

# Fiscal Analysis Department

## Minnesota House of Representatives

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### **ISSUE BRIEF - Cigarette & Tobacco Taxes**

#### **STATE TAXES/FEES IMPOSED ON CIGARETTES:**

Cigarette used or sold in Minnesota are subject to both excise taxes and an in-lieu sales tax and may also be subject to a fee imposed on certain manufacturers of cigarettes and tobacco.

The excise tax on cigarettes is levied at a (dollar) rate per 20-pack of cigarettes that is adjusted annually for inflation. As of January 1, 2015, the excise tax is \$2.90 per pack of 20. Cigarettes are also subject to an in-lieu sales tax. Effective January 1, 2015, the in-lieu sales tax is \$0.526 cents for each 20-pack of cigarettes and is annually adjusted for the change in the average retail price of cigarettes. The total state tax rate (excise tax plus sales tax) per pack of 20 is \$3.43.

An additional fee of 50 cents per pack is imposed on cigarette manufacturers that were not a part of a settlement agreement with the state of Minnesota (i.e. companies other than Philip Morris USA and RJ Reynolds). For those manufacturers, the total state tax rate per 20-pack is \$3.93 after the non-settlement fee is imposed. This fee substitutes for the tobacco settlement monies that are being paid by Philip Morris USA and RJ Reynolds to the State of Minnesota.

Use and storage taxes are imposed on cigarettes that are also used or stored in Minnesota on which the sales tax had not been previously paid.

These state taxes and fees are paid by distributors or wholesalers when the products are received in Minnesota for sale. Minnesota Department of Revenue (DOR) reports that there are 45 cigarette that remit these taxes to the state.

#### **STATE TAXES/FEES IMPOSED ON OTHER TOBACCO PRODUCTS:**

The excise tax on tobacco products, unlike the per pack tax on cigarettes, is levied as a percentage of the price. The tobacco products excise tax is equal to 95 percent of the wholesale price. The tobacco excise tax for moist snuff and premium cigars, however, also contains minimum and maximum tax threshold requirements. For each container of moist snuff, the tax is equal to the 95 percent of the wholesale price with a minimum tax equal to the excise tax for 20-pack of cigarettes. For premium cigars, the tobacco tax is equal to the lesser of: (1) the rate of 95 percent of the wholesale sales price of premium cigars or; (2) \$3.50 per premium cigar. Minnesota Department of Revenue (DOR) reports that there are 266 tobacco distributors that remit these taxes to the state.

Tobacco products are also subject to the state sales & use tax.

Legislation enacted in 2013 increased state taxes on both cigarette and tobacco taxes. Table A shows the state excise tax rates for cigarette and other tobacco products under current law as of July 1, 2015 compared to the tax rates in existence before the 2013 legislation.

**Table A. State Excise Tax Rates Under Current Law Compared to Prior Law.**

CIGARETTES  (ALSO INCLUDES LITTLE CIGARS)	STATE EXCISE TAX/ STATE FEE PER PACK		TOBACCO PRODUCTS  (INCLUDES, BUT NOT LIMITED TO, CIGARS, CHEWING TOBACCO, E-CIGARETTES)	STATE EXCISE TAX BASED ON WHOLESALE PRICE	
	PRIOR TO JULY 1, 2013	AS OF JANUARY 1, 2015		PRIOR TO JULY 1, 2013	AS OF JULY 1, 2015
EXCISE TAX	\$0.48	\$2.90	EXCISE TAX	35.0%	95.0%
HEALTH IMPACT FEE	\$0.75	\$0.00	HEALTH IMPACT FEE	35.0%	0.0%
IN-LIEU SALES TAX	\$0.493	\$0.526			
<b>TOTAL STATE TAX*</b>	<b>\$1.723</b>	<b>\$3.426</b>	<b>TOTAL</b>	<b>70.0%</b>	<b>95.0%</b>

\*Cigarette Non-settlement fee and sales tax on tobacco not shown in this table.

**TOTAL COLLECTIONS & DISPOSITION OF CIGARETTE & TOBACCO STATE TAXES:**

Prior to July 1, 2013, Cigarette & Tobacco State tax revenues were deposited into the following three state funds: General Fund; Health Impact Fund; and Special Revenue Fund. After July 1, 2013, these proceeds are now deposited into two state funds and into a stadium reserve account. All tax/fee proceeds from cigarette and tobacco products are deposited into the General Fund except \$26.187 million each year is deposited into two special revenue fund accounts and earmarked for the Academic Health Center at the University of Minnesota and to the Commissioner of Health. On a one-time basis in FY 2014 only, \$26.5 million was deposited into the stadium reserve account and amounts in this account are appropriated as necessary for application against any shortfall in stadium funding.

**Total State Cigarette & Tobacco State Tax Collections**

All Dollars in Thousands by Fiscal Year	2009	2010	2011	2012	2013	2014
<b>Cigarette</b>						
Excise Tax (\$0.48)/20-Pack)	123,156	110,466	114,790	94,296	121,588	0
Excise Tax (\$2.83)/20-Pack)*	0	0	0	0	0	488,416
Health Impact Fee (\$0.75/20-pack)	190,373	191,880	178,769	185,152	164,927	0
In Lieu Sales Tax	68,764	80,481	81,718	89,124	80,526	83,297
Non Settlement Fee (\$0.35/20-pack)	2,818	2,712	2,211	2,755	2,881	0
Non Settlement Fee (\$0.50/20-pack)	0	0	0	0	0	3,422
<b>subtotal</b>	<b>385,111</b>	<b>385,539</b>	<b>377,488</b>	<b>371,327</b>	<b>369,922</b>	<b>575,135</b>
<b>Tobacco Products**</b>						
Excise Tax (35% of wholesale price)	21,251	23,569	24,603	30,474	27,657	0
Excise Tax (95% of wholesale price)	0	0	0	0	0	78,200
Health Impact Fee (35% of wholesale price)	21,281	23,479	24,552	22,664	26,283	0
<b>subtotal</b>	<b>42,532</b>	<b>47,048</b>	<b>49,155</b>	<b>53,138</b>	<b>53,940</b>	<b>78,200</b>
<b>Total Collected</b>	<b>427,643</b>	<b>432,587</b>	<b>426,643</b>	<b>424,465</b>	<b>423,862</b>	<b>653,335</b>

Source: DOR Tax Collection History through FY 2014. FY 2014 collections for cigarettes include the one-time floor stocks tax. \*The cigarette excise tax rate is adjusted for inflation each year starting in 2014. Effective January 1, 2015, the cigarette excise tax rate is \$2.90/pack versus the rate at \$2.83/pack in the preceding year. \*\* Sales tax on tobacco products not included in this table.

**CIGARETTE & TOBACCO EXCISE TAX INCIDENCE:**

The Minnesota Department of Revenue (DOR) computes the Suits Index for state taxes every two years in its Minnesota Tax Incidence Study. The Suits Index is defined as a summary measure of regressivity and progressivity and represented as a value between -1 and +1. A progressive tax has a positive Suits index in the range of 0 and +1, with +1 being the most progressive. A progressive tax is a tax in which the tax rate increases as the amount of taxable income increases. A regressive tax has a negative Suits index in the range of 0 and -1, with -1 being the most regressive. A regressive tax is a tax in which the tax rate decreases as the amount of taxable income increases. A Suits Index of zero indicates that the tax system is proportional.

DOR's 2015 Tax Incidence Study lists cigarette and tobacco taxes (Suits Index = -0.602) as the state's most regressive taxes and the table below shows the Suits Index for cigarette and tobacco taxes relative to all state taxes (Suits Index = -0.006). Also, cigarette and tobacco taxes are borne mostly by Minnesota residents who pay 91 percent of total collections.

TAX INCIDENCE	Percentage By Taxpayer Category			Suits Index
	Resident	Non Resident	Business	Full Sample
2012 –MN Cigarette/Tobacco Excise	91%	9%	0%	-0.602
2012 –All State Taxes	68%	5%	27%	-0.006

Source: [2015 Tax Incidence Report](#), page 112.

**CURRENT LAW CIGARETTE TAX EXPENDITURES:**

The State of Minnesota, Tax Expenditure Budget, published by DOR, defines tax expenditures as a statutory provisions which reduce the amount of revenue that would otherwise be generated, including exemptions, deductions, credits or lower tax rates. Different types of tax expenditures provide different levels of tax savings for different taxpayers. For cigarette and tobacco taxes, there is one exemption for consumer purchases made out of state. For further reference, a full description of each tax expenditure is published every two-years in the DOR Tax Expenditure Budget Report.

Exemption	Tax Expenditures (000's)				
	Enacted	2014	2015	2016	2017
Consumer Purchases Made Out of State	1949	\$43,400	\$43,900	\$44,400	\$44,900

Source: [State of Minnesota Tax Expenditure Report](#), page. 158.

**MINNESOTA EXCISE TAXES COMPARED TO THE NEIGHBORING STATES:**

This table compares the excise tax rate compared to bordering states. This table does not include any comparison of the application of sales tax on cigarette and tobacco products by bordering states.

STATE	CIGARETTES	TOBACCO PRODUCTS (CIGARS, CHEWING TOBACCO, E-CIGARETTES)
	STATE TAX/PER PACK	STATE TAX BASED ON PRICE
IOWA	\$1.36	50% OF WHOLESALE PRICE
MINNESOTA*	\$2.90	95% OF WHOLESALE PRICE
NORTH DAKOTA	\$0.44	CIGARETTES & TOBACCO AT 28% OF WHOLESALE PRICE. EXCEPT, SNUFF & CHEW TOBACCO IS BASED ON WEIGHT AT 60 CENTS AND 16 CENTS PER OUNCE RESPECTIVELY.
SOUTH DAKOTA	\$1.53	35% WHOLESALE PRICE
WISCONSIN	\$2.52	71% OF MANUFACTURER'S PRICE
U.S.	\$1.36	NOT APPLICABLE

Source: FTA, State Excise Tax Rates on cigarettes as of January 1, 2015.

\* For tobacco products, of the states listed in this table, only Minnesota imposes a tobacco excise tax on e-cigarettes.

## OTHER MINNESOTA CIGARETTE & TOBACCO PRODUCT USAGE AND BUDGET/TAX STATISTICS:

Quick Facts & Estimations	
Minnesota Population, 2014 Estimate from US Census Bureau	5,457,173
Minnesota Adult Population, Age 18 and Over, US Census Bureau	4,175,347
20.7 Percent, Minnesota Adult Population Currently Using Tobacco Products or E-Cigarettes Based on the Minnesota Adult Tobacco Survey, 2015	864,297
Mean Price Per Pack of Cigarettes Paid by Minnesota Adults Smokers Based on the Minnesota Adult Tobacco Survey, 2015	\$7.16
Total State Cigarette and Tobacco (excise tax + sales and use tax + fees) Taxes/Fees Paid, Per Capita in FY 2014	\$116
Total State Cigarette and Tobacco (excise tax + sales and use tax + fees) Taxes/Fees as a Percentage of the Total State Tax Collections, FY 2014	2.99%

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