

MEMO

To: AWMA Members

From: Scott Ramminger

Date: April 1, 2004

Tobacco Excise Tax Increases: Outlook for 2004 & Information You Can Use to Combat Excessive Increases

With state legislatures going into session as we begin what promises to be another tough budget year for most states, tobacco tax increases are on the front burner.

In this memo, we have prepared a set of talking points that you can use to communicate with your legislators and others regarding the inadvisability of excessive tobacco tax increases.

Go to the Government Relations section of awmanet.org and you'll find tools you can use to contact your state legislators if you do business in an area that appears ripe for an increase.

AWMA is also working with state association Executive Directors to track state action on this issue and to ensure effective lobbying efforts in combating these proposed increases. AWMA has launched a regular monthly conference call with state association Executive Directors from across the country to coordinate action on important issues like this one.

Background

The economic boom of the 1990's enabled many states to cut taxes and still enjoy overall economic good health and soaring revenues. What a difference a few years makes! When the Republican Governors gathered to celebrate the preservation of their majority status among the nation's governors, the celebration was brief as talk turned to the dismal fiscal situation facing most states across the nation. Governor Mike Rounds (R-SD) summed up the sentiment across the board when he said, "As much as we are going to talk about education and other things, the real thing in front of all of us is our budget."

The pressure on states facing tremendous budget shortfalls to find revenue is intense and cigarette excise taxes are very much in the crosshairs for 2004. And, to add insult to injury, those states that already saw significant increases may not be immune to

additional increases in 2004. Already, in 2004, we've seen 7 states propose higher excise taxes on cigarettes - California, Iowa, Kentucky, West Virginia, Missouri, Virginia and Oklahoma. In 2003, 14 states passed higher state excise taxes and 3 states put previously passed increases into effect.

Impact of Excise Tax Increases

While the pressure to raise cigarette excise taxes may be strong – such action would not alleviate the states economic problems because the unintended consequences of an increase would adversely affect future budgets.

One of the most onerous results of any hike in cigarette taxes is the fact that smokers will be forced to find alternative ways of purchasing cigarettes, such as through the Internet or from Native American territories where state excise taxes can be avoided or evaded illegally. Unduly high excise taxes also give rise to cigarette and tax stamp counterfeiting. In addition, smokers may travel to nearby states to purchase cheaper cigarettes. All of these alternatives – in addition to a variety of other consequences – obviously result in a loss of revenue to the state raising the tax.

Aside from the budget shortfalls resulting from the cigarette tax increase, another result of tax hikes is an increase in law enforcement problems such as higher demand for counterfeit cigarettes and greater incentives for organized smuggling from low-tax to high-tax states. Such illegal activities also places a tremendous burden upon the state raising the tax as law enforcement officials respond to the increase in these contraband and tax evasion activities.

And if smokers turn to the Internet as a cheaper avenue to purchase their cigarettes as a result of a tax increase, it will be more difficult to control underage access to these products. Face to face interaction in purchasing cigarettes offers the opportunity for better age verification controls. However, these youth access controls are not as effective or even available when buying cigarettes online.

Excise tax hikes also may induce adult smokers to change brands from one participating in the Master Settlement Agreement (MSA) to a lower cost cigarette manufactured by companies not complying with the MSA and state escrow statutes.

Extreme increases in state tobacco excise taxes are simply bad public policy. A December 27, 2002 *Wall Street Journal* article documented the increase in criminal activity in New York City that has resulted from the recent city and state cigarette excise tax increases there.

###

Talking Points:
Adverse Impact of Cigarette Excise Tax Increases

- Increased excise taxes on cigarettes force smokers to find alternative methods of purchasing this product such as through the internet or from Native American territories – both of which can result in evasion of state excise taxes.
- When smokers turn to the Internet as a cheaper avenue to purchase cigarettes it becomes much more difficult to control underage access to these products.
- Face to face interaction in purchasing cigarettes offers the opportunity for better age verification while Internet purchases do not have the same access controls and are not as effective or even have such controls available.
- Substantial hikes in cigarette taxes create greater incentives for organized smuggling from low-tax to high-tax states.
- A hike in the cigarette tax translates into a hike in demand for counterfeit cigarettes.
- This increase in illegal activities directly resulting from cigarette tax increases places a tremendous burden upon the state raising the tax as law enforcement officials respond to the increase in these contraband and tax evasion activities.
- Studies have shown that when a state raises its excise tax on cigarettes smokers may travel to nearby states with lower taxes to purchase cheaper cigarettes. Obviously, this results in lost revenues to the state raising the tax.
- Excise tax increases may also induce an adult smoker to change brands from one participating in the Master Settlement Agreement (MSA) to brands that are not either signatories to the agreement or properly making escrow payments as non-participating manufacturers.
- Extreme increases in state cigarette excise taxes are simply bad public policy. A December 27, 2002 *Wall Street Journal* article documented the increase in criminal activity in New York City that has resulted from the recent city and state cigarette excise tax increases there.