

Approved April 22, 1983
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION

The meeting was called to order by Senator Paul "Bud" Burke at
Chairperson

11:25 a.m./~~p.m.~~ on April 21, 1983 in room 529-S of the Capitol.

All members were present ~~except~~

Committee staff present: Tom Severn, Research Department
Wayne Morris, Research Department
Don Hayward, Revisor's Office

Conferees appearing before the committee: Paul Coleman, Kansas Tobacco-Candy Distributors
and Vendors Inc.

The committee held a hearing on HB 2106, which increases the cigarette tax rate by 5 cents, effective July 1, 1983.

The chairman recognized Paul Coleman who spoke in opposition to the tax rate increase. (See Attachment #1) In addition to his written testimony, he referred to the new Section 6 of the bill which requires the legislature to consider appropriating a portion of the revenue from the tax to local health departments. He said he doesn't think money from the cigarette tax should be earmarked for health departments. He also suggested a sunset provision, effective October 1985, for at least a less than 5¢ tax.

Senator Hayden moved and Senator Mulich seconded a motion to strike new Section 6 of HB 2106. The motion passed.

Tom Severn explained the procedure for computing the discount allowed to wholesalers.

Senator Angell made a conceptual motion to amend HB 2106 to keep the discount constant, in terms of dollars. Senator Chaney seconded the motion and the motion passed.

Senator Ehrlich moved and Senator Mulich seconded a motion to report HB 2106 as amended adversely. The motion failed to pass.

Senator Angell moved and Senator Chaney seconded a motion to report HB 2106 as amended favorable for passage. The motion passed.

The chairman adjourned the meeting at 12 noon.

ASSESSMENT AND TAXATION

OBSERVERS
(PLEASE PRINT)

DATE NAME ADDRESS REPRESENTING

April 21

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OPPOSITION TO AN INCREASE
IN THE KANSAS CIGARETTE TAX RATE

SUMMARY OF CONTENTS

- In FY '82, more than \$40 million in excise and sales taxes were collected from cigarette sales
- Taxes already add 38% to the cost of a pack of cigarettes
- Kansas smokers already bear a disproportionate share of the tax burden
- Additional revenues can be realized without an increase in the tax rate
- The cigarette tax is regressive
- Consumption is declining, and any increase in the tax will further erode the tax base

4-21-83
Paul Coleman

Attachment #1

Atch. 1

During Fiscal Year 1982, the net cigarette tax revenues to the state were approximately \$33,122,000. In addition, the estimated sales tax collections were approximately \$7,155,000, for a total of over \$40 million. Since 1971, when the tax was raised to its current rate of 11 cents per pack, annual revenues have increased from \$24.1 million to \$33.1 million, an increase of over \$9 million or 37% with no increase in the tax rate.

As of November 1, 1982, the weighted average price of a pack of cigarettes was 77 cents. Included in this price was the 11 cent state excise tax, the 8 cent federal excise, and the 2 cent sales tax for a total of 21 cents. This amounts to approximately 27% of the cost of a pack of cigarettes being attributable to some form of tax. Stated another way, the weighted average price, exclusive of all taxes, was 56 cents. The 21 cents total tax added 38% to the cost of a pack of cigarettes.

The federal excise tax on cigarettes was doubled from 8 cents to 16 cents effective January 1, 1983. As a result, the Kansas taxpayer now pays 30 cents in taxes on each pack. This amounts to 35% of the total cost, or 54% added to the price without taxes. If the state tax were raised by another 5 cents, the total 35 cents tax would equal 38% of the total price, or 63% of the cost without taxes. It would also mean that the total tax burden would have increased by 67% since January 1, 1983.

The watchwords of the Legislature have been "fair and equal." But is an increase in the cigarette tax fair? Ideally, a tax program should place the lowest possible tax on the broadest possible base. But the 608,000 smokers in Kansas represent only about 35% of the adult population. This small segment is already paying a disproportionate share of the total tax burden, and is receiving no special benefits.

Are additional revenues needed from cigarette taxes? If so, is an increase in the tax rate necessary to accomplish this? Let us look at what has happened in the past and what can be expected to happen if the tax rate is NOT raised.

It should be pointed out that cigarettes are not exempt from sales tax. During the last fiscal year, the price increase at the retail level was approximately \$1.50 per carton. Based upon our current 3% sales tax, and using last year's sales figures, the state should realize an increase of over \$1.4 million in sales tax alone. As inflation continues to increase the costs of all goods and services, the sales tax revenues from cigarettes will continue to increase. In addition, the sales tax is levied on the total cost, including excise taxes. As a result, the recent doubling of the federal tax will serve to increase sales tax revenues even further.

As this memo is being drafted, S.B. 183 is awaiting action on the floor of the House of Representatives. The bill, for which we were the proponents, and on which you have already received information, will have a positive fiscal impact.

-----INCOME-----

	UNDER 7,000	7,000- 14,999	15,000- 24,999	OVER 25,000
AGE				
17-19	30.1%	27.9%	23.0%	17.2%
20-24	37.8	40.8	30.5	33.4
25-34	45.9	41.9	36.3	29.0
35-44	51.4	41.8	37.2	35.0
45-64	40.1	38.8	35.8	31.0
65 up	17.4	18.0	15.6	18.2

A report by the Institute for Research on the Economics of Taxation concluded that, "selective excises should not be employed merely to raise revenues. These taxes are distortionary and given the current emphasis on broad-based, comprehensive neutral tax systems, the use of excise taxes purely for revenue purposes would be a giant step backwards."

One of the main objections to excise taxes is their regressivity. The basis of a tax system should be one's ability to pay. But the percentage of income devoted to buying cigarettes falls as income rises. This is a classic example of a regressive tax. Kansas cigarette taxes are already levied at higher effective rates on the disadvantaged than on the more affluent. More than 18% of Kansas families have an average buying income of less than \$8,000 per year. An individual in this category pays more than four times as much of his income for the pleasure of smoking than does his neighbor with an income of \$35,000. Over 13% of Kansas residents are age 65 and over. The regressivity of this tax is particularly oppressive on that segment of the population living on a fixed income.

The cigarette tax is even more regressive when one considers the fact that more people in the lower income brackets smoke. The following table is based on the National Health Interview Survey for the National Center for Health Services.

Governor Carlin and the supporters of his tax package say that his proposals tax wealth, the ability to pay, which should be the hallmark of any tax package. In view of the foregoing table, can this really be said of a cigarette tax increase?

The Governor has eschewed increases in property taxes, sales taxes, and motor fuels taxes because they are regressive, yet he proposes an increase in the even more regressive cigarette tax. Certainly this is inconsistent! Can one regressive tax be any less objectionable than another simply because it affects only 35% of the taxpayers?

Any increase in the tax rate will reduce tax-paid sales and thus revenues. During Fiscal Year 1982, total tax-paid sales were down .1% from the previous year. Even more alarming, the per capita sales were down .8%. Then, on January 1, 1983, the federal excise tax doubled from 8 cents to 16 cents. We are about to witness the principle of "Elasticity of Demand" in practice.

In a memorandum dated December 13, 1982, the Kansas Legislative Research Department said, "Increases in price will, other things remaining equal, decrease the quantity sold. Increases in taxes which lead to increases in prices of goods or services may, as a result of the decrease in the base, lead to less than proportional increases in receipts."

Not determined yet is what reaction consumers will have to the 100% increase in the federal excise tax. The United States Department of Agriculture predicts Americans will continue to buy fewer packs in 1983 because of increased excise taxes. Eric Toder, a financial economist for the U.S. Department of the Treasury, estimates that this doubling will decrease sales in Kansas by 16.8 million packs. Even at the current 11 cent rate, this will reduce revenues by \$1.8 million. Lost sales taxes from these cigarettes will mean another loss of \$388,000.

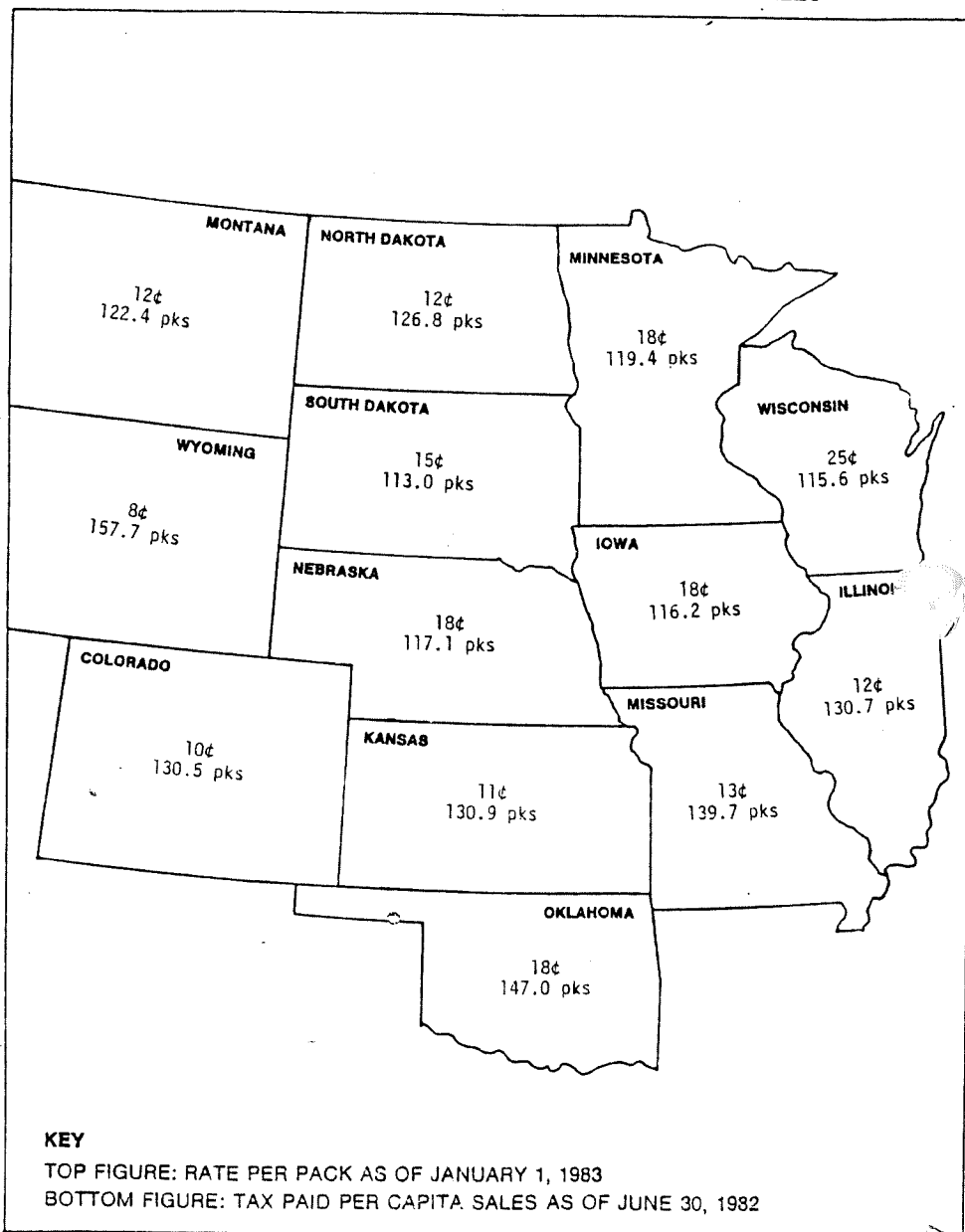
North Carolina State University's Department of Economics predicts that the doubling of the federal cigarette excise will cause domestic consumption to drop 5 to 6 percent in 1983. Robert H. Miller of The U.S.D.A.'s Agricultural Stabilization and Conservation Service reports that continued tax increases, coupled with stepped-up anti-smoking efforts, could result in a decline in consumption of 10 to 20 percent in the next decade.

Even the Governor's staff apparently recognizes this principle, for in their estimated yield of the proposed cigarette tax increase, they base it upon 296 million packs, down from 312 million last year. But yet in the rationale for the increase, we read, "Sin taxes are a stable and slowly growing revenue source when compared to alternatives." As has already been shown, the opposite is actually true. Consequently, any increase in the state tax rate would not only continue to erode this already shrinking tax source, but would also be premature in light of all the uncertainties as to future tax-paid sales.

Certainly, the anti-smoking activists will view this decline as disirable; however, it is ironic that it is often these same people who look to cigarettes as a source of revenue. Further, the decline in tax-paid sales does not necessarily translate directly to declining consumption.

Attached is a map showing the tax rates and per capita consumption for Kansas and neighboring states. This shows the general rule that higher taxes result in lower consumption. Two notable exceptions are the states of Oklahoma and Missouri. Oklahoma, for example, does not charge sales tax on cigarettes. The remainder of the difference could be attributed, at least in part, to different urban/rural mix and/or to differences in personal per capita income.

CIGARETTE TAX RATE AND TAX-PAID PER CAPITA SALES



Take, for example, the states of Oregon and Washington. As of June 30, 1981, and before rate increases last fiscal year, Oregon's tax was 9 cents, while Washington's was 16 cents. Washington has a higher percentage of urban population and a higher personal per capita income than Oregon. These two factors should produce a larger per capita sale of cigarettes in Washington than in Oregon, but actually the reverse is true. The reason is that cigarettes are cheaper in Oregon.

Consider also the situation in the New England area. Massachusetts and Connecticut each had, as of June 30, 1981, tax rates of 21 cents, while New Hampshire and Vermont had rates of 12 cents. Massachusetts and Connecticut are more urban and have higher per capita incomes than New Hampshire and Vermont, but their cigarette consumption was lower. In fact, New Hampshire leads the nation in per capita consumption.

The point is that while higher taxes may have some effect on consumption, an even greater problem is declining tax-paid sales and thus declining revenues to the state.

When one hears the term "bootlegging," it usually conjures up images of prohibition or Elliot Ness. Perhaps you feel this point has been over-emphasized for years. But the problem remains, and ignoring it will not make it go away. In its December 13 memo, the Legislative Research Department said, "The possibility of tax evasion by purchasing in another state is very real whenever the tax is a major part of the price of a product...The loss of sales by in-state merchants must also be considered."

In a study by the Advisory Commission on Intergovernmental Relations, updated by the Bureau of Alcohol, Tobacco and Firearms, estimates were generated for each state and the impact on state revenue due to cigarette tax evasion. The estimate for Kansas was \$900,000, or about 3% of total cigarette tax revenues.

Kansas is currently at a competitive advantage over three of the four neighboring states, which means that most of this cross-border traffic is coming our way. Any increase in our tax rate would reduce this practice, and it would not take a very large increase for the flow to shift in the other direction. Missouri, for example, has a rate of 13 cents. As already pointed out, Oklahoma is at 18 cents, but does not charge sales tax. Nebraska, also at 18 cents, is scheduled to drop to 15 cents next year. So, the disparity among the states is not as large as many may have been led to believe.

Consider also the following fictitious conversations. While hypothetical, they represent actual situations now going on in Kansas.

1. "I don't care how high they raise the tax. I buy my cigarettes (or get a friend to buy them for me) at the PX, so I don't pay any tax."
2. "I have in-laws who live in Goodland, so when we go out there for a visit, we just drive over the state line and buy a case or two a lot cheaper."
3. "A friend of mine has family in North Carolina (or Kentucky or even Wyoming), so when he goes there, I have him pick up a couple of cases of cigarettes at really cheap prices."

In other words, higher taxes and thus higher prices may not cause very many people to cut down or quit, but rather to get their cigarettes through other means. This not only cuts into the state's cigarette excise tax revenues, but also decreases the sales tax collections. Sales by Kansas merchants are less, resulting in lower profits and therefore lower income tax payments to the state.

Taxpayers have not been silent on this issue. An editorial appeared in the Joplin (Missouri) Globe, which is just as applicable to the situation in Kansas. It reads, in part, "One could easily get the impression that a cigarette-smoking minority of the population is being taxed excessively to benefit the general public good. Equity in taxation, a cherished although unattainable goal of responsive society, has been set aside when it comes to tobacco...Seemingly, its always open season on cigarettes by lawmakers...This will assuredly lead ultimately to a drastically reduced tax source, an eventuality that probably won't concern the majority of non-smokers and legislators until the lost revenue has to be recovered by some other means."

Closer to home, the Topeka Capital-Journal carried an editorial, which is included herein.

The Capital-Journal Forum

Higher and higher

Just recently the cigarette smokers were burdened by a tax hike on a pack of cigarettes by the federal government of a whopping 100 percent.

Figures as yet haven't been calculated or estimated as to the percentage of people who were forced to reduce smoking or even quit buying cigarettes.

Oh yes, I recall before Uncle Sam started collecting his harvest, the manufacturers said: "well if 'old Uncle' is going to raise the price 8 cents a pack we should be entitled to a few 'chips' ourselves."

So sure enough, they boosted the price by 4 cents for 20 cigarettes.

We Kansas people are aware of the fact that our supposedly smart Legislature is now in session. Guess what they do? If you guessed that they maintain cigarettes are too costly, your guess was in error.

Seems as though they intend to collect \$12 million from the cigarette smokers.

Not realizing or even thinking about poor people who can't afford it, they are fixing to raise the ante another 4 cents a pack.

And, oh yes, they are on the ball, as one smart Democrat in our capital city is looking ahead to 1986 to be the time he maintains that cigarette taxes take a slight raise of 8 cents a pack.

If all these so-called brainstorm become effective by the year 1986 the cigarette smokers will be obliged to pay nearly 3 cents tax each and every time they light up a cigarette.

It's quite possible that many people will be forced to quit smoking. Then what will our governing bodies use for money? — WALT VOBACH, Alma.

In some other states, where cigarettes are concerned, political expediency rather than tax equity has been the controlling factor. Other legislators have said, in effect, "I have already made up my mind. Don't confuse me with facts. But the facts remain: any increase in the cigarette tax will only lessen our competitive advantage, erode the tax base, and increase this already inequitable, regressive, punitive tax.

No one is saying cigarettes should not be taxed, but we are saying enough is enough.

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