LEGISLATIVE FISCAL OFFICE
Fiscal Note

Louisiana Legislative Fiscal Office
Fiscal Notes

Fiscal Note On: **HB 148** HLS 15RS 483
Bill Text Version: **ORIGINAL**
Opp. Chamb. Action:
Proposed Amd.:
Sub. Bill For.:

Date: May 3, 2015 2:34 PM
Author: BADON
Dept./Agy.: Revenue
Subject: Tobacco Tax Increase
Analyst: Greg Albrecht

TAX/TOBACCO TAX OR +$214,000,000 SD RV See Note
Levies an additional tax on cigarettes and tobacco products and dedicates the monies

Current law imposes an excise tax on cigarettes of 36¢ per 20-pack, 8% of invoice and 20% of invoice on cigars, 33% of invoice on smoking tobacco, and 20% of invoice on smokeless tobacco.

Proposed law increases the tax on cigarettes by $1.05 per 20-pack, to a new tax rate of $1.41 per 20-pack. Cigars taxed at 8% of invoice are increased to 16%, smoking tobacco is increased to 66%, and smokeless is increased to 40%. Cigars taxed at 20% are not increased. Inventories are explicitly not subject to the tax increase proposed by this bill.
Proposed law also creates the Louisiana Healthy Living Fund to receive the avails of the tax increases levied by this bill. Monies in the fund are to be used as follows: 70% for the Board of Regents to distribute to the college systems, and 30% to the Department of Health and Hospitals for smoking cessation programs.
Effective for the period beginning July 1, 2015.

EXPENDITURES	2015-16	2016-17	2017-18	2018-19	2019-20	5 -YEAR TOTAL
State Gen. Fd.	$70,000	$70,000	$70,000	$70,000	$70,000	**$350,000**
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	$0	$0	$0	$0	$0	**$0**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**$70,000**	**$70,000**	**$70,000**	**$70,000**	**$70,000**	**$350,000**

REVENUES	2015-16	2016-17	2017-18	2018-19	2019-20	5 -YEAR TOTAL
State Gen. Fd.	$0	$0	$0	$0	$0	**$0**
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	$214,000,000	$233,000,000	$233,000,000	$233,000,000	$233,000,000	**$1,146,000,000**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**$214,000,000**	**$233,000,000**	**$233,000,000**	**$233,000,000**	**$233,000,000**	**$1,146,000,000**

EXPENDITURE EXPLANATION

In the past, the Department of Revenue has indicated that it will incur one-time costs to notify affected taxpayers of the tax rate increases, to revise tax forms, and make tax system programming changes. In addition, these relatively large tax rate increases may warrant enhancements of security features of tax stamps to deter counterfeiting, entailing a recurring cost increase for more expensive tax stamps. Security measures are estimated to be at least $70,000 per year. Additional workload costs to modify the tax system and educate taxpayers will add costs in FY16.

REVENUE EXPLANATION

The bill raises tax rates on almost all currently taxed tobacco products (other than cigars taxed at 20% of invoice price). The bulk of the revenue estimate is associated with cigarettes, and its taxation is discussed at length on page 2.

The result of the analysis of cigarettes alone is a revenue gain of $195 million in FY16, and $205 million in FY17 and subsequent fiscal years.

Other tobacco products were estimated based on the per 1% tax rate average yield in FY14 multiplied by the percentage point increases in tax proposed by this bill. That approach generates a potential revenue gain of $28 million. There is little actual Louisiana specific evidence of tax avoidance with respect to tax rate increases levied on these other tobacco products. When federal tobacco taxes were raised in 2009 a temporary reduction in state tax receipts from these products did occur, evidencing some negative behavioral response. However, within a year state tax-paid consumption rebounded and these products have continued to exhibit modest growth. Based on that experience, the average yield result above is reduced for FY16 by the same average amount experienced with cigarettes over the last few rate increases; 33% adjustment resulting in a $19 million revenue gain in FY16. Then for FY17 and beyond a return to the average yield estimate is projected.

The total revenue effect of this bill is projected at $214 million in FY16, and $233 million in FY17 and subsequent years. These receipts are dedicated to the Louisiana Healthy Living Fund, newly created by this bill.

Senate — Dual Referral Rules — House

☐ 13.5.1 >= $100,000 Annual Fiscal Cost {S&H}

☒ 13.5.2 >= $500,000 Annual Tax or Fee Change {S&H}

☐ 6.8(F)(1) >= $100,000 SGF Fiscal Cost {H & S}

☐ 6.8(F)(2) >= $500,000 Rev. Red. to State {H & S}

☐ 6.8(G) >= $500,000 Tax or Fee Increase or a Net Fee Decrease {S}

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CONTINUED EXPLANATION from page one:

Tobacco taxes on cigarettes currently make up approximately 80% of total tobacco tax collections. The state cigarette tax was increased in 1990, 2000, and 2002, and the federal tax was increased in 2009. In each of those cases additional collections were less than the simple average yield of 1¢ of tax (prior to the tax rate increase) implied. In the last state episode (2002), the new collections level was only about 82% of what would be implied from the simple average yield, and only 54% with the last federal episode (2009). That is, total tax-paid sales decline when prices increase (in these cases from a tax increase) as consumers avoid the tax by purchasing the product in lower tax locales and reducing real consumption of the product altogether.

A simple calculation of revenue gain based on the current average yield of 1¢ of existing tax would result in an anticipated annual gain of some $327 million in FY16 from the cigarette tax increase proposed in this bill. However, this assumes no purchase response on the part of consumers. A somewhat more complicated calculation encompassing average prices, state & local sales taxes, industry markups, and a cross-border/single-state rate change purchaser response results in an anticipated annual gain of some $191 million in FY16. Adjusting the simple average yield calculation above for what has actually happened with past state tax increases compared to the simple average yield expectation at the time can result in a revenue gain of $219 million (with considerable variation, actual gains from past state tax increases have averaged 33% less than an average yield would suggest, and incorporating the federal tax increase, 36% less).

Previous state tax increases were individually relatively small (4¢, 4¢, and 12¢, respectively; percent increases of 25%, 20%, and 50%) compared to the $1.05 increase of this bill (nearly quadrupling the current tax), while the federal increase was relatively large at 61.66¢ (158%). Texas, Arkansas, and Mississippi all have higher current tax rates of $1.41/pack, $1.15/pack, and 68¢/pack, respectively. These tax rate differentials may have generated sales and tax receipts in Louisiana from neighboring state residents. The tax rate increase proposed by this bill may work to negate this effect somewhat with respect to all three neighboring states. Additional remote sales and other tax avoidance behaviors may also reduce the revenue gain potential from the bill. With less than certainty as to the magnitude of these effects under this bill's tax increase, an average of the two calculations above that attempt to account for tax-paid purchase response is utilized for the bill's base cigarette tax increase of $205 million per full year. Given the exemption for inventories and an effective date of July 1, 2015, a reduction for FY16 is imposed for the possible stockpiling and work-off behavior of tobacco wholesalers for a final <u>FY16 estimate for cigarettes alone of $195 million, and $205 million in subsequent fiscal years</u>.

A complicating factor here is the stockpiling and work-off behavior of tobacco wholesalers. In the months leading up to the tax increases of 2000 and 2002 (and even in 2005 when a tax increase was proposed by the Governor but ultimately not enacted) wholesalers purchased substantial amounts of tax stamps in advance of the tax rate increases (stockpiling). These stamps were then "worked off" in the months after the tax increases before new stamps were purchased at the higher tax rates. This behavior can effectively shift more than $10 million of tax increase receipts into the fiscal year prior to the effectiveness of the tax increases and out of the fiscal year within which the tax increase becomes effective, even with tax rate increases smaller than the one imposed by this bill. This is possible because state tax increases are not typically imposed on tax stamp inventories, and this bill explicitly excepts inventories from the tax rate increase it imposes (federal tax increases are imposed on inventories). This effect reduces the estimate above to $195 million in FY16, but may reduce it somewhat less since this bill's rate increase is moderate (FY15 receipts would increase by a like amount).

The stockpiling and work-off behavior of wholesalers may be even more complicated than discussed above. While this behavior was exhibited with respect to the tax increase proposals of 2000, 2002, and 2005, it was not exhibited during the debate regarding a tax increase proposal in 2009, even though that proposed increase was as much as $1.00 per pack. That proposed tax increase was not supported by the governor, and wholesalers apparently did not perceive the proposal as likely enough to be enacted to warrant stockpiling. It is not clear if the tax increase proposed by this bill will be supported by the governor. Thus, the stockpiling and work-off behavior built into this fiscal note may not occur. If not, the estimated revenue gain for FY16 may be some $10 million greater than shown in the table above, and FY15 collections would likewise not be benefited by the timing shift of receipts that results from this behavior.

<u>Senate</u> <u>Dual Referral Rules</u> <u>House</u>

- [ ] 13.5.1 >= $100,000 Annual Fiscal Cost {S&H}
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