



CREATING FEDERAL TAX EQUITY AMONG ALL TOBACCO PRODUCTS WOULD INCREASE FEDERAL REVENUES & PROMOTE PUBLIC HEALTH

The current federal tax rates for tobacco products produce inequities and loopholes that sharply reduce federal revenues and, by keeping tobacco product prices low, increase overall tobacco use and harms. In 2009, Congress increased the federal tax rate on cigarettes and, for the first time, equalized the tax rates on cigarette-like small cigars and roll-your-own (RYO) cigarettes to that of cigarettes. But cigars, smokeless tobacco products, and pipe tobacco are still substantially under-taxed compared to cigarettes. As detailed in reports by the U.S. Government Accountability Office (GAO) and the U.S. Centers for Disease Control and Prevention (CDC), the current tobacco tax code has numerous loopholes that enable and even incentivize manufacturers to manipulate products so they can be classified into lower-tax categories.¹

The inequities in the current federal tobacco tax code include:

- The federal tax on loose tobacco for pipe smoking is less than one-eighth the tax rate on loose tobacco used for rolling into cigarettes or cigars, which has led some manufacturers to re-label their RYO tobacco as “pipe tobacco” to qualify for the lower tax rate. In just the twelve months after the 2009 rate increases created a disparity in tax rates between RYO and pipe tobacco, RYO tobacco sales dropped by 61 percent, but “pipe tobacco” sales increased by 233 percent compared to the same period the year before, and the gap in sales has widened since then.²
- The federal tax on large cigars is based on the price of the product (52.75% of the manufacturer’s price), with a cap at only 40.26 cents per cigar, compared to the tax on cigarettes and small cigars at \$1.01 per pack of 20 sticks. Manufacturers modified their cigarettes and “little cigar” products to qualify for the lower tax rate on large cigars by slightly increasing their weight and, in the case of cigarettes, adding some tobacco into their wrapper paper. As a result, in the year after the 2009 tax increase, sales of products in the “small cigars” category dropped 79 percent, while sales of products labeled and taxed as “large cigars” increased by 77 percent, and the difference in sales persists today.³
- The federal tax on a standard can of loose smokeless tobacco is less than one-eighth of the tax on a standard pack of cigarettes.
- The weight-based federal tax on “snuff” taxes low-weight smokeless tobacco products (e.g., snus) at a rate that is as little as one-eighth of the tax on regular loose moist snuff. As a result, the tax on each unit of these new low-weight smokeless products is as little as 1/70th of the tax on cigarettes.
- Some products being regulated by the U.S. Food and Drug Administration (FDA) as tobacco products, such as e-cigarettes, are not taxed at all at the federal level.

Core principles of tax equity call for eliminating all of the tobacco tax loopholes and setting all of the federal tobacco product tax rates at levels that parallel the federal cigarette tax rate. The GAO recommends that “Congress should consider modifying tobacco tax rates to eliminate significant tax differentials between similar products” to stop the projected \$615 million to \$1.1 billion in federal tobacco tax revenue loss due to the loopholes that allowed manufacturers to evade the federal excise taxes.⁴ In addition to the curbing the revenue losses, equalizing all federal tobacco tax rates would reduce tobacco use, thereby locking in substantial future healthcare savings.

Existing Federal Tobacco Product Tax Rates

| | <u>Rate in Tobacco Tax Code</u> | <u>Amount per Unit or Standard Package</u> |
|---------------------------------|--|--|
| Cigarettes | \$50.33 per thousand | \$1.00 ^{66/100} per pack of 20 |
| Small Cigars (~cigarettes) | \$50.33 per thousand | \$1.00 ^{66/100} per pack of 20 |
| RYO Tobacco | \$24.78 per pound | \$1.00 ^{66/100} per 20 cigarettes worth |
| Smokeless - loose moist snuff | \$1.51 per pound | 11.3¢ per 1.2-oz. can |
| Smokeless - snus & dissolvables | \$1.51 per pound | 1.6¢ to 7.7¢ per pack of 20 |
| Smokeless - chewing tobacco | 50.3¢ per pound | 9.4¢ per 3-oz. pouch |
| Pipe Tobacco | \$2.8311 per pound | 11.5¢ per 20 cigarettes worth |
| Regular Cigars | 52.75% of manufacturer price with 40.26¢ per cigar maximum | |
| – 3.6¢ cigar (mfrs price) | | 1.9¢ per cigar (52.75%) |
| – 25¢ cigar (mfrs price) | | 13.2¢ per cigar (52.75%) |
| – 50¢ cigar (mfrs price) | | 26.4¢ per cigar (52.75%) |
| – \$1 cigar (mfrs price) | | 40.26¢ per cigar (40.26%) |
| – \$5 cigar (mfrs price) | | 40.26¢ per cigar (8.05%) |
| – \$10 cigar (mfrs price) | | 40.26¢ per cigar (4.03%) |

Pack = 20 sticks or units. A pack-worth of RYO tobacco is 0.65 ounces (0.0325 oz per cigarette). Listed cigar prices are the Manufacturer Price (the price charged when manufacturers sell to wholesalers and distributors). A standard can of smokeless moist snuff (e.g., Skoal, Grizzly) is 1.2 ounces. Snus and other new smokeless tobacco products sold in discrete single-use tablets or candy-like lozenges weigh as little as one-eighth to one-tenth as much as regular smokeless tobacco.

Setting All Federal Tobacco Product Tax Rates at Equal Levels

The following table shows all the federal tax rates set at parallel levels, on either a per unit, per pound, or per standard package basis – e.g., taxing each tobacco product sold in single-use or single-dose units at the same current rate as cigarettes (\$1.00^{66/100} per 20 sticks), taxing similar tobacco products according to their weight (\$24.78 per pound), and taxing each standard package of other tobacco products at the same rate as a standard pack of cigarettes (\$1.00^{66/100} per 20-pack).

| <u>Tobacco Product</u> | <u>New Tax Equity Tax Rates</u> |
|---|--|
| Cigarettes | \$1.00 ^{66/100} per pack (no change) |
| Small Cigars (~cigarettes) | \$1.00 ^{66/100} per pack (no change) |
| RYO Tobacco | \$1.00 ^{66/100} per 20 cigarettes worth (no change) |
| Smokeless - loose moist snuff | 100.66¢ per 1.2-oz. can |
| Smokeless - snus and dissolvables | 100.66¢ per 20 units |
| Smokeless - chewing tobacco | 100.66¢ per 3-oz. pouch |
| Pipe Tobacco | 100.66¢ per 20 cigarettes worth |
| Large Cigars (e.g., premium cigars, cigarillos, and blunts) | \$1.00 ^{66/100} for a cigar that weighs the same as 20 cigarettes with 5.033¢ per cigar minimum |

20 cigarettes worth of smoking tobacco = 0.65 ounces (0.0325 oz per cigarette). By weight, pipe tobacco and large cigars should be taxed at the same rate as cigarettes and RYO tobacco to account for substitutability of these combustible products and variation in sizes of cigars.

Campaign for Tobacco-Free Kids, September 7, 2017

¹ GAO, *Illicit Tobacco: Various Schemes Are Used to Evade Taxes and Fees*, March 2011, <http://www.gao.gov/new.items/d11313.pdf>. GAO, *Tobacco Taxes: Large Disparities in Rates for Smoking Products Trigger Significant Market Shifts to Avoid Higher Taxes*, April 2012, <http://www.gao.gov/assets/600/590192.pdf>. CDC,

"Consumption of Cigarettes and Combustible Tobacco – United States, 2000-2011," *MMWR* 61(30) August 3, 2012, <http://www.cdc.gov/mmwr/pdf/wk/mm6130.pdf>.

² Alcohol and Tobacco Tax and Trade Bureau (TTB), Tobacco Statistics, <http://www.ttb.gov/tobacco/tobacco-stats.shtml>. See also, Morris, DS & Tynan, MA, "Fiscal and Policy Implications of Selling Pipe Tobacco for Roll-Your-Own Cigarettes in the United States," *PLoS ONE* 7(5):e36487, doi:10.1371/journal.pone.0036487, May 2, 2012. Tynan, MA, Morris, D, & Weston, T, "Continued implications of taxing roll-your-own tobacco as pipe tobacco in the USA," *Tobacco Control* 24(e2):e125-7, June 2015.

³ GAO, *Illicit Tobacco: Various Schemes Are Used to Evade Taxes and Fees*, March 2011, <http://www.gao.gov/new.items/d11313.pdf>. GAO, *Tobacco Taxes: Large Disparities in Rates for Smoking Products Trigger Significant Market Shifts to Avoid Higher Taxes*, April 2012, <http://www.gao.gov/assets/600/590192.pdf>. CDC, "Consumption of Cigarettes and Combustible Tobacco – United States, 2000-2011," *MMWR* 61(30) August 3, 2012, <http://www.cdc.gov/mmwr/pdf/wk/mm6130.pdf>. Being taxed as a "cigar" (instead of as a "cigarette") also helps cigarettes evade being subject to other laws that apply to cigarettes but not cigars.

⁴ GAO, *2013 Annual Report: Actions Needed to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits*, April 2013, <http://www.gao.gov/assets/660/653604.pdf>.