



5225 Wisconsin Avenue, NW, Suite 503 • Washington, DC 20015

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

November 20, 2013

Dear Chairman Williams:

In August, the DC Tobacco Free Coalition (DCTFC) submitted a letter encouraging the DC Tax Revision Commission to improve the District's tobacco tax system in order to create a fair and adequate tax system for all tobacco products. DCTFC commends the Commission for taking its suggestions seriously and proposing *Policy Option #5: Unified Taxation of Tobacco Products* on September 30, 2013. In this letter, we would like to offer feedback and additional information on this proposal.

Proposed Changes

Definitions. The proposal suggests a definition of tobacco products to include “made or derived from tobacco.” Although we originally suggested this language in our August 2013 letter, we have since learned that it is incomplete and may not cover all products that might not be specifically derivative of tobacco, but do contain the addictive chemical nicotine. Instead, the phrase, “contains, made, or derived from tobacco or nicotine” would be more inclusive of present and possible future tobacco products.¹

In addition, when changing the definition, we also urge the Commission to explicitly exclude products approved by the FDA for tobacco cessation, to minimize any financial barriers to using such products.

Tobacco Tax Rate. The percentage-of-wholesale price tax rate on other tobacco products (OTP) should be set equal to the value of the cigarette tax rate as a percentage of the cigarette wholesale price. To make sure that these two tax rates are always equal, it makes sense to link together these two rates, so that whenever the cigarette tax rate is increased, the OTP tax rate automatically changes as well, without requiring additional action by the City Council. For instance, rather than setting the numerical value of the OTP tax rate, the District should state that the OTP tax rate will always be equal to the cigarette tax rate expressed as a percentage of the cigarette wholesale price.

California is an example of a state that has tied its OTP tax rate to its cigarette tax rate. The California Board of Equalization recalculates the new OTP tax rate each year.²

Pros

In addition to the three “Pro” arguments laid out in the Policy Option document, another advantage of changing the tax system is that the District will collect more revenue per product sold at the proposed rate than previously. Thus, any declines in use will be more than offset by the higher amount of revenue gained per product sold.

Cons

Finally, we wanted to clarify and correct the claims made in two of the “Con” arguments in the Policy Option document.

First, the fact that tobacco use is higher among the lower-income population is an argument *for* increasing the tobacco tax. The disproportionate toll that tobacco use and its resulting health care costs take on lower-income families is regressive. Research shows that this population is more sensitive to price; thus more of them will quit in response to the price increase, and they will also pay proportionately less of the new tax than wealthier tobacco users. Fixing DC’s tax system and increasing the tax rates on tobacco products will thus benefit the lower-income population, particularly if some of the revenue is used for services to encourage and support their quit attempts.³

Second, the annual re-calculation of the OTP tax rate is not as burdensome as is claimed. To clarify, the wholesale price of cigarettes and cigarette tax rate is what is needed to calculate the OTP tax rate, not the wholesale price of OTP, since the OTP tax rate is equal to the cigarette tax rate as a percentage of the cigarette wholesale price. Wholesale prices of cigarettes can be obtained by requiring wholesalers and/or manufacturers to submit reports of the wholesale prices for all brands monthly or on a specific date. Monthly reports, which allow the Office of Tax and Revenue to look at trends over time, offer the benefit of discouraging attempts to artificially increase the wholesale price to give the false impression that the cigarette tax rate is a smaller percentage of the wholesale price and, therefore, lower the OTP tax rate. It may also be important to weight the average price by sales of brands. As mentioned earlier, the Board of Equalization in California recalculates the state OTP tax rate each year.

Thank you again for the opportunity to discuss Policy Option #5. It is a good starting point for improving the District’s tax policy on tobacco products and we look forward to hearing more about the proposal’s progress. Please feel free to contact us if you have further questions or need more information.

Sincerely,



Charles Debnam
Chair, DC Tobacco Free Coalition

Cc: Steve Rosenthal
Richard Auxier

¹ We have also heard some claims that certain products, such as electronic cigarettes, should not be included as a tobacco product and, therefore, not taxed. While electronic cigarettes do not look like traditional tobacco products, the liquid solutions used in them contain nicotine derived from tobacco, which qualifies them as a tobacco product, as defined by the Food and Drug Administration (FDA) in 21 U.S.C. 321(rr). All of the major companies making electronic cigarettes and liquid solutions for electronic cigarettes identify their solutions as having nicotine derived from tobacco. Synthetic nicotine, thus far, has been proven too expensive to use for electronic cigarettes (see, for instance, response from Christian Berkey at Johnson Creek, which makes the liquid solution for blu eCigs, owned by cigarette company Lorillard, at <http://www.e-cigarette-forum.com/forum/nicotine/47322-synthetic-nicotine-there-really-such-thing.html>).

Further, DC would not be the first place to tax electronic cigarettes equal to other tobacco products. Minnesota currently taxes non-cigarette tobacco products at 95% of the wholesale price, including electronic cigarettes, in the same way suggested in the Policy Options document – through an inclusive definition of tobacco products. The Department of Revenue applies the tax rate to the nicotine-containing part of the electronic cigarette. (See Minnesota Department of Revenue, *Revenue Notice #12-10: Tobacco Products Tax – Taxability – E-Cigarettes*, http://www.revenue.state.mn.us/law_policy/revenue_notices/RN_12-10.pdf)

It is also important to note that the rate suggested in the Policy Options document would not be equal to the cigarette tax rate, since one electronic cigarette cartridge is claimed to be equal to a carton of cigarettes. Thus the tax paid on the electronic cigarette and on refill cartridges is actually much lower than the cigarette tax rate on a per-dose basis. While this does go against the fairness principle, using a percentage-of-price tax is, overall, the easiest way to apply the tax on the broad category of tobacco products, including electronic cigarettes.

² California State Board of Equalization, Cigarette and Tobacco Products Taxes, Publication 93 LDA, August 2013, <http://www.boe.ca.gov/pdf/pub93.pdf>.

³ See Campaign for Tobacco-Free Kids factsheet, *State Cigarette Tax Increases Benefit Lower-Income Smokers and Families*, <http://www.tobaccofreekids.org/research/factsheets/pdf/0147.pdf>.