

Kansas House  
House Committee on Taxation  
Testimony of  
Patrick Fleenor  
Regarding House Bill 2306

Mister Chairman and Members of the Committee, thank you for the opportunity to speak today.

My name is Patrick Fleenor, and I am here today on behalf of Altria Client Services, Inc. and their affiliate, Philip Morris USA, to offer testimony regarding House Bill 2306.

Before I delve into the content of this bill, I think it would first be appropriate to provide the Committee with a brief summary of the knowledge and experience that form the basis of the comments and opinions that I have prepared to offer the Committee.

I am Chief Economist of Fiscal Economics, Inc., a Washington-based consulting firm specializing in the economics of taxation. My experience also includes 7 years as Chief Economist of the Tax Foundation, a national public policy organization. I also served as a Senior Economist with the Joint Economic Committee of the United States Congress where I advised lawmakers in both the House and Senate on a broad range of federal tax policy issues. In these roles, I have conducted research on a wide range of federal, state and local tax and budget issues, including the adverse effects of excessive tobacco taxes. I have examined the effects of high tobacco taxes nationally as well as in states and localities for a variety of clients and provided analysis and commentary that has appeared in leading publications including the *Wall Street Journal*, *Boston Globe*, *Chicago Tribune*, *Los Angeles Times*, and *Christian Science Monitor*.

I begin my remarks by reminding the Committee that effective April 1 of 2009, the federal excise tax on cigarettes increased by approximately \$0.61 per pack. Currently, the total excise tax, state and federal, on a pack of cigarettes in Kansas is \$1.80. I ask Committee Members to



keep this in mind as I discuss several reasons it should not approve the proposed \$1.50 increase in Kansas' cigarette tax rate.

First, recent experience has shown that raising taxes on tobacco products can be an unpredictable proposition. Over the years, states across the country have resorted to a tax increase on tobacco only to see revenues fall well short of their projections. In three cases – New Jersey, D.C., and Hawaii – cigarette tax increases actually caused tax revenues to decline.<sup>1</sup>

Indeed Kansas' recent history should guide this committee as it weighs this issue. Thirteen years ago, Governor Bill Graves proposed closing a budget gap with a number of tax hikes including a 65-cent increase in the cigarette excise tax. Aware of the states' past difficulties collecting the tax, the legislature initially balked, but after the longest legislative session in the state's history it eventually relented with a 55-cent increase.

When Governor Graves and legislators who supported the bill were asked how realistic their revenue projections were they pointed to official revenue estimates which attempted to take into account reductions in smoking as well as increases in smuggling and cross-border shopping in response to the tax and insisted that the higher tax would bring in \$81.6 million in new revenue during fiscal year 2003.<sup>2</sup> In later years these estimates assumed that adult smokers would eventually resume many of their old buying patterns, guaranteeing the state a steady stream of new revenue.

We now know that was wishful thinking. Tax-paid cigarettes fell over 20 percent in fiscal year 2003 as both adult smokers and the businesses who served them fled the state and instead of rebounding, sales have continued to remain low, exacerbating the state's budget woes.<sup>3</sup>

Experts predict the same outcome will occur if HB 2306 is passed. Researchers from the Mackinac Center and Tax Foundation used a sophisticated econometric model to forecast the

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<sup>1</sup> Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.

<sup>2</sup> For official revenue estimate of final bill see Conference Committee Report on Senate Bill No. 39 As Agreed to May 16, 2002. Document may be accessed at <http://www.kansas.gov/government/legislative/supplemental/2002/CCRB39.pdf>

<sup>3</sup> Author's calculations using data from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.



likely effects of a \$1.50 tax hike in Kansas and the results are troubling.<sup>4</sup> They found that under current law approximately 15 percent of the cigarettes consumed in the state evade the tax.<sup>5</sup> If the tax were to be increased by \$1.50 per pack, they predict that this figure would rise to 46.5 percent and lead to a 37 percent reduction in tax-paid cigarette sales. Under such a scenario, they forecast that the tax hike would not raise the \$80 million forecast by state revenue estimators.

A second factor to ponder when considering a cigarette tax increase is the impact such a tax could have on smuggling and associated crime. John D'Angelo of the Bureau of Alcohol, Tobacco, Firearms and Explosives, has stated "There is no doubt that there's a direct relationship between the increase in a state's tax and an increase in illegal trafficking."<sup>6</sup> A tax increase could contribute to increased incentives for smuggling and other contraband activities. This may include buying tobacco products in other states and jurisdictions, on Native American reservations, over the Internet or at other similar venues, where taxes may not be collected at all. Ever since a cigarette tax was first levied in Kansas in 1927 the state has had severe problems with smuggling and cross-border shopping.<sup>7</sup>

If passed, the proposed cigarette excise tax will cause packs of cigarettes to be much more expensive in Kansas when compared to its neighbors. The current tax per pack in Kansas is \$0.79. If a \$1.50 per pack increase in the state cigarette excise tax were implemented, the tax would jump to \$2.29 per pack. Such a tax would far exceed any of our neighboring states – and notably, more than thirteen times that of the neighbor to the East, Missouri, which stands at \$0.17 per pack.<sup>8</sup> The resulting per pack tax difference between Kansas and its neighbors will provide incentives for adult smokers to cross the border to buy cigarettes in states with lower excise taxes.

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<sup>4</sup> Dion Lefler, "Kansas Tax Hike on Tobacco Would Triple Smuggling Rates, Researchers Predict," *Wichita Eagle*, February, 9 2015.

<sup>5</sup> Michael D. LaFaive, Todd Nesbit, Ph.D and Scott Drenkard, *Cigarette Smugglers Still Love New York and Michigan, But Illinois Closing In*, Mackinac Center For Public Policy, January 14, 2015. Document may be accessed at <http://www.mackinac.org/20900>.

<sup>6</sup> Maria Schultz, *Raised Tax on Smokes May Stoke Illicit Sales*, DETROIT NEWS, (July 21, 2002).

<sup>7</sup> Patrick Fleenor, *Masters of the Tax Avoidance: Kansans and the Cigarette Excise, 1927 – 2009*, Americans for Prosperity – Kansas, April 15, 2009. Document may be accessed at [http://americansforprosperity.org/files/Kansans\\_And\\_The\\_Cigarette\\_Excise.pdf](http://americansforprosperity.org/files/Kansans_And_The_Cigarette_Excise.pdf)

<sup>8</sup> Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.



A third factor to think about when considering HB 2306 is that tax hikes on tobacco products work against small businesses that rely heavily on tobacco sales to stay afloat. Cigarette sales are an important source of revenue for many of Kansas's approximately 2,700 retailers.<sup>9</sup> According to the National Association of Convenience Stores, cigarette sales account for 31.8% of all in-store sales at convenience stores nationwide.<sup>10</sup>

It is known that cigarette excise taxes currently provide a significant source of revenue for Kansas. In fiscal year 2014, the sale of cigarettes in Kansas generated \$90 million in state excise taxes.<sup>11</sup> This is in addition to the payments Kansas received under the tobacco settlement agreement. 2014 settlement payments were about \$71 million.<sup>12</sup> PM USA believes that adult smokers in Kansas already pay a fair amount of taxes on the cigarettes they purchase. The adverse economic impact this proposal would have on adult Kansas smokers is another reason the cigarette excise tax should not be raised.

The Kansas adult who purchases one pack per day already pays \$1,046 per year to the federal and state government.<sup>13</sup> This is on top of the other taxes that a typical household may pay, including: income taxes, social security taxes, excise taxes on other products (such as gasoline), and property taxes. Including the proposed \$1.50 cigarette excise tax increase, the total government costs imposed on cigarettes could increase to as high as \$1,646 per year for an adult purchasing one pack per day.<sup>14</sup>

Should the proposed \$1.50 cigarette excise tax increase be enacted, adult smokers would be paying \$4.51 in government revenue for a pack of cigarettes in Kansas, which would then account for approximately 60% of the total cost for a pack of cigarettes.<sup>15</sup> The large share of

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<sup>9</sup> Retail locations based on internal PMUSA data and rounded to nearest 10.

<sup>10</sup> *State of the Industry: Convenience Store Totals, Trends & Averages*, NATIONAL ASSOCIATION OF CONVENIENCE STORES, 2009.

<sup>11</sup> Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.

<sup>12</sup> Campaign for Tobacco Free Kids, *ACTUAL TOBACCO SETTLEMENT PAYMENTS RECEIVED BY THE STATES, 2002-2010*

<sup>13</sup> This includes the state excise tax and federal excise tax paid by a pack a day smoker per year based on information from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.

<sup>14</sup> This includes the state excise tax and federal excise tax paid by a pack a day smoker per year based on information from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc.

<sup>15</sup> The existing excise taxes can be found in, Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc. Product costs are estimated based on prices and taxes from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 49 (February 2015); funded in part by Altria Client Services Inc. The estimated settlement cost per pack and the estimated quota buyout payment are from PM USA internal data. The FDA user fee revenues are estimated based on total FDA user fee revenues and total national and state tax-paid sales. The estimated trade markup is based on data from: NACS State of the Industry Report –



cigarette revenues the government already receives should be strongly considered before any further tax increase is implemented.

Moreover, cigarette excise taxes are unfair and regressive, impacting lower-income adult smokers more than high-income adult smokers. This is because the taxes are placed on the product and not based on income level. Increasing the cigarette excise tax will disproportionately burden lower income households.

Over the last several years Kansas has embarked on a major tax reform with the goals of improving economic performance while improving equity in the tax system. Hiking the cigarette tax by \$1.50 per pack would be a step backward on both of these fronts. Such a hike will send both adult consumers and businesses across borders, reducing business activity and lowering income, property, sales, and excise tax revenue in the state. It will also significantly raise the tax burden of low income Kansans, harming equity.

For all of these reasons, please vote against HB 2306 and reject this proposed tax increase.

Thank you for your time.

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2013, National Association of Convenience Stores, 27th Edition, Table 9A. Actual retail prices will vary. Numbers may not add due to rounding.



Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc.

For more information please visit [www.pmuusa.com](http://www.pmuusa.com)

As of 2.16.15