

CIGARETTE TAX

Revenue Description

Section 16-11-111, MCA, specifies a tax of \$1.70 on each pack of 20 cigarettes. If a pack contains more than twenty cigarettes, the tax is pro-rated by 1/20th of the 70-cent tax for each cigarette exceeding 20 cigarettes.

Historical and Projected Revenue

Table 1 shows actual general fund revenue from the cigarette tax for FY 1998 through FY 2006 and forecast revenue for FY 2007 through FY 2009.

Table 1 Cigarette Tax - General Fund (\$ millions)		
Fiscal Year	General Fund	Percent Change
A 1998	9.544	
A 1999	8.823	-7.56%
A 2000	8.418	-4.59%
A 2001	8.285	-1.58%
A 2002	7.887	-4.80%
A 2003	12.576	59.46%
A 2004	36.002	186.27%
A 2005	35.117	-2.46%
A 2006	34.573	-1.55%
F 2007	33.950	-1.80%
F 2008	33.783	-0.49%
F 2009	33.606	-0.52%

Cigarette Tax

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Prior to FY 1998, cigarette taxes were not allocated to the general fund. HB 166, (1997 Session) distributed cigarette tax revenue 73.04% to the general fund; 15.85% to the long-range building account; and 11.11% to the Department of Public Health and Human Services, as provided for in 16-11-119, MCA.

Beginning May 1, 2003, SB 407 (2003 Session) increased the tax on cigarettes from \$0.18 to \$0.70 per pack. SB 407 also changed the distribution of cigarette taxes, increasing the general fund portion to 87.40%, the long-range building account to 4.3%, and the Department of Public Health and Human Services to the greater of 8.3% or \$2.0 million. The tax increase under SB 407 explains the overall increase in cigarette tax revenue in FY 2003 and FY 2004.

Initiative 149 (I-149) further increased the tax on each pack of cigarettes to \$1.70 as of January 1, 2005. I-149 also changed the allocation of total collections as follows: 45.1% to the general fund; 44.0% to the health and Medicaid initiative account; 2.6% to the long-range building account; and the greater of 8.3% or \$2 million for operation of state veterans' nursing homes.

The forecast projects general fund revenue to decrease 1.80% in FY 2007. This decrease can be attributed to a larger portion of total collections going towards tribal payments in FY 2007. The decreases in general fund revenue in FY 2008 and FY 2009 reflect a combination of a 1% decline in smoking and around 0.5% population growth.

Forecast Methodology and Projection Calculation

The primary steps in estimating cigarette tax revenue are as follows: 1) estimate taxable per capita cigarette consumption; 2) estimate cigarette tax revenue 3) calculate tribal revenue sharing agreement payments; and 4) calculate state cigarette tax revenue and allocation.

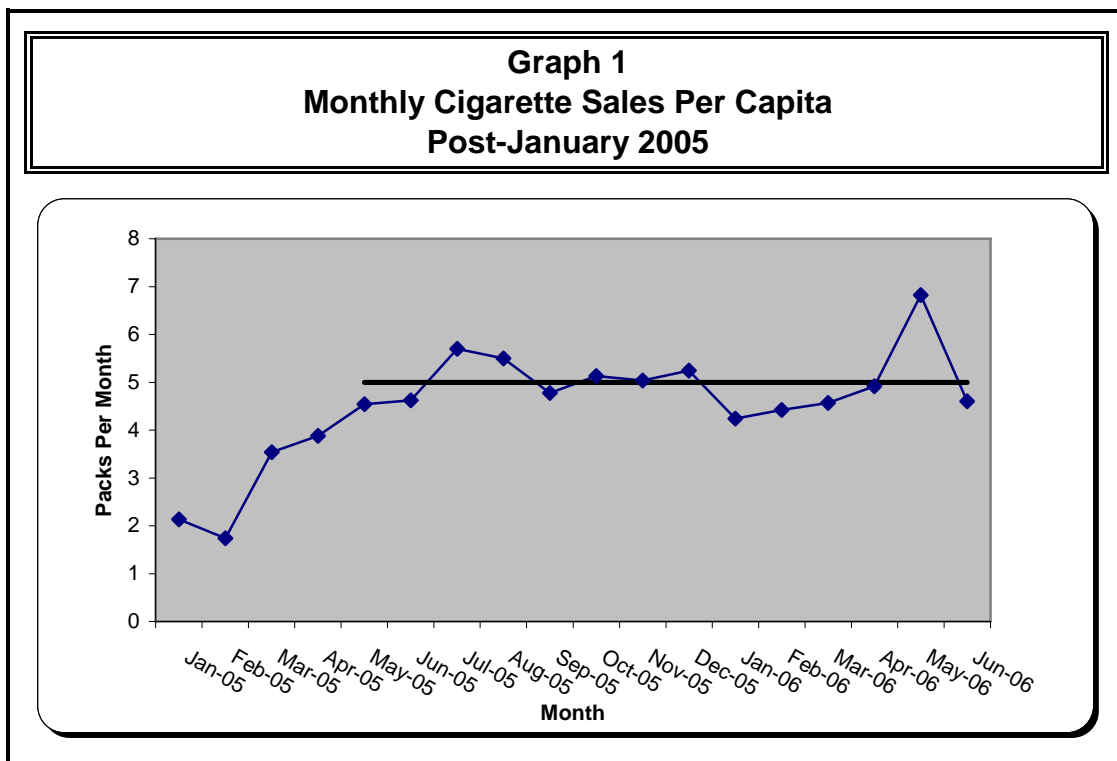
Step 1: Estimate Taxable Per Capita Cigarette Sales

Table 2 shows average monthly and annual per capita taxable cigarette package sales. Per capita cigarette package sales is total tax revenue divided by the per package tax rate, divided by Montana's population over 15 years of age. Overall, per capita sales have steadily declined since FY 1998. The declines in FY 2005 and FY 2006 are a notable result of I-149 tax increases.

Table 2 Cigarette Sales Rate: Packs Per Capita Per Month FY 1996 through FY 2006							
Fiscal Year	Cigarette Tax Revenue (millions)	Tax Rate	Packs Per Year	MT population over 15	Months	Packs Per Capita Per Month	Percent Change
A 1996	\$12.969	÷ \$0.180	= 72,050,761	÷ 693,450	÷ 12	= 8.66	-1.37%
A 1997	\$13.267	÷ \$0.180	= 73,816,667	÷ 699,017	÷ 12	= 8.80	1.64%
A 1998	\$13.245	÷ \$0.180	= 73,583,333	÷ 704,057	÷ 12	= 8.71	-1.03%
A 1999	\$12.265	÷ \$0.180	= 68,140,817	÷ 710,729	÷ 12	= 7.99	-8.27%
A 2000	\$11.766	÷ \$0.180	= 65,368,172	÷ 718,917	÷ 12	= 7.58	-5.16%
A 2001	\$11.628	÷ \$0.180	= 64,602,547	÷ 729,222	÷ 12	= 7.38	-2.57%
A 2002	\$11.052	÷ \$0.180	= 61,400,968	÷ 736,177	÷ 12	= 6.95	-5.85%
A 2003	\$16.093	÷ \$0.325	= 49,500,779	÷ 748,052	÷ 12	= 5.51	-20.66%
A 2004	\$41.365	÷ \$0.700	= 60,271,774	÷ 761,039	÷ 12	= 6.60	19.68%
A 2005	\$53.686	÷ \$0.944	= 56,870,474	÷ 772,051	÷ 12	= 6.14	-6.99%
A 2006	\$80.365	÷ \$1.700	= 47,273,428	÷ 778,106	÷ 12	= 5.06	-17.52%

Tax increases affect the consumption level of cigarettes. Price elasticity represents a value that captures how much consumption will change when price changes. Prior tax increases in Montana have been estimated and observed to have price elasticities of demand of approximately -0.44. However, past tax increases in Montana were at a much smaller level, and, for the 2005 Session, it was anticipated that a very large increase, such as provided for in I-149, would involve a greater elasticity (between -0.7 and -0.8). This means relatively more smokers would reduce smoking or find alternative places to purchase cigarettes.

After a large tax increase, taxable cigarette sales are expected to decline abruptly and then level off to a new sales pattern where fewer consumers buy taxable cigarettes. In November and December 2004, cigarette consumers began stockpiling cigarettes to avoid paying the higher tax under I-149. In November 2004, an average of 12.7 packs per capita were purchased. In December 2004 this average was 9.7. As shown in Graph 1, in January and February 2005, consumers, while depleting their stockpiles, purchased an average of only 2.1 and 1.7 packs per capita. In March and April 2005, sales increased to 4.57 and 4.92 packs per capita respectively. In May 2005, a new sales trend began. Monthly cigarette pack sales from May 2005 to June 2006 averaged 5 packs per capita. This new rate of taxable cigarette sales is estimated based on the monthly data available since May of 2005, as the past baseline sales rates are skewed by the two recent tax increases in May 2003 and January 2005.



Graph 1 illustrates taxable cigarette sales leveling out during the time period of May 2005 to June 2006. This limited yet current data depicts a relatively flat sales trend.

However, national trends indicate that ultimately downward pressure on cigarette consumption will persist. As more people quit smoking, locate and purchase from nontaxable sources of cigarettes, or decide to use other taxable tobacco, the level of taxable cigarette consumption will further decline. Additionally, the new Montana law preventing smoking in most public places, 50-40-104, MCA, will further discourage people from smoking. Therefore, this estimate assumes a 1% decline in taxable cigarette sales per year for FY 2007 through FY 2009. This calculation is shown at the top of Table 3.

Step 2: Estimate Cigarette Tax Revenue

Table 3 shows the calculations used to project cigarette tax revenue. After the decline rate calculation, the average packs taxed per capita per month is multiplied by 12 to yield annual packs consumed per capita. Second, the total packs taxed per capita per year is multiplied by Montana’s adult population to get total packs taxed each year. Total annual revenue is then calculated by multiplying the tax rate by the total packs sold per year.

Table 3			
Gross Cigarette Tax Revenue Calculation			
<u>Description</u>	<u>FY2007</u>	<u>FY2008</u>	<u>FY2009</u>
Base Packs Per Capita Per Month	5.00000	4.95000	4.90050
Multiply by Decline Rate	x -1%	x -1%	x -1%
Packs Per Capita Per Month	4.95000	4.90050	4.85150
Multiply by 12 Months	x 12	x 12	x 12
Taxable Packs Per Capita Per Year	59.4	58.8	58.2
Multiply by Adult Population	x 782,488	x 786,503	x 790,278
Total Taxable Packs Per Year	\$46,479,787	\$46,251,095	\$46,008,357
Multiply by Tax Rate	x \$1.70	x \$1.70	x \$1.70
Gross Cigarette Tax Revenue	<u>\$79,015,638</u>	<u>\$78,626,862</u>	<u>\$78,214,207</u>

Step 3: Calculate Tribal Revenue Sharing Agreement Payments

There are three types of arrangements for cigarette taxes with the seven Indian reservations in Montana:

- 1) The Northern Cheyenne has a tax-free quota agreement with the state.
- 2) The Flathead Reservation abides by the tax-free quota law with no specific agreement with the state.
- 3) The Blackfeet, Fort Belknap, Rocky Boy, Fort Peck, and Crow Reservations have a revenue sharing agreement with the state.

Tribes in categories 1 and 2 receive cigarettes tax free for the enrolled tribal members residing on the reservation. Under the revenue sharing agreements, the tribal and state cigarette tax rates are the same. The tribe's share of the tax revenue is 150% of the per capita cigarette tax collected for each of the tribes' enrolled members residing on the reservation.

As additional tribes entered into revenue sharing agreements by mid-FY 2006, tribal revenue sharing agreement payments are forecast using the tribal payment percentage of total collections in the fourth quarter of FY 2006. This number is 4.73%. As shown in Table 4, revenue sharing agreement payments are estimated at \$3.737 million in FY 2007, \$3.719 million in FY 2008, and \$3.700 million in FY 2009.

Table 4				
Tribal Revenue Sharing Payments Calculation				
Fiscal Year	Total Collections		Tribal Percent	Tribal Amount
FY 2006(Q4)	\$21,605,290	x	4.73%	= \$1,021,930
FY 2007	\$79,015,638	x	4.73%	= \$3,737,440
FY 2008	\$78,626,862	x	4.73%	= \$3,719,051
FY 2009	\$78,214,207	x	4.73%	= \$3,699,532

Step 4: Calculate State Cigarette Tax Revenue and Allocation

Table 5 shows the calculation and allocation of state cigarette tax revenue for FY 2007 through FY 2009. Tribal payments are subtracted from cigarette tax revenue to yield state cigarette tax revenue. Revenue is allocated to each fund by multiplying state cigarette tax revenue by the fund's share. The general fund will receive \$33.950 million in FY2007, \$33.783 million in FY 2008, and \$33.606 million in FY 2009.

Table 5			
Calculation of Cigarette Tax Revenue Allocation			
Calculation	FY2007	FY2008	FY2009
Gross Cigarette Tax Revenue	\$79,015,638	\$78,626,862	\$78,214,207
Subtract Tribal Payments	(\$3,737,440)	(\$3,719,051)	(\$3,699,532)
Total State Cigarette Tax Revenue	\$75,278,199	\$74,907,812	\$74,514,675
Allocation			
General Fund (45.1%)	\$33,950,468	\$33,783,423	\$33,606,119
Long Range Building Fund (2.6%)	\$1,957,233	\$1,947,603	\$1,937,382
State Veterans' Nursing Homes (8.3%)	\$6,248,090	\$6,217,348	\$6,184,718
Health and Medicaid (44.0%)	\$33,122,407	\$32,959,437	\$32,786,457
Total State Cigarette Tax Revenue	\$75,278,199	\$74,907,812	\$74,514,675

Data Sources

The general fund revenue data is in SABHRS report MTGL0109. Monthly insignias sold and current tribal payments are provided by DOR. Population data forecasts are provided by Global Insight (July 2006).