c/o Mautner Project-Whitman Walker Health
1701 14th Street, NW ● Washington, DC 20009

Anthony Williams
Chairman, DC Tax Revision Commission
1101 4th Street, SW
Suite W770
Washington, DC 20024

August 27, 2013

Dear Chairman Williams:

On behalf of the DC Tobacco Free Coalition (DCTCF) and its members, including the American Heart Association, the American Lung Association in the District of Columbia, the American Cancer Society, Campaign for Tobacco-Free Kids, DC Cancer Consortium, Breathe DC, Latino Council for Alcohol and Tobacco Prevention, and Smokefree, D.C., thank you for the opportunity to provide information on tobacco tax collection in the District of Columbia. This letter will help:

1. Clarify how cigarettes and other tobacco products are currently taxed in DC,
2. Explain how DC can improve its taxation of these products to fit with the goals of the DC Tax Revision Commission, and
3. Briefly explain the benefits of increasing tobacco tax rates.

The Commission has the opportunity to improve the way the District taxes tobacco products, to not only make tax collection more efficient and maximize revenues, but also to make sure that all tobacco products are adequately taxed.

How Tobacco Products are Currently Taxed in DC

DC levies different taxes at different rates on different tobacco products:

- ***Cigarettes.*** The excise tax rate on cigarettes is 12.5 cents per stick, or $2.50 per pack of 20 cigarettes. Currently, the highest rate is in New York at $4.35 per pack (New York City imposes an additional $1.50 per pack tax on cigarettes); and the lowest rate is in Missouri at 17 cents per pack.[1] In addition, cigarettes sold in DC are subject to a sales tax; but in 2011, the District changed the way that the sales tax was applied to cigarettes. Rather than charging the sales tax at the retail level, the percentage sales tax became surtax charged per-pack, updated each year, and is now collected at the wholesale level.

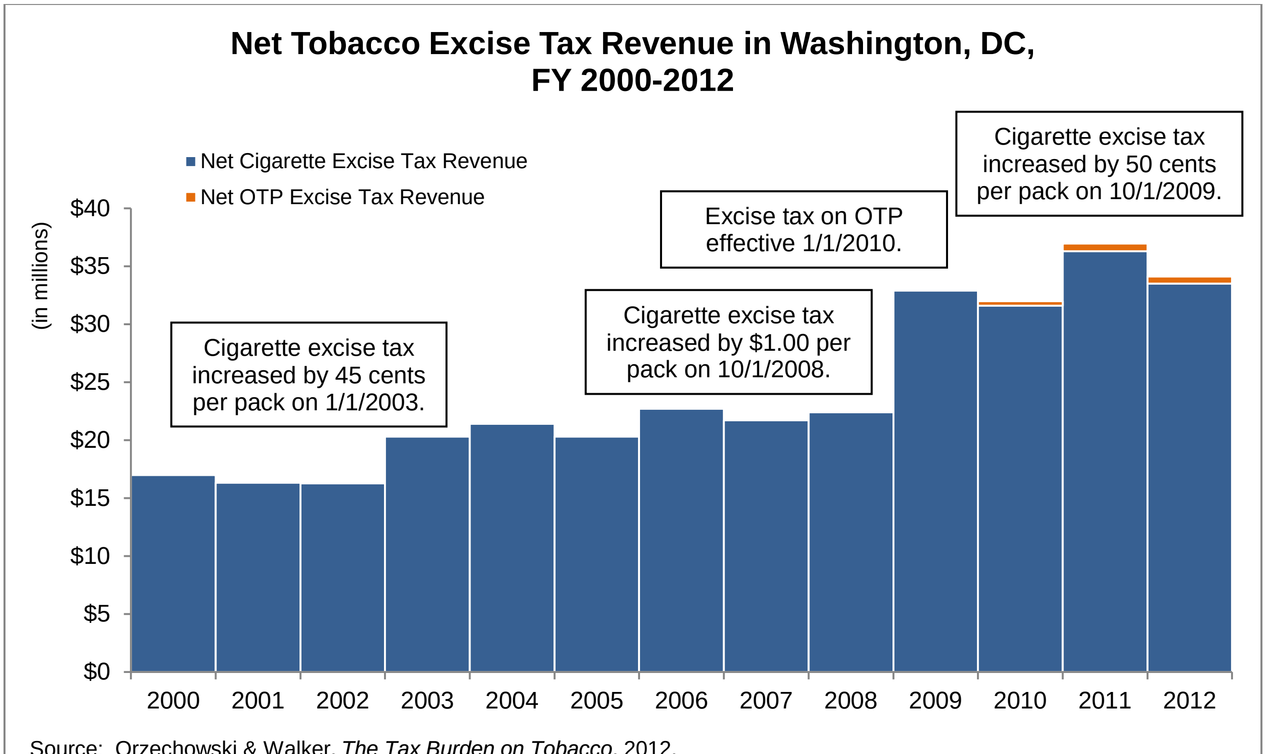
- ***Cigars.*** In the District of Columbia, premium cigars currently are not taxed (neither through an excise tax or a sales tax). Premium cigars are defined in the DC Code as "any cigar with a retail cost of $2.00 or more, or packaged units of cigars averaging

$2.00 or more per packaged cigar at retail" [DC Code §47-2001(i-1)]. The definition of cigarettes was improved in 2010 to include products that were essentially cigarettes with a little tobacco in the wrapper. Thus, those products, sometimes referred to as "little cigars," are subject to the cigarette excise tax rate. Cigars that do not fall into the cigarette nor premium cigar category are subject to a sales tax of 12% of the retail price, but not the excise tax.

- ***Other Tobacco Products.*** The excise tax rate on all other tobacco products (OTP), such as smokeless tobacco products and roll-your-own tobacco, is 75 cents per ounce. These products are also subject to a sales tax of 12% of the retail price.

As indicated above, the District has made some significant changes to its tobacco tax system in the last few years. In terms of tax rates, the cigarette tax was last increased by 50 cents to the current rate of $2.50 per package of 20 in 2008. In 2006, the 12% sales tax was first imposed on non-cigarette tobacco products (other than premium cigars and pipe tobacco), with the Other Tobacco Products Act of 2005. Prior to 2006, other non-cigarette tobacco products were not subject to any tax. The Fiscal Year 2010 Budget Support Act of 2009 added the 75-cent per ounce weight-based tax on some tobacco products, while also increasing the cigarette tax and fixing the cigarette definition.

The graph below shows the tobacco excise tax revenue collections in DC since 2000. It's clear that every time DC increased its cigarette tax rate, revenues increased and stayed at the higher level. Even in 2009, after the federal excise tax on cigarettes increased by 61.66 cents per pack, DC's cigarette tax revenues remained significantly higher than in the years prior to the tax increases.



Source: Orzechowski & Walker, *The Tax Burden on Tobacco*, 2012.

The current DC tobacco tax system gives an unfair advantage to some tobacco products, because it does not implement a flat tax across all non-cigarette tobacco products. It is also a complicated system, requiring knowledge of the differences between certain products, regardless of their package labeling (see discussion below on roll-your-own tobacco and pipe tobacco), to determine which products are taxed, at what rates, and what the exceptions are. With the wide array of tobacco products available on the market today, this is a difficult and onerous burden on tax collectors and enforcement agents. In addition, there are some discrepancies in the DC Code that make it unclear if the 75-cent per ounce tax applies to non-premium cigars or pipe tobacco products.

The District improved its tax system in 2010 when it fixed the cigarette definition to include so-called "little cigars," which are actually cigarettes. These products were created by cigarette companies to evade cigarette taxes and regulations. Expanding the definition ensures that DC collects the appropriate tax owed.

Recommendations for Improving DC's Tobacco Excise Taxes

The District can more fairly tax tobacco products with four changes: correcting tax code definitions, switching the sales tax on OTPs to an excise tax, switching its weight-based tax to an ad valorem (percentage-of-price) tax, and equalizing the tax rates on all tobacco products.

1. **Correct Tax Code Definitions.** The two definitions that affect the taxation of tobacco products other than cigarettes and cigars are in the sections of the DC Code pertaining to the gross sales tax (title 47, chapter 20) and the cigarette excise tax (title 47, chapter 24). In the gross sales tax chapter, "other tobacco product" is defined as "any product containing tobacco that is intended or expected to be consumed, other than a cigarette, cigar, premium cigar, or pipe tobacco" [DC Code §47-2001(h-3)], while in the cigarette excise tax chapter, this term "means a cigar, pipe tobacco, chewing tobacco, smokeless tobacco, snuff, roll-your-own tobacco, or any other product containing tobacco that is intended for human consumption." [DC Code §47-2401(5A)]. Two separate definitions for the category of "other tobacco product" make it difficult to determine exactly what products are subject to the sales and excise taxes. In addition, both definitions fail to apply to all current and future tobacco products on the market, such that some tobacco products are falling through the loophole and not paying any tax.

   To eliminate the confusion, both definitions should be coordinated and strengthened, by including products that are "made or derived from tobacco." Those added terms (or similar) are already in use in several states[*] and in the federal Family Smoking Prevention and Tobacco Control Act of 2009[†] and ensure that all products are covered by the relevant regulations. With the addition of these terms, however, it is also important to exempt any products approved by the U.S. Food and Drug Administration (FDA) for tobacco cessation, since nicotine replacement therapies (NRTs) use nicotine derived from tobacco, but are medications rather than tobacco products.

[*] At least Minnesota (MN Statutes, Section 297F.01) and Vermont (VT Statutes Title 32, Chapter 205 §7702).
[†] See 21 U.S.C. 321(rr). This Act gave the U.S. Food and Drug Administration authority over all tobacco products, although currently the FDA is only regulating cigarettes, roll-your-own tobacco, and smokeless tobacco and has announced plans to assert its jurisdiction over cigars, pipe tobacco, and other tobacco products.

2. **Apply an Excise Tax Rather Than a Sales Tax.** Experience shows that excise taxes are more effective than sales taxes to both increase revenues and improve public health. Excise tax rates tend to be higher than general sales tax rates and are acceptably so. For instance, some of the highest percentage-of-price excise tax rates in the U.S. include Wisconsin's 100% of the manufacturer's price on moist snuff (71% of the manufacturer's price for other types of OTP) and Washington state's 95% of the taxable sales price for tobacco products other than cigarettes and moist snuff. Most recently, Minnesota increased its OTP tax rate from 70% of the wholesale price to 95% of the wholesale price, with minimum tax rates, effective July 1, 2013. State surveys show that voters support tobacco excise tax increases to prevent tobacco use.[2]

   Another advantage of an excise tax is that it is often collected at the wholesale level rather than the retail level. In fact, in 2011, the District changed the way the sales tax was applied to cigarettes from a percentage of the retail price, the same way as sales tax on other items at the retail level, to a surtax at the rate of 36 cents per pack, collected at the wholesale level. Minnesota is the only other state that applies sales tax per pack at the wholesale level, and it changed its collection method in 2005. DC recognized the difficulty in collecting sales tax even on cigarettes in the District, and chose to change the tax essentially to an excise tax.

3. **Replace the Weight-Based Tax with a Percentage-of-Price Excise Tax.** A percentage-of-price tax is better for the District than a weight-based tax for several reasons. A weight-based tax is solely dependent on the amount of taxable product sold, so the only way the District could currently generate increasing levels of revenue would be to sell more tobacco product or increase the tax rates. However, under a percentage-of-price system, revenues can increase with increases in inflation, whenever the tobacco companies increase their product prices (usually several times per year), *and* if tobacco product sales increase. Moreover, from the public health and health economics perspectives, it does not benefit the District to have increases in tobacco product sales, since more tobacco use also means more health-related problems and higher health care costs.

   The reason why some tobacco companies want to switch from a percentage-of-price tax to a weight-based tax is because the tobacco companies, which make the more expensive premium brands of smokeless tobacco products, have lost market share to companies making bargain-priced smokeless tobacco products. Under a percentage-of-price tax system, the lower-priced products will pay a smaller tax compared to the more expensive product, but it is due to the difference in price – the tax rate itself is fair across all products because the same percentage is applied across all products. Under a weight-based tax, the percentage of the price paid in tax on a lower-priced product is higher compared to the tax on a higher-priced product. However, from a public health and economic perspective, it makes sense to keep the percentage-of-price tax system and add a minimum tax rate to ensure that the very low-priced products pay an adequate amount of tax. Although this makes the tax percentage of price uneven for lower-priced products, it helps to keep the cheaper products out of the hands of youth.

4. **Equalize All Tobacco Excise Tax Rates.** Bringing the tax rates on all tobacco products equal to the cigarette excise tax rate ensures that the District will collect all the revenues it is due, because any financial incentive to switch to lower-taxed products will be eliminated. For instance, cigarette smokers may try to avoid the higher cigarette tax by switching to untaxed non-premium cigars, either entirely or partially, thereby reducing the revenue that the District would collect. Leaving some tobacco products subject to lower tax rates – or no tax rates at all – compared to other tobacco products leaves money on the table.

Fixing the District's Tobacco Tax System Aligns with the Goals of the Commission

The recommendations for fixing the way DC taxes tobacco products meet the five goals of this Commission:

1. **Provide for fairness in apportionment of taxes.** As discussed above, the current weight-based tax unfairly taxes some products at higher percentages of their price than others. In addition, there is no reason why some tobacco products should be left untaxed. Switching to a percentage-of-price excise tax rate on non-cigarette tobacco products and equalizing it to the cigarette tax rate will improve the fairness of tax rates on tobacco products.

2. **Broaden the tax base.** Some tobacco products are not currently subject to excise taxes. Making them subject to an excise tax would broaden DC's tax base. As mentioned previously, there is no reason to leave some products untaxed, particularly since it is fairly easy for tobacco companies to make small changes to their product in order to qualify for lower tax rates. In DC, for instance, a company making roll-your-own (RYO) tobacco, subject to the 75-cent per ounce excise tax, would simply have to change the label on their packages to be called "pipe tobacco," and then its products would no longer be subject to a tax. This has already happened at the federal level, where the current RYO tobacco tax is at the same rate as cigarettes (to prevent smokers from switching to RYO tobacco cigarettes) but higher than the pipe tobacco tax. RYO manufacturers simply replaced the product labels to say "pipe tobacco" so that, according to the Government Accountability Office, the federal government failed to collect $255 million to $492 million over two and a half years.[3]

3. **Make the District's tax policy more competitive with surrounding jurisdictions.** One of the tobacco industry's common, but false, arguments against tobacco tax increases is that differences in tax rates will drive a large portion of tobacco users in high-tax states to nearby low-tax states. While some cross-border purchasing does occur, evidence shows that it does not occur to the extent that the tobacco industry claims. In state after state, including the tightly-packed and small states in New England, the state that increases its tobacco tax rates benefits much more from the increase than neighboring states without an increase. While neighboring states may see a limited increase in sales, their revenue collections are by no means close to what the state with the increase collects.

   One example is from New England in 2009 (see table below). New Hampshire, Connecticut, Rhode Island, and Vermont all increased their tobacco tax that year, although Vermont's increase was small. Each of these states showed substantial increases in revenue in the year following the tax, despite declines in cigarette sales. The two states that did *not* raise their tax, Maine and Massachusetts, either saw revenue stay the same or decline a bit, with little change in cigarette sales.

	Increase Amount (per pack)	Tax Rate after Increase (per pack)	Effective Date	Cigarette Tax Revenues (in millions)				Cigarette Pack Sales (in millions)		
				FY 2009	FY 2010	$ Change	% Change	FY 2009	FY 2010	% Change
Connecticut	$1.00	$3.00	10/1/09	$308.4	$380.2	+ $71.7	+ 23.2%	160.7	143.7	- 10.5%
Maine		$2.00		$137.5	$137.8	+ $0.2	+ 0.1%	68.8	69.8	+ 1.4%
Massachusetts		$2.51		$562.1	$556.6	- $5.5	- 0.9%	224.7	222.0	- 1.2%
New Hampshire	45¢	$1.78	7/1/09	$190.8	$229.6	+ $38.8	+ 20.3%	153.4	128.6	- 16.1%
Rhode Island*	$1.00	$3.46	4/10/09	$121.2	$133.6	+ $12.3	+ 10.2%	46.9	39.1	- 16.6%
Vermont	25¢	$2.24	7/1/09	$60.4	$64.9	+ $4.5	+ 7.5%	30.4	29.7	- 2.3%

* Note that the RI tax increase was during the fiscal year. New revenue for the full twelve months following the tax increase was almost $18 million.

Another example shows that doing the opposite also does not benefit the state: lowering a state's tobacco tax rates to encourage cross-border sales does not work to increase the state's revenues. New Hampshire lowered its cigarette tax rate by 10 cents in 2011, as well as its tax rates on other tobacco products, because the industry convinced legislators that doing so would attract tobacco users from neighboring states. Instead, the state lost revenues over the next two years as a result of the rate declines. Just this year, New Hampshire reinstated the tax rates from before the decrease.

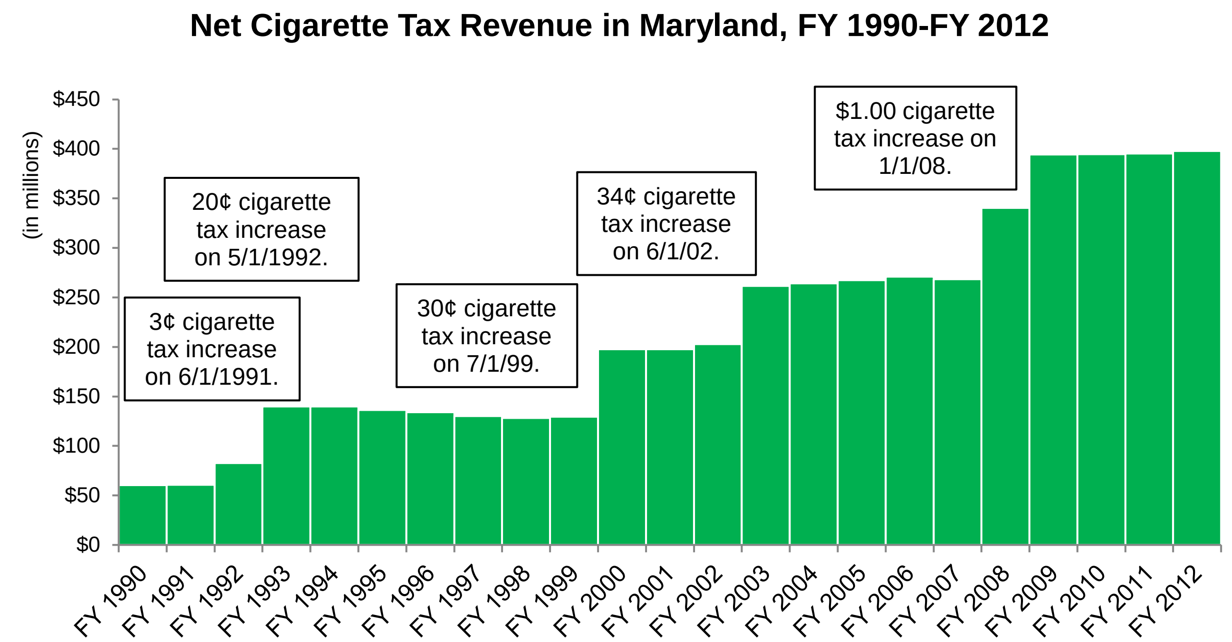
A competitive tax policy does not mean that DC has to lower its standards – and risk the health of its residents – to that of its neighbors.

4. **Encourage business growth and job creation.** Contrary to what tobacco companies and their allies claim, improving and increasing tobacco taxes does not reduce employment or shut down businesses. A study looked across all states and found that cigarette tax increases were not associated with declines in the number of convenience stores. In fact, they were associated with slight increases in the number of such stores.[4] An earlier study also found that employment in stores that sold tobacco does not decline in response to tobacco tax increases.[5]

5. **Modernize, simplify, and increase transparency in the District's tax code.** The current tax system for all tobacco products in DC is confusing. There are different rates on different products, while some tobacco products are untaxed entirely. If the District were to adopt the recommendations in this letter to improve the way that taxes are imposed on tobacco products, it would create a simpler and fairer tax system across all tobacco products.

Tobacco Taxes Generate Steady Revenue While Reducing Tobacco Use

Tobacco tax increases generate reliable and predictable revenue, reduce tobacco use (thereby reducing health care costs associated with tobacco use), and have the support of the public. Despite the decrease in tobacco product sales as a result of the rate increase, states still generate revenue above the amount the state would have collected otherwise. Unlike other taxes collected by states and the District, tobacco tax revenues are more predictable and less volatile than many other state revenue sources. As shown in the chart on page two, DC is not an exception to that rule, and revenue trends from state after state show that cigarette revenues remain at a high level for years after the rate increase. The chart below shows the cigarette tax revenue collections in Maryland. Changes in cigarette tax revenue collection (usually the largest part of tobacco tax collections) are gradual, predictable declines that are more than offset by the savings in health care costs. For example, cigarette tax increases work best to reduce smoking among youth, lower-income smokers, and pregnant women; and those smoking declines directly reduce state Medicaid program expenditures.



Source: Orzechowski & Walker, *The Tax Burden on Tobacco*, 2012

Economic research confirms that tobacco tax increases reduce tobacco use, particularly among youth. The general consensus is that every 10% increase in the real price of cigarettes reduces overall cigarette consumption by approximately three to five percent, reduces the number of young-adult smokers by 3.5%, and reduces the number of kids who smoke by six or seven percent.[6] In every state that has significantly raised its cigarette tax rate, pack sales have gone down sharply.[7] Reduced consumption of cigarettes comes from smokers quitting and cutting back. In fact, calls to state quitlines increase dramatically around tobacco tax increases, indicating that people are trying to quit in response to the rising cost of cigarettes and other tobacco products.

Fixing the District's tobacco tax system and increasing the tobacco tax rates would help lessen the toll of tobacco use in the District. Each year in DC, 1,600 kids under 18 try cigarettes for the first time and another 400 kids become new, daily smokers.[8] About 720 adults die each year from their own smoking; and, given current smoking rates, 8,000 kids alive today will ultimately die from smoking.[9] Smoking causes the District $243 million in health care costs, with $78 million of that amount spent by the Medicaid program.[10] Loss of productivity from smoking-caused shortened work lives costs DC another $232 million each year.[11]

It is particularly important that DC address the non-existent tax rates on non-cigarette tobacco products, particularly on cigars, since data show that cigar smoking among high school students in DC increased between 2007 and 2011, from 10.1% to 13.7%. The District's overall cigar smoking rate among high school students is slightly higher than the national high school cigar smoking rate of 13.1%. The 2011 cigar smoking rate among high school boys (17.3%) is higher than that for girls (9.6%).[12]

Unlike any other consumer product, tobacco products, when used as intended, will kill and/or cause disease in the user. Even though it is not one of the goals of the DC Tax Revision Commission, fixing the District's tax structure for tobacco products can go a long way to benefit

DC in many ways beyond just improving revenue collections. Economically, reducing tobacco use will help the District's budget through improved work productivity and reduced health care costs.

Please feel free to contact us if you have further questions or need more information.

Sincerely,

Charles Debnam
Chair, DC Tobacco Free Coalition

Cc: Gerry Widdicome
Steve Rosenthal

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[1] See, for instance, Campaign for Tobacco-Free Kids (TFK) factsheet, *State Cigarette Excise Tax Rates & Rankings*, http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf.

[2] See, for instance, TFK factsheet, *Voters in All States Support Significant Increases in State Cigarette Taxes*, http://www.tobaccofreekids.org/research/factsheets/pdf/0309.pdf.

[3] U.S. Government Accounting Office (GAO), *Tobacco Taxes: Large Disparities in Rates for Smoking Products Trigger Significant Market Shifts to Avoid Higher Taxe*s, April 2012, http://www.gao.gov/assets/600/590192.pdf.

[4] Huang, J & Chaloupka, FJ, "The economic impact of state cigarette taxes and smoke-free air policies on convenience stores," *Tobacco Control* 22(2):91-6, March 2013.

[5] Ribisl, KM, Evans, WN, & Feighery, EC, "Falling cigarette consumption in the U.S. and the impact upon tobacco retailer employment," in Bearman, P, Neckerman, KM, & Wright, L, eds., *After Tobacco: What would happen if Americans stopped smoking?*, New York: Columbia University Press, 2011.

[6] See, e.g., Chaloupka, FJ, "Macro-Social Influences: The Effects of Prices and Tobacco Control Policies on the Demand for Tobacco Products," *Nicotine and Tobacco Research* 1(Suppl 1):S105-9, 1999; other studies at http://tigger.uic.edu/~fjc/; Tauras, J, "Public Policy and Smoking Cessation Among Young adults in the United States," *Health Policy* 6:321-32, 2004; Tauras, J, et al., "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis," Bridging the Gap Research, ImpacTeen, April 24, 2001, and others at http://www.impacteen.org/researchproducts.htm. Chaloupka, FJ & Pacula, R, *An Examination of Gender and Race Differences in Youth Smoking Responsiveness to Price and Tobacco Control Policies*, National Bureau of Economic Research, Working Paper 6541, April 1998; Emery, S, et al., "Does Cigarette Price Influence Adolescent Experimentation?," *Journal of Health Economics* 20:261-270, 2001; Evans, W & Huang, L, *Cigarette Taxes and Teen Smoking: New Evidence from Panels of Repeated Cross-Sections*, working paper, April 15, 1998; Harris, J & Chan, S, "The Continuum-of-Addiction: Cigarette Smoking in Relation to Price Among Americans Aged 15-29," *Health Economics Letters* 2(2):3-12, February 1998, http://www.mit.edu/people/jeffrey/HarrisChanHEL98.pdf. U.S. Department of Health and Human Services (HHS), *Reducing Tobacco Use: A Report of the Surgeon General*, Atlanta, Georgia: HHS, CDC, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2000, http://profiles.nlm.nih.gov/NN/B/B/L/Q/_/nnbblq.pdf.

[7] TFK Factsheet, *Raising State Cigarette Taxes Always Increases State Revenues (and Always Reduces Smoking),* http://tobaccofreekids.org/research/factsheets/pdf/0098.pdf.

[8] Estimate based on U.S. Dept of Health & Human Services (HHS), *"Summary Findings from the 2011 Nat'l Survey on Drug Use and Health*," with the state share of the national number allocated through the formula in U.S. Centers for Disease Control & Prevention (CDC), "Projected Smoking-Related Deaths Among Youth—United States," *Morbidity & Mortality Weekly Report (MMWR)* 45(44):971-74, November 8, 1996 [based on state young adult smoking rates, as updated in CDC*, Sustaining State Programs for Tobacco Control, Data Highlights, 2006*].

[9] CDC's STATE System (avg annual deaths from 2000-2004), http://apps.nccd.cdc.gov/StateSystem/systemIndex.aspx. CDC, "State-Specific Smoking-Attributable Mortality and Years of Potential Life Lost—United States, 2000-2004," *MMWR* 58(2), January 22, 2009; U.S. General Accounting Office (GAO), "CDC's April 2002 Report on Smoking: Estimates of Selected Health Consequences of Cigarette Smoking Were Reasonable," letter to U.S. Rep. Richard Burr, http://www.gao.gov/new.items/d03942r.pdf, July 16, 2003. CDC, *State Highlights 2006;* CDC, "Projected Smoking-Related Deaths Among Youth—United States," *MMWR* 45(44):971-974, November 11, 1996.

[10] CDC, *State Data Highlights 2006* [and underlying CDC data/estimates], http://www.cdc.gov/tobacco/data_statistics/state_data/data_highlights/2006/index.htm. CDC, Smoking Attributable Mortality, Morbidity and Economic Costs, SAMMEC http://apps.nccd.cdc.gov/sammec/. GAO, http://www.gao.gov/new.items/d03942r.pdf, July 16, 2003. State Medicaid program expenditures are before any federal reimbursement.

[11] CDC, *State Data Highlights 2006* [and underlying CDC data/estimates], http://www.cdc.gov/tobacco/data_statistics/state_data/data_highlights/2006/index.htm. CDC, Smoking Attributable Mortality, Morbidity and Economic Costs, SAMMEC http://apps.nccd.cdc.gov/sammec/. GAO, http://www.gao.gov/new.items/d03942r.pdf, July 16, 2003.

[12] CDC, Youth Behavior Risk Survey online, “Smoked Cigars, Cigarillos, Or Little Cigars On At Least 1 Day, District of Columbia,” accessed July 22, 2013.