

TOBACCO TAX INCREASE

House Bill 5248 as enrolled
Public Act 503 of 2002
First Analysis (9-13-02)

Sponsor: Rep. Keith Stallworth
House Committee: Tax Policy
(Discharged)
Senate Committee: None

THE APPARENT PROBLEM:

At the May 16, 2002 Consensus Revenue Estimating Conference, economists from the two houses of the state legislature and from the Engler administration agreed to revise downward earlier estimates of the amount of revenue the state could expect in both the 2001-2002 and the 2002-2003 fiscal years. The conferees estimated that general fund revenues would be over \$350 million less for fiscal year 2001-2002 and over \$300 million less for fiscal year 2002-2003 than they had previously predicted at the January 2002 conference. School Aid Fund revenues were also revised downward. The decline in state revenues prompted those responsible for crafting state budgets to assemble a package of budget reductions, revenue increases, and transfers from the Budget Stabilization (or "rainy day") Fund in an attempt to meet the constitutional requirement to balance the current and subsequent fiscal year budgets. One component of the budget balancing package was an increase in the state's tobacco tax.

THE CONTENT OF THE BILL:

The bill amended the Tobacco Products Tax Act to do the following, as of August 1, 2002:

- Raise the tax on cigarettes from 75 cents per pack (of 20 cigarettes) to \$1.25 per pack.
- Increase the tax on other tobacco products (cigars, noncigarette smoking tobacco, and smokeless tobacco) from 16 percent of the wholesale price to 20 percent of the wholesale price.
- Earmark the revenue from the additional taxes.

Earmarking. The additional revenue from the non-cigarette tobacco products is to be distributed as follows: 75.6 percent to the School Aid Fund; 6 percent to the Healthy Michigan Fund; and 18.4 percent to the General Fund. However, from October

1, 2004 through September 30, 2007, the 18.4 percent is to go to the Budget Stabilization Fund.

The additional revenue from the first 30 cents of the 50-cent increase in the cigarette tax is to be distributed as follows: 12.2 percent to the Medicaid Benefits Trust Fund; 3 percent to Wayne County for indigent health care; 6 percent to the Healthy Michigan Fund; 4.6 percent to the School Aid Fund; and 74.2 percent to the General Fund. However, from October 1, 2004 through September 30, 2007, the 74.2 percent is to go to the Budget Stabilization Fund.

The additional revenue from the remaining 20 cents of the 50-cent-per-pack increase is to be distributed 94 percent to the School Aid Fund and 6 percent to the Healthy Michigan Fund.

Certificates of compliance. The bill also contains provisions regarding the sale of cigarettes by nonparticipating manufacturers, those manufacturers of cigarettes not considered participating manufacturers under the master settlement agreement reached between states' attorneys general and major tobacco companies. The bill would require each nonparticipating manufacturer to certify to the Department of Treasury by April 30 each year that it was not a participating manufacturer and that it had established the required escrow account and deposited funds into the account as required by Public Act 244 of 1999, which put the tobacco settlement model statute into state law (House Bill 5088 of the 1999-2000 legislative session). Otherwise, the manufacturer could not sell cigarettes in the state. The bill also would require wholesalers (and unclassified acquirers) to retain for at least four years all certificates of compliance received and would require them to report to the Department of Treasury all cigarettes acquired that were manufactured by nonparticipating manufacturers.

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The department would be required to maintain and regularly update a list of participating manufacturers and nonparticipating manufacturers who had provided the required certificate of compliance; publish the list on its web site; and provide a copy of the list on request. Beginning May 1, 2003, the department could seize or confiscate cigarettes acquired from or manufactured by a nonparticipating manufacturer that had not provided the required certification. For violations of these provisions, the department could impose a civil fine not to exceed \$1,000 for each violation. The civil fine would be in addition to other fines and penalties imposed under the Tobacco Products Tax Act or Public Act 244 of 1999.

MCL 205.426c et al.

BACKGROUND INFORMATION:

The cigarette tax was increased to 75 cents per pack from 25 cents per pack in 1994 as part of the new school financing system (known as Proposal A), and the tax on other tobacco products was raised accordingly. According to the September issue of State Legislatures, the magazine of the National Conference of State Legislatures (NCSL), 17 other states have recently raised the cigarette tax. The NCSL reports that 10 states have tax rates equal to or greater than \$1 per pack.

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the total of increased revenues from the bill would be \$58.9 million in fiscal year 2001-2002 and \$291.5 million in fiscal year 2002-2003.

The revenue from the cigarette tax would increase by \$56.1 million in fiscal year 2001-2002 and by \$282.4 million in fiscal year 2002-2003. The revenue from the tax on other tobacco products would increase by \$1.4 million in fiscal year 2001-2002 and by \$4 million in fiscal year 2002-2003. Sales tax revenue would increase by \$1.4 million in fiscal year 2001-2002 and by \$5.1 million in fiscal year 2002-2003. (The state's 6 percent sales tax is applied on top of the cigarette and other tobacco tax.) The commission the state pays to wholesalers (for collecting taxes) would increase (and thus reduce state revenues by) \$0.7 million in fiscal year 2001-2002 and by \$5.7 million in fiscal year 2002-2003.

The revenue increases are distributed as described in the Content section. The bill would result for fiscal year 2002-2003 in an increase of \$140.2 million in

the General Fund; \$105.1 million in the School Aid Fund; \$24.7 million in the Medicaid Trust Fund; \$17.2 million in the Healthy Michigan Fund; \$6.1 million to Wayne County for indigent health care; and \$1.2 million for revenue sharing to local units. For further information, see the analysis dated 7-8-02 by the House Fiscal Agency.

ARGUMENTS:

For:

Raising the tax on cigarettes and other tobacco products is a reasonable component of a prudent plan to balance the state budget in the current and next fiscal years. Reducing spending, transferring funds from the Rainy Day Fund, and increasing revenues will all be necessary to protect valuable state programs. Given the decline in state revenues from the economic downturn, the bursting of the so-called technology bubble in the stock market, and the aftereffects of the terrorist attacks of September 11, 2001, among other things, those responsible for balancing the state budget have little choice but to find new revenues. Rather than jeopardizing the state's future economic well-being by raising broad-based taxes like the income tax or single business tax, the bill focuses on increasing revenues by raising tobacco taxes. Smoking is an individual choice; a bad habit; a health hazard, with high costs to individuals and society alike, including the costs of treating the illness and disease to which it contributes. Raising the tax on tobacco will have dual beneficial results, by generating new state revenue, which is badly needed at present, and by providing an incentive for smokers to quit and for non-smokers not to start, particularly among young people.

Against:

There are a number of arguments that can be made against using an increase in tobacco taxes as a means to increase state revenues. (1) It singles out one product, and the people who choose to use that product, for exorbitant taxation. Moreover, some people allege that the targeted taxpayers tend to be disproportionately from moderate and lower-income families. (2) It smacks of moralism, attempting to use taxes to discourage the use of a legal product that is an easy target because of its health hazards. Other products are also, in some sense, unhealthy, from fatty fast foods to pastries to alcohol. Many pleasurable activities are hazardous or unhealthy. Why single out tobacco and smoking? (3) There is an inconsistency in goals inherent in a high tax aimed at both increasing state revenue and decreasing

consumption of the product being taxed. This is not a long-term solution to state revenue problems. It simply puts off for another day the hard questions about taxing and spending. (4) High taxes on tobacco will encourage smuggling and other forms of tax avoidance, and will increase the costs of enforcement. Businesses selling tobacco in border areas will suffer a loss of business due to Michigan's high rate of taxation. Other alternatives exist, including simply halting (even temporarily) the scheduled reductions in the state income tax and single business tax. Such action should not be seen as increasing taxes but as holding to current tax rates. That approach would spread the burden of dealing with current fiscal problems more fairly.

Against:

Some people believe that the state should address budget problems by reducing spending, not by raising taxes.

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.