snuff, $.75 per ounce.

(5) (a) The tax under this section on moist snuff shall be imposed on the basis of the net weight of the moist snuff as listed by the manufacturer.

(b) If the net weight of moist snuff is in a quantity that is a fractional part of one ounce, a proportionate amount of the tax described in Subsection (4)(b) is imposed on that fractional part of one ounce.

The equivalency rates in Table 2 assume a constant can size – 1.2 ounces. However, MST products are sold in different sized cans (e.g., low-weight MST products). As the name implies, a weight-based tax method would result in a lower tax for lower-weight products of the same price. Unit-based taxes would not.

Currently, only Kentucky imposes a MST excise tax per unit, although Washington State considered replacing its current ad valorem tax with a per unit tax. Because MST products come in different size cans (i.e., 1.5 oz, 1.2 oz, and 0.12 oz), per unit tax proposals will typically include a "band" where the smaller-sized containers are taxed at the same rate as the standard containers.

A per unit tax with this feature is often referred to as a "banded" tax. Tax bands establish a tax floor such that the tax on lower-weight products is the same as the tax on standard-weight products. And proportionally larger per unit taxes are levied on larger sized cans such that the tax burden is not minimized by marketing larger products. Below is language from the 2008 Washington House Bill 2288, a "banded" bill.

Two dollars and thirty-five cents per ounce of moist snuff with a proportionate tax at the like rate on all fractional parts of an ounce thereof, provided that cans or packages of moist snuff with a net weight of less than one and two-tenths ounces shall be taxed at the equivalent rate of packages or cans weighing one and two-tenths ounces. Such tax on moist snuff shall be computed based on the net weight as listed by the manufacturer.

Table 3 illustrates the tax equivalency calculation based on Tier 1 products that are *banded* up to cans of 1.2 ounces.

Table 3
Equivalent Ad valorem, Per Can, and Per Ounce MST Taxes
By MST Product Size, for Tier 1 MST Products
In Florida
(Based on 2008 Ad valorem Tax, All products cost $3.00)

Wholesale Price	Ad Valorem	Unit-Based	Weight-Based (per ounce)
1.5 ounces	$0.75	$0.94	$0.94
1.2 ounces	$0.75	$0.75	$0.75
0.12 ounces	$0.75	$0.75	$0.08

The tax rates in Table 3 show that a unit-based (or banded) tax creates a tax floor of $0.75 per can for all products, including those of a lower weight. Therefore, even though there is tax equivalency for products with a weight of 1.2 ounces and above, similar products with less weight will have a higher tax burden than under ad valorem or weight-based tax methods.

What MST Wholesale Price?

An important difficulty arises for ad valorem taxation: How does the ad valorem excise tax statute define *wholesale price*? The retail chain varies depending upon many factors. In some instances, MST is distributed from the manufacturer, to a wholesaler, then to a retailer and finally the customer. In this case, defining the wholesale price is straightforward.

Oftentimes the retail chain is longer than this example. In circumstances where there are two (or more) wholesalers, defining the wholesale price becomes more complex. This complexity creates problems. For instance, *A company that distributes smokeless tobacco products to retailers in Florida filed a lawsuit against the Department of Business & Professional Regulation (DBPR), claiming a refund of more than $14 million dollars in Other Tobacco Products Taxes over a five-year period. The core of the argument was what constitutes the "wholesale sales price."*

The distributor contended the taxable wholesale sales price was the lower price a smokeless tobacco company's sales and marketing subsidiary paid to its manufacturing subsidiary for the product the distributor later purchased. The distributor had been taxed on the price it paid to the sales and marketing subsidiary.

In March 2005, the Court approved a settlement under which DBPR gave the distributor a $6.2 million credit against future taxes. The Court retained jurisdiction for one year. The potential for other such claims exists.[2]

Standard industry discounting actions also impact tax revenues from ad valorem taxes. Oftentimes, manufacturers promote their products by offering "buy 1, get 1 free" or "buy 2, get 1 free" specials. Because the price is $0 for a product that is given away, ad valorem taxes do not levy a tax on promotional products under an ad valorem tax system.

Quantity-based taxes avoid both of the problems discussed above. Under a quantity-based tax system the definition of the tax base is straightforward and not subject to differences in interpretation. The same logic applies to the promotional problem. With per unit or weight-based taxes, the manner in which products are promoted are irrelevant. Quantity taxes include both purchased products and promotional products as part of the tax base. These features create significant advantages for state governments that levy per unit or weight-based MST excise taxes instead of an ad valorem MST excise taxes.

Weight-based or Unit-based Taxes Are More Stable and Easier to Forecast

Related to the issue of price variability is the added difficulty state revenue forecasters face forecasting ad valorem MST taxes compared to quantity-based MST taxes.

Forecasting a quantity-based MST tax only requires the forecaster to track overall volume trends. Any changes in expected prices will impact consumption, and consequently tax revenues. However, the price impacts affect tax revenues only through their impact on the quantity sold – the changes in price do not directly increase or decrease the total tax revenues. Furthermore, price differentials across different

[2] Wenner Kurt R. and Turcotte John (2006) "Legislature Should Consider a Unit-Based Tobacco Products Tax" *Florida TaxWatch Briefings*, April.

types of products do not matter for tax revenue forecasts for quantity-based MST taxes, only the overall price trends. These features lead to a more stable, and consequently easier to forecast, tax revenue source from per unit or weight-based taxes.

Forecasting an ad valorem excise tax requires forecasters to track both price and volume trends. In addition, it is not just the overall price and volume trends that matter. Total MST ad valorem excise tax revenues will vary depending upon the price and volume trends by price category. Consequently, in states that impose MST ad valorem excise taxes, forecasters must predict the average MST price for all three MST price tiers, the changes in price differentials across the price tiers, and then predict how these changes in absolute and relative prices will impact expected volumes for each price tier. These complexities make accurately forecasting MST tax revenues from ad valorem excise taxes much more difficult than forecast MST tax revenues from per-unit excise taxes – it also can create a more variable excise tax revenue source.

Prices That Go Up Can Also Come Down

Proponents of ad valorem taxes on MST claim ad valorem taxes provide automatic protection against inflation. As the argument goes, when inflation increases, MST prices will increase in step, therefore tax revenues will be protected against inflation. Such arguments overlook the complexity of actual pricing decisions made by consumers and manufacturers.

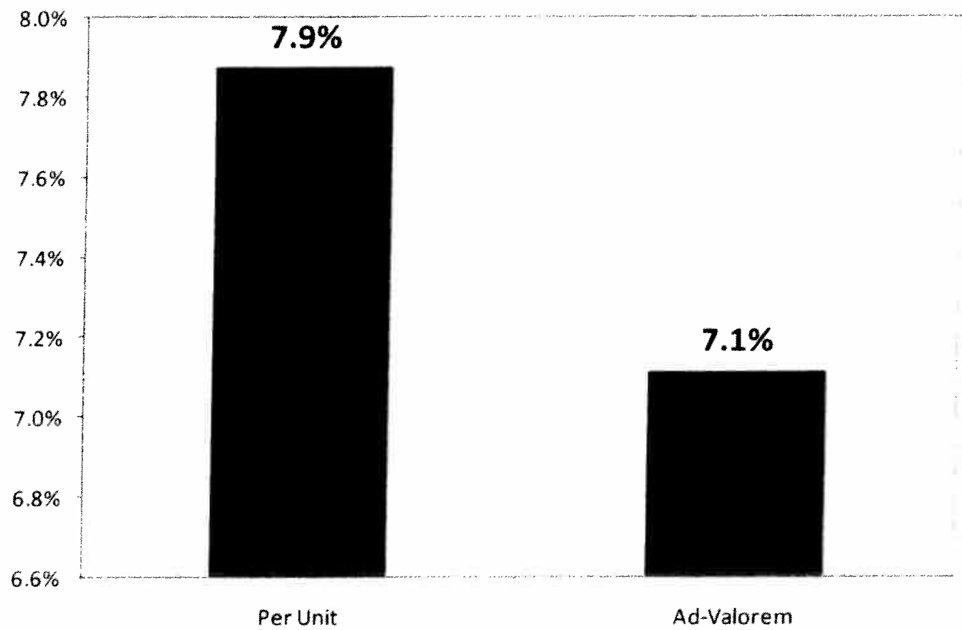
Manufacturers often engage in price discounts in order to gain/protect market share. When the MST excise tax is based on the wholesale price of the product, then state government revenues are directly impacted by manufacturer's competitive actions. These impacts are compounded when one manufacturer's price discounts turn into an all out pricing war. The lower prices on all products lower the state excise tax revenues from the entire category. Such pricing actions may or may not occur during periods of high inflation.

Consequently, there is no guarantee that MST prices will increase in line with inflation. In fact, between 2000 and 2007, total OTP tax revenues in those states that impose a per unit tax on MST (either weight-based or based on the number of cans) grew more than total OTP tax revenues in those states that impose an ad valorem tax on MST, see Figure 1.

Consumers can also impact government revenues by their purchasing decision. Because most excise taxes are imposed on a quantity-basis, the type of product a consumer chooses is irrelevant to the government. For instance, gasoline excise taxes are levied on cents per gallon. Consequently, whether gasoline consumers choose regular or premium gasoline does not matter from the state government's perspective. State gasoline tax revenues are precisely the same. This is not the case for states that impose ad valorem MST taxes. State revenues change depending upon which product category a consumer chooses when states impose ad valorem MST taxes. This dynamic creates unexpected revenue declines if consumers change their product choice. In fact, this dynamic is taking place:

> *Data from Citigroup shows that sales of MST grew 6.4% nationwide in 2005 and that while Tier 3 grew by 28.8%, sales of Tier 1 products fell by 2.8%.*[3]

Figure 1
Compound Annual Growth Rate in Per Unit and Ad Valorem OTP Taxes
2000 - 2007[4]



More troubling for state governments, consumer price sensitivity increases during more difficult economic times. Consumers will be looking toward economizing on their costs and may be more willing to purchase lower priced products. Manufacturers, aware of this dynamic, will be more sensitive to consumers' price consciousness and will be more willing to forgo price increases and perhaps even cut prices. As a result, both consumer and manufacturer actions will work toward limiting price increases during difficult economic times, and may even push actual average prices down.

Not surprisingly, state tax revenues are generally under pressure during the same tough economic times, see Figure 2. The gray shaded areas in Figure 2 represent recessions. The gray dotted line represents

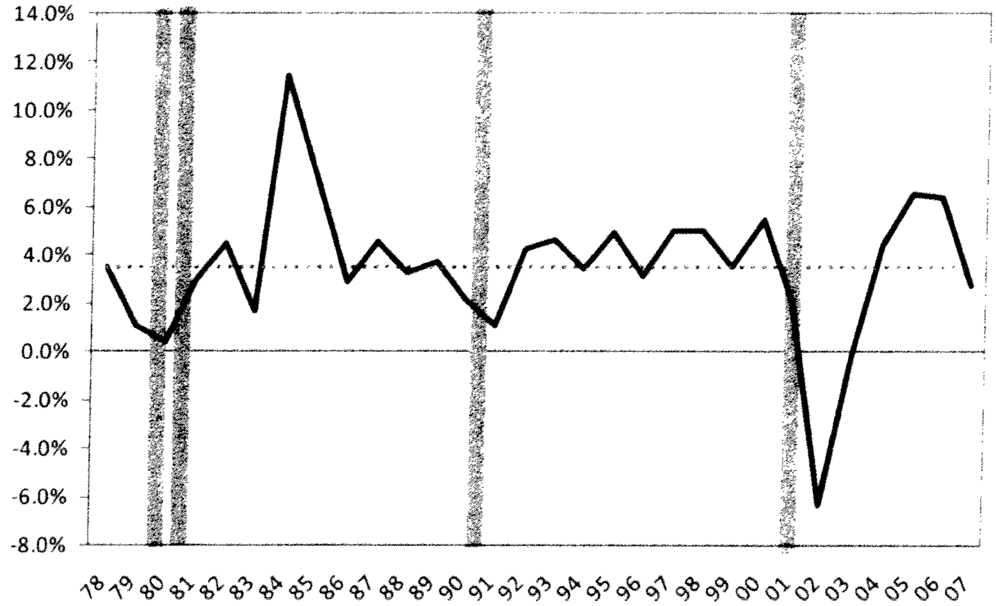
---

[3] Wenner Kurt R. and Turcotte John (2006) "Legislature Should Consider a Unit-Based Tobacco Products Tax" *Florida TaxWatch Briefings*, April.

[4] Source: Orzechowski Bill and Walker Rob (2008) *The Tax Burden on Tobacco* vol. 42. In order to ensure comparability across time, only those states that levied an MST tax throughout the entire period were included in the analysis.

the average growth in real state tax revenues, which has been 3.5% between 1978 and 2007. State tax revenue growth was well below the average state tax revenue growth rate during and following all four official recessions since 1978. Recently, 2007 state tax revenues have fallen below average, and the quarterly data from the U.S. Census shows that tax revenues will likely fall even further in 2008 – consistent with the declining economy.

Figure 2
Percent Change in Inflation Adjusted Total State Tax Revenues
1978 - 2007[5]



Ad valorem MST taxes are determined by both the price of the product and the quantity sold. Due to pressure on MST prices (driven either by manufacturers or consumers) during a slowing economy, ad valorem MST taxes will under-perform state tax revenue needs at the precise time when states need revenues the most. Quantity based MST taxes avoid this problem by being determined by the quantity sold alone.

Equity Considerations

According to the National Conference of State Legislatures, tax equity "has two primary components – horizontal equity and vertical equity. Horizontal equity means that taxpayers with similar economic

[5] Source: U.S. Census, www.census.gov.

circumstances have similar tax burdens. Vertical equity refers to the distribution of tax burdens among taxpayers with different economic circumstances."[6]

The issue of horizontal equity is the most relevant with respect to ad valorem MST taxation. Ad valorem excise taxes create an artificial market advantage for the lower-priced MST products. As illustrated in the example above, in a state with a 40% ad valorem tax on the wholesale price of the product (and assuming that the wholesale price can be clearly defined), the actual dollar tax paid on a product that wholesales for $3 per can ($1.20) will be 300% more than the actual dollar tax paid on a product that wholesales for $1 per can ($0.40).

Because the tax burden is levied on the product not the individual, ad valorem MST taxes vary the tax burden on individuals that is not based on the individual's ability to pay. The ad valorem system, consequently, violates the horizontal equity consideration defined by the National Conference of State Legislatures.

Conclusion

Most states levy an ad valorem tax on MST products. Not only is this atypical for excise taxation in the U.S., but it is also less efficient. The evidence shows that tax revenues in those states that rely on ad valorem taxes do not necessarily grow faster than those states that levy a per unit MST tax. In fact, between 2000 and 2007, revenues in the states that levied a per unit tax grew at a faster rate than revenues in the states that levied an ad valorem tax.

Ad valorem taxation also creates unnecessary complexity in the tax code, which makes it more difficult to forecast tax revenues and exposes the state's tax revenues to unnecessary volatility. For all of these reasons, taxing Moist Smokeless Tobacco on a per unit basis is more efficient than an ad valorem tax.

[6] Fiscal Affairs Program (2003) "Tax Policy Handbook for State Legislators" *National Conference of State Legislators*, April.

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

ISSUE ALERT

To: Alaska ALEC House Member
From: Michael Hough, Task Force Director
Re: House Bill 188
Date: March 24, 2009

The Alaska House is considering **HB 188,** which would change the current tax on moist smokeless tobacco (MST) from an ad valorem basis (percentage tax based on price) to a weight-based system. **The American Legislative Exchange Council (ALEC) fully supports this concept.** Changing the current tax on moist smokeless tobacco to weight-based system is sound tax policy that provides tax fairness and fits squarely within the Jeffersonian Principles of free market enterprise and fair commerce.

In fact, ALEC recently passed a model resolution and statement of principles explaining the importance of implementing this needed change in tax law. We have attached the resolution, *Resolution on the Enhancement of Economic Neutrality, Commercial Efficiency, and Fairness in the Taxation of Moist Smokeless Tobacco Products* to this Issue Alert.

ALEC believes that all like products would be taxed the same and there should be no tax preference for inexpensive products that could harm state revenues. Additionally, such a tax change would simplify and ease compliance for retailers and state tax administrators and would erase the tax-conferred market advantage that some products have enjoyed in recent years, while restoring the principles of sound tax policy.

Proponents' claim that taxes based upon price discourages consumption, especially among teenagers. To the contrary, an ad valorem tax merely shifts demand from one product to the next. Proponents also suggest that this is no different than a consumer who pays higher taxes for a more expensive car than a cheaper alternative. This confuses an excise tax with a sales tax rate; sales taxes are solely intended to tax the price or value of a product while excise taxes are intended to tax actual consumption. Automobiles are not consumable items and therefore this argument is without merit.

Regardless of the politics or perceived social benefits, sound tax policy should still apply to excise taxes. ALEC does not believe any state should support a tax policy which creates a preference for one product over another, nor should the state interfere with the invisible hand of the free market by encouraging the use of one product over another. True to Jefferson's core principles, states should not be in the business of picking winners and losers, but rather let the market decide free of discriminatory government intervention.

Finally, ALEC does not believe this legislation should be used for a revenue enhancer and do not support the idea of raising taxes during these tough economic times. While we fully support the concept of **replacing the ad valorem tax with a weight-based tax, we do not support the overall tax increase that results from this legislation.**

If you should have any questions please contact ALEC's Commerce, Insurance and Economic Development Task Force Director, Michael Hough at 202-742-8530 or mhough@alec.org.

Tax Policy: A Fair Deal for Smokeless Tobacco

ALEC resolution calls on 40 states to change tax structure and adopt fair excise tax policy for smokeless tobacco products.

By Michael Keegan

In December 2006, ALEC fully approved a resolution and statement of principles calling for states to change their tax treatment of smokeless tobacco products — and any other consumer products taxed in a similar way — from an ad valorem basis (percentage tax based upon price) to a weight- or unit-based system. This change would ensure that all like products would be taxed at the same rate, it would eliminate a tax preference for inexpensive products that could harm state revenues and it would align smokeless tobacco products with all other consumer products subject to an excise tax. Additionally, such a tax change would simplify and ease compliance for retailers and state tax administrators, and it would erase the tax-conferred market advantage that some products have enjoyed in recent years, while restoring the principle of sound tax policy.

The cornerstone of excise tax policy is simply to tax the consumption of a product. The federal and state governments impose excise taxes on a range of products, including gasoline, beer, alcohol and tobacco products. In all instances, state excise taxes are based upon the unit or weight of a product (i.e., a gallon of gasoline, a liter of alcohol, a pack of cigarettes).

The beneficial result of an excise tax based upon unit or weight is that like products are taxed equally regardless of price, and the tax is spread evenly. For example, a gallon of 87-octane gasoline is taxed at the same rate as a gallon of 93 octane, a pack of premium cigarettes is taxed at the same rate as a pack of generic cigarettes and the same holds true across the line for many other products.

In 40 states, however, moist smokeless tobacco (MST) is taxed as a percentage of its price, not its weight. A tax based upon price not only creates the effect of a double sales tax (as these products are also subject to a sales tax based upon price) but worse, it distorts consumer behavior by taxing similar products in a very dissimilar manner. The result of ad valorem taxation is that certain products are subject to a much higher tax than similar less expensive products.

This policy creates a glaring market distortion as the tax treatment of the more expensive products artificially shifts demand toward lower priced products by exacerbating the price difference between the two. As highlighted by Americans for Tax Reform, "Excise taxes based upon price are taxes on autopilot, which creates a double and triple taxation effect and hides the real tax burden."

Although proponents claim that taxes based upon price discourage consumption — especially among teenagers — the reality is that an ad valorem tax merely shifts demand from one product to the next. Supporters of this disparate tax system also suggest that it is no different than when consumers pay higher taxes for a more expensive car than for a cheaper alternative. This argument confuses an excise tax with a sales tax.

The difference is that sales taxes are solely based on the price or value of a product while excise taxes are generally fixed-fee and can be imposed at the point of production, importation or sale. They are intended to both raise revenue and to discourage particular behavior.

Regardless of the politics or perceived social benefits, sound tax policy should still apply to excise taxes. ALEC does not believe any state should support a tax policy that creates a preference for one product over another, nor should the state interfere with the invisible hand of the free market by encouraging the use of one product over another. True to Jefferson's core principles, states should not be in the business of picking winners and losers, but should let the market decide free of discriminatory government intervention.

It is with these guiding principles relating to tax equity, tax fairness, free market economy and commerce without discriminatory interference by government that ALEC encourages all policymakers in states that currently tax smokeless tobacco on price (ad valorem) to support and adopt legislation that taxes all consumer products — including smokeless tobacco products — fairly, based upon the weight of a can.

This chart indicates states that currently tax smokeless tobacco products on an ad valorem basis and shows the wide discrepancies in the state excise tax rates on smokeless tobacco products.

*Adjusted annually by the California Board of Equalization.
Source: Tax Foundation and Federation of Tax Administrators.

State	Tax Rate on Smokeless Tobacco	Type of Tax
Alaska	75% of wholesale price	ad valorem
Arkansas	32% of manufacturer's price	ad valorem
California	46.76% of wholesale price*	ad valorem
Colorado	40% of manufacturer's price	ad valorem
Delaware	15% of wholesale price	ad valorem
Florida	25% of wholesale price	ad valorem
Georgia	10% of wholesale price	ad valorem
Hawaii	40% of wholesale price	ad valorem
Idaho	40% of wholesale price	ad valorem
Illinois	18% of wholesale price	ad valorem
Indiana	18% of wholesale price	ad valorem
Iowa	22% of wholesale price	ad valorem
Kansas	10% of wholesale price	ad valorem
Louisiana	20% of manufacturer's price	ad valorem
Maine	78% of wholesale price	ad valorem
Maryland	15% of wholesale price	ad valorem
Massachusetts	90% of wholesale price	ad valorem
Michigan	32% of wholesale price	ad valorem
Minnesota	70% of wholesale price	ad valorem
Mississippi	15% of manufacturer's price	ad valorem
Missouri	10% of manufacturer's price	ad valorem
Nebraska	20% of wholesale price	ad valorem
Nevada	30% of wholesale price	ad valorem
New Hampshire	19% of wholesale price	ad valorem
New Mexico	25% of product value	ad valorem
New York	37% of wholesale price	ad valorem
North Carolina	3% of wholesale price	ad valorem
Ohio	17% of wholesale price	ad valorem
Oklahoma	60% of wholesale price	ad valorem
Oregon	65% of wholesale price	ad valorem
South Carolina	5% of manufacturer's price	ad valorem
South Dakota	35% of wholesale price	ad valorem
Tennessee	6.6% of wholesale price	ad valorem
Texas	40% of manufacturer's price	ad valorem
Utah	35% of manufacturer's price	ad valorem
Virginia	10% of wholesale price	ad valorem
Washington	75% of wholesale price	ad valorem
West Virginia	7% of wholesale price	ad valorem
Wisconsin	25% of manufacturer's price	ad valorem
Wyoming	20% of wholesale price (or 10% of retail)	ad valorem

Resolution on the Enhancement of Economic Neutrality, Commercial Efficiency and Fairness in the Taxation of Moist Smokeless Tobacco (MST) Products

WHEREAS, excise taxes are levied by individual states on the distribution of a variety of consumer products in the United States.

WHEREAS, excise taxes are levied at various points or transactions during the distribution of these consumer products having a compounding effect on all other taxes levied further along the distribution chain, including sales taxes.

WHEREAS, levy of excise taxes should be equally applied to all products of a like nature or category, as to not create a tax policy that benefits one product and penalizes another of the same nature or category.

WHEREAS, state tax policy should not create preferences among products of a like nature or category.

WHEREAS, taxes that create a consumer preference within a product category impede free market commerce.

WHEREAS, excise taxes levied on the basis of value or price "ad valorem" at any point during the distribution of any products greatly aggravate the compounding effect on taxes and prices between products and distort consumer preference between similar products.

WHEREAS, MST products are all of a like nature and category, and packaging is distinguishable only by volume, weight or labeling.

WHEREAS, ad valorem excise taxes on MST creates a tax preference for inexpensive MST products, thereby artificially disrupting free market consumer dynamics.

WHEREAS, ad valorem excise taxes on MST result in automatic tax increases or decreases **without** legislative oversight or action, and negatively impact consumers and producers while denying them any legislative recourse.

WHEREAS, ad valorem excise tax statutes are subject to differing interpretations as to the appropriate point or transaction to apply the tax, creating compliance problems for producers and state tax administrators.

WHEREAS, excise taxes on MST based on volume or weight eliminate the possibility of market distortions and manipulations, tax preferences for lower priced products and aggravation of the compounding nature of an excise tax levied during distribution.

WHEREAS, virtually all other products on which excise taxes are levied carry a tax based on volume or weight, ensuring that manufacturers and consumers face a level marketplace based on freedom of consumer choice.

NOW, THEREFORE BE IT RESOLVED, THAT the American Legislative Exchange Council (ALEC) will support efforts to change or convert state excise taxes levied on MST from ad valorem or price based to weight or volume based.

NOW, THEREFORE BE IT FURTHER RESOLVED THAT ALEC shall support the following statement of principles.

Statement of Principles Regarding State Ad Valorem Taxes on Consumer Products

The Problem: Ad Valorem Excise Taxes on Consumer Products

- Ad valorem taxes give less expensive products a tax preference, which encourages consumers to switch to those products, thus artificially distorting the market and influencing consumer behavior.
- Market distortions created by ad valorem taxes erode and destabilize state revenues over time.
- Ad valorem excise taxes lack neutrality. Products with identical weights and packaging can have widely different tax burdens, harming commercial activity and artificially distorting the dynamics of the marketplace.
- Ad valorem excise taxes are not consistent with virtually all other consumer product excise taxes that tax solely on the basis of the amount of the product purchased and consumed, and do not discriminate on price.
- Ad valorem state excise taxes amount to a tax on top of a tax because a portion of the price basis for applying the excise tax is attributable to any existing federal excise tax.
- Ad valorem excise taxes result in automatic tax increases and decreases **without** legislative oversight or action.

— Ad valorem excise tax statutes are subject to differing interpretations regarding the appropriate tax base and payer; this increases complexity and compliance problems for manufacturers, distributors and state tax administrators.

The Solution: Weight-Based Excise Taxes

— Under a weight-based tax structure, not a state tax system that arbitrarily gives a preference to one product over another, consumer products compete fairly in the marketplace on the basis of product attributes and price.
— Weight-based excise taxes eliminate the market distortions and revenue erosion caused by ad valorem excise taxes.
— Like products should carry identical taxes. All products and taxpayers are treated fairly and equally under a weight-based tax system.
— A weight-based excise tax would equalize the tax treatment of all like consumer products in the states and eliminate an economic disincentive that hinders commercial activity.
— A weight-based excise tax on MST eliminates the possibility of a tax on tax.
— A weight-based excise tax eliminates automatic tax increases, and requires specific legislative action to increase or decrease taxes.
— Weight-based taxes are easy for taxpayers to understand and for tax administrators to support and enforce.

Conclusion

Adherence to the principles of sound tax policy, economic neutrality, fairness, simplicity, efficiency and fiscal stability should lead state legislators in states that currently tax consumer products on an ad valorem basis to replace that method of taxation with one that taxes products on a per unit, weight or volume basis.

Adopted by the Commerce, Insurance and Economic Development Task Force on July 21, 2006, and approved by the ALEC Board of Directors in December 2006.

Michael Keegan is the former director of the ALEC Commerce, Insurance and Economic Development Task Force. For additional information please view the resolution and Statement of Principles on the ALEC Web site or contact Jonathan Shore at jshore@alec.org

American Legislative Exchange Council ALEC

Published by
American Legislative Exchange Council
1129 20th Street, N.W., Suite 500
Washington, DC 20036
Publications Order Code: 1234
Cost to non-members: $10.00 + S/H

The Effect of Federal Tobacco Tax Increases on Alaska's Tobacco Taxes

Prepared by: Johanna Bales

Alaska levies an excise tax on cigarettes and on other tobacco products (OTP). The tax rates, tax calculation, and how the tax is levied differ between cigarettes and OTP. The following outlines those differences and the effect of recent federal tobacco tax increases on Alaska tobacco taxes:

<u>Cigarette Tax</u>

Alaska's cigarette tax is levied on each cigarette. The tax is currently 10 cents per cigarette or $2.00 per pack of twenty cigarettes. The tax is levied when cigarettes are brought into the state for sale or personal consumption. What this means is that if an individual buys cigarettes over the Internet or has friends or family ship cigarettes to them through the mail, they are liable to pay the Alaska tax. The federal tax was 39 cents per pack, but is now $1.01 per pack of twenty. The increase in the federal tax does not affect Alaska's tax rate. However, it can and probably will affect revenue as people either quit smoking or cut back due to the higher cost of cigarettes that will result from the federal increase. We also expect smuggling to increase in all states, including Alaska, which will also cut into Alaska's cigarette tax revenue.

<u>Other Tobacco Products (OTP)</u>

Alaska's OTP tax is levied at the rate of 75% of the wholesale price of the tobacco product. OTP includes little cigars, cigars, pipe tobacco, chewing tobacco, snuff, roll-your-own tobacco, etc. Basically, anything other than a cigarette that has tobacco in it. The tax is levied when OTP is brought into the state for sale. It is important to note, the OTP tax is not levied when OTP is brought into the state for personal consumption. The wholesale price is defined in statute as the "established price for which a manufacturer sells a tobacco product to a distributor . . . ." This is basically the manufacturer's list price.

The federal law increased many OTP products significantly. For example, the tax on little cigars increased from 4 cents per pack to $1.01 per pack of twenty. Chewing tobacco increased from 19.5 cents to 50.33 cents per pound and roll-your-own tobacco increased from $1.0969 to $24.78 per pound. The federal tax is paid by the manufacturer. Therefore, the manufacturer's list price will increase to reflect the increases in the federal tax. Even though our tax rate of 75% of the wholesale cost remains the same, the amount upon which the 75% is multiplied will be significantly higher. As such, Alaska's tax on OTP will also increase.

Will people start buying roll-your-own and other OTP from states without a tax? Most states have a tax, but if the product is exported from the state that state's tax doesn't apply. The question should be, "will people start buying roll-your-own and other OTP from Internet sellers?" The answer is, "yes." When Alaska increased the tax on OTP in 1997 from 25% to 75% of the wholesale cost, we did see an increase in people buying OTP through the mail. It is perfectly legal for them to do so since the OTP tax is only levied when OTP is imported or brought into the state for sale. With the increase in the federal tax and resultant increase in the Alaska tax, we will definitely see individuals and possibly even businesses purchasing OTP from Internet sites and through the mail. This will result in lost revenue to the state.

When Alaska increased its cigarette tax during a special legislative session in the summer of 2004, a couple of legislators tried to insert language that made it so the OTP tax was levied on individuals who imported OTP for personal consumption. Their concern was that local businesses which sell OTP were unable to compete with Internet sellers because it was legal for individuals to buy through the mail and

Internet without paying Alaska's tax, but the local retailer had to pay the tax. I think this will be even more of an issue now that the federal tax has significantly increased and the Alaska tax will be even more.

Alaska's cigarette and OTP tax rates are set in statute. The Department of Revenue has no authority to change the tax rates.

One other thing to note is that the federal law provides for a floor stock tax. What this means is that every distributor and retailer in the state must identify their inventory as of April 1, 2009 and pay the difference between the new and old federal tax rates to the federal government by August 1, 2009. Alaska does not have a floor stock tax. Even though distributors and retailers must remit the higher tax on their inventory to the federal government, the Alaska tax on OTP will be based on the manufacturer's list price at the time the product was imported into the state for sale.

Attached is the new federal language with a chart showing the changes in the federal tax rates by product.

Product	Current Tax Rates	Senate SCHIP Tax Rates
Cigarettes	39¢ per pack	$1.01 per pack
Large Cigars	20.719% of manufacturer's price; cap of 4.875¢/cigar	52.75% of manufacturer's price; cap of 40.26 cents per cigar
Little Cigars	4¢ per pack	$1.01 per pack:
Pipe Tobacco	$1.0969 per pound	$2.8311 per pound
Chewing Tobacco	19.5¢ per pound	50.33¢ per pound
Snuff	58.5¢ per pound	$1.51 per pound
RYO; Cigar Wrappers	$1.0969 per pound	$24.78 per pound
Cigarette Paper	1.22¢ per 50 papers	3.15¢ per 50 papers
Cigarette Tubes	2.44¢ per 50 tubes	6.30¢ per 50 tubes

H.R.2

Children's Health Insurance Program Reauthorization Act of 2009 (Engrossed Amendment as Agreed to by Senate)

SEC. 701. INCREASE IN EXCISE TAX RATE ON TOBACCO PRODUCTS.

(a) Cigars- Section 5701(a) of the Internal Revenue Code of 1986 is amended--

(1) by striking `$1.828 cents per thousand ($1.594 cents per thousand on cigars removed during 2000 or 2001)' in paragraph (1) and inserting `$50.33 per thousand',

(2) by striking `20.719 percent (18.063 percent on cigars removed during 2000 or 2001)' in paragraph (2) and inserting `52.75 percent', and

(3) by striking `$48.75 per thousand ($42.50 per thousand on cigars removed during 2000 or 2001)' in paragraph (2) and inserting `40.26 cents per cigar'.

(b) Cigarettes- Section 5701(b) of such Code is amended--

(1) by striking `$19.50 per thousand ($17 per thousand on cigarettes removed during 2000 or 2001)' in paragraph (1) and inserting `$50.33 per thousand', and

(2) by striking `$40.95 per thousand ($35.70 per thousand on cigarettes removed during 2000 or 2001)' in paragraph (2) and inserting `$105.69 per thousand'.

(c) Cigarette Papers- Section 5701(c) of such Code is amended by striking `1.22 cents (1.06 cents on cigarette papers removed during 2000 or 2001)' and inserting `3.15 cents'.

(d) Cigarette Tubes- Section 5701(d) of such Code is amended by striking `2.44 cents (2.13 cents on cigarette tubes removed during 2000 or 2001)' and inserting `6.30 cents'.

(e) Smokeless Tobacco- Section 5701(e) of such Code is amended--

> *(1) by striking `58.5 cents (51 cents on snuff removed during 2000 or 2001)' in paragraph (1) and inserting `$1.51', and*
>
> *(2) by striking `19.5 cents (17 cents on chewing tobacco removed during 2000 or 2001)' in paragraph (2) and inserting `50.33 cents'.*

(f) Pipe Tobacco- Section 5701(f) of such Code is amended by striking `$1.0969 cents (95.67 cents on pipe tobacco removed during 2000 or 2001)' and inserting `$2.8311 cents'.

(g) Roll-Your-Own Tobacco- Section 5701(g) of such Code is amended by striking `$1.0969 cents (95.67 cents on roll-your-own tobacco removed during 2000 or 2001)' and inserting `$24.78'.

(h) Floor Stocks Taxes-

> *(1) IMPOSITION OF TAX- On tobacco products (other than cigars described in section 5701(a)(2) of the Internal Revenue Code of 1986) and cigarette papers and tubes manufactured in or imported into the United States which are removed before April 1, 2009, and held on such date for sale by any person, there is hereby imposed a tax in an amount equal to the excess of--*
>
> > *(A) the tax which would be imposed under section 5701 of such Code on the article if the article had been removed on such date, over*
> >
> > *(B) the prior tax (if any) imposed under section 5701 of such Code on such article.*
>
> *(2) CREDIT AGAINST TAX- Each person shall be allowed as a credit against the taxes imposed by paragraph (1) an amount equal to $500. Such credit shall not exceed the amount of taxes imposed by paragraph (1) on April 1, 2009, for which such person is liable.*
>
> *(3) LIABILITY FOR TAX AND METHOD OF PAYMENT-*
>
> > *(A) LIABILITY FOR TAX- A person holding tobacco products, cigarette papers, or cigarette tubes on April 1, 2009, to which any tax imposed by paragraph (1) applies shall be liable for such tax.*
> >
> > *(B) METHOD OF PAYMENT- The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall prescribe by regulations.*
> >
> > *(C) TIME FOR PAYMENT- The tax imposed by paragraph (1) shall be paid on or before August 1, 2009.*