MEMORANDUM July 14, 1989

To: Mr. John A. Kochevar, Chairman
W.E. Ainsworth, Jr., Esq.
James R. Cherry, Esq.
Mr. John H. Hager
Mr. Edward D. Kratovil
Mr. Donald E. Mott
Mr. Roger L. Mozingo
Mr. John R. Nelson, Jr.

From: Kurt L. Malmgren KLM

Subj: After-Action Reports - Tax Issue

As discussed at the Policy Committee meeting, enclosed are after-action analyses from our field staff on six states which recently increased cigarette excise taxes. Reports are included from:

Connecticut
Illinois
Maine
Nevada
New Hampshire
Rhode Island

Please do not hesitate to call me should you have any observations about these reports or recommendations for future activity on this important issue.

KLM:sc

Enclosures

cc: Mr. Samuel D. Chilcote, Jr.
Mr. Charles H. Powers
David H. Remes, Esquire
Ms. Susan M. Stuntz
Stanley L. Temko, Esquire
State Activities Staff

MEMORANDUM

July 14, 1989

TO: Paul Emrick

FROM: Dennis Dyer

RE: Region I - Tax Issues After-Action Analysis

The states of Region I have experienced a series of cigarette excise tax increases during 1989. Connecticut, Maine, New Hampshire and Rhode Island enacted increases. Only Vermont rejected any tax increase. The Massachusetts legislature has yet to act on proposed increases ranging from $.04 to $.20. This memorandum will review the situations that led to the increases and suggest possible future industry activities in the tax area.

OVERVIEW

There are some basic concepts that need to be addressed at the outset. These issues will establish a context for a discussion of the recent tax increases.

Basic Concepts

1. Legislatures have determined it is appropriate to impose excise taxes on certain consumer products (alcohol, gasoline, automobiles, tobacco, etc.)

2. Legislators perceive a need for a taxed good to maintain its level of contribution to general revenues.

3. During periods of economic expansion, consumer buying increases the amount of the excise taxes generated. During periods of economic contraction consumer buying and the taxes it generates decreases. This strains the revenue resources of the various states.

4. Legislatures will increase taxes as a last resort, preferably during the first year of the legislative cycle, on those taxable items least likely to create political fallout.

Region I Tax History

It may be of benefit to review the cigarette excise tax history of the region. This may allow us to rationally assess the sometimes made suggestions that cigarette excise taxes are currently at the highest level in history and that recent increases are punitive in nature.

Tax increases were more frequent during the period 1955 to 1975 than in the period 1976 to 1988. As an example, since 1955 Connecticut has experienced eight tax increases: six occurred prior to 1975 with an average increase of 47.21 percent and a high of 100 percent; two have been enacted since 1975 with an average of only 38.83 percent and a high of 53.85 percent. A similar situation can be demonstrated in Maine (8 of 11 increases prior to 1975), Massachusetts (6 of 7 increases prior to 1975), New Hampshire (6 of 8 increases prior to 1975), and Vermont (5 of 6 increases prior to 1975).

1989 Situation

The above brief historical review should not be seen as an apology for the 1989 tax increases. It does not suggest a need to excuse the increases. However, it does suggest the need to put the increases in the proper perspective in order to develop a correct theory of opposition. It is, as an example, futile to develop a theory of opposition to tax increases based on a punitive anti-tobacco notion when, in fact, the increases are designed to raise revenue for an expanding government bureaucracy.

The 1989 increases were predicted and occurred because of anticipated economic contraction and declining tax revenues. In each case the cigarette increase was part of general tax packages that affected the vast majority of consumer products and corporate taxes. In each case budget deficits existed and/or loom for the 1990 fiscal year. In most cases cigarette taxes had not been increased since 1983. In no case were the traditional anti-tobacco activists players in the tax increases. To be sure, in some instances, they participated in what was perceived as an opportunity to hurt the industry. However, their participation was not pivotal to the success or failure of the tax increase.

STATE ANALYSIS

The following is a brief state-by-state analysis of the tax increases enacted to date.

Connecticut

The $.14 cigarette excise tax increase was one of 22 separate tax increases imposed in the largest tax bill in the state's history (see Attachment A).

The industry's opposition included the direct lobbying by all industry lobbyists, the support of organized labor and the state's wholesalers and retailers. Successful direct mail and phone bank operations were implemented by our member companies. Point of sale materials were placed in more than 3,000 retail locations throughout the state. Member company lobbyists reported constituent calls opposing the tax to legislators ran between 10 and 50 per day. In spite of the effort, the pressure for added revenue forced the increase.

The effects of the program were significant enough to drop the tax proposal from $.24 to $.14 and actually have it removed entirely from the Senate version of the budget. However, the omission could not be sustained.

A review of the Connecticut revenue situation and a proposal to offset future short-falls has been offered to The Institute under separate cover. The industry is likely to face similar tax increases in future years. Because there is no personal income tax, the state is primarily reliant on consumer taxes to raise revenues. These taxes tend to be unstable and unreliable. Therefore, tax rate increases are necessary to make up for revenues lost as a result of declining sales.

Maine

The cigarette excise tax increase imposed in Maine is unique and may offer some interesting opportunities over the course of the next three to five years. The enacted increase of $.09 phased in over a three year period ($.03 on 10/01/89; $.02 on 01/01/91; $.04 on 07/01/91) was part of a package of broad tax and sales tax exemptions imposed by the Legislature during the year (see Attachment B). The taxes imposed become part of the general tax revenues, but their passage was tied to major pieces of social legislation, including universal health care, property tax relief and income tax reform.

The industry's lobbying program included the efforts of both The Institute and member company lobbyists, organized labor, the associations representing the wholesalers and retail grocers, and the national organization of Citizens for Tax Justice. Direct mail and phone bank operations were developed by our member companies and supported by similar operations developed by the Maine State Grocers Association. The effort was significant enough to force the proponents of the health care legislation to abandon plans to include a $.20 cigarette tax increase in the original text of the legislation. Similarly, it forced the legislature to seek other sources of revenue in order to significantly decrease the size of the cigarette excise tax increase, not only in total but during the individual years of the program.

The adopted plan may, in fact, provide the industry with an institutional respite from tax increases during the next four years. This is likely to be a period when the fiscal situation in the state deteriorates significantly and added revenues are needed. The Legislature, by its three year phase-in, may have saved the industry from consideration during this time. It will also offer the marketing organizations of the companies an opportunity to work with known future tax rates.

New Hampshire

Like its counterparts in Connecticut and Maine, the $.04 tax increase in New Hampshire was a much debated part of a major tax package in the state (see Attachment C). With no sales and no income taxes the lure of low consumer taxes and prices has become an integral part of the New Hampshire tax scheme for many years. Historically, New Hampshire has enjoyed one of the nations highest per capita consumption rates for cigarettes, alcohol and a number of other consumer goods. However, like its counterparts in the Democratically controlled states of New England, the Republican controlled government of New Hampshire has enjoyed unprecedented increases in available revenues and spending during the past eight years. That period has ended and even they are finding it hard to wean themselves of 10 percent growth.

The industry effort included lobbying by The Institute and R.J. Reynolds counsel, supported by the efforts of the State's wholesalers, and retail grocers. The effort was significant enough to reduce the tax proposal from $.09 to the approved level of $.04. Utilizing a "tax bounty" theory that suggested New Hampshire would benefit from the recent tax increases in Connecticut and New York, the Legislature was almost convinced to eliminate the tax and monitor events.

It is anticipated that New Hampshire will suffer significant revenue shortfalls during the next two fiscal years. It is likely, because of the action taken this year, that cigarette taxes will not be a part of the solution to those revenue problems of 1990 and 1991. Those not included in the 1989 tax package are likely to suffer significant tax increases or newly imposed taxes.

Rhode Island

Like the other New England states, Rhode Island is suffering from a decline in anticipated revenues. The enacted $.10 tax increase was part of a broad tax package that effected a variety of consumer and corporate taxes (see Attachment D).

The only anomaly in the Rhode Island tax picture occurred during the final twenty-four hours of the budget debate. During this period the anticipated elimination of the sales tax exemption for cigarettes was replaced with a "revenue neutral" $.10 excise tax increase. As is sometimes the case in the legislative arena, the industry's opportunity to address the problem was eliminated by the unavailability of a key member of the legislative leadership, Senate President Bevilacqua, due to the tragic death of his father. By accepted practice, neither the Speaker of the House nor the Governor (the other key negotiators of the package) would break the deal without approval of the absent Bevilacqua. This could not be accomplished prior to the passage of the budget by the House. Again, according to Rhode Island tradition, the Senate does not amend the approved package. Therefore, in spite of the efforts of the industry's lobbyists and their supporters in the wholesale community, it was impossible to amend the action.

There are certain idiosyncrasies peculiar to the state that need to be understood, but may be best discussed during a meeting on the subject.

CONCLUSION

The tax experience in New England during 1989 suggests a need to analyze the way in which we look at and, therefore, approach cigarette excise taxes.

There is, I think, a need to abandon the distraction of thinking that cigarette excise tax increases are punitive and linked to health issues. This does not ignore the fact that health advocates get involved when there is an opportunity to increase taxes. It does not ignore the fact that some of the rhetoric surrounding the final stages of a tax increase include suggestions that cost increases will reduce consumption, especially to minors. However, it also does not ignore the reality that tax increases come only as a result of revenue pressures. At least in New England no health community generated tax proposal aimed at harming the industry has ever gotten out of committee.

If, therefore, economics are the driving force behind tax increases, then the industry needs to assess and expand its economic data regarding the impact of the industry and the effect of tax increases on sales and revenues.

Understanding that the industry's tax jeopardy is linked to the economic health of the state, then there may be a need to become active in non-tobacco revenue issues. This suggests activity not usually a part of the industry's legislative program. The following opportunities have suggested themselves in recent years:

1. Passage of the income tax indexing referendum in Maine in 1983 virtually assured the enactment of massive consumer tax increases in subsequent years. The industry refused to support the legislative leadership's opposition to the referendum. (Three tax increases followed in an eighteen month period.)

2. Passage of Proposition 2-1/2 in Massachusetts in 1981 assured stress on the state's revenues. (Tax increase followed the first year of implementation.)

3. Neither New Hampshire nor Connecticut have income taxes. This forces reliance on a variety of consumer and corporate taxes. The state's fiscal situation is likely to deteriorate in the future. The industry has resisted requests for support from income tax advocates in Connecticut. We have taken a similar stance in the past in New Hampshire.

These are a few examples of situations where non-tobacco revenue issues have had severely negative results for the industry. Because of prior actions, the defeat of proposed tobacco taxes became virtually impossible.

In essence, a better understanding of the nature of our tax situation, the economic health of the states, and a recognition of the interdependence of the two is necessary. New strategies and tactics will become apparent if we take the time to research the economics of tobacco and the economic health of the states. Our ability to defeat legislation is severely hampered by the distraction of focusing on social and health issues as a cause of tobacco tax increases.

If you have questions or would like to discuss the future of tobacco taxes in the region, give me a call.

DMD/spg

Attachments

cc: E. Barclay Jackson

Attachment A

MEMORANDUM

June 30, 1989

TO: Dennis M. Dyer

FROM: E. Barclay Jackson

RE: Connecticut Tax Increases 1989

The state of Connecticut, caught in the familiar New England deficit crunch, this year enacted a sweeping two-part budget package which imposes new taxes, increases old taxes, and removes former tax relief measures. The tobacco industry, along with other so-called sin products, was a primary target of the first part of the budget plan. The second part of the plan was much less discriminating: it targets all businesses and all consumers within the state. A synopsis of the components of these budgets is below.

Part I (March 1989)

(1) 100% beer tax increase
(2) 50% wine and wine cooler tax increase
(3) 50% liquor tax increase
(4) 150% minimum corporate tax increase
(5) 15% surcharge imposed on corporate income tax
(6) 54% cigarette tax increase

Part II (May 1989)

(1) Sales tax increase from 7-1/2% to 8%
(2) Sales tax imposed on utilities
(3) Sales tax extended to include meals under $2.00
(4) Corporate income tax surcharge increased from 15% to 20%
(5) Deduction removed for corporate income taxes paid to other states
(6) $25,000 tax savings removed for corporations filing combined form
(7) 8% sales tax imposed on services from lawn mowing to lobbying
(8) 60% exclusion removed for long term capital gains
(9) Dividend and interest tax increased
(10) Commercial property transfer tax increased
(11) Occupational tax increased
(12) 15% surcharge imposed on business property tax

(13) Real estate transfer tax increased to .5% on vacant land and 1% on residential property above $800,000

(14) Transfer tax increased to 1.11% on sale of controlling interest of stock in a business

(15) 20% tax imposed on other tobacco products

(16) Fines and fees increased:

a. 50% increase on speeding fines

b. 66% increase of state and municipal permit fees

c. 100% increase of recording fees

d. 100% increase of birth and death certificate fees

e. 100% increase of marriage license fee

EBJ/spg

Attachment B

MEMORANDUM

July 10, 1989

TO: Dennis Dyer

FROM: Barclay Jackson

RE: Maine Budget and 1989 Tax Increases

Despite Maine's revenue surplus, the legislature increased three existing taxes and imposed two new taxes during this past legislative session. Four of those taxes were established to fund a major health care access bill (L.D. 1322) and are as follows:

1. Tobacco Tax: The excise tax on cigarettes is increased by $.03 on 10/1/89, by $.02 on 1/1/91 and by $.04 on 7/1/91. Similarly, the tax on smokeless tobacco will increase from 45% to 50% of the wholesale price on 10/1/89, to 55% on 1/1/91, and to 62% on 7/1/91. The tax on cigars, pipe tobacco and other tobacco intended for smoking will increase to 13% on 10/1/89, to 14% on 1/1/91, and to 16% on 7/1/91.

2. Alcohol Sales Tax: The sales tax on alcohol (beer, wine and liquor) sold in restaurants and bars will increase from 5% to 10% on 12/1/89.

3. Sales Tax on Casual Sales of Boats: Isolated casual sales of boats and other watercraft will become subject to a 5% sales tax on 10/1/89.

4. Long-Term Lodging: The sales tax will be applied to rentals, of 28 or more days, of hotels, camps and rooming houses. An exemption has been retained for residential rentals. This tax takes effect on 7/1/91.

Video Tapes and Equipment: The fifth revenue-producing measure is the imposition of a 5% sales tax on the rental of video tapes and equipment.

The legislature also enacted the following tax reform measures:

Personal Income Tax Reform: The legislature effectuated a realignment of the four tax rates, increasing the highest rate from 8% to 8.5%. A companion bill was also passed which is intended to return the $5 million "windfall" which resulted from the federal tax reforms and which creates new investment tax credits on machinery and equipment used in manufacturing.

Property Tax: The legislature enacted a major property tax relief package which was funded through the General Fund. The package provides for reimbursement to qualified residents for half of the property tax that is between 4.5% and 8.5% of their income and complete reimbursement for any amount over 8.5% of their income. The package also provides for a homestead exemption and for payments of up to $3,000 for households with incomes of less than or equal to $60,000. Finally, the package includes $11 million to supplement state subsidies to school districts whose subsidies are less than the state average.

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Attachment C

MEMORANDUM

July 6, 1989

TO: Dennis Dyer

FROM: Barclay Jackson

RE: New Hampshire Budget and 1989 Tax Increases

Former New Hampshire Governor Sununu apparently left his successor with a dramatic cash problem similar to those in other New England states. While Gregg stood on the Bush "No New Taxes" platform Sununu was chuckling. As outlined below, the 1989 tax increases are substantial. Unfortunately, the outlook for 1990 is bad and the legislature is going to come back to the same donors next year.

In 1989 New Hampshire raised taxes in five major areas, expecting to raise the following amounts:

(1) Real estate transfer tax . . . . $9 million
(2) Cigarette tax increase. . . . . $5 million
(3) Racing tax. . . . . $5 million
(4) All state fees increased across the board . $6 million
(5) Court fines and penalties increased . . . $4 million
(6) Estate and legacy tax . . . . $5 million

The following increases are effective July 1:

(1) Tax increase on buying <u>and</u> selling real estate from $3.50 per $1,000 to $4.75
(2) Tax increase on cigarettes from $.17 to $.21
(3) Fee increase for drivers' licenses from $20 to $30
(4) Fee increase for auto certificates of title from $7 to $10
(5) Fee increase for auto registration from $16.80 to $19.20

Other increases include:

(1) Fishing licenses from $17.25 to $22.25 (resident) and $29.50 to $34.50 (non-resident)
(2) Combination hunting/fishing license from $24.50 to $29.50
(3) Dog licenses from $3.50 to $4.50
(4) Marriage licenses from $20 to $40
(5) Operating license for childrens' camps from $35 to $50
(6) Condominium registrations from $20 per unit to $30
(7) Trade name registrations from $40 to $50
(8) Annual fee for foreign corporations doing business in New Hampshire from $150 to $200

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(9) New elevator inspections from $25 to $50
(10) Liquor license for new vendors in New Hampshire from $400 to $600
(11) Annual liquor license for special rooms at ski areas from $787.50 to $1,200

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Attachment D

MEMORANDUM

June 29, 1989

TO: Dennis M. Dyer

FROM: E. Barclay Jackson

RE: Rhode Island Budget Tax Increases

The fiscal picture in Rhode Island is similar to that in most of the other New England states: dismal. In response the Legislature has patched together an appropriations act, H-7262 Sub A, which increases revenues in twelve areas. Each area represents behind-closed-door political maneuvers and the resultant unhappy constituents. Tobacco is one of these areas. All of the tax increases are outlined below.

1. Beverage Tax

   Article 14 increases the tax on alcohol by 50 percent. The tax on barrels of beer increases from $2 to $3
   on wine . . . . from $.40 to $.60
   on fruit juice. . . . . from $.20 to $.30
   on sparkling wine. . . . from $.50 to $.75
   on whiskey . . . . from $2.50 to $3.75
   on alcohol for beverages . from $5.00 to $7.50
   on alcohol not for beverage from $.05 to $.08

   In addition, a surtax of 16% of the new price is contemplated, which would be another 25% of the old tax.

2. Article 15 increases the tax on sports racing wagers from 1 percent to 2 percent.

3. Article 18 postpones for a year the reduction of taxes on public service telecommunications services.

4. Article 19 increases the gasoline tax from $.13 to $.18.

5. Article 20 increases the business corporations tax from 8 percent to 9 percent.

6. Article 21 removes the exemption of lottery and parimutuel betting winnings from the income tax.

7. Article 25 places a fee up to $2,000 on adoption studies performed for interstate and international adoptions.

8. Article 26 earmarks fees collected for professional regulation of the Health Department.

9. Article 40 increases the hotel tax from 4% to 5%, earmarking the funds for tourism promotion.

10. Article 44 applies the sales tax to long distance telephone calls.

11. Article 52 increases the real estate transfer tax from $1.10 to $1.40 per $500 of purchase price.

12. Article 16 increases the cigarette tax from $.27 to $.37.

As you can see, the legislature sought out numerous nooks and crannies to squeeze out revenue. 1990 looms ahead with a promised $80 million shortfall. At that time surely an income tax increase will be discussed, but 1990 is an election year with its attendant pressures. Therefore, the sales tax exemption repeal will be reintroduced. The Northeast's financial difficulties have not been adequately addressed, and Rhode Island will be looking at us again next year.

EBJ/spg