

# FISCAL NOTE

**STATE OF ALASKA**  
**2004 LEGISLATIVE SESSION**

Fiscal Note Number: 2  
 Bill Version: HB 1001  
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Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Revenue  
 Title Cigarette and Tobacco Products Tax Increase RDU Revenue Programs & Services  
 Component Tax Division  
 Sponsor Governor  
 Requester Rules Component No. 2476

**Expenditures/Revenues** (Thousands of Dollars)

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

| OPERATING EXPENDITURES | FY 2005      | FY 2006      | FY 2007      | FY 2008      | FY 2009      | FY 2010      |
|------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Personal Services      | 466.1        | 466.1        | 466.1        | 466.1        | 466.1        | 466.1        |
| Travel                 | 60.0         | 60.0         | 60.0         | 60.0         | 60.0         | 60.0         |
| Contractual            | 248.0        | 246.8        | 246.8        | 246.8        | 246.8        | 246.8        |
| Supplies               | 6.0          | 6.0          | 6.0          | 6.0          | 6.0          | 6.0          |
| Equipment              | 48.0         | 0.0          | 0.0          | 0.0          | 0.0          | 0.0          |
| Land & Structures      |              |              |              |              |              |              |
| Grants & Claims        |              |              |              |              |              |              |
| Miscellaneous          |              |              |              |              |              |              |
| <b>TOTAL OPERATING</b> | <b>828.1</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> |

| CAPITAL EXPENDITURES | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 |
|----------------------|---------|---------|---------|---------|---------|---------|
|                      |         |         |         |         |         |         |

| CHANGE IN REVENUES ( ) | 29,100.0 | 35,000.0 | 35,000.0 | 35,000.0 | 35,000.0 | 35,000.0 |
|------------------------|----------|----------|----------|----------|----------|----------|
|                        |          |          |          |          |          |          |

**FUND SOURCE** (Thousands of Dollars)

|   |              |              |              |              |              |              |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| 1002 Federal Receipts                   |              |              |              |              |              |              |
| 1003 GF Match                           |              |              |              |              |              |              |
| 1004 GF                                 | 828.1        | 778.9        | 778.9        | 778.9        | 778.9        | 778.9        |
| 1005 GF/Program Receipts                |              |              |              |              |              |              |
| 1037 GF/Mental Health                   |              |              |              |              |              |              |
| Other (Specify Type--Do not abbreviate) |              |              |              |              |              |              |
| <b>TOTAL</b>                            | <b>828.1</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> | <b>778.9</b> |

Estimate of any current year (FY2004) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

**POSITIONS**

|           |   |   |   |   |   |   |
|-----------|---|---|---|---|---|---|
| Full-time | 6 | 6 | 6 | 6 | 6 | 6 |
| Part-time |   |   |   |   |   |   |
| Temporary |   |   |   |   |   |   |

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

**Cigarette and Tobacco Products Tax Increase - Bill Analysis (December 24, 2003)**

**Bill Language:** This bill will increase the cigarette tax from \$1 per pack of twenty cigarettes to \$2 per pack and the tobacco products tax (OTP) from 75% to 100% of the wholesale cost. This bill will also institute a floor stock tax on existing cigarette inventories held for sale in an attempt to reduce the amount of stockpiling of cigarettes on the effective date. In an attempt to reduce the amount of cigarette smuggling and tax evasion, this bill will also allow the Department of Public Safety to seize and dispose of equipment, vehicles, monies and other assets used in activities which violate the cigarette and tobacco products statutes.

(cont. on page 2)

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 Division Tax Division Date/Time 6/15/04 9:53 AM  
 Approved by: Steve Porter, Deputy Commissioner Date 6/15/2004  
 Agency Department of Revenue

**ANALYSIS CONTINUATION**

**Assumptions:** The Department of Revenue (DOR) will have primary enforcement responsibility for the cigarette and tobacco products excise tax program. However, DOR will work with the Department of Public Safety (DPS) and Department of Law (DOL) as part of a task force responsible for cigarette tax stamp enforcement in the state. DPS, at the request of DOR, will provide investigative support through a reimbursable services agreement (RSA). The amount of this RSA has been estimated by DPS. Monies for the RSA are included in the Contractual costs requested in this fiscal note. This fiscal note does not include additional costs that may be incurred by DOL as a result of this legislation. From information obtained from other states with cigarette tax rates of \$1.50 to \$2.05 per pack, DOR expects that the increase in the tax rates will result in a significant increase in incidents of cigarette smuggling and tax evasion.

**Program Summary:** DOR will conduct periodic inspections of cigarette and tobacco products licensees as well as retailers who hold tobacco endorsements with the Department of Community and Economic Development for unstamped cigarettes. In addition, DOR will be the primary contact for complaints from the public and compliant retailers regarding unstamped cigarettes. DOR will work with DPS and DOL to develop cases against cigarette smugglers, including seizing unstamped product and assets used in activities that violate the cigarette and tobacco products statutes. DOR will prepare assessments for unstamped cigarettes and untaxed cigarettes and OTP imported into the state by individuals for personal use and/or resale and work with federal agencies to stop out-of-state entities, specifically Internet sellers, from shipping cigarettes into the state in violation of existing statutes.

**Positions:** DOR expects that it will need 6 additional positions, 1 Revenue Auditor Supervisor II, 2 Investigator III's, 1 Revenue Auditor III, 1 Accounting Technician III and 1 Appeals Officer (Revenue Auditor V), to manage the workload of the task force, conduct investigations, prepare assessments, and work appeals filed in disputes involving assessments, seized cigarettes, and seized assets. These six positions, along with the two existing investigator positions already assigned to tobacco cases, will represent DOR as part of the task force explained above. DOR estimates the total cost of these additional positions to be \$466,100 each year.

**Other Operating Expenditures:** (1) Travel - DOR estimates it will need \$60,000 for travel costs for investigators to conduct routine inspections of the approximate 1,600 known cigarette retail establishments throughout the state each year. DOR estimates that each investigator will need to conduct, at a minimum, ten separate inspections/investigations in villages within the state each year to insure an effective enforcement program and respond to complaints from the public of unstamped product. (2) Contractual - Contractual costs in the amount of \$248,000 in the first year and \$246,800 each year thereafter are primarily to fund an RSA between DOR and DPS and for the lease, operation and maintenance of two vehicles to be used by investigators to conduct inspections/investigations in the Anchorage, Mat-Su and Kenai Peninsula areas of the state where most cigarette retail establishments are located. Investigators must be able to respond to complaints of unstamped product quickly and perform unscheduled inspections of retail establishments on an ongoing basis. Contractual costs also include leasing office space and providing phone service for 6 additional employees and renting storage facilities for seized cigarettes and other assets. (3) Supplies - DOR estimates \$1,000 per each FTE each year (a total of \$6,000) for supplies needed to perform the duties of these positions. (4) Equipment - DOR expects equipment expense of \$8,000 per FTE (a total of \$48,000) in the first year for computers, telephones, cubicle parts, software, and other one-time purchases of office equipment needed to perform the duties of these positions.

**Revenue:** DOR estimates cigarette and tobacco products revenues to increase between \$33 and \$37 million each year. However, DOR believes these revenues will be much smaller unless we institute an aggressive investigation and enforcement program. Although we believe the provision for cigarette tax stamps, which took effect January 1, 2004, will be an effective tool in enforcement of the cigarette excise tax, its success depends upon aggressive enforcement. Even at \$1.00 per pack, the incentive for smuggling and tax evasion is great. At \$2.00 per pack, it will be much more attractive. An aggressive enforcement program will help protect the projected revenue increase.