



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: <http://legis.wisconsin.gov/lfb>

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Joint Committee on Finance

Paper #351

Impose Cigarette Tax on Little Cigars (General Fund Taxes -- Excise Taxes and Other Taxes)

[LFB 2019-21 Budget Summary: Page 155, #3]

CURRENT LAW

An excise tax is imposed on tobacco products, including cigars and little cigars, at the rate of 71 percent of the manufacturer's established list price to distributors, not to exceed 50 cents per cigar or little cigar.

GOVERNOR

Change the tobacco products tax imposed on little cigars to be set at the same rate as the excise tax rate currently imposed on cigarettes. Certain administration and enforcement procedures under current law regarding the cigarette tax would also apply to the administration and enforcement of the tax on little cigars. These would include: (a) the imposition of an inventory (floor) tax on little cigars held in inventory for sale or resale; (b) the affixing of stamps to each package of little cigars prior to their first sale in Wisconsin to denote tax paid; (c) discounts for purchasers of tax stamps at 0.8 percent of the tax paid; and (d) penalties for possessing little cigars for which no tax has been paid.

Definitions. Current law makes no distinction between little cigars and other cigars for purposes of the tobacco products tax. The bill would specifically define cigars and little cigars as follows. A little cigar would mean a cigar that has an integrated cellulose acetate filter and is wrapped in a substance containing tobacco. A cigar would mean a roll, of any size or shape, of tobacco for smoking that is made wholly or in part of tobacco, regardless of whether the tobacco is pure, flavored, adulterated, or mixed with an ingredient if the roll has a wrapper made wholly or in part of tobacco. Little cigars would be enumerated in the definition of tobacco products.

Imposition of Tax. While the tax on cigars would remain at the rate imposed for tobacco products under current law, the bill would impose a tax on little cigars weighing not more than three pounds per thousand at a rate of 126 mills per little cigar (\$1.26 per 10), and on little cigars weighing more than three pounds per thousand at a rate of 252 mills per little cigar. A mill equals one-tenth of one cent. Therefore, a rate of 126 mills per little cigar = \$2.52 per pack of 20. These tax rates are the same as those levied on cigarettes under current law. In addition, the cigar tax limit under current law of 50 cents per cigar or little cigar would not apply to the taxation of little cigars under the bill.

The provision would take effect on the first day of the third month following publication of the bill. The administration estimates that imposing the cigarette tax on little cigars would increase state tax revenues by \$2.9 million in 2019-20 and \$3.9 million in 2020-21 and annually thereafter. The Governor's recommendations did not include any revenues associated with the imposition of the inventory tax.

DISCUSSION POINTS

1. Little cigars are similar in shape, size, and tobacco content to cigarettes. In addition, like cigarettes, many little cigars have filters. A primary difference between little cigars and cigarettes is that the former are wrapped in tobacco leaf while the latter are wrapped in white paper. In addition, little cigars are available in several flavors, while cigarettes are typically sold in limited flavor varieties (in 2009, the federal Food and Drug Administration banned all cigarette flavors other than menthol).

2. The 2009 Children's Health Insurance Program Reauthorization Act altered the federal tax rate levied on little cigars to be the same as the federal tax rate levied on cigarettes. Though the definition of a little cigar can vary across states, as of May, 2019, the Campaign for Tobacco-Free Kids reports that 18 states and the District of Columbia tax little cigars at the same rate as the tax rate they impose on cigarettes.

3. Proponents of increasing the tax on little cigars argue that their similarity to cigarettes justifies taxing both products at the same rate. Health experts report that cigars (including little cigars) contain similar toxins, and carry the same carcinogenic risks, as cigarettes. A general rationale for selectively taxing products that are viewed as unhealthy is to discourage people from continuing the unhealthy behavior. Some would argue that, given the evidence of similar health risks between cigars and cigarettes, it is unclear why little cigars should be taxed at a lower rate than cigarettes.

4. Supporters of increasing the tax on little cigars also worry about the use of these products by adolescents. They contend that the current lower tax on little cigars relative to cigarettes makes little cigars more attractive to price-sensitive consumers, who tend to be younger. In addition, they caution that the variety of flavors available for little cigars makes them more appealing to young people. The potential for increased use of little cigars by young adults is especially worrisome to certain public health officials, who point to data that show that nearly 90% of smokers begin smoking before the age of 18. Thus, they argue that preventing young people from ever starting to smoke is critical to reducing overall smoking rates, and that any product that may be more appealing to adolescents should not be subject to a relatively lower tax rate.

5. Between 2007-08 and 2017-18, overall cigarette consumption in Wisconsin, as measured by the number of taxed cigarette packs sold to distributors, is estimated to have declined by 39%. This decline has been spurred, in part, by increases in the state cigarette tax rate in 2008 and 2009, as well as an increase in the federal cigarette tax rate in 2009. Therefore, it could be argued that increasing the excise tax on cigarettes has been an effective tool for discouraging people from using a product that is harmful to their health. Such an argument could also be applied to the proposed tax increase on little cigars as a mechanism for the reduced consumption of these products.

6. Opponents of taxing little cigars at the same rate as the tax on cigarettes contend that the two products have multiple differences that justify their taxation at different rates. They report that both products contain different types of tobacco, sugar contents, and levels of acidity, and should not be considered similar products. Moreover, they counter that the current differential tax treatment of the two products does not artificially boost the consumption of little cigars, because the market share of little cigars is significantly lower than that of cigarettes. Based on data from the Alcohol and Tobacco Tax and Trade Bureau, the amount of little cigars manufactured annually represent approximately 1.5 percent of the amount of cigarettes manufactured annually.

7. Critics also argue that the burden of these taxes is often borne disproportionately by people with lower incomes. They point to research that suggests that smoking behaviors are more common among individuals with lower financial resources. As such, critics argue that a tax on a product more commonly purchased by low-income individuals will mean that the revenue-generating burden of the tax will be placed more heavily on, and will comprise a higher income percentage of, such individuals.

8. Both tobacco industry representatives and organizations that generally advocate for higher taxes on tobacco products have expressed support for taxing products based on their level of harm. Under this approach, products that are demonstrated to be less harmful to health would be taxed at lower rates than those that are more damaging to health. If the goal of an excise tax on harmful products is to reduce the use of those products, the Committee could consider whether it believes little cigars to be less harmful than conventional cigarettes, so as to justify their continued lower rate of taxation.

9. On May 1, 2019, the administration submitted an erratum seeking to clarify administration of the inventory tax on little cigars in the Governor's budget bill. According to the administration, most retailers would not have paid the tobacco products tax on little cigars held in inventory and may have difficulty determining the manufacturer's established list price upon which the tobacco products tax was previously paid. To ensure efficient administration of the inventory tax, the administration indicates that an amendment is necessary to require manufacturers or distributors to provide the manufacturer's established list price information to retailers no later than five days prior to the effective date of the rate increase.

10. The administration's fiscal estimate of this provision has been revised slightly, based on more recent information. Before any revenues associated with a floor tax, it is estimated that this provision will increase excise tax collections by approximately \$2.6 million in 2019-20 and \$3.5 million in 2020-21 and annually thereafter. In addition, as noted above, the fiscal estimate created with this provision did not include any revenues associated with the imposition of the inventory tax.

Based on data provided by DOR on revenues resulting from the imposition of previous floor taxes, it is estimated that the floor tax on little cigars under the bill would generate additional excise tax revenues of approximately \$300,000 on a one-time basis. Therefore, total excise tax collections resulting from these provisions are estimated at \$2.9 million in 2019-20 and \$3.5 million in 2020-21.

11. However, DOR also indicates that enforcing the floor tax would pose a significant administrative burden. Specifically, the Department reports that new software programming would be required to accommodate a floor tax on a product that has not before been subject to such a tax. DOR also expects to incur additional costs related to enforcement of the tax. The Department estimates that the administrative costs associated with the inventory tax on little cigars would total approximately \$230,000, comprised of \$165,000 for computer programming costs, and the remaining \$65,000 for general administration of the tax. If the Committee chose to impose the floor tax included in the Governor's recommendations, the Committee could consider providing additional funding of \$230,000 GPR to DOR for the associated administrative costs (Alternative 2).

12. The Committee could also consider whether to impose the floor tax (Alternative 3). Under this alternative, if the floor tax were not implemented, it is assumed that some retailers and distributors would make additional purchases of little cigars in the near term that would otherwise have been subject to the new, higher tax rate before that rate takes effect. In this scenario, the increased excise tax collections under the bill are estimated to be reduced by approximately \$200,000 on a one-time basis.

ALTERNATIVES

1. Approve the Governor's request, and specify that manufacturers or distributors are required to provide the manufacturer's established list price information to retailers no later than five days prior to the effective date of the rate increase. Estimate increased excise tax revenues of \$2,900,000 in 2019-20 and \$3,500,000 in 2020-21.

ALT 1	Change to	
	Base	Bill
GPR-Tax	\$6,400,000	- \$400,000

2. Approve the Governor's request, and specify that manufacturers or distributors are required to provide the manufacturer's established list price information to retailers. Provide funding of \$230,000 GPR on a one-time basis (\$165,000 to the administrative services and space rental -- integrated tax system technology appropriation and \$65,000 to the collection of taxes -- general program operations appropriation) to fund the administrative costs associated with implementation of the floor tax. Estimate increased excise tax revenues of \$2,900,000 in 2019-20 and \$3,500,000 in 2020-21.

ALT 2	Change to	
	Base	Bill
GPR	\$230,000	\$230,000
GPR-Tax	\$6,400,000	- \$400,000

3. Approve the Governor's request, but delete the provision that would require the imposition of an inventory tax on little cigars. Estimate increased excise tax revenues of \$2,400,000 in 2019-20 and \$3,500,000 in 2020-21.

ALT 3	Change to	
	Base	Bill
GPR-Tax	\$5,900,000	- \$900,000

4. Take no action. Estimate reduced excise tax revenues under the bill of \$2,900,000 in 2019-20 and \$3,900,000 in 2020-21.

ALT 4	Change to	
	Base	Bill
GPR-Tax	\$0	- \$6,800,000

Prepared by: Dan Spika