

RAISING TOBACCO TAX REVENUES & CREATING TOBACCO TAX EQUITY IN NORTH CAROLINA

To raise needed new revenues and avoid counterproductive budget cuts, North Carolina could increase and equalize its tobacco tax rates and close some related tax loopholes. A \$1.00 per pack cigarette tax increase (to match the current national average cigarette tax rate of \$1.45 per pack) that also closes tax loopholes and brings the tax rates on other tobacco products to parallel levels would raise annual state revenues by \$391.5 million.

<u>Current Tax Rates</u>	Current Rate Per Standard Pack	Rate Per Dose/Unit	Rate as Percent of Wholesale Price
Cigarettes	\$0.45	2.25¢	16%¹
Other Tobacco Products	varies	varies	12.8%

Standard pack = 20 cigarettes. Single dose/unit = cigarette. Wholesale price = price charged by manufacturer to wholesaler, not including state taxes (typically less than half of the final retail price).

Proposal

- Raise the state cigarette tax rate by \$1.00 per pack.
- Raise the tax on other tobacco products (OTPs) from 12.8% to at least 50% of wholesale price.
- Establish minimum tax rates for each major type of OTP based on the new cigarette tax.
- Close tax loopholes that allow some cigarettes to be taxed as cigars.
- Fix definitions that could allow some new types of tobacco products to slip through the cracks and escape taxation.
- Increase penalties for tax evasion and contraband trafficking.
- Allocate a significant portion of the new revenues each fiscal year to fund the state tobacco prevention program, including funding for the state Medicaid program's tobacco use cessation assistance.

Why Not Keep Just a Stand-Alone Percentage-of-Price Tax on OTPs?

An OTP tax rate set as a percentage of wholesale price, by itself, works quite well, applying the same flat-tax rate on the many different types, styles, packages, prices and weights of tobacco products other than cigarettes. But a percentage-of-price tax, alone, also allows tobacco products or brands with below-market or bargain-basement prices to pay significantly smaller amounts of tax on a per-dose basis than the same type of tobacco product sold at average or premium market prices – which can encourage and facilitate predatory pricing and other unfair competition strategies. This problem is eliminated by complementing the percentage-of-price tax with a minimum tax on each of the major types of OTPs – which also raises more revenue and makes the tax rates on all OTPs more directly parallel the state cigarette tax rate.²

¹ Based on available data on the average wholesale price of a pack of cigarettes.

² For more on this problem – and the even bigger problem from taxing “moist snuff” smokeless with just a weight-based tax – see the Campaign for Tobacco-Free Kids factsheet, *The Best Way to Tax Smokeless Tobacco*, <http://tobaccofreekids.org/research/factsheets/pdf/0282.pdf>. See, also, *The Problem with Roll-Your-Own (RYO) Tobacco*, <http://tobaccofreekids.org/research/factsheets/pdf/0336.pdf>; and *How to Make Cigar Tax Rates Fair & Effective*, <http://tobaccofreekids.org/research/factsheets/pdf/0335.pdf>.

Proposed New OTP Tax Rates

The new tax on OTPs would be the higher of 50% of wholesale price and a minimum tax rate set to equal to the state's cigarette tax based on a per-price, per-pack or per-dose basis (depending on the characteristics of the type of tobacco product). The following table shows exactly how each of the different categories of tobacco products would be taxed.

New Tax Equity Rates for All Tobacco Products	
Cigarettes	\$1.45 per 20
"Small-cigar" cigarettes	\$1.45 per 20
Cigarillos, blunts	\$1.45 per pack of five or 50% of wholesale price
Premium cigars	\$1.45 per cigar or 50% of wholesale price
Conventional moist snuff smokeless	\$1.45 per 1.2 oz. can or 50% of wholesale price
Snus, lozenges, other single-dose smokeless	\$1.45 per 20 or 50% of wholesale price
Roll-your-own tobacco	\$1.45 per 0.65 oz. or 50% of wholesale price

Cigarillos, blunts and other manufactured non-premium cigars typically are sold in packs of five, which are taken to equal a pack of cigarettes and taxed at the same rate. Any cigarettes that can currently qualify as "cigars" and any cigarette-sized cigars would be taxed at the same rate as cigarettes.³

Conventional moist snuff smokeless (Skoal, Copenhagen, Grizzly) is typically sold in a 1.2 ounce tin or can, which is taken to equal a pack of cigarettes and taxed accordingly. Smokeless snus, orbs, pouches, lozenges, tablets, sticks and the like are all sold in discrete single-dose units, which are each taken to equal a single cigarette for tax purposes. State definitions would also be revised to make sure they reach all smokeless tobacco products.

There is approximately 0.0325 ounces of roll-your-own tobacco in each RYO cigarette (0.65 oz. per pack). Federal tax law and the Master Settlement Agreement each take 0.0325 ounces of RYO tobacco to equal one cigarette.

New Revenues and Other Benefits

These proposed changes would increase state tobacco tax revenues by more than \$390 million in the first year, even after accounting for possible increases in tax evasion and the significant declines in smoking and other tobacco use (especially among youth) from the rate increases.

The cigarette tax increase, alone, would bring in \$338.4 million, prompting 49,500 adult smokers to quit and reducing the number of youth smokers by more than 15 percent. These smoking declines would save 39,100 North Carolina residents from dying prematurely from smoking and would lock in \$1.8 billion in future healthcare cost reductions.

By itself, the OTP tax changes would raise another \$53.1 million or more, while reducing OTP consumption by roughly 13 percent and shrinking the number of youth users by more than 24 percent. It is not currently possible to provide specific estimates of all the related public health benefits and healthcare cost savings that these tobacco use declines would secure for the state, but they would be significant.⁴

Neither a stand-alone percentage of price tax nor a simple weight-based tax could bring in as much net new OTP tax revenue in the first year unless they had significantly higher weight-based or percentage tax rates than those in the proposal. Thanks to inflation and changing tobacco use patterns, a stand-alone percentage of price tax and, to an even greater extent, a simple weight-based tax would, over time, bring in less and less OTP tax revenue compared to the proposal, even if set up to bring in the same amount in the first year.

³ *The Rise of Cigars & Cigar-Smoking Harms*, <http://tobaccofreekids.org/research/factsheets/pdf/0333.pdf>.

⁴ See, e.g., the CFTFK factsheet, *State Benefits from Increasing Smokeless Tobacco Tax Rates*, <http://tobaccofreekids.org/research/factsheets/pdf/0180.pdf>.]