

**GENERAL ASSEMBLY OF NORTH CAROLINA**

**Session 2005**

**Legislative Fiscal Note**

**BILL NUMBER:** House Bill 15 (First Edition)

**SHORT TITLE:** Cigarette Tax Increase for Public Health

**SPONSOR(S):** Representative Miller

<b>FISCAL IMPACT (\$ in millions)</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b><u>FY 2005-06</u></b>	<b><u>FY 2006-07</u></b>	<b><u>FY 2007-08</u></b>	<b><u>FY 2008-09</u></b>	<b><u>FY 2009-10</u></b>
<b>REVENUES:</b>					
<b>General Fund</b>	<b>\$435.5</b>	<b>\$468.7</b>	<b>\$454.0</b>	<b>\$439.8</b>	<b>\$423.7</b>
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> NC Dept. of Revenue					
<b>EFFECTIVE DATE:</b> July 1, 2005					

**BILL SUMMARY:**

This bill increases the excise tax on cigarettes from \$0.05 per pack to \$1.20 per pack.

**ASSUMPTIONS AND METHODOLOGY:**

Cigarette tax revenue is calculated by first computing the number of packs of cigarettes that would be sold in North Carolina without a tax increase. The change in consumption for future years is projected using a combined growth percentage that uses average per capita consumption and population trends to predict future consumption. Based on this methodology, cigarette sales are projected to decline between 2 and 3 percent per year absent any price increases, creating the following baseline revenue stream:

	<b>(\$ in millions)</b>				
	<b><u>2005-06</u></b>	<b><u>2006-07</u></b>	<b><u>2007-08</u></b>	<b><u>2008-09</u></b>	<b><u>2009-10</u></b>
Total Cigarette Revenue	\$38.4	\$37.5	\$36.7	\$35.9	\$35.0
Revenue Per Penny	\$7.7	\$7.5	\$7.3	\$7.2	\$7.0

While these numbers are a good indication of revenues from existing taxes and even small increases in the tax on cigarettes, research papers on the issue indicate that larger price increases could result in smaller per penny gains. To predict the impact of a tax increase on cigarette tax revenue for a \$1.15 tax increase, an elasticity factor is used to calculate the impact on consumption

of each 10% increase in price. For the purposes of this estimate, an elasticity of -.4 is used, which implies a decline in consumption of 4% for each 10% increase in price. Because of the uncertainty associated with larger price increases, an additional reduction in consumption of 12.5% is factored into this analysis.

A reduction in demand due to negative cross border effects could also be expected to occur as a result of the loss of North Carolina’s competitive advantage relative to other states. A 2003 report from RTI International studied the impact of tax increases on cigarette smuggling activities and cross border sales. The report estimated that a cigarette tax increase of 65 cents would result in the elimination of long-distance smuggling activities in North Carolina and a reduction in sales of 105 million packs annually. The report also estimated that an additional sales reduction of 30 million packs annually would result from North Carolina residents shifting their consumption to lower-tax states and out-of-state residents who previously purchased cigarettes in North Carolina choosing to shift their consumption elsewhere. Because the RTI study is based on a 65-cent increase, the impact is adjusted proportionally for a \$1.15 increase to account for the greater cross border effect expected with a larger price discrepancy.

A 2% reduction in annual revenue is factored into the analysis to account for the current discount to distributors for collecting the tax. The annual revenue for FY05-06 is reduced to account for a one-month collection lag that results from the fact that the tax is remitted by distributors in the month following the liability month. Finally, revenue is adjusted to account for reduced sales tax as a result of reduced cigarette consumption.

Based on the above assumptions, the potential revenue stream from a \$1.15 increase in the tax on a pack of cigarettes is estimated as the following:

**(\$ in millions)**

<b>\$1.15 Increase</b>					
	2005-06	2006-07	2007-08	2008-09	2009-10
Cigarette Tax Revenue	\$ 463.3	\$490.9	\$477.0	\$463.7	\$448.4
Sales Tax Revenue	(\$27.7)	(\$22.2)	(\$23.0)	(\$23.9)	(\$24.6)
Total New General Fund Revenues	\$435.5	\$468.7	\$454.0	\$439.8	\$423.8

**SOURCES OF DATA:**

*Impact of Cigarette Excise Tax Increases in Low-Tax Southern States on Cigarette Sales, Cigarette Excise Tax Revenue, Tax Evasion, and Economic Activity*, RTI International, September 2003; NC Department of Revenue; and Dr. Blake Brown, NCSU

**TECHNICAL CONSIDERATIONS:** None

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**Signed Copy Located in the NCGA Principal Clerk's Offices**