

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation

The meeting was called to order by Senator Fred A. Kerr at  
Chairperson

11:00 a.m./~~p.m.~~ on Wednesday, March 27, 1985 in room 519-S of the Capitol.

All members were present ~~XXXX~~.

Committee staff present:

Tom Severn, Research Department  
Melinda Hanson, Research Department  
Don Hayward, Revisor's Office  
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:

Harley Duncan, Department of Revenue  
Frances Kastner, Kansas Food Dealers' Association  
Dr. Sherman Hanna, Tobacco Institute  
Bill Sneed, Kansas Tobacco and Candy Wholesalers  
Dave Minich, Tobacco Institute  
David Litwin, Kansas Chamber of Commerce and Industry  
Charles Nicolay, Kansas Oil Marketers Association  
Gene Sager, Western Retail and Hardware Dealers Association

H.B. 2513 - Cigarette vendor licensure requirements

Secretary Harley Duncan read his testimony supporting H.B. 2513 (Attachment 1). The bill would change licensing requirements to a biennial system and would give the Department discretion with regard to refusing to license certain persons.

Senator Burke moved that the bill be recommended favorably for passage. Senator Mulich seconded the motion, and the motion carried.

H.B. 2512 - Cigarette tax rate increase

Staff explained that the bill provides for an 8¢ increase in the cigarette tax and a one-time inventory tax as of July 1, 1985. Senator Parrish asked how much money would be raised by the bill. Staff advised that they estimate approximately 24 million dollars the first year and 22 million thereafter, but that these figures do not take into account any elasticity factors. Staff provided a memorandum (Attachment 2) on "Cigarette Excise Tax - Pending Legislation".

Frances Kastner read her statement in opposition to H.B. 2512 (Attachment 3). She stated that an 8¢ increase would put Kansas grocers at a competitive disadvantage with surrounding states, not only with regard to cigarettes, but other items as well. Chairman Kerr asked what alternative the Food Dealers' Association would recommend since they supported H.B. 2159 (the inventory tax reduction). Ms. Kastner replied that they support a half-cent increase in the sales tax and do not feel this would cause a competitive disadvantage.

Copies of "Excise Taxes: The Fairness Issue" were distributed to the Committee (Attachment 4).

Dr. Sherman Hanna read his testimony in opposition to the bill (Attachment 5). Dr. Hanna said the state would have a net loss of revenue of at least 6 million dollars from the effects of a combination of H.B. 2512 and H.B. 2159. He discussed why he feels the tax is a regressive tax and said it is a tax that higher income consumers will be able to escape more easily than lower income consumers. Senator Karr asked Dr. Hanna his estimate of what the tax would raise the first year. Dr. Hanna said his best "guesstimate" would be 20 million dollars.

Bill Sneed testified in opposition to the bill. He discussed the effect the bill would have on wholesalers' surety bonds. Mr. Sneed told the Committee that their best estimate is that close to 50% of their members would be unable

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation,  
room 519-S Statehouse, at 11:00 a.m./~~XXX~~ on Wednesday, March 27, 1985.

to purchase a surety bond if H.B. 2512 is passed. He mentioned the black market on cigarettes. He is of the opinion that the federal excise tax will remain at its current level. Staff asked whether or not wholesalers would buy larger bonds if they could get them. Mr. Sneed answered that they would.

Dave Minich spoke in opposition to the bill. He said there are ever-increasing pressures on the cost of doing business. He discussed increases in capital investments and accounts receivable. Mr. Minich mentioned bonding problems and concerns about increased bootlegging. Chairman Kerr asked Mr. Minich about his best information on what surrounding states will do regarding cigarette taxes. Mr. Minich answered that he does not think Missouri will take any action and the other states will only pick up any amount that might be abated at the federal level. Mr. Minich said that businesses in the Kansas City, Kansas metropolitan area benefit from lower excise taxes not only on cigarette sales but other items as well.

David Litwin testified that his association would prefer a half-cent sales tax increase rather than H.B. 2512 to fund H.B. 2159.

Charles Nicolay said members of his association market cigarettes and would prefer a sales tax increase over an increase in cigarette taxes in order to fund the inventory tax reduction. They support total exemption of merchants' inventories. Mr. Nicolay said they have no position on increasing the income tax.

Gene Sager testified that his organization supports H.B. 2159 and would endorse a half-cent increase in the sales tax rather than increasing the cigarette tax.

Senator Burke moved that the minutes of the March 26, 1985 meeting be approved. Senator Mulich seconded the motion, and the motion carried.

Meeting adjourned.







*Kansas*  
DEPARTMENT OF REVENUE

State Office Building  
Topeka, KS 66625

## MEMORANDUM

March 27, 1985

TO: The Honorable Fred A. Kerr, Chairman  
Senate Committee on Assessment and Taxation

FROM: Harley T. Duncan  
Secretary of Revenue *H. T. Duncan*

SUBJECT: House Bill 2513

Thank you for the opportunity to appear before you on House Bill 2513. The Department of Revenue supports this measure.

House Bill 2513 amends K.S.A. 79-3304 and 3306 governing the procedures and requirements for obtaining cigarette wholesaler, retailer, vending machine operator and related licenses. It first converts current law annual licensing requirements to a biennial licensing system and increases the license fees accordingly. This will have the effect of reducing modestly the paperwork in the Department, yet allow us to maintain the controls we feel are necessary. The Department currently licenses roughly 125 cigarette wholesalers, 6,000 cigarette retailers and 1,100 vending machine operators.

House Bill 2513 also amends K.S.A. 79-3304 governing the qualifications of those persons eligible to be licensed as cigarette retailers and wholesalers. Current law requires that a license shall be refused to a person (including a corporation) who has been convicted of a felony crime involving moral turpitude or cigarette and tobacco laws and who has within the last two years finished serving the sentence for that crime. House Bill 2513 would make such refusal discretionary rather than mandatory.

The Department supports this legislation because current law places us in the position of denying persons the ability to do business in Kansas for activities that may in no way be related to the conduct of their business in Kansas. Given such circumstances, the Department feels that administrative discretion is desirable. The Department can still fulfill what I perceive to be intent of current law with this amendment.

I must be frank with you and admit that this legislation comes before you at this time because of a situation we are currently facing. A sizeable corporation with some 25 retail cigarette outlets has been convicted of a felony violation of federal tax law. This act was allegedly committed by one or a few individuals and was unrelated to the operations of the corporation in Kansas.

Under the provisions of House Bill 2513, the Department could deal with this type of situation without the company having to resort to various maneuvers to continue their operations should they so desire. We could still, however, deny licenses to those whose prior activities cause them to be questionable cigarette vendors which is what I think the statute was intended to address. It would, however, allow us to deal equitably with situations in which one or a few members of a corporation violate the law in areas unrelated to their Kansas activities.

I would also note that there is some inconsistency in state law with respect to this situation. While the cigarette statutes require refusal of a license, the tobacco products statutes do not.

I would be glad to attempt to answer any questions.

HTD:b/2/S770

## MEMORANDUM

Kansas Legislative Research Department

March 27, 1985

## CIGARETTE EXCISE TAX — PENDING LEGISLATION

Information from Commerce Clearing House and from telephone conversations with research department staff of a number of states' legislatures indicates the following legislation concerning cigarette tax rates is under consideration as of March 19, 1985:

Surrounding States

Colorado. Rate is scheduled to drop from 15 cents to 10 cents on July 1, 1985, but legislation is pending to raise the tax from 15 cents to 23 cents on that same date. Municipalities are not prohibited from imposing additional tax.

Missouri. No legislation pending.

Nebraska. Rate would increase from 18 cents in the amount of the difference between 34 cents and whatever federal rate were in effect on October 1, 1985.

Oklahoma. Current rate of 18 cents would increase in an amount equal to any federal tax decrease, effective October 1, 1985.

Elsewhere

Alabama. Rate would increase from 16 1/2 cents to 19 1/2 cents per package, effective as of the date of any decrease in the federal tax. An alternative bill would increase the rate from 16 1/2 cents to 17 1/2 cents.

Alaska. Rate would increase from 8 cents to 16 cents on October 1, 1985, regardless of federal tax. Alternative legislation would establish a basic tax of 5 cents per package plus an amount such that the total federal and state tax would equal 19 cents per package.

District of Columbia. Rate would increase from 13 cents in an amount equal to any federal tax decrease.

Florida. Rate would increase from 21 cents to 29 cents on October 1, 1985, regardless of federal tax.

Hawaii. Rate would increase so as to keep the retail price of cigarettes constant should the federal tax be reduced.

Idaho. Rate would increase from 9.1 cents to 10 cents, effective July 1, 1985. An alternative bill would increase the rate from 9.1 cents to 17 cents, effective October 1, 1985.

Maryland. Rate would increase in the amount by which the federal tax would be changed to be less than 16 cents per package.

Minnesota. Rate would increase from 18 cents to 54 cents per package of 20.

Mississippi. Rate would increase from 11 cents to 13 cents as of April 1, 1985. In addition, the rate would be changed on October 1, 1985 to reflect the amount of the federal reduction, minus the 2 cents already reduced.

Montana. Rate would increase from 16 cents to 21 cents, effective July 1, 1985.

New Mexico. Rate would increase from 15 cents to 20 cents if the federal tax changed so as to be not more than 4 cents per 1,000 cigarettes.

Oregon. Current tax, scheduled to sunset on December 31, 1985, would be retained, and an increase in the amount of the federal reduction would be effective as of October 1, 1985 or later. Alternative legislation would levy an additional 18-cent tax until 1986, 8 cents thereafter.

Rhode Island. Rate (sales and use tax) would increase from 23 cents to 31 cents upon reduction of federal cigarette tax.

South Dakota. One bill would increase the rate from 15 cents to 23 cents effective July 1, 1985. Another bill would make the same change effective on October 1, 1985.

Utah. Rate would increase from 12 cents on October 1, 1985 by the same amount as any decrease in the federal excise tax.

Vermont. Rate would change from 17 cents to 25 cents on October 1, 1985, regardless of federal law.

Washington. Rate would increase from 23 cents to 31 cents if the federal rate were to become less than \$4 per 1,000 cigarettes.

West Virginia. Rate would increase from 17 cents to 22 cents.

Wyoming. Rate would rise from 8 cents to an amount to cover the amount in federal tax reduction.

MEMORANDUM

Kansas Legislative Research Department

March 27, 1985

LEGISLATION CONCERNING CIGARETTE EXCISE TAX

Information from Commerce Clearing House and from telephone conversations with research department staff of a number of states' legislatures indicates the following legislation concerning cigarette tax rates is under consideration as of March 19, 1985:

Surrounding States

Colorado. Rate is scheduled to drop from 15 cents to ten cents on July 1, 1985, but legislation is pending to raise the tax from 15 cents to 23 cents on that same date.

Missouri. No legislation pending.

Nebraska. Rate would increase from 18 cents to an amount equal to the federal tax decrease, such that the total state and federal tax would be 34 cents.

Oklahoma. Current rate of 18 cents would increase in an amount equal to any federal tax decrease, effective October 1, 1985.

The following table summarizes significant features of cigarette excise tax legislation under consideration in various state legislatures. Detail has been omitted in instances when source materials did not provide specific information.



	<u>Amount of Increase (Per Package of 20 Cigarettes)</u>	<u>Contingent on Federal Tax Decrease?</u>	<u>Effective Date of Increase</u>
Alabama (option A)	3 cents	Yes	10/1/85
Alabama (option B)	1 cent	No	
Alaska <sup>(1)</sup>	8 cents	No	10/1/85
District of Columbia	Amount of federal reduction	Yes	
Florida	8 cents	No	10/1/85
Hawaii <sup>(2)</sup>	Amount of federal reduction	Yes	10/1/85
Idaho (option A)	.9 cents	No	7/1/85
Idaho (option B)	7.9 cents	No	10/1/85
Maryland	Amount of federal reduction	Yes	
Minnesota	36 cents		
Mississippi <sup>(3)</sup>	2 cents		4/1/85
Montana	5 cents		7/1/85
New Mexico	5 cents	Yes	
Oregon <sup>(4)</sup>	Amount of federal reduction	Yes	10/1/85
Rhode Island	8 cents	Yes	
South Dakota (option A)	8 cents		7/1/85
South Dakota (option B)	8 cents		10/1/85
Utah	Amount of federal reduction	Yes	10/1/85
Vermont	8 cents	No	10/1/85
Washington	8 cents	No	10/1/85
West Virginia	5 cents		
Wyoming	Amount of federal reduction	Yes	

- 1) Alternative legislation would establish a basic tax of 5 cents per package plus an amount such that the total federal and state tax would be 19 cents per package.
- 2) The current tax in Hawaii is a 40 percent tax imposed on the wholesale price of tobacco products.
- 3) In addition, the rate would change on October 1, 1985 to reflect the amount of any federal reduction, minus the 2 cents already reduced.
- 4) The pending legislation would also provide for retention of the current 19 cents per package tax rate, which is due to expire on December 1, 1985.

Alternative legislation would levy an additional cigarette tax of 18 cents per package until 1986 and 8 cents per package thereafter.

## Table of Rates

The following are rates of state cigarette taxes per pack of twenty cigarettes exclusive of any local taxes.\*

State	Rate	State	Rate
Alabama	16.5¢	Montana	16¢
Alaska	8¢	Nebraska	18¢
Arizona	15¢	Nevada	15¢ <sup>1</sup>
Arkansas	21¢	New Hampshire	17¢
California	10¢	New Jersey	25¢ <sup>2</sup>
Colorado	15¢ <sup>3</sup>	New Mexico	12¢
Connecticut	26¢	New York	21¢ <sup>4</sup>
Delaware	14¢	North Carolina	2¢
District of Columbia	13¢	North Dakota	18¢
Florida	21¢	Ohio	14¢
Georgia	12¢	Oklahoma	18¢
Hawaii	40% <sup>5</sup>	Oregon	19¢ <sup>6</sup>
Idaho	9.1¢	Pennsylvania	18¢
Illinois	12¢	Rhode Island	23¢
Indiana	10.5¢	South Carolina	7¢
Iowa	18¢	South Dakota	15¢
Kansas	16¢ <sup>7</sup>	Tennessee	13¢
Kentucky	3¢ <sup>8</sup>	Texas	19.5¢ <sup>9</sup>
Louisiana	16¢	Utah	12¢
Maine	20¢ <sup>10</sup>	Vermont	17¢
Maryland	13¢	Virginia	2.5¢
Massachusetts	26¢	Washington	23¢
Michigan	21¢	West Virginia	17¢
Minnesota	18¢	Wisconsin	25¢
Mississippi	11¢	Wyoming	8¢
Missouri	13¢		

<sup>1</sup> Kansas: If the increase in the federal excise tax on cigarettes imposed and in effect on January 1, 1983, is abolished, the Kansas rate becomes 24¢ on and after October 1, 1985.

<sup>2</sup> Hawaii: 40% of wholesale price.

<sup>3</sup> Colorado: The tax rate is reduced to 10¢ per pack on July 1, 1985.

<sup>4</sup> Oregon: Tax rate drops to 9¢ on January 1, 1986.

<sup>5</sup> New York: Tax rate lowered to 15¢ on April 1, 1985.

<sup>6</sup> Kentucky: Plus a \$.001 tax each package of cigarettes.

<sup>7</sup> Nevada: Effective July 1, 1985, the tax rate is reduced to 10¢ per pack.

<sup>8</sup> Texas: The tax rate is increased to 20.5¢ per pack on September 1, 1985.

<sup>9</sup> New Jersey: The figure includes a surtax levied at the same percentage as the sales tax and based on average wholesale price.

<sup>10</sup> Maine: The tax rate is increased to 23¢ on October 1, 1985.

State Tax Guide

Table of Rates



### MISSOURI Cigarette Tax

Local Taxes.—Jefferson City imposes a tax of \$2 per 1,000 cigarettes (4¢ per pack). Kansas City, St. Joseph and Springfield levy taxes of \$2.50 per 1,000 cigarettes (5¢ per pack). St. Louis levies a tax of \$3.50 per 1,000 (7¢ per pack). St. Louis County levies a tax of 2.5 mills per cigarette (5¢ per pack).

\*OCH, MISSOURI TAX REPORTER at 155-045 and 70-000



# Kansas Food Dealers' Association, Inc.

2809 WEST 47th STREET SHAWNEE MISSION, KANSAS 66205  
PHONE: (913) 384-3838

March 27, 1985

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## DIRECTOR OF GOVERNMENTAL AFFAIRS

FRANCES KASTNER

## SENATE ASSESSMENT & TAX COMM.

RE: HB 2512

EXECUTIVE DIRECTOR  
JIM SHEEHAN  
Shawnee Mission

Some of our members operating stores along the borders of Kansas are very concerned that the increase in cigarette tax to 24 cents will have a dramatic impact upon their sales.

We have been informed of the following cigarette tax rates in our surrounding states:

Oklahoma	.15
Colorado	.18
Nebraska	.18
Missouri	.13

Although our current rate of .16 puts us in a competitive position, the rate of 24 cents will make our cigarette tax not only much higher than our neighboring states, but the highest in the nation.

We wanted to share this information with you, and also point out that when such a variance of price structure occurs, not only do Kansans travel to another state if they live along the border to purchase the product that is cheaper, but they also do much of their weekly shopping at that same time.

With this in mind, there would no doubt be less tax collected on cigarettes than is currently being projected, as well as the sales tax on cigarettes and other products purchased outside the state.

As always, we want to keep our grocers on a good competitive basis with our bordering states. We appreciate the opportunity to appear before you today to express our concerns with HB 2512.

Frances Kastner, Director  
Governmental Affairs, KFDA

Attachment 4

# EXCISE TAXES:

# THE FAIRNESS ISSUE

Attachment 4



## EXCISE TAXES: THE FAIRNESS ISSUE

### Summary

From an economic perspective, excise taxes are unfair: they place the heaviest burden on families at the lowest end of the income scale. The cigarette excise is the most regressive of all selective consumption taxes currently levied by state and federal governments. Its burden on consumers increases drastically as income decreases.

Excise taxes are also inequitable with respect to business and public policy. They hurt everyone in the economy (e.g., producers, labor and retailers) not just consumers. They single out particular industries to bear the brunt of raising general revenues. They impose a moral judgment on consumers of selected goods.

Samuel Johnson called excise taxes "hateful"; Alexander Hamilton call them "inquisitive and peremptory." And every school child knows it was an obnoxious excise tax that triggered the Boston Tea Party. The inequitable taxes on items such as alcohol and cigarettes, which we still have today, are nothing more than modern versions of the same taxes our founding fathers abhorred.

### Tax Fairness

It is essential to estimate the projected revenue-raising ability of proposed tax policies in order to develop efficient, long-term solutions to fiscal problems. But the issue of tax equity is equally important.

Equity is a measure of how fairly or evenly the tax burden is distributed. A tax that falls most heavily on families at the lower end of the income scale (that is, a "regressive" tax) is viewed as unfair. On the other hand, a tax that is geared to one's ability to pay is considered a fair tax. A determination of the impact of various tax options on low- and middle-income families is critical to the ultimate adoption of an equitable tax package.

### Excise Taxes and the Consumer

Conservatives and liberals alike favor broad-based revenue raising measures over excise taxes, which are selective consumption taxes on specific goods.

In 1982, two prominent conservative U.S. Congressmen condemned increases in excise taxes. Writing to the Office of Management and Budget, Jack Kemp (R-NY) and Trent Lott (R-MS) complained

that those who try to solve economic problems in this way seem to think that "because blue-collar workers will pay the tax at their taverns, stores, and gas stations, not on their 1040 forms, it does not come out of their income..." In 1984, Representative Kemp joined with liberal Senator Bill Bradley (D-NJ) in opposing excises. The following excerpt from their dialogue on tax reform in the New York Times on September 30, 1984 makes their opposition clear:

Mr. Kemp: Both of us are very critical of consumption-based taxes, because [they] would hurt the poor and families the most.

Mr. Bradley: As the debate [went] in 1913: Can a rich man consume more tobacco, or more alcohol, or whatever the [sales tax] is, than a poor man? The answer is basically that they are going to consume roughly the same amount, but the excise tax is going to be a much greater burden on the middle- and lower-income person.

Ray Denison, director of the AFL-CIO's department of legislation, recently raised similar objections to excises. In testimony to the Health Subcommittee of the U.S. House Ways and Means Committee, he opposed increasing taxes on alcohol and tobacco to raise revenue for the Medicare Trust Fund and similar healthcare programs because: "These are excise taxes, the most regressive of all taxes, which would disproportionately impact the low-income population..."

The Bakery, Confectionery and Tobacco Workers International Union echoed these sentiments in their testimony on the same subject: "Excises on alcohol and tobacco are regressive taxes which disproportionately impact low-income and working people. The effective tax rate for individuals in lower tax brackets is ten times as high as that paid by individuals who earn in excess of \$50,000 per year."

And finally, Harold Hochman, professor of economics at City University of New York, concluded his remarks before the U.S. Treasury's panel on fundamental tax reform with comments on excises and the consumer:

It is certainly no secret that many of our excise taxes are unfair when evaluated against the standard of horizontal equity. Study after study has confirmed that as income goes up, the effective tax rates on these goods go down. If by way of reform we adopt a plan to reintroduce taxation based on the ability-to-pay principle, then we must give serious consideration to...abolish[ing] existing excise taxes.

#### The Cigarette Excise

An examination of the cigarette excise reveals that it is one of the most unfair consumption taxes. The cigarette excise burden -- the percentage of income taken by the tax -- falls drastically as income increases. Economist Thomas W. Calmus demonstrated this in his study of excise taxes by income class published in the Quarterly Review of Economics and Business.

Calmus calculated the regressivity index of various excise taxes and found only the tax on smoking tobacco to be more regressive than the cigarette excise.

Robert Tollison, professor of economics at George Mason University, agreed with Calmus' findings. In testimony submitted to the U.S. Treasury, he wrote: "Excise tax[es] on tobacco products [are] the most regressive of the selective consumption taxes [currently] levied."

The regressivity of the cigarette excise is compounded when smoking among income levels, races and occupational groups is examined. According to economist James Savarese, former director of public policy analysis for the American Federation of State, County and Municipal Employees, in testimony submitted to the New York state legislature, "a significantly [larger] proportion of lower income individuals smoke than persons earning higher incomes. The latest survey data from the National Center for Health Statistics reveal that persons earning \$7,000 or less are 50 percent more likely to be smokers than persons earning \$25,000 or more."

And according to the Bakery, Confectionery and Tobacco Workers International Union, "Blacks are more likely to smoke than their white counterparts and persons in occupations traditionally



classified as blue-collar are more likely to smoke than persons working in jobs classified as white-collar and professional."<sup>1</sup>

Both proportionately and absolutely, the cigarette excise is borne more by low- and moderate-income people than upper-income people.

### Hidden Taxes

Excise taxes, by their nature, are hidden taxes. They become part of the product price and, so, are not obvious like retail sales taxes. This means consumers are unable to maintain effective control of their tax burden. In a written statement for the U.S. Senate Finance Committee hearings on major tax reform options, Roger Kormendi, associate professor of economics at the University of Chicago, described this unfair aspect of excise taxes:

The problem that arises from hidden taxes is that without the knowledge of their true tax burden, the tax-paying public cannot exercise effective political control over their overall tax burden. People will see the resulting price increases and/or wage reductions but will generally fail to recognize the source to be hidden taxes. Constituent political pressure on [the legislature] will therefore be misdirected away from the true problem.

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<sup>1</sup>John DeConcini, "Statement of the Bakery, Confectionery and Tobacco Workers International Union to the Health Subcommittee, House Ways and Means Committee, Regarding Earmarking of Alcohol and Cigarette Excise Tax Revenues for Medicare Funding," September 13, 1984.

Excise Taxes and Industry

Excise taxes create a general drag on the economy. They are burdensome to producers, retailers and labor, as well as consumers. In their book, Five Economic Challenges, Robert Heilbroner, professor of economics at the New School for Social Research, and Lester Thurow, professor of economics and management at MIT, describe the effect:

Because the cost of the commodity is higher [with the excise tax], less of it is sold -- gasoline or liquor or cigarette sales, for example, always suffer when taxes are placed on them. It follows that the...tax must affect individuals other than just the buyers. The seller of the commodity must bear some of the tax because his sales have declined and presumably so has his income. The workers or other suppliers of services who produce the commodity will also be penalized, because less of the taxed commodity will be bought and therefore fewer people will be employed making it.

President of the U.S. Chamber of Commerce, Richard L. Leshner, said it more briefly in his statement on tax proposals submitted to the U.S. Senate Finance Committee: "Tax increases reduce consumer spending power and businesses' ability to invest, thus slowing private economic activity and raising unemployment."

In the past two years, articles in prominent news dailies demonstrated the devastating effect of an excise tax:

From the New York Times, January 22, 1983: R.J. Reynolds Industries said it was asking more than 10 percent of its cigarette workers to quit or retire early, and that it had already cut back next week's production schedule at the R.J. Reynolds Tobacco Company to four days, as a result of an expected sales decline attributable to the increase in the federal tax on cigarettes.

From the Wall Street Journal, March 5, 1984: Philip Morris, Inc....said it laid off 175 workers at its cigarette making plant...because of lower than expected sales....A spokesman said that while sales were up in the U.S. and worldwide, an increase in federal and state excise taxes on cigarettes held the sales increase below company expectations.

Indeed, excise taxes on selected goods are unfair because particular industries must bear the brunt of raising general revenues. Some 200 years ago, Alexander Hamilton warned that taxes on specific items [would lead] to "the oppression of particular branches of industry" among other evils. It is no different today.

The Minority Report of the 1982 Advisory Council on Social Security, written by Stanford Arnold, secretary-treasurer of the Building Trades Council, Michigan State AFL-CIO, and Alvin Heaps, President of the Retail, Wholesale and Department Store Union, opposed increasing taxes on alcohol and tobacco to raise revenue for Medicare because: "These are regressive taxes which would disproportionately impact the low-income population and unfairly single out particular industries."

A Richmond Times-Dispatch editorial, from December 20, 1983, criticized the excise taxes on tobacco for threatening to destroy an important American industry:

Since the settling of America, tobacco has been an important part of the nation's economy. But today it is fashionable to treat the leaf as Public Enemy No. 1, and one result is the somber news from Petersburg that Brown and Williamson will close its plant there within two years. More than

1200 employees will be affected....Company officials say that soaring taxes...are a major reason for their decision.

The beneficent economic impact of the tobacco industry is deep and widespread, and so would be the devastating effects of its destruction. But it will be difficult for the industry to survive if [it] continues to [be] leech[ed] with confiscatory taxes.

Richard A. Shoemaker, assistant majority leader in the Wisconsin Assembly, outlined the widespread economic effect of more taxes on tobacco. In an article for Legislative Policy magazine, Shoemaker wrote:

When cigarette taxes increase and demand declines, small businesses are hardest hit. Cigarette purchases -- and cigarette industry operations -- have a ripple effect on the economy that goes far beyond the direct interaction of buyer and seller....This spillover effect reaches employment as well. Nearly 400,000 persons are employed full-time in the tobacco industry. Another 1.6 million jobs exist in other industries associated with producing, wholesaling, and retailing tobacco products....National or state excise tax-rate increases lead to a decline in demand and therefore revenue, output, earnings and employment in the cigarette industry and each of its supporting sectors.

In testimony before the California state legislature, Thomas Borcharding, professor of economics at Claremont College, agreed with Shoemaker that small businesses are hardest hit by an increase in the cigarette excise tax:

Another related factor to be considered is the impact on small business. A doubling of the cigarette excise tax would create serious hardship for small retail establishments in California. Cigarettes are the key traffic builders for many of the state's 44,000 retail establishments. Among convenience stores, cigarettes are the number one selling product and account for 16.7% of gross profit dollars. The conclusion here is obvious: the real burden of a cigarette

excise tax increase will fall on large segments of the small business community, much of which is just turning to profitability since the last recession.

An article in the March 1983 issue of Convenience Store Merchandiser confirmed that small businesses, not only tobacco manufacturers, are hurt by increases in excises. Gerald Coelsh, vice president of marketing for an Ohio-based convenience store chain, was asked how the doubling of the federal excise tax on cigarettes affected his company's sales: "It is a strain. When a category that accounts for ten to 15 percent of total sales falls off, you're talking about one-half to one percent of gross store profits."

#### Excise Taxes and Government

We have discussed how excise taxes are unfair to consumers and to particular industries that are singled out to bear the brunt of what should be a more equitably distributed tax burden. Excises on items such as alcohol and tobacco are additionally unfair as a matter of public policy. Namely, they impose a moral judgment on consumers of selected products.

Taxes are inevitable, but at what point do they become destructive? Robert Nozick, philosophy professor at Harvard University, raised this question in his book, Anarchy, State and Utopia. In Nozick's ideal state, government would not interfere with "capitalist acts between consenting adults"; it would be required to maintain



a hands-off policy regarding the freedoms of individuals and the rights of corporations, ideally two sides of the same coin.<sup>2</sup>

An editorial in National Review, February 19, 1982, described the destructive nature of excise taxes on goods such as alcohol and tobacco:

They say that if you only wait long enough, anything will come back into fashion. Even so, who would have guessed that 1982 would see a renewed vogue for sin taxes? Until President Reagan quashed the idea, the pundits were making a tax on alcohol and tobacco sound like the freshest, most innovative scheme ever to hit representative democracy. It punished the wicked; it rewarded the virtuous; it replenished Washington's touchingly depleted coffers; and it restored discipline to what even George Will said was a sadly undertaxed nation.

Sin taxes appeal...to those with a yen for paternalism. In [this group] are some ardent Naderites who seem to support such taxes primarily as a way to change behavior -- that is, to restrict liberty -- and only secondarily to raise money.

An article in the Chicago Tribune, January 17, 1982, echoed the National Review's editorial stance:

Raising the tax on tobacco and liquor would be a cheap shot by the government. It is as if they were challenging us to complain about an excessive tax on something as bad for us as whiskey and cigarettes probably are. In putting proportionately higher taxes on those two things than on most other products, the government has already made a moral judgment. It has decided tobacco and whiskey are bad. When the government gets into deciding what's good or bad

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<sup>2</sup>James Bowling, "Cigarette and Alcohol Taxes Hurt Poor Men Most," Business and Society Review, Spring 1976, Number 17.

for us, it's over its head and ought to get out. It's none of the government's business if we smoke or drink.

In 1976, Gene Haislip, deputy assistant secretary for legislation at the Department of Health, Education and Welfare, testified before the U.S. Senate Committee on Labor and Public Welfare on the "National Health Research and Development Act." In his testimony, Haislip disapproved of using excise taxes to discourage smoking:

We believe that it is inappropriate for government to intervene in the individual decision to smoke cigarettes through a tax penalty....We are not convinced that it is proper to tax individuals on the basis of their decision to smoke cigarettes any more than it would be proper to tax people to encourage physical exercise or better eating habits.

### Conclusion

Excise taxes are unfair to consumers: they are regressive taxes which disproportionately have a greater effect on families with low and middle incomes. They are also inequitable with respect to business. Indeed, their present magnitude makes them oppressively burdensome to both industry and labor. And finally, as we have discussed, excises are unfair as a matter of public policy. Taxes on items such as alcohol and cigarettes impose an inappropriate moral judgment on consumers of these selected goods.

Ronald A. Pearlman, assistant secretary of the Treasury, agreed with these conclusions at a tax conference held in Washington, D.C. on December 14, 1984. "I think you will not find any economist

and you will not find me defending excise taxes as anything other than revenue raisers," Pearlman said. "They are regressive. They are industry specific. They are unsound in my judgment from any kind of economic or tax policy basis....I would not seek to defend [them] on any rational basis."

Statement  
of Sherman Hanna  
RE: H.B. 2512 : Increasing Tax on Cigarettes

My name is Sherman Hanna, and I am appearing on behalf of the American Tobacco Institute. I am an economist, with a B.S. in economics from the Massachusetts Institute of Technology, and a Ph.D. in consumer economics from Cornell University. I am a professor of family economics at Kansas State University, although my appearance here has no connection to my official duties at the university.

House Bill 2512 would increase the tax on the standard cigarette pack from 16 cents to 24 cents. This bill is tied to House Bill 2159. The increase in the cigarette tax would be used to make up part of the losses created by a 33.3 percent tax credit against the ad valorem tax on business inventories. (The first year the tax credit would be 20 percent.) I am here to speak against the proposed increase in the cigarette excise tax for three reasons: the state would have a net loss of revenue of at least six million dollars; the cigarette tax is an extremely regressive tax that hits the poor the hardest; and it is a tax that higher income consumers will find easier to escape.

Under House Bills 2512 and 2159, after the first year, businesses could receive 33.3 percent of their ad valorem tax on inventories as a credit on their state income tax. According to Mr. Ryan at Legislative Research, the revenues from the ad valorem inventory tax to all governments and school districts amounted to roughly 90 million dollars in 1984. The 33.3 percent tax credit would cost the state approximately 30 million dollars, while the increase in the cigarette tax might raise 24 million

dollars, a net loss of six million dollars.

The fairness of a tax should be considered in terms of its impact on families at different income levels. A tax is considered to be regressive, and thus unfair, if it requires relatively greater sacrifice by lower income families than by higher income families. All evidence indicates that taxes on tobacco products are among the most regressive, and therefore most unfair, taxes.

Table 1 below presents information based on the most recent data released by the United States Bureau of Labor Statistics, which interviewed a national cross-section of households regarding their spending. Households with annual incomes less than \$5,000 spent 3.5 percent of income on tobacco products, while households with incomes over \$30,000 spent less than 0.5 percent of income on tobacco products. Less than half of people

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Table 1. Consumer Spending on Tobacco, Food, and Gasoline, by Income Level (Includes both smokers and nonsmokers.)

<u>Annual Income</u>	<u>Mean Income</u>	<u>Tobacco</u>		<u>Food</u>		<u>Gasoline</u>	
		<u>Spend- ing</u>	<u>% of Income</u>	<u>Spend- ing</u>	<u>% of Income</u>	<u>Spend- ing</u>	<u>% of Income</u>
Less than \$5,000	\$2,512	\$89	3.54%	\$1,720	68.47%	\$406	16.16%
\$5,000 to \$9,999	\$7,384	\$141	1.91%	\$2,224	30.12%	\$689	9.33%
\$10,000 to \$14,999	\$12,279	\$182	1.48%	\$2,651	21.59%	\$1,009	8.22%
\$15,000 to \$19,999	\$17,367	\$195	1.12%	\$3,058	17.61%	\$1,265	7.28%
\$20,000 to \$29,999	\$24,414	\$212	0.87%	\$3,715	15.22%	\$1,542	6.32%
\$30,000 and over	\$44,152	\$218	0.49%	\$4,916	11.13%	\$1,868	4.23%

Based on data from Bureau of Labor Statistics, U.S. Department of Labor, "Consumer Expenditure Survey: Results from the 1980-81 Interview", press release, December 19, 1984.

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smoke\*, so low income smokers spent over seven percent of income on tobacco products.

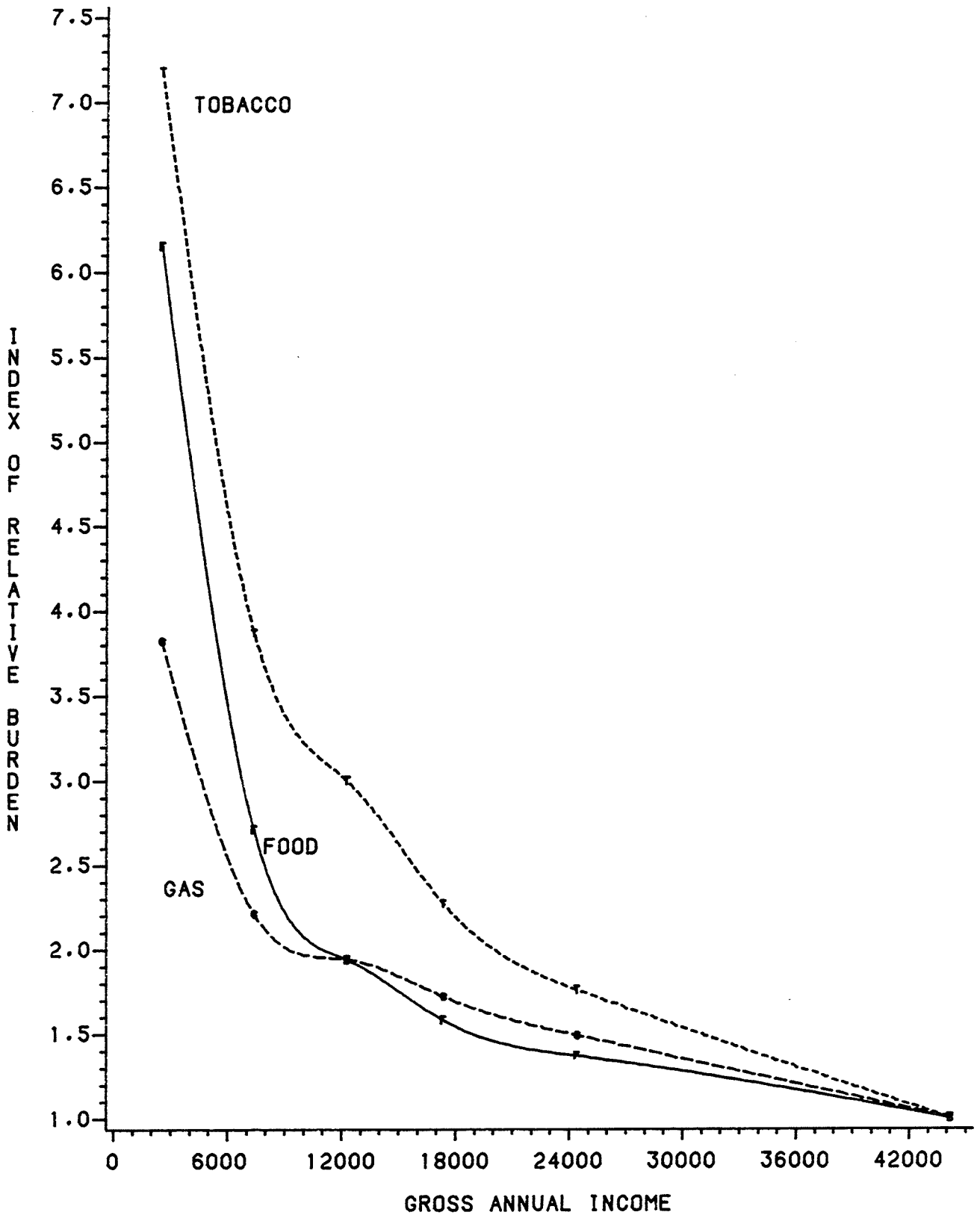
Clearly, cigarette taxes qualify as regressive taxes, but as Table 1 shows, they are even more regressive than taxes on food and gasoline. The low income (less than \$5,000) families' percentage of income spent on tobacco products was 7.22 times as high as the percentage of income spent by the high income (\$30,000 and over) families. By way of comparison, the low income families' percentage of income spent on food was only 6.15 times as high as the percentage of income spent on food by the high income families. The low income families' percentage of income spent on gasoline was only 3.82 times as high as the high income families percentage of income spent on gasoline. The graph on page 4 shows how the relative burden on lower income families of the excise tax on tobacco is higher than the burden of taxes on food and on gasoline.

Obviously, sales and excise taxes on all three of these products are regressive, but cigarette taxes, which are heavier than taxes on almost any other product, are the most regressive, and thus the most unfair. An increase in the state tax on cigarettes would hit especially hard on poor consumers, on unemployed workers, and on farmers in financial distress.

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\*Based on data from the National Health Interview Survey, National Center for Health Statistics, 1980 interviews.

**INDEX OF RELATIVE BURDENS OF TAXES ON TOBACCO, FOOD  
AND GASOLINE, (BURDENS ON HIGH INCOME FAMILIES = 1)**



Another argument against increasing the tax on cigarettes is the increase in the incentive to buy cigarettes in other states. The proposed increase would make cigarettes in Kansas more expensive than cigarettes in bordering states. Higher income consumers would find it easier than lower income consumers to stock up on cigarettes in Missouri, Colorado, Oklahoma or Nebraska. Lower income Kansas consumers would be hardest hit, having neither the money nor the mobility to stock up in another state. Illegal bootlegging by professionals would also increase. The likely decrease in Kansas cigarette sales was not taken into account in the projection of 24 million dollars of revenues, which was based on no decline in cigarette sales.