



South Dakota Legislative Research Council

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A HISTORY AND COMPARISON OF TOBACCO TAXES & FEES

BACKGROUND

Governments cherish the income from tobacco taxes while they legislate protective measures to protect the consumer and general public from negative effects associated with tobacco. The use of tobacco products has widespread social and political implications, from teenage smoking to cancer, from government subsidies to government revenue, and from paid advertisements to required warning labels. There are passionate discussions from Washington, D.C. to the state capitals on regulating, taxing and subsidizing the tobacco industry, especially as society becomes more health conscious and tax weary. Some individuals wish to prohibit smoking, while others believe it is an infringement on their right to choose to smoke.

It is important when comparing the tax and fee structure of states to understand where tobacco production occurs and the influence of geographic location. Tobacco is primarily produced in a belt across several southern states, including the states of Tennessee, Kentucky, North Carolina, South Carolina, Georgia, and Virginia. These six states produce 93 percent of the tobacco grown in the United States.

Only 16 states are listed by the U.S. Department of Agriculture as producers of tobacco, including the New England states

of Connecticut and Massachusetts. These production areas date back to the time of the colonies. As might be expected, the taxes and other fees assessed by the producing states are less than they are in the other 34 states. For example, these 16 states have an average cigarette tax of 22 cents per pack versus 34 cents for the rest of the nation. The average cigarette tax per pack in the six primary producing states is seven cents. North Carolina is the only major tobacco producing state that has raised cigarette taxes during the last five years, and it only increased from two cents a pack to five cents.

The six high production states have very few taxes and fees or other mandates which would discourage consumption or production. In contrast, the states bordering Canadian population centers appear to be increasing their cigarette and tobacco taxes to capture the potential income from that market. It was estimated that smugglers had seized 30 to 40 percent of Canada's tobacco market in 1993.

The reason for this smuggling was simple; in the late 1980s Canada and its provinces levied a tax of more than \$3 per pack. The motivation for this tax rate was to discourage consumption, and in turn help lessen the burden on their national health care system and produce revenue. Since that time national and provincial taxes

have been reduced from 25 to 50 percent to curb smuggling. The national decrease was also to pacify the province of Quebec.

TAXES AND FEES

Cigarette and tobacco taxes are a means to discourage consumption, reimburse government for social expenses associated with use, and produce general funds. A comparison of the 50 states portrays a myriad of policies, fees, licenses, permits, taxes, discounts, definitions, etc.

It is extremely difficult to draw parallels from one state to another on how they establish their fees and taxes on cigarettes and other tobacco products. Tobacco taxes have existed before the time of the

revolution. In the few states producing most of the tobacco, there is little incentive to discourage production or consumption through taxes or fees. The lobbyist for the producers and manufacturers of tobacco products also possess significant influence in these states and Washington, D.C.

South Dakota’s taxes on cigarettes are near the national average, including the discount to distributors for affixing stamps or imprinting an impression. However, the recently imposed wholesale tax on tobacco products other than cigarettes is lower than most of the surrounding states as well as the other non-tobacco producing states.

STATE	CIGARETTE TAX	WHOLESALE TAX	SALES TAX
South Dakota	33 cents	10.0%	4.0%
Iowa	36 cents	22.0%	5.0%
Minnesota	48 cents	35.0%	6.5%
Montana	18 cents	12.5%	0.0%
Nebraska	34 cents	15.0%	5.0%
North Dakota	44 cents	28.0%	5.0%
Wyoming	12 cents	10.0%	4.0%

A few states have established several tiers for levying tobacco taxes. The tax structure on tobacco products in South Dakota requires that taxes be collected from the wholesaler or distributor responsible for affixing the stamps or its impression. This tax is passed on to the consumer. In addition to excise taxes levied, many states, including South

Dakota, subject tobacco products to sales tax. Several states have initiated surcharges or additional cigarette and tobacco fees for enforcement. This policy may relate to providing funds to ensure collection of taxes and to police illegal purchases by minors. Tobacco use of South Dakota adolescents has increased from 23 percent in 1992 to 28 percent in 1993.

A few states have stopped the practice of discounting the stamps. This accounting practice may have been stopped because some states may have thought it unnecessary to first levy a tax on a wholesaler or distributor then give a discount. Historically stamps were used as

means to identify black market sales of tobacco products and to police interstate traffic of tobacco projects. Stricter enforcement of federal interstate commercial transfers has lessened this problem.

Cigarette and Tobacco Licenses and Fees

ACTIVITY	LICENSE AND FEE	YEAR IMPLEMENTED
Wholesaler or Distributor	\$ 150 license fee	1966
Transfer of License	\$ 2.50	1966
Cigarettes	\$.33 per pack (17.5 mills per cigarette, weighing not more than 3 lbs. per 1,000)	1995
Tobacco Products	10% wholesale tax	1995
Cigarettes and Tobacco Products	4% sales and use tax and local sales tax	1987
Discount	0.035	1969

LICENSE STRUCTURE AND OTHER RESTRICTIONS

Manufacturers, wholesalers, and distributors may sell only to other wholesalers and to retailers. The state may not issue a wholesale license to any manufacturer or a copartner or a majority stockholder of a parent or subsidiary corporation.

The South Dakota license fee for wholesalers appears to be about average even though this license fee has not been increased in years. This license fee was raised from \$20 to \$150 in 1966. License

fees vary greatly, from no fee in several states to \$1,500 in New York. Each person or business selling cigarettes, except a retailer, must be licensed in South Dakota.

Cigarette and tobacco licenses are valid for one year and must be renewed annually by the first day of July. Renewal of a license is treated the same as a new license. Licenses obtained after the first day of January are charged one-half the full license fee. Unlike alcohol licenses there are no restrictions on the number of licenses issued nor are the local governments involved in issuance.

REVENUE

Though government is addicted to the income generated, it also issues strong proclamations and actions discouraging consumption of tobacco products. It also requires the tobacco industry to place warning labels on their products. Thus, these policies create a paradox between budget revenue requirements and public health.

The federal government annual administrative costs are estimated to be \$16 million in FY 1993 for tobacco price support operations. There is a minimal fiscal impact from the tobacco loan program because of the No-Net-Cost Tobacco Program Act. The President's 1996 budget does suggest eliminating this price support system.

Tobacco taxes are a significant revenue producer for the country and states like South Dakota. Approximately \$5.9 billion was collected in the form of tobacco taxes and fees by the federal government in 1993. South Dakota's revenue was \$13.7 million in FY 1993. The FY 1996 South Dakota tax increases for cigarettes and the new wholesale tax on tobacco products are estimated to generate an additional \$6.8 million which is dedicated to property tax relief.

ELASTICITY OF TOBACCO SALES

The experts argue whether the Canadian experience illustrated that tobacco consumption is bound to the amount of taxes levied or public awareness. The Canadian tobacco industry argued that increased taxes affected their profitability

because of decreased sales, yet also argued that taxes are not a successful means to control consumption.

Michigan recently increased their cigarette tax from 25 cents a pack to 75 cents, but there is not sufficient information to determine how this affected consumption or state revenues. Washington has increased its tax to 81.5 cents a pack and to 45 percent of wholesale price of other tobacco products.

South Dakota increased its cigarette taxes in 1986 from 13 cents a pack to 23 cents. The revenue statistics do show a slight decrease in total sales even though tax revenue increased. A part of this decrease in sales could be attributed to a declining demand. The chart above illustrates the revenue over the last 14 years.

CONCLUSION

Strict regulation of the sale of tobacco products and assessment of taxes have long been and will continue to be administered by the state. The licensing of wholesalers, affixing stamps, and collecting taxes have been means to provide substantial revenue for the general fund and most recently the property tax relief.

This issue memorandum was written by Fred Baatz, Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
