

TENNESSEE GENERAL ASSEMBLY  
FISCAL REVIEW COMMITTEE



FISCAL NOTE

SB 917 - HB 888

March 14, 2013

**SUMMARY OF BILL:** Phases out the excise tax on cigarettes from three cents per cigarette to: two cents per cigarette between July 1, 2013, and June 30, 2014; one cent per cigarette between July 1, 2014, and June 30, 2015, and zero cents per cigarette on or after July 1, 2015. Phases out the tax on all other tobacco products from 6.6 percent of the wholesale price to: 5.5 percent between July 1, 2013, and June 30, 2014; 4.4 percent between July 1, 2014, and June 30, 2015; 3.3 percent between July 1, 2015, and June 30, 2016; 2.2 percent between July 1, 2016, and June 30, 2017; 1.1 percent between July 1, 2017, and June 30, 2018; and zero percent on or after July 1, 2018.

**ESTIMATED FISCAL IMPACT:**

**Decrease State Revenue – \$87,702,600/FY13-14**  
**\$178,327,300/FY14-15**  
**\$272,149,200/FY15-16**  
**\$275,482,200/FY16-17**  
**\$279,127,500/FY17-18**  
**\$283,108,300/FY18-19 and Subsequent Years**

**Decrease Local Revenue – \$1,433,300/FY13-14**  
**\$2,889,200/FY14-15**  
**\$4,372,600/FY15-16 and Subsequent Years**

Assumptions:

- Pursuant to Tenn. Code Ann. § 67-4-1004(a), the excise tax of three cents per cigarette, or \$0.60 per a pack of 20 cigarettes, is imposed. In addition, pursuant to Tenn. Code Ann. § 67-4-1004(d)(1), an additional one-tenth of one cent per cigarette, or \$0.02 per a pack of 20 cigarettes, is imposed. The total tax rate imposed is \$0.62 per 20-pack of cigarettes (\$0.60 + \$0.02).
- The average price per pack of 20 cigarettes in Tennessee is estimated to be \$5.00. This number is assumed to remain constant into perpetuity under current law.
- According to the Department of Revenue (DOR), cigarette tax collections were approximately \$264,889,000 in FY11-12. Assuming negative growth of 0.6 percent in FY12-13 and 0.5 percent in FY13-14, cigarette tax collections in FY13-14 are assumed to be approximately \$261,983,168.

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- The total number of 20-pack cigarettes sold in FY13-14 is estimated to be 422,553,498 (\$261,983,168 / \$0.62). This number is assumed to remain constant into perpetuity under current law.
- Based on various studies, the price elasticity of demand for cigarettes is estimated to be negative 0.4. It is assumed that, under current law, the entire amount of the tax is borne by cigarette consumers. It is further assumed that any decrease in the excise tax on cigarettes will be reflected on the price charged to the consumer.

Assumptions related to cigarette tax in FY13-14:

- Reducing the tax rate from three cents to two cents per cigarette, or from \$0.62 to \$0.42 per 20-pack, in FY13-14 will result in a price reduction of 20-pack cigarettes from \$5.00 to \$4.80 (\$5.00 - \$0.62 + \$0.42).
- This represents a 4.0 percent decrease in the price of cigarettes sold to the consumer per each 20-pack [ $(\$4.80 - \$5.00) / \$5.00 \times 100$ ]. The decrease in price of cigarettes will result in an increase in the consumption of cigarettes.
- The 4.0 percent decrease in the price of cigarettes is estimated to result in a 1.6 percent increase in the quantity of cigarettes consumed ( $-4.0\% \times -0.4$ ).
- The number of 20-pack cigarettes sold as a result of this bill in FY13-14 is estimated to be 429,314,354 [ $422,553,498 \times (100\% + 1.60\%)$ ].
- The decrease in cigarette tax collections in FY13-14 is estimated to be \$81,671,139 [ $\$261,983,168 - (429,314,354 \times \$0.42)$ ].
- The current state sales tax rate is 7.0 percent; the average local option sales tax rate is estimated to be 2.5 percent.
- The total taxable sales of cigarettes is estimated to decrease by \$52,058,591 in FY13-14 as a result of this bill [ $(429,314,354 \times \$4.80) - (422,553,498 \times \$5.00)$ ].
- The decrease in state sales tax revenue in FY13-14 is estimated to be \$3,644,101 ( $\$52,058,591 \times 7.0\%$ ); the decrease in local option sales tax revenue in FY13-14 is estimated to be \$1,301,465 ( $\$52,058,591 \times 2.5\%$ ).
- Pursuant to Tenn. Code Ann. § 67-6-103(a)(3)(A), local governments receive 4.603 percent of state sales tax revenue as state-shared sales tax revenue.
- Pursuant to Tenn. Code Ann. § 67-6-103(q), no portion of revenue derived from the 0.5 percent sales tax rate increase, from 5.5 percent to 6.0 percent (effective April 1, 1992), or the 1.0 percent sales tax rate increase, from 6.0 percent to 7.0 percent (effective July 15, 2002), shall be distributed to local government.
- The effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.617% [ $(5.5\%/7.0\%) \times 4.603\%$ ].
- The net decrease in state sales tax revenue in FY13-14 is estimated to be \$3,512,294 [ $\$3,644,101 - (\$3,644,101 \times 3.617\%)$ ].
- The total decrease in local sales tax revenue in FY13-14 is estimated to be \$1,433,272 [ $\$1,301,465 + (\$3,644,101 \times 3.617\%)$ ].
- The total decrease in state revenue in FY13-14 as a result of the cigarette tax rate reduction is estimated to be \$85,183,433 ( $\$81,671,139 + \$3,512,294$ ).

Assumptions related to cigarette tax in FY14-15:

- Reducing the tax rate to one cent per cigarette, or to \$0.22 per 20-pack, in FY14-15 will result in a price reduction of 20-pack cigarettes from \$4.80 to \$4.60 ( $\$4.80 - \$0.42 + \$0.22$ ).
- This represents a 4.17 percent decrease in the price of cigarettes sold to the consumer per each 20-pack [ $(\$4.60 - \$4.80) / \$4.80 \times 100$ ].
- The 4.17 percent decrease in price of cigarettes is estimated to result in a 1.67 percent increase in the quantity of cigarettes consumed ( $-4.17\% \times -0.4$ ).
- The number of 20-pack cigarettes sold as a result of this bill in FY14-15 is estimated to be 436,483,904 [ $429,314,354 \times (100\% + 1.67\%)$ ].
- The decrease in cigarette tax collections in FY14-15 is estimated to be \$165,956,709 [ $\$261,983,168 - (436,483,904 \times \$0.22)$ ].
- The total taxable sales of cigarettes is estimated to decrease by \$104,941,532 in FY14-15 as a result of this bill [ $(436,483,904 \times \$4.60) - (422,553,498 \times \$5.00)$ ].
- The decrease in state sales tax revenue in FY14-15 is estimated to be \$7,345,907 ( $\$104,941,532 \times 7.0\%$ ); the decrease in local option sales tax revenue in FY13-14 is estimated to be \$2,623,538 ( $\$104,941,532 \times 2.5\%$ ).
- The net decrease in state sales tax revenue in FY14-15 is estimated to be \$7,080,206 [ $\$7,345,907 - (\$7,345,907 \times 3.617\%)$ ].
- The total decrease in local sales tax revenue in FY14-15 is estimated to be \$2,889,239 [ $\$2,623,538 + (\$7,345,907 \times 3.617\%)$ ].
- The total decrease in state revenue in FY14-15 as a result of the cigarette tax rate reduction is estimated to be \$173,036,915 ( $\$165,956,709 + \$7,080,206$ ).

Assumptions related to cigarette tax in FY15-16 and subsequent years:

- Reducing the tax rate to one cent per cigarette, or to \$0.02 per 20-pack, in FY15-16 and subsequent years will result in a price reduction of 20-pack cigarettes from \$4.60 to \$4.40 ( $\$4.60 - \$0.22 + \$0.02$ ) relative to what the price would be under current law.
- This represents a 4.35 percent decrease in the price of cigarettes sold to the consumer per each 20-pack [ $(\$4.40 - \$4.60) / \$4.60 \times 100$ ].
- The 4.35 percent decrease in price of cigarettes is estimated to result in a 1.74 percent increase in the quantity of cigarettes consumed ( $-4.35\% \times -0.4$ ).
- The number of 20-pack cigarettes sold as a result of this bill in FY15-16 and subsequent years is estimated to be 444,078,724 [ $436,483,904 \times (100\% + 1.74\%)$ ].
- The decrease in cigarette tax collections in FY15-16 and subsequent years is estimated to be \$253,101,594 [ $\$261,983,168 - (444,078,724 \times \$0.02)$ ].
- The total taxable sales of cigarettes is estimated to decrease by \$158,821,105 in FY15-16 and subsequent years as a result of this bill [ $(444,078,724 \times \$4.40) - (422,553,498 \times \$5.00)$ ].
- The decrease in state sales tax revenue in FY15-16 and subsequent years is estimated to be \$11,117,477 ( $\$158,821,105 \times 7.0\%$ ); the decrease in local option sales tax revenue in FY15-16 and subsequent years is estimated to be \$3,970,528 ( $\$158,821,105 \times 2.5\%$ ).

- The net decrease in state sales tax revenue in FY15-16 and subsequent years is estimated to be \$10,715,358 [ $\$11,117,477 - (\$11,117,477 \times 3.617\%)$ ].
- The total decrease in local sales tax revenue in FY15-16 and subsequent years is estimated to be \$4,372,647 [ $\$3,970,528 + (\$11,117,477 \times 3.617\%)$ ].
- The total decrease in state revenue in FY15-16 and subsequent years as a result of the cigarette tax rate reduction is estimated to be \$263,816,952 ( $\$253,101,594 + \$10,715,358$ ).

Assumptions related to tax on other tobacco products:

- Pursuant to Tenn. Code Ann. § 67-4-1005, the excise tax rate on all other tobacco products is 6.6 percent of the wholesales cost price.
- According to DOR, tax collections on other tobacco products were approximately \$13,710,000 in FY11-12. Such collections grew at approximately 8.7 percent annually from FY05-06 to FY11-12.
- Taxable sales of other tobacco products are estimated to be \$207,727,273 in FY11-12 ( $\$13,710,000 / 6.60\%$ ). Assuming an average annual 5.0 percent growth for the next 7 years, estimated taxable sales are: \$218,113,637 in FY12-13; \$229,019,318 in FY13-14; \$240,470,284 in FY14-15; \$252,493,799 in FY15-16; \$265,118,488 in FY16-17; \$278,374,413 in FY17-18; and \$292,293,133 in FY18-19 and subsequent years.
- The reduction in the price of other tobacco products will not result in a significant increase in the quantity of such products consumed.
- Reducing the tax rate to 5.5 percent will result in a decrease in state revenue in FY13-14 of \$2,519,212 [ $\$229,019,318 \times (6.6\% - 5.5\%)$ ].
- Reducing the tax rate to 4.4 percent will result in a decrease in state revenue in FY14-15 of \$5,290,346 [ $\$240,470,284 \times (6.6\% - 4.4\%)$ ].
- Reducing the tax rate to 3.3 percent will result in a decrease in state revenue in FY15-16 of \$8,332,295 [ $\$252,493,799 \times (6.6\% - 3.3\%)$ ].
- Reducing the tax rate to 2.2 percent will result in a decrease in state revenue in FY16-17 of \$11,665,213 [ $\$265,118,488 \times (6.6\% - 2.2\%)$ ].
- Reducing the tax rate to 1.1 percent will result in a decrease in state revenue in FY17-18 of \$15,310,593 [ $\$278,374,413 \times (6.6\% - 1.1\%)$ ].
- Eliminating the tax rate fully will result in a decrease in state revenue in FY18-19 and subsequent years of \$19,291,347 ( $\$292,293,133 \times 6.6\%$ ).

Assumptions related to the total impact of the bill:

- The total decrease in state revenue in FY13-14 as a result of this bill is estimated to be \$87,702,645 ( $\$85,183,433 + \$2,519,212$ ). The total decrease in local revenue in FY13-14 as a result of this bill is estimated to be \$1,433,272.
- The total decrease in state revenue in FY14-15 as a result of this bill is estimated to be \$178,327,261 ( $\$173,036,915 + \$5,290,346$ ). The total decrease in local revenue in FY14-15 as a result of this bill is estimated to be \$2,889,239.

- The total decrease in state revenue in FY15-16 as a result of this bill is estimated to be \$272,149,247 (\$263,816,952 + \$8,332,295). The total decrease in local revenue in FY15-16 and subsequent years as a result of this bill is estimated to be \$4,372,647.
- The total decrease in state revenue in FY16-17 as a result of this bill is estimated to be \$275,482,165 (\$263,816,952 + \$11,665,213).
- The total decrease in state revenue in FY17-18 as a result of this bill is estimated to be \$279,127,545 (\$263,816,952 + \$15,310,593).
- The total decrease in state revenue in FY18-19 and subsequent years as a result of this bill is estimated to be \$283,108,299 (\$263,816,952 + \$19,291,347).
- According to DOR, this bill will not result in a significant decrease in state expenditures as the taxes imposed under Tenn. Code Ann. § 67-4-1004(b) and Tenn. Code Ann. § 67-4-1004(d) will still remain in place.

**CERTIFICATION:**

The information contained herein is true and correct to the best of my knowledge.



Lucian D. Geise, Executive Director

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