



## THE MANY WAYS STATES CAN RAISE REVENUES WHILE ALSO REDUCING TOBACCO USE AND RELATED HARMS & COSTS

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The following is a list of some of the ways that states (and localities) can increase government revenues while simultaneously helping to prevent and reduce tobacco use and its many harms and costs. So far, many states have focused on just raising their cigarette tax rates, often neglecting many other possibilities (and even failing to implement their cigarette tax most effectively).

1. ***Raise the state cigarette tax rate and raise all other tobacco product tax rates to parallel levels***. If it does not make sense to raise the cigarette tax rate (because of a recent increase to a very high rate), raising the other state tobacco product tax rates to match the state cigarette tax rate can still bring in significant amounts of new revenue. To match a \$2.00 cigarette tax rate, the OTP tax rate should be 70 percent of wholesale price, and individual tax rates on different types of tobacco products can be established that are the same as the tax for cigarettes on a per-package or per-dose basis.
2. ***To maximize new state revenues from new cigarette or OTP tax rate increases:***
  - a) ***Make sure that the rate increase will apply to all cigarettes or OTP held in retailer or wholesaler inventories at the time the rate increase goes into effect.*** All states regularly do this unless there are drafting errors or they forget to check.
  - b) ***Make sure any statutory percentage-of-tax discount given to wholesaler tax-stampers (typically meant just to help cover the cost of applying the tax stamps) is adjusted to reflect the new, higher cigarette tax rate (and avoid any windfall increase to the discount).*** A 0.25 percent discount for a 50-cent tax, for example, will triple in size if the tax is increased to \$1.50; but the wholesalers' tax-stamping application costs will not increase at all.
3. ***To maximize state tobacco tax revenues, whether the tax rates are increased or not:***
  - a) ***Make sure that the state definitions of "cigarette" and "tobacco products" are comprehensive with no loopholes that allow some cigarettes or other tobacco products to evade taxation.*** The easiest way to fix the state "cigarette" definitions is to add: "and includes any roll containing tobacco, however wrapped, that weighs not more than three and a half pounds per thousand unless wrapped in whole tobacco leaf without any filter." The easiest way to fix the definitions of "other tobacco products" or "smokeless tobacco" is to add: "and includes any other product containing tobacco that is expected or intended to be consumed without being combusted."
  - b) ***For percentage-of-price OTP taxes, establish a supplementary minimum tax to ensure that tobacco products sold at predatory prices or other low anti-competitive prices still pay a reasonable tax per package or dose.*** One simple way to do that is for the law to state: "Any tobacco product subject to a percentage-of-price tax in this chapter that has a taxable price of less than \$2.50 per package or unit shall be taxed as if its price were \$2.50." Another option is to make the OTP tax the higher of the percentage-of-price tax and specific tax rates for each different types of tobacco products that are the same as the tax for cigarettes on a per-package or per-dose basis.
  - c) ***Make sure any weight-based tax for "moist snuff" is fixed so the definition of moist snuff subject to the weight-based tax does not include the new generation of super-low-weight moist-snuff products.*** Weight-based "moist snuff" definitions can be fixed by adding: "but does not include any such product with a moisture content of less than 45% or that comes in

individual single-dose tablets or other discrete single-dose units.” Making the tax on moist snuff the higher of the weight-based tax or the OTP percentage-of-price tax will also fix this problem.

**d) Link the state’s tax rates for tobacco products other than cigarettes to the state cigarette tax rate so that they will go up automatically whenever the state cigarette tax rate is increases.** Many states forget to raise their OTP tax rates when they raise their cigarette tax rates, thereby losing state revenues, creating tax inequities and loopholes, and failing to prevent youth initiation. By setting tax rates on OTPs to equal the higher of the percentage-of-price tax rate or “an amount equal to the total state tax on a pack of cigarettes” for each individual package” is one way to make sure OTP tax rates keep up with the state cigarette tax rate.

**e) Eliminate any existing caps on tobacco tax rates or amounts, such as the maximum amount of tax on any single cigar.** Why subsidize wealthy smokers of expensive cigars? [If some cap must be maintained for political reasons, make it no lower than “an amount equal to the total state tax on a pack of cigarettes,” which will automatically go up over time as the cigarette tax rate is increased.]

- 4. Increase fines and penalties for tobacco tax evasion and for violations of all other state laws pertaining to tobacco control or tobacco products.** Many state fines and penalties were set many years ago and have not changed since. Updating them to account for inflation (or more) will bring in new revenue per fine or penalty and also create stronger incentives for enforcement, which will bring in even more new revenue in the form of both increased penalty and fine payments and increased recovery of unpaid tobacco taxes. Indexing the fine and penalty amounts to inflation or tobacco product price increases (or to increases to the state cigarette tax rate) will ensure that the fines and penalties, and the revenue they generate, do not shrink in significance over time.
- 5. Increase the state’s recovery of currently evaded taxes by creating new incentives and cost-free sustained funding for increased state enforcement efforts.** Simply add provisions into state law stating that the state agencies and offices involved in enforcing the state’s tax laws and underlying investigations can recover attorneys fees and costs from violators and can retain half of all obtained fines and penalties to support expanded new enforcement efforts (with general revenues getting both the other half of all fines and penalties and all the recovered unpaid taxes, plus interest).
- 6. Increase licensing, permit, and registration fees for manufacturers, distributors, wholesalers, and retailers of tobacco products so that the fees cover all state costs associated with administering and enforcing the state’s laws and regulations pertaining to the manufacture, distribution, and sale of tobacco products, including tax collection and preventing sales to youth.** As with penalties and fines, licensing fees may have been set years ago with no later increases to account for inflation or higher state costs. Indexing the fees to inflation or tobacco product price increases, or to changes in the state cigarette tax rate, will make sure the fees do not shrink in significance over time.
- 7. Establish a new manufacturer permit fee for each brand and sub-brand of tobacco products sold in the state.** This permit fee, perhaps \$10,000 for each tobacco product brand or sub-brand a manufacturer wants to sell in the state, could raise significant amounts of revenue because there are more than 1,500 cigarette brands and sub-brands, alone. Under some state laws, localities might not be able to establish such permit fees for general revenue raising purposes, but they could still establish them as formal user fees if all the revenues were directed solely to support the administration and enforcement of the fee system, itself, and all of the jurisdictions related laws pertaining to the marketing, distribution and sale of tobacco products.

8. **Make sure the state sales tax applies to all tobacco products and to the total retail price of tobacco products, including the federal and state excise tax portions.** The vast majority of states apply their sales tax to the full retail price of all tobacco products (including all excise taxes). But Oklahoma's sales tax does not apply to tobacco products; Minnesota's regular retail sales tax does not apply to cigarettes; and the sales tax in Georgia and Missouri does not apply to the state excise tax portion of the retail price. Fixing those loopholes will bring in new revenues and reduce tobacco use and harms.
9. **Impose new state fees on any smokeless tobacco company that does not sign onto the Smokeless Tobacco MSA – creating a parallel to the state's existing laws relating to cigarette MSA Non-Participating Manufacturers (NPMs).** So far, UST is the only smokeless tobacco company that has signed onto the Smokeless MSA, which means none of the other smokeless tobacco companies have to comply with the STMSA marketing restrictions or make any related payments. [Fortunately, cigarette companies that also sell smokeless brands (e.g., RJR with Camel Snus or Philip Morris with Marlboro Snus) must comply with the cigarette MSA's marketing restrictions re: their smokeless sales.]
10. **Reduce cigarette tax evasion by implementing a new high-tech tax stamp system.** High-tech tax stamps quickly pay for themselves by preventing and reducing tobacco tax evasion and facilitating related enforcement efforts to obtain unpaid taxes and fines and penalties from those involved in contraband cigarette trafficking and tax-evading sales. When California implemented its new high-tech tax stamp, with enhanced enforcement, its cigarette tax revenues increased by \$100 million over the next 20 months (with no tax rate increase). Implementing other measures to reduce tobacco product smuggling and tax evasion will bring in even more new revenues.
11. **Establish a new fee levied against all manufacturers of cigarettes sold in the state based on their respective shares of the illegal youth market for cigarettes in the state.** This ground-breaking measure would set a special fee based on each brand's share of the youth market for cigarettes (new surveys might be needed to get that information). The fee could be set at any amount (e.g., \$100,000 per each percent of youth market), or could be calculated so that it roughly charges the cigarette companies the current value of the total future revenue stream they will get from the youth smokers of their brands over those youths' lifetimes. This kind of fee has been proposed as a remedy in various tobacco lawsuits but could also be implemented by law. This provision could also be structured more broadly to apply to youth cigar and other OTP use, as well.

*Campaign for Tobacco-Free Kids, June 7, 2011 / Ann Boonn*

#### **Additional Information**

For assistance with structuring or drafting any of these tobacco-prevention revenue-raising measures, please contact the Campaign for Tobacco-Free Kids at [factsheets@tobaccofreekids.org](mailto:factsheets@tobaccofreekids.org).

More information on cigarette and OTP tax increases is available at [http://www.tobaccofreekids.org/facts\\_issues/fact\\_sheets/policies/tax/us\\_state\\_local/](http://www.tobaccofreekids.org/facts_issues/fact_sheets/policies/tax/us_state_local/).

For more information on high-tech tax stamps, see the Campaign factsheet available at: <http://tobaccofreekids.org/research/factsheets/pdf/0310.pdf>. For information on other ways to reduce tobacco product smuggling and tax evasion, see the Campaign factsheet at: <http://tobaccofreekids.org/research/factsheets/pdf/0274.pdf>.