

Cigarette Taxes: Issues and Options

Efforts to increase taxes usually face some opposition, particularly increases to broad-based taxes such as the sales or income tax. Yet in many states, lawmakers have been able to agree on one approach to revenue-raising: the cigarette tax. Since 2002, nearly every state has enacted a cigarette tax increase to fund health care, discourage smoking, or to help balance state budgets. This policy brief looks at the advantages and disadvantages of cigarette taxes, and cigarette tax increases, as a source of state and local revenue.

A Regressive Tax

Cigarette taxes are regressive: that is, low- and middle-income taxpayers pay more of their income in these taxes, on average, than do upper-income families. In 2015 the poorest twenty percent of Americans spent 0.8 percent of their income, on average, on cigarette taxes while the wealthiest 1 percent spent less than 0.1 percent of their income on these taxes. Simply put, cigarette taxes fall disproportionately on low-income taxpayers.

These taxes are regressive because the fixed amount of tax on a pack of cigarettes represents a larger share of income for low-income smokers. For instance, all Pennsylvania smokers, regardless of income, pay a state cigarette tax of \$2.60 per-pack. This is on top of any local cigarette taxes, state and local sales taxes, and the \$1.01 per-pack federal tax.

These taxes also disproportionately affect low-income individuals because they are more likely to smoke than their upper-income neighbors. The prevalence of smoking is higher among individuals living below the poverty line.¹

A Declining Tax

Per-pack basis

Over time, cigarette tax revenues grow more slowly than do most other taxes. This is partly because these taxes tend to be calculated on a flat per-pack basis: a 50-cent-per-pack tax will always yield the same amount of tax revenue for each pack sold. By contrast, general sales taxes are calculated as a percentage of the sale price of a taxable item. This means that when inflation drives prices up, sales tax revenues will automatically increase. Absent policy change or an uptick in smoking, cigarette tax revenues remain stagnant even as the cost of the public services they are meant to fund tends to rise.

Reduced smoking rates

Because cigarette taxes are calculated on a flat, per-pack basis, a state's cigarette tax revenues can only grow when the tax rate is increased or when cigarette consumption rises. Yet in reality, the smoking rate among Americans has been declining for decades—from over 40 percent in the 1960s to roughly 15 percent today.² This steep, ongoing decline in smoking means that unless tax rates are regularly increased, state revenues from cigarette taxes are likely to decline in the future.

Another potential source of revenue loss relates to the growing popularity of e-cigarettes and “vaping” as alternatives to smoking. These markets have expanded in recent years and are projected to triple to nearly \$16 billion between 2015 and 2019.³ While over half of the states have considered a tax on vaping products, only a handful have actually implemented them.

Tax evasion and cigarette smuggling

There is also some evidence that tax evasion is a growing problem for cigarette tax collections. A few states, including California, New York, and Massachusetts, have created task forces in recent years with the aim of reducing and ultimately eliminating cigarette smuggling and tax evasion. While both federal and state lawmakers are taking steps to increase compliance with cigarette taxes, tax evasion remains a potential problem for states considering cigarette tax hikes. However, the scale of this issue should not be overstated.

Cigarette tax increases are still a realistic way of raising revenue even if smuggling increases somewhat as a result of a boost in the tax rate.

No Federal Deductibility

State taxpayers cannot write off cigarette taxes on their federal tax returns, as they can with broad-based taxes on property, sales, or income. This means

that when state residents pay a dollar in cigarette taxes, the entire dollar comes out of their pockets. By contrast, any state resident who itemizes deductions on their federal income tax return can deduct their state and local property taxes and their choice of income or sales taxes—which means that part of these taxes is effectively paid by the federal government, a savings for state residents. This “federal offset” is an often-overlooked advantage of broad-based state taxes, particularly the income tax. (See ITEP’s brief, [“A Primer on the Federal Offset”](#) for more information.)

When to Consider Cigarette Tax Increases

Taxes exist primarily to help pay for public services. Cigarette tax increases, often politically feasible and expedient revenue-raisers, can help do just that.

As explained above, however, cigarette tax revenues tend to grow more slowly than the cost of almost any public service that could be funded using these taxes. So states that use cigarette taxes to fund public services may be disappointed in the long-run.

But cigarette taxes are also a relatively stable revenue source. The tax is less volatile than income and sales taxes over the course of the business cycle because economic downturns do not affect cigarette consumption to the degree that they affect other types of purchases. In short, cigarette taxes—while regressive and declining—are a predictable revenue source for state governments.

A tool to discourage smoking

Cigarette taxes are sometimes imposed not only to raise revenue but to discourage smoking, and have been shown to be effective in this regard. Every 10 percent increase in the price of cigarettes can be expected to reduce overall

cigarette consumption by roughly three to five percent.⁴ Cigarette price increases are especially effective among children and young adults who, as a result, are two to three times more likely to stop smoking.⁵ But given the addictive qualities of nicotine, many smokers will simply pay the higher tax, regardless of the rate, and continue their habit.

Long-term health benefits

To the extent that cigarette taxes encourage consumers to stop smoking, they may be a successful social policy tool and even offer some long-term budgetary and health benefits. A smoker whose secondhand smoke affects the health of current or future Medicare recipients, for example, is necessitating higher spending on the part of the government due to her decision to smoke. Between direct medical care and lost productivity due to exposure to secondhand smoke, smoking-related illness costs Americans more than \$300 billion each year.⁶ Moreover, if a cigarette tax increase does cause smokers to quit or discourage them from taking up the habit, states will enjoy savings in health care costs as the health of smokers and those directly impacted by secondhand smoke improves.

Conclusion

There are a range of advantages and disadvantages that lawmakers must consider when deciding whether to raise cigarette taxes. As a clear smoking deterrent, particularly among children and young adults, these taxes can improve the general health of a state’s residents. Moreover, cigarette tax increases can raise meaningful public revenues in the short-term.

If a state is relying on the revenue from the tax to fund programs or supplement a state budget, however, it is important to note that the revenues raised by cigarette taxes are unlikely to be sustainable in the long-run, and that their impact will fall disproportionately on lower-income individuals.

¹ Cigarette Smoking and Tobacco Use Among People of Low Socioeconomic Status. Centers for Disease Control and Prevention (CDC). <http://www.cdc.gov/tobacco/disparities/low-ses/index.htm>

² Smoking & Tobacco Use: Trends in Current Cigarette Smoking Among High School Students and Adults, United States, 1965-2014. Centers for Disease Control and Prevention (CDC). http://www.cdc.gov/tobacco/data_statistics/tables/trends/cig_smoking/; National Health Interview Survey: Early Release of Selected Estimates Based on Data from the 2015 National Health Interview Survey. Centers for Disease Control and Prevention (CDC). <http://www.cdc.gov/nchs/>

³ E-Cigarettes Could Be Taxed by States Missing Out on Tobacco Revenue, Bloomberg. May 19, 2016. <http://www.bloomberg.com/news/articles/2016-05-19/e-cigarette-tax-may-be-new-fix-as-tobacco-money-goes-up-in-smoke>

⁴ Economic Facts About U.S. Tobacco Production and Use, Centers for Disease Control and Prevention (CDC) (Updated April 8, 2016). http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/

⁵ Ibid.

⁶ Ibid.