



AMERICANS FOR TAX REFORM

# Americans for Tax Reform

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## ATR Tax Policy Research

### Special Focus: Tobacco Tax Trends

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### *States Turn to Tobacco for Spending Growth, Revenue Collections Lower than Expected*

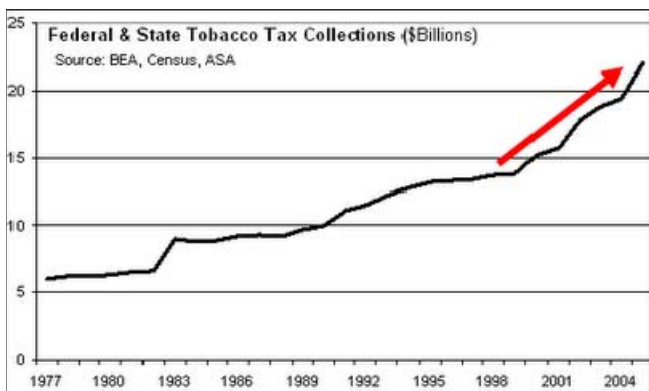
As members of Congress debate reauthorizing and expanding the State Children's Health Insurance Program, S-CHIP, some lawmakers are calling for an increase in the federal excise tax on tobacco. Proponents of the tax increase assert that the federal tax has not risen in a decade, therefore taxpayers are due for an increase.

In fact, following the taxpayers' revolts of the 1990's and political fallout from state officials raising income, sales, and corporate taxes, states adopted a new policy of targeted tax increases to fuel their spending appetite.

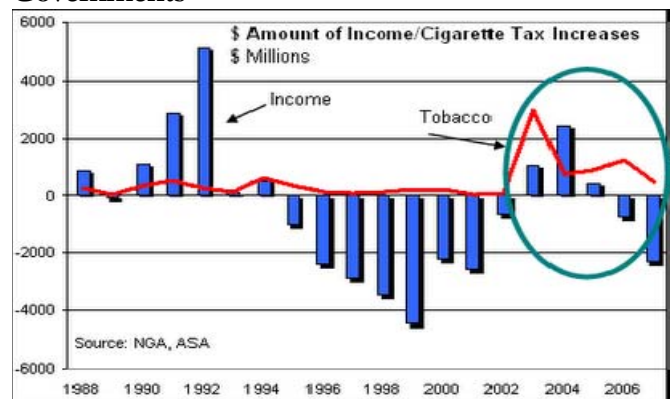
However, only considering the federal tax rate ignores the actual tax burden on tobacco. States have steadily raised taxes on cigarettes and other tobacco products, even while surpluses made other tax cuts politically popular. According to analysis by the American Shareholders Association, over the past seven years, the average state cigarette tax rate has more than doubled from 42 cents to 92 cents per pack.

Tobacco became the number one target both in terms of number of tax increases and dollar amounts. Moreover, states raised more money from tobacco taxes than they did from income taxes over the past seven years. And tobacco taxes accounted for 30 percent of all state tax increases in the last recession compared to just 5 percent in the previous recession.

### **Tobacco Tax Collections Up 59 Percent since 1999, 8.1 Percent per Year**



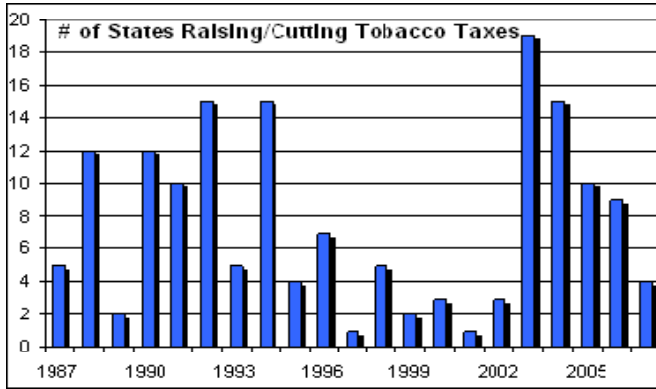
### **Cigarettes Are the New Cash Cow for State Governments**



Even in years of surplus when states are cutting taxes, tobacco tax increases remain on the agenda. This upward trend of state tobacco taxes is likely to continue.

According to the National Association of State Budget Officers, NASBO, 12 states are proposing higher tobacco tax rates for fiscal year 2008, for a net tax increase of \$1,220.9 million.

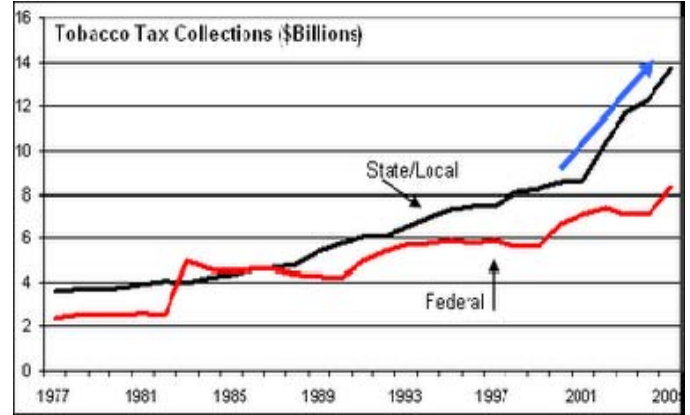
**While States Cut Taxes in 2007, Tobacco Tax Increases Continued**



The doubling of average state tobacco tax rates is responsible for a spike in state and local tobacco tax collections. However, while the average tax rate has doubled, tax collections have "only" increased 69 percent. States that have raised their tobacco taxes in recent years are facing diminishing revenue streams due to consumers crossing state borders, purchasing products online or on Indian reservations as well as smuggling and black market activity. Michigan, for example, has seen taxable cigarette sales drop by more than 25 percent since 2001. According to a recent quote in *The Daily Oakland Press* by Michigan's treasury spokesman Caleb Buhs, "...every time the price has been raised, the amount of packs of cigarettes has gone down."

An increase in the federal excise tax is expected to further slow state revenue growth and magnify the negative impact on small businesses which often lean on tobacco sales to stay in business.

**Collections Rising Slower than Tax Rates**



Even beyond the skyrocketing state and local excise tax rates and revenue growth, it is important to note that raising taxes will not cure SCHIP. Funding an expansion of the broken children's health insurance program on a declining revenue source is dangerous policy.

Instead of morphing the program into a universal entitlement, Congress should implement free market reforms that empower low-income working families and strengthen access to private health care coverage. As 70 percent of the uninsured children in this country already qualify for Medicaid or S-CHIP, an expansion of the program is the wrong direction. Rather than following the states' lead in raising the tax on tobacco products, Congress should follow the lead of states like South Carolina and Florida in creating consumer driven health care programs.