

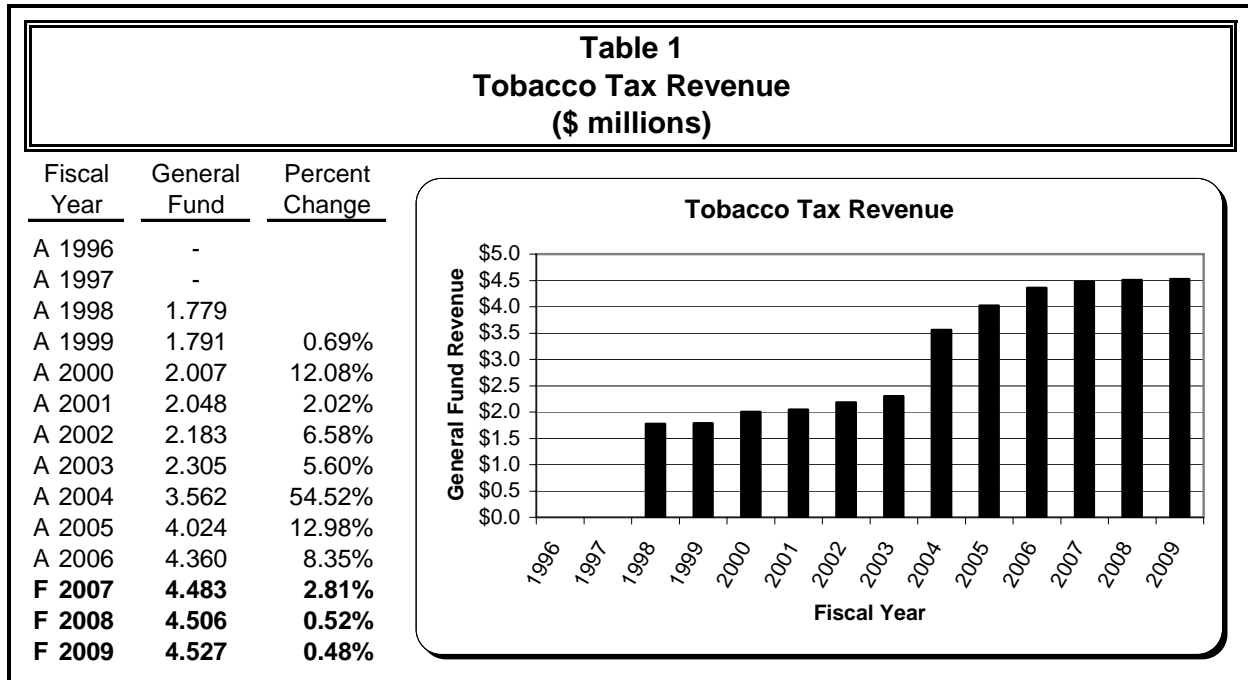
TOBACCO PRODUCTS TAX

Revenue Description

Section 16-11-111, MCA, directs the Department of Revenue (DOR) to collect a tax of 85 cents per ounce of moist snuff and 50% of the wholesale price of all other tobacco products. Tobacco products destined for retail sale and consumption outside Montana are not subject to this tax. The general fund and the health and Medicaid initiative account each receive 50% of the tobacco products tax revenue after payments are made as per tribal revenue sharing agreements.

Historical and Forecasted Revenue

Table 1 shows actual general fund revenue from the tobacco products tax for FY 1996 through FY 2006 and forecast revenue for FY 2007 through FY 2009.



Prior to FY 1998, tobacco taxes were not allocated to the general fund. Under the provisions of HB 166 (1997 Session) all tobacco tax revenue was distributed to the general fund.

On May 1, 2003, SB 407 (2003 Session) changed the tax on moist snuff from 12.5% of the wholesale price to 35 cents per ounce, an effective increase of 7 cents per ounce. SB 407 also increased the tax on all other tobacco from 12.5% of the wholesale price to

25% of the wholesale price. The tax increases under SB 407 explain the overall increase in tobacco tax revenue in FY 2004.

Further, on January 1, 2005, Initiative 149 (I-149) changed the tax on moist snuff to 85 cents per ounce and increased the tax on all other tobacco to 50% of the wholesale price. This tax increase explains the increase in total tobacco tax revenue in FY 2005 and FY 2006. Revenue is forecast to increase 2.81% in FY 2007 as a result of a larger proportion of refunds for unsalable tobacco product than usual being credited back to sellers in FY 2006. The forecast projects general fund revenue to grow at the rate of population growth as per capita consumption is held constant for FY 2008 and 2009.

Forecast Methodology and Projection Calculation

The tobacco tax revenue category is actually two taxes: (1) the moist snuff tax of 85 cents per ounce and (2) the other tobacco tax of 50 percent of the wholesale price.

The primary steps in estimating tobacco tax revenues are as follows: 1) estimate per capita tobacco consumption; 2) estimate projected gross tobacco tax revenue; 3) calculate wholesaler discounts; 4) calculate tribal revenue sharing agreement payments; 5) calculate refunds for unsalable product; and 6) calculate state tobacco tax revenue and allocation.

Step 1: Estimate Per Capita Tobacco Consumption

Tax increases affect the tobacco consumption level. The higher the relative tax increase, the greater the decrease in consumption. While proportionally significant, the tobacco tax increase under I-149 was not as extreme as the cigarette tax increase under that same initiative. Consequently the decrease in tobacco product consumption due to the I-149 tax change is expected to be less than the decrease in cigarette consumption. It is also likely that some cigarette smokers began using roll-your-own tobacco cigarettes or other tobacco products to save money. This will offset part of the prospective decrease in tobacco product consumption.

As shown in Table 2, moist snuff consumption has remained steady for the last two fiscal years. An average 10.3 ounces of moist snuff per capita was consumed in FY 2005. Likewise in FY 2006, 10.3 ounces of moist snuff per capita was

| Table 2 Moist Snuff Consumption FY 2005 and FY 2006 | | | | |
|---|------------------|-----------------------|------------|---------------------------|
| Fiscal Year | Total Revenue | MT | | Per Capita Consumption |
| | | Population Over 15 | Tax Rate | |
| A 2005 | \$4,601,976 ÷ | 772,051 | ÷ \$0.58 = | 10.3 |
| A 2006 | \$6,784,300 ÷ | 778,106 | ÷ \$0.85 = | 10.3 |

consumed. This number is calculated by dividing the total moist snuff tax revenue by the population of Montana over fifteen, divided by the per ounce tax rate.

As shown in Table 3, other tobacco consumption has also remained relatively steady for the last two fiscal years. Per capita other tobacco consumption is calculated by dividing total other tobacco tax revenue by the population of Montana over 15, divided by the tax rate. Average per capita other tobacco consumption is \$7.32 (wholesale price) for FY 2005 and FY 2006.

| Table 3 Other Tobacco Consumption FY 2005 and FY 2006 | | | | |
|--|---------------|-----------------------|----------|----------------------------------|
| Fiscal Year | Total Revenue | MT Population Over 15 | Tax Rate | Per Capita Wholesale Collections |
| A 2005 | \$1,695,216 ÷ | 772,051 ÷ | 30% | = \$7.32 |
| A 2006 | \$2,848,435 ÷ | 778,106 ÷ | 50% | = \$7.32 |

Tobacco consumption has not changed significantly in the last two years. Therefore, projected tobacco consumption is not expected to change during the next three fiscal years. Projected moist snuff consumption is expected to remain stable at the FY 2005 and FY 2006 average of 10.3 ounces per capita. Projected consumption of other tobacco is also expected to remain at the FY 2005 and FY 2006 average of \$7.32 per capita.

Step 2: Estimate Gross Tobacco Tax Revenue

Table 4 shows the calculation of total tobacco tax revenue for FY 2007 through FY 2009. This calculation is done for both moist snuff and other tobacco products. The calculation is as follows:

1. Estimated moist snuff per capita consumption is multiplied by Montana’s population over 15 years of age to yield total moist snuff consumption.
2. Total moist snuff consumption is multiplied by the tax rate of 85 cents per ounce to yield gross moist snuff tax revenue.
3. Estimated other tobacco product per capita consumption is multiplied by Montana’s population over 15 years of age to yield total other tobacco product consumption.
4. Total other tobacco product consumption is multiplied by the 50% of wholesale price tax rate to yield total other tobacco product gross tax revenue.
5. Gross other tobacco product tax revenue and gross moist snuff tax revenue are added together to yield gross tobacco tax revenue.

Table 4
Gross Tobacco Tax Revenue Calculation

| <u>Description</u> | <u>FY2007</u> | <u>FY2008</u> | <u>FY2009</u> |
|--|--------------------|--------------------|--------------------|
| <u>Moist Snuff</u> | | | |
| Moist Snuff Per Capita Consumption (ounces) | 10.3 | 10.3 | 10.3 |
| Montana Population Over 15 | x 782,488 | x 786,503 | x 790,278 |
| Total Moist Snuff Consumption (ounces) | 8,059,627 | 8,100,981 | 8,139,859 |
| Moist Snuff Tax Rate | x \$0.85 | x \$0.85 | x \$0.85 |
| Gross Moist Snuff Tax Revenue | \$6,850,683 | \$6,885,834 | \$6,918,880 |
| <u>Other Tobacco Product</u> | | | |
| Other Tobacco Product Per Capita Consumption | \$7.32 | \$7.32 | \$7.32 |
| Multiply by Montana Population Over 15 | x 782,488 | x 786,503 | x 790,278 |
| Total Other Tobacco Product Consumption | \$5,727,109 | \$5,757,202 | \$5,784,832 |
| Multiply by Other Tobacco Product Tax Rate | x 50% | x 50% | x 50% |
| Gross Other Tobacco Product Tax Revenue | \$2,863,554 | \$2,878,601 | \$2,892,416 |
| Total Gross Tobacco Revenue | \$9,714,238 | \$9,764,435 | \$9,811,296 |

Step 3: Calculate Wholesaler Discounts

The excise tax on tobacco products is imposed on retail consumers, but is collected by wholesalers. Wholesalers are allowed a discount equal to 1.5% of total tax collections to defray collection and administrative costs.

As shown in Table 5, wholesaler discounts for moist snuff and other tobacco products are estimated at \$145,714 in FY 2007, \$146,467 in FY 2008, and \$147,169 in FY 2009.

Table 5
Wholesalers Discounts Calculation

| <u>Fiscal Year</u> | <u>Gross Tobacco Revenue</u> | <u>Wholesaler Discount Percentage</u> | <u>Wholesaler Discount Amount</u> |
|--------------------|------------------------------|---------------------------------------|-----------------------------------|
| FY 2006 | \$9,632,735 | x 1.50% | \$144,491 |
| FY 2007 | \$9,714,238 | x 1.50% | = \$145,714 |
| FY 2008 | \$9,764,435 | x 1.50% | = \$146,467 |
| FY 2009 | \$9,811,296 | x 1.50% | = \$147,169 |

Step 4: Calculate Tribal Revenue Sharing Agreement Payments

Five Indian reservations in Montana have a tobacco revenue sharing agreement with the state: Blackfeet, Fort Belknap, Rocky Boy, Fort Peck and Crow Reservations.

Under the revenue sharing agreements, the tribal and state tobacco tax are the same. The tribe's share of the tax revenue is 150% of the per capita state tobacco tax collected for each of the tribes' enrolled members residing on the reservation.

As a result of additional tribes entering 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 6, tribal revenue sharing agreement payments are estimated at \$452,591 in FY 2007, \$454,930 in FY 2008, and \$457,113 in FY 2009.

| <u>Fiscal Year</u> | <u>Total Collections (less discounts)</u> | | <u>Tribal Payment Percentage</u> | <u>Tribal Payment Amount</u> |
|--------------------|---|----------|--|--------------------------------------|
| FY 2006(Q4) | \$2,358,076 | × | 4.73% | = \$111,537 |
| FY 2007 | \$9,568,524 | × | 4.73% | = \$452,591 |
| FY 2008 | \$9,617,969 | × | 4.73% | = \$454,930 |
| FY 2009 | \$9,664,126 | × | 4.73% | = \$457,113 |

Step 5: Calculate Refunds for Unsalable Product

Each year a percentage of tobacco products cannot be sold due to faulty packaging or bad product. Tobacco product sellers can obtain a refund credit for tobacco products that could not be sold due to defect. The percentage of defective product credits of total collections in FY 2005 is used to forecast FY 2007 through FY 2008 refund credits. In FY 2006, more refund credits were claimed than usual due to an alteration made by the Department of Revenue in reporting procedure. This estimate forecasts an average of 1.55% of total collections will be credited back to sellers in FY 2007 through FY 2009. As Table 7 shows, this amount will be \$150,571 in FY 2007, \$151,349 in FY 2008, and \$152,075 in FY 2009.

| <u>Fiscal Year</u> | <u>Total Collections</u> | | <u>Credit Refund Percentage</u> | <u>Credit Refund Amount</u> |
|------------------------|------------------------------|----------|---|-------------------------------------|
| FY 2005 | \$6,297,192 | × | 1.55% | \$97,616 |
| FY 2007 | \$9,714,238 | × | 1.55% | = \$150,571 |
| FY 2008 | \$9,764,435 | × | 1.55% | = \$151,349 |
| FY 2009 | \$9,811,296 | × | 1.55% | = \$152,075 |

Step 6: Calculate State Tobacco Tax Revenue and Allocation

Table 8 shows the calculation and allocation of state tobacco tax revenue for FY 2007 through FY 2009. Wholesaler discounts and tribal revenue sharing payments are subtracted from gross tobacco tax revenue to yield state cigarette tax revenue. Fifty percent of the revenue goes to the general fund and 50% goes to the health and Medicaid fund. Estimated general fund tobacco tax revenues total \$4.483 million in FY 2007, \$4.506 million in FY 2008, and \$4.527 million in FY 2009, as shown in Table 8.

Table 8
Calculation of Tobacco Tax Revenue Allocation

| <u>Calculate Tobacco Tax Revenue</u> | <u>FY 2007</u> | <u>FY 2008</u> | <u>FY 2009</u> |
|--|-----------------------|-----------------------|-----------------------|
| Total Tobacco Tax Revenue | \$9,714,238 | \$9,764,435 | \$9,811,296 |
| Subtract Wholesaler Discounts | (\$145,714) | (\$146,467) | (\$147,169) |
| Subtract Tribal Payments | (\$452,591) | (\$454,930) | (\$457,113) |
| Subtract Refund Credits | (\$150,571) | (\$151,349) | (\$152,075) |
| Total State Tobacco tax Revenue | <u>\$8,965,362</u> | <u>\$9,011,690</u> | <u>\$9,054,938</u> |
| <u>Allocate State Tobacco Tax Revenue</u> | | | |
| Total to General Fund (50%) | \$4,482,681 | \$4,505,845 | \$4,527,469 |
| Total to Health and Medicaid (50%) | <u>\$4,482,681</u> | <u>\$4,505,845</u> | <u>\$4,527,469</u> |
| Total State Tobacco tax Revenue | <u>\$8,965,362</u> | <u>\$9,011,690</u> | <u>\$9,054,938</u> |

Data Sources

The general fund revenue data is from SABHRS report MTGL0109. Monthly tobacco tax collections and current tribal payments are provided by DOR. Population data is provided by Global Insight, Inc (July 2006 Data).