Legislative Analysis

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CAP TAX ON CIGARS

Senate Bill 1004 (Substitute H-1)
Sponsor: Sen. Arlan Meekhof
House Committee: Commerce
Senate Committee: Finance

First Analysis (8-15-12)

BRIEF SUMMARY: The bill would limit the tax on cigars to 50 cents per cigar, and require retailers to post signs regarding the obligation to pay taxes on cigars purchased through catalog or internet sales.

FISCAL IMPACT: This bill would reduce tobacco tax revenue by a minimal amount. This revenue reduction would affect General Fund/General Purpose and the Medicaid Benefits Trust Fund.

THE APPARENT PROBLEM:

According to the U. S. Center for Disease Control (CDC) Office of Smoking and Health, sales of large cigars more than doubled from 2008 to 2011, after manufacturers increased the weight of certain small cigars, enabling them to be classified as large cigars which are taxed at a lower rate than small cigars and cigarettes (this due to a 2009 increase in the federal tobacco excise tax that hit cigarettes and small cigars, but not big cigars). From 2008 to 2011, the number of small cigars sold dropped to fewer than a billion from 5.9 billion, while sales of large cigars rose to 12.9 billion from 5.7 billion. (See "Big Cigars Offer Way for Smokers to Save," *New York Times, 8-2-12)*

CDC officials also have noted that cigars have increased in popularity because the Food and Drug Administration regulations that bar adding flavoring to tobacco, or using "light" or "low tar" labels, do not apply to cigars.

Currently under the law, Michigan levies a tax on cigars, smokeless tobacco, and non-cigarette smoking tobacco equal to 32 percent of the wholesale price. As a result, a larger more costly cigar is taxed at the same rate as a smaller less expensive one, but the tax goes up the greater the cost. For example, the tax on a $1 cigar cannot exceed 32 cents; the tax on a $2 cigar cannot exceed 64 cents; and the tax on a $3 cigar cannot exceed 96 cents.

Legislation has been introduced to cap the amount of tax on a cigar at 50 cents per cigar.

Further, according to committee testimony, cigar smokers increasingly purchase their cigars (large and small) from on-line dealers who sell their products using electronic catalogs. The buyers seldom remit sales tax on their on-line purchases of cigars, and the sellers of cigars seldom pay the State of Michigan the sales tax on the products they have sold.

This legislation introduced to cap the tax on all of the cigars that cost more than $1.56 each (now taxed at 32 percent of their wholesale price which results in the maximum 50-cent tax) also includes a requirement that vendors in stores post a notice to inform their customers they must pay sales tax when they purchase their cigars through catalogs or on-line.

THE CONTENT OF THE BILL:

Senate Bill 1004 (H-1) would amend the Tobacco Products Tax Act (MCL 205.427 & 205.431) to do the following:

- Limit the tax on cigars to 50 cents per cigar.
- Require retailers to post signs regarding the obligation to pay taxes on cigars purchased through catalog or internet sales.

Currently, the tax on cigars, non-cigarette smoking tobacco, and smokeless tobacco is 32 percent of the wholesale price. The bill states that, beginning October 1, 2012, the amount of tax levied on cigars under this provision could not exceed 50 cents per individual cigar.

Further, beginning October 1, 2012, the bill would require a retailer who is licensed as an unclassified acquirer, or retail importer of tobacco products other than cigarettes, to post a sign that informs purchasers of cigars through catalog sales or internet sales of their responsibility to pay all applicable unpaid state taxes on those cigars. The sign would have to be visible to the public inside the retail establishment.

HOUSE COMMITTEE ACTION:

The members of the House Commerce Committee reported out an H-1 substitute for Senate Bill 1004. The H-1 substitute was necessary to embody the changes made to the Tobacco Products Tax Act when the current legislature passed Public Act 188 of 2012--the bill sometimes known as the "roll you own" law, because it regulates those who retail loose tobacco so their customers can roll their own cigarettes.

Senate Bill 1004 (Substitute H-1) also incorporates the Senate floor amendment that specifies the bill would, if enacted, go into effect beginning October 1, 2012.

No other changes were made to the bill by the members of the House Commerce Committee.

ARGUMENTS:

For:

Cigar retailers argue that capping the tax on higher cost cigars will decrease costs to consumers, and enable them to compete with on-line suppliers. Further, these proponents of the bill say state tax collections will increase, if the cigar tax is capped.

Those who favor the bill say that unlike cigarettes, cigars can be legally shipped to consumers' homes and businesses. Further, individuals can purchase their cigars on-line through catalog sales. In these instances, buyers are required to "voluntarily" pay the excise and sales tax on their on-line and catalog cigar purchases, by filling out a form and including the tax on their annual income tax returns. Because they seldom do so (and the sellers are not required to collect the excise or sales tax), buyers enjoy a 38 percent reduction in their cigar purchases. Often they can buy on-line or from catalogs cheaper than retailers must pay on the wholesale market. Consequently, the cigar industry estimates that about two-thirds of all cigars smoked in Michigan are purchased on-line or through catalog sales.

Those who favor the bill say that capping the tax on high-end cigars will allow retailers to compete with on-line and catalog suppliers, because it will bring the price of their cigars down; more cigars will be sold; and tax collections will increase. Further, they say on-line buyers will be more apt to pay their taxes if they are reminded to do so. Given a reminder--that is, a poster on display at their cigar retailer's shop--their on-line tax compliance will increase.

Indeed, proponents say that six states have capped their tax on cigars, and as a result have experienced substantial increases in the collections of their Other Tobacco Products (OTP) excise tax and their sales tax. The average annual increases in tax collections that they claim range from 4 percent to 22 percent. According to committee testimony, Iowa is estimated to have had a 9 percent OTP increase in premium cigar collections over two years (average 4 percent); Rhode Island an estimated 16 percent increase over 4 years (average 4 percent); Washington an estimated 30 percent increase over 5 years (average 6 percent); Oregon an estimated 86 percent increase over 8 years (average about 8 percent); and Wisconsin an estimated 42 percent increase over two years (average 22 percent).

Against:

Opponents of the bill note that the increases in six states' premium cigar tax collections presented by proponents of the bill are *estimates* calculated by the tobacco industry in their report entitled "The Tax Burden on Tobacco." They argue it is questionable that capping the tax on high-end cigars will result in tax collection increases. Indeed, both fiscal agencies of the Michigan legislature expect that the bill, if enacted into law, will decrease tobacco tax collections.

Further, those who oppose the bill say it does not address the problem of tax avoidance by consumers who purchase cigars on-line or through catalogs, but fail to pay the sales tax owed. To increase compliance, opponents of the bill say that Michigan must enact and enforce laws to require that sales tax be paid for purchases made on-line or by mail. Then, and only then, sales tax revenue will rise. They note that thus far, the Michigan legislature has failed to enact policies that will work to solve this problem. They argue this bill most certainly will not.

Against:

Those who oppose the bill note that cigar smoking--which is on the rise--is deadly, addictive, and produces toxic secondhand smoke. They say there is no justification for giving cigars any special tax treatment, as is proposed by Senate Bill 1004.

Opponents--including the Michigan Heart Association and the Michigan Cancer Society--say cigar smoking is increasing in popularity, especially among the young, because cigars are taxed less than cigarettes, and consequently less costly to purchase. Further, cigars can be laced with fruit and other flavorings that are banned for use in cigarettes.

Opponents say that the failure of the State of Michigan to adequately tax cigars creates a significant public health problem. Higher taxes on cigars would dissuade new smokers, and incentivize veteran smokers to quit or cutback. Lower taxes, as proposed by Senate Bill 1004, will encourage smokers to continue their high-risk behavior, and to ignore the day of reckoning that will eventually jeopardize their good health.

POSITIONS:

The Jenuwines Cigar Factory Outlet supports the bill. (7-18-12)

The International Premium Cigar & Pipe Retailers Association supports the bill. (7-18-12)

The Department of Treasury would support the bill with changes. (7-18-12)

The American Cancer Society opposes the bill. (7-18-12)

The American Heart Association opposes the bill. (7-18-12)

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■ 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.