

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: H.B. 1606 (First Edition)

SHORT TITLE: Raise Alcohol/Cigarette Rev. to Save Services

SPONSOR(S): Representatives Insko, Weiss, Luebke, and Alexander

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$million)				
	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>
REVENUES					
General Fund					
Cigarette Tax	144.8	154.5	148.3	142.4	136.7
Alcohol Tax	90.1	112.5	114.9	117.1	119.3
Sales Tax					
Cigarettes	6.5	6.2	5.9	5.7	5.5
Alcohol	<u>4.2</u>	<u>4.7</u>	<u>4.8</u>	<u>4.9</u>	<u>5.0</u>
Total G.F.	245.6	277.9	273.9	270.1	266.5
Local Governments					
Sales Tax - Cigarettes	2.9	3.9	3.7	3.6	3.4
Sales Tax – Beer & Wine	<u>1.7</u>	<u>2.5</u>	<u>2.6</u>	<u>2.6</u>	<u>2.7</u>
Total Local	4.6	6.4	6.3	6.2	6.1
EXPENDITURES					
General Fund*	.075				
* Up to \$75,000 may be withheld from alcohol tax collections to pay administrative costs.					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, Alcoholic Beverage Control Commission					
EFFECTIVE DATE: Section 1 (cigarette tax) is effective July 1, 2002. Section 2 (liquor tax) is effective October 1, 2002. Section 3 (beer and wine surtax) is effective August 1, 2002.					

BILL SUMMARY: Section 1 of the bill increases the tax on cigarettes from \$0.05 per pack (20 cigarettes) to \$0.30 per pack. Section 2 increases the excise tax on liquor from 25% to 28%. Section 3 imposes the following surtaxes: (1) 53 cents per gallon on beer, (2) 21 cents per liter on unfortified wine, and (3) 24 cents per liter on fortified wine.

ASSUMPTIONS AND METHODOLOGY:

CIGARETTE TAX

In FY 1999-00 and FY 2000-01 the state received the following revenues from the sale of cigarettes and other tobacco products:

	(\$million)	
	<u>1999-00</u>	<u>2000-01</u>
Cigarette	40.5	38.5
Other Tobacco Products	3.2	3.5

According to a March 2002 report from the Council of State Governments, cigarette consumption is expected to decline nationally by approximately 1.5% a year. (This estimate is based on the four-year average since the adoption of the Master Settlement Agreement in 1998.) However, as the above data indicates, North Carolina has seen a much more dramatic decline. Therefore, independent of any change in price, Fiscal Research estimates that cigarette tax revenues will decrease by approximately 4% annually, creating the following baseline revenue stream:

	(\$million)				
	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Total Cigarette Revenue	35.5	34.1	32.7	31.4	30.1
Revenue Per Penny	7.1	6.8	6.5	6.3	6.0

While these numbers are a good indication of revenues from existing taxes and even small increases in the tax on cigarettes, academic research suggests that larger price increases could result in smaller per penny gains. According to a 1998 report from the National Bureau of Economic Research, "a ten-percent increase in cigarette prices would reduce overall cigarette consumption by three to five percent". A similar study offered in 1998 by Blake Brown at North Carolina State University suggests that a 10% increase in the price of cigarettes will result in a decline in consumption of 2% - 7.5%. An average of these ranges suggests that a 10% increase in price will result in a decline in consumption of approximately 4.9%. However, because travelers often stop in North Carolina to purchase cigarettes, Fiscal Research believes consumption will be more sensitive than average to changes in price. Therefore, a factor of 6.9% decline in consumption is used to determine the impact of each 10% increase in price. In addition, under current law, cigarette distributors get to retain 4% to defray the cost of administering the tax. The 2001 Tax Burden on Tobacco publications indicates that the average cigarette price in North Carolina is \$3.12.

Once the necessary adjustments are made for consumption and the distributors discount, the potential estimated increase in cigarette tax revenue is as follows:

	(\$million)				
	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Cigarette Tax Revenue	160.9	154.5	148.3	142.4	136.7

Note: All academic literature on price and the consumption of cigarettes indicates that over a long period of time (10 years or more), an increase in price will result in an even greater reduction in

consumption. Generally most researchers believe the long run rate of decline will be an 8% decline in consumption for every 10% increase in price.

SALES TAX REVENUE: Sales tax is also levied on cigarettes at the general rate (currently 6.5%). Because this legislation will increase the price of a pack of cigarettes by \$0.25 cents, the bill will also result in a small increase in sales tax revenues for both the state and local governments.

	(\$million)				
	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
State Sales Tax	7.2	6.2	6.7	6.4	6.2
Local Sales Tax	3.2	3.9	3.7	3.6	3.4

The estimate in the fiscal impact box for the first year is reduced, as the state is unlikely to collect the full amount in the first month. This estimate assumes 80% collection of the first month's revenue and assumes that distributors are given appropriate notice of the tax change. It also assumes that the tax becomes effective August 1, 2002.

ALCOHOL TAX

BACKGROUND: The current excise taxes on alcoholic beverages are shown in the table below. The 2001 General Assembly reduced the excise tax on liquor from 28% to 25%, but imposed a 6% state sales tax on the retail price of liquor. The sales tax became effective on December 1, 2001, and the excise tax reduction became effective February 1, 2002. The last increase in the excise tax on wine was 1979 and the last increase in the beer excise tax was 1969. There was a minor change in the beer tax in 1998 when two rates based on differing container size were combined into one revenue neutral rate.

	Excise Tax Rate	Tax per Average Container Size
Beer	\$.53177 per gallon	5 cents per 12 oz bottle/can
Unfortified Wine	\$.21 per liter	3 cents per 5 oz glass
Fortified Wine	\$.24 per liter	3.5 cents per 5 oz glass
Liquor	25% of distiller's price	

CURRENT TAX REVENUE: The Fiscal Research Division (FRD) General Fund Revenue Forecast for fiscal years 2002-03 through 2006-07 for alcoholic beverage excise taxes is shown below. This May 2002 forecast correlates alcohol sales growth directly with state personal income growth for the five-year period. The forecast is adjusted for the income elasticity of each beverage.

	Excise Tax Rate	FY 02-03 Est.	FY 03-04 Est.	FY 04-05 Est.	FY 05-06 Est.	FY 06-07 Est.
Beer	\$0.53177	\$89,250,000	\$90,950,000	\$92,660,000	\$94,160,000	\$95,670,000
Unfortified wine	\$0.21	\$9,200,000	\$9,430,000	\$9,660,000	\$9,860,000	\$10,060,000
Fortified wine	\$0.24	\$1,570,000	\$1,570,000	\$1,570,000	\$1,570,000	\$1,570,000
Liquor	25%	\$87,437,500	\$91,767,857	\$96,232,143	\$100,294,643	\$104,446,429
		\$187,457,500	\$193,717,857	\$200,122,143	\$205,884,643	\$211,746,429

PROPOSED EXCISE TAX REVENUE: Using the FRD forecast as the base, revenue for the increased excise tax rate is computed. The surtax revenue from beer and wine in FY 2002-03 will be for only ten months due to the August 1, 2002, effective date and a 15-day lag in collections that pushes one month's collection into the next fiscal year. Similarly, the October 1, 2002, effective date and collection lag for the liquor excise tax increase produces only eight months collection in FY 2002-03. No adjustment is made in the five-year projection of tax revenue for the price sensitivity of consumers, since there is uncertainty about the impact of higher prices on alcoholic beverage consumption. Economic literature is inconclusive about the consumer response to price increases because of the "substitution effect" for alcoholic products. Instead of reducing demand due to higher prices, consumers may choose a lesser-priced product or choose a different type of alcoholic beverage. The additional tax revenue due to HB 1606 is shown below.

	Excise Tax Rate	FY 02-03 Est.	FY 03-04 Est.	FY 04-05 Est.	FY 05-06 Est.	FY 06-07 Est.
Beer	\$1.062	\$74,127,442	\$90,506,077	\$92,209,555	\$93,722,004	\$95,226,148
Unfortified wine	\$0.42	\$7,666,666	\$9,410,833	\$9,640,833	\$9,843,333	\$10,043,333
Fortified wine	\$0.48	\$1,308,333	\$1,570,000	\$1,570,000	\$1,570,000	\$1,570,000
Liquor	28%	\$6,995,000	\$10,968,839	\$11,503,214	\$11,994,732	\$12,492,053
Total Additional Funds		\$90,097,441	\$112,455,749	\$114,923,603	\$117,130,069	\$119,331,534

SALES TAX REVENUE: All beer and wine purchases are subject to the 6.5% state and local sales tax (7% Mecklenburg) and liquor is subject to a 6% state sales tax. This fiscal note assumes the increased excise tax on beer, wine, and liquor will be added to the shelf price of the alcoholic products and will result in increased state and local sales tax receipts. The additional state sales tax from alcoholic beverage sales tax will be deposited into the General Fund. Local governments will receive the additional tax in their normal disbursements.

The FY 2002-03 revenues are based on eight months of collections for liquor and 10 months collections for beer and wine. The state sales tax is assumed to be 4.5% in FY 2002-03 and 4% in the following fiscal years. The local sales tax is assumed to be 2% in FY 2002-03 and 2.5% in the following fiscal years.

	State Sales Tax	Local Sales Tax
FY 02-03	\$4,159,310	\$1,662,049
FY 03-04	\$4,717,607	\$2,537,173
FY 04-05	\$4,827,008	\$2,585,510
FY 05-06	\$4,925,097	\$2,628,383
FY 06-07	\$5,023,102	\$2,670,987

SOURCES OF DATA: Department of Revenue - Tax Research Division; National Bureau of Economic Research; Dr. Blake Brown (NCSU); "Tobacco Settlement and Declining State Revenues" March 2002, Council of State Governments

TECHNICAL CONSIDERATIONS: The October 1 effective date may prove a hardship for the NC Alcoholic Beverage Control Commission because its pricing list is updated and published quarterly on August 1, November 1, February 1 and May 1.

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