plaid pantry
convenience stores
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March 12, 2013

Chair Phil Barnhart
Vice-Chair Jules Bailey
Vice-Chair Vicki Berger
Representative Cliff Bentz
Representative Jason Conger
Representative John Davis
Representative Sara Gelser
Representative Tobias Read
Representative Jessica Vega Pederson

House Revenue Committee
900 Court St. NE, Room 143
Salem, OR 97301

Dear Chair Barnhart and Vice-Chairs Bailey and Berger:

Plaid Pantries, Inc. owns and operates 107 convenience stores in the Northwest, with the majority of our stores being here in Oregon. Plaid is also a member of the Oregon Neighborhood Store Association (ONSA), which provides legislative and regulatory representation for Oregon's 2,500 smaller, mostly family-owned and operated convenience food stores.

Plaid and ONSA oppose HB 2275 and its $1.00 per pack state excise tax increase on cigarettes. This represents an enormous 85% increase from the current $1.18 per pack tax.

1. **Cigarette taxes are selective and regressive.**

About eighteen percent of Oregon's adult population use tobacco. This proposed tax affects a higher percentage of lower-income citizens than high-income Oregonians. Tobacco taxes therefore target a minority of the population, and disproportionately impact lower income citizens, particularly in terms of their percentage of disposable income.

2. **Increasing taxes on a small group of citizens to benefit the overall population is not fair.**

Tobacco products are already heavily taxed at both the Federal and State level, and tobacco users are already paying considerably more in taxes than other citizens. It is not fair or equitable to single out only a fifth of Oregon's citizens with additional taxes, and not ask all other citizens to help with the State's current budget challenges. Tobacco users are going through what the rest of the population is facing in their personal finances. They are mostly working people who have bills and mortgages or rent to pay. Some of them have lost their jobs and are struggling to make ends meet while seeking employment. Those that are fortunate enough to have jobs have just been hit with the reinstatement of the 2% payroll tax, which represents a very significant dent in their disposable incomes.

Tobacco customers are just like everyone else.... except they use tobacco. This is not justification to single them out as the only relatively small group of citizens being asked to pay increased taxes.

3. **Higher tobacco taxes do not significantly reduce consumption, but drive consumers to avoid/evade taxes.**

Oregon relies on tobacco revenue to meet its budget needs, and this revenue stream is declining (Exhibit 1). Consumption is decreasing somewhat, but the larger factor is tax avoidance and evasion. Continual tax increases have driven a very significant amount of the formerly-taxed product underground, to gray and black market sources, untaxed Native American outlets, organized crime operations, the internet, and “roll-your-own” cigarettes using lower-taxed bulk tobacco.

Raising Oregon’s cigarette tax will considerably further erode the existing tax paying cigarette tax base. Oregon’s neighboring states’ tobacco taxes, except for Washington, are much lower than Oregon. Growing cigarette tax differentials have made cigarette bootlegging both a national problem and a lucrative criminal enterprise. The top cigarette tax rate States lose half of their expected revenues to smuggling, according to a recent study by The Tax Foundation (Exhibit 2). Their most recent data reports that smuggling rates rise in States after they adopt large cigarette tax increases.

Higher taxes will only drive these trends further in that direction, resulting in the tax burden increasingly falling only on remaining law-abiding consumers and law-abiding retailers; again unfair to a small minority of Oregon citizens.

4. **Higher cigarette taxes will decrease significant cross-border cigarette purchases and tax revenues from Washington consumers.**

Washingtonians avoid/evade taxes on a quite astonishing 48.5% of cigarettes consumed (Exhibit 2), which represents 13.5 million untaxed cartons annually. Data indicate that about 4.7 million of these cartons are purchased in Oregon. This amounts to over $55 million in Oregon tax revenue collected from non-Oregon residents. Raising Oregon’s tax rate will dramatically alter this tax revenue stream, and would adversely affect retail and wholesale economic activity for Oregon small businesses and the State overall. Tobacco customers purchase other retail products, lottery, and motor fuel on the same trips, all of which provide significant Oregon taxes and revenue. Marketing data show that on average a tobacco customer purchases $2.59 in non-tobacco products per pack of cigarettes. Also important, from a tax revenue standpoint, Oregon tax increases would permanently reduce the taxable base for future revenue from the lost sales.

5. **<u>Washington State is a noteworthy example of extreme excise tax evasion.</u>**

Exhibit 3 shows historical taxable cigarette carton sales for Oregon and Washington. In 2011, nationwide consumption of cigarettes averaged 52 packs per year per-capita. Oregon taxable cigarette sales in 2011 were 46 packs per-capita, while Washington collected taxes on only 21 packs per-capita. Washington's incidence of smoking is not half that of Oregon, so these numbers are consistent with the data presented in Exhibit 2. With 4.7 million cartons purchased in Oregon, there remain 8.8 million Washington cartons purchased from other States and other non-taxed sources of supply.

6. **<u>Increasing the cigarette tax never raises the amount of revenue expected, and the expected revenue gains will be even less than historically realized.</u>**

There are three primary factors affecting the reduced expected tax revenue from tax rate increases, and these factors will result in increasingly disproportionate effects as the tax rate increases from current high levels.

A. <u>Washington State Cross-Border Purchases</u>

It is tempting to view the current cigarette tax differential with Washington, thinking logically that as long as Oregon is below Washington we can still expect high levels of cross-border shopping. However the increased gap in Washington's excise tax in 2010 generated nearly half of the current cross-border purchases of tobacco.

Washington last increased their cigarette tax by $1.00 per pack in 2010, resulting in an increase of over 2.3 million cartons (23 million packs) of the currently estimated 4.7 million cartons of cigarettes purchased by Washington residents in Oregon. There is no reason to expect that these differential cartons will remain in Oregon if the Oregon tax is returned to the differential that existed in 2009.

B. <u>Higher Tax Avoidance/Evasion Decreases Oregon Taxable Unit Sales</u>

Oregon cigarette excise tax receipts for the first half of fiscal year 2012/13 indicate an expected 16.9 million taxable cartons for the full year. Subtracting the cross-border loss of 2.3 million cartons leaves 14.6 million cartons subject to increased tax avoidance/evasion due to the proposed tax increase. Washington's $1.00 per pack increase in 2010 resulted in a 23% decrease in taxable cartons in that State. A conservative estimated loss of only 15% to increased tax avoidance and evasion of the proposed Oregon tax increase will cause a one-time permanent reduction of approximately 2.2 million cartons.

C. <u>Underlying Trend Loss to Un-Taxed, Lower-Taxed, and Alternative Products</u>

Aside from the effects of the currently proposed tax increase, cigarette taxes are a declining revenue source. Taxable cigarette volumes have a well-established and predictable 3.3% annual trend decline. Even with no changes in the current tax structure we can be certain of an underlying decrease of about four (4) million packs annually. While this is a relatively small factor in any given year, the more significant fact is that there will be a continuous ongoing reduction in this tax base.

The combined effect of the first two major factors that have the largest direct effect on tax revenues is a reduction of 4.5 million taxed cartons (45 million packs), resulting in a reduction in expected revenue of $45 million from the proposed new tax, and a loss of the existing $1.18 excise tax on 45 million packs in the amount of $53 million.

From experience with prior tax increases, we know that we cannot expect to realize an additional $169 million from an additional $1 per pack tax on the current 16.9 million cartons. Due to the current already high levels of taxation, the losses to increased tax avoidance and evasion will be more pronounced than previous history in this regard. With the combined effect of taxable cartons being reduced to only 12.4 million (16.9 – 4.5 as discussed above), we can expect only $124 million from the new tax, offset by a loss of $53 million in existing excise taxes, for a net revenue gain of only $71 million. But this would be largely offset by reductions in consumer spending in other areas caused by such a punitive additional tax, and the devastating effect on legitimate small businesses.

The average retail price of a pack of cigarettes today is $5.03, and with the aforementioned additional non-tobacco sales of $2.59 per transaction, the average tobacco customer transaction amounts to $7.62. This proposed tax increase will wipe out 45 million legal pack transactions between legitimate businesses and law-abiding customers, and will transfer $343 million in economic activity to the untaxed underground economy. Such losses ripple through the entire supply chain, damaging wholesale and transportation trade activity, and reducing jobs and benefits for those working in our industry.

7. <u>**Higher cigarette taxes hurt Oregon small businesses and Oregon's economy.**</u>

Higher cigarette taxes don't hurt "Big Tobacco"; they hurt consumers and small businesses. Oregon retailers collect $1.01 per pack of cigarettes in Federal excise taxes. Oregon retailers also collect $1.18 per pack in Oregon excise taxes. By comparison, a retailer realizes only about $0.58 in gross margin on the sale of a pack of cigarettes. Most of this gross margin goes directly to generating an interrelated stream of Oregon economic activity.

Well over half of these margin dollars go directly to support jobs, wages, and employee benefits. Plaid and similar small retailers contract with many hundreds of companies, mostly Oregon small businesses, which provide maintenance, repairs, supplies, transportation, and other services to our retail operations. Wholesale and retail companies pay rent to Oregon landlords, property taxes, and income taxes. Only a very tiny percentage of sales goes to the bottom line, but our industry's economic contribution still does not stop there. Most of a company's after-tax net profit is re-invested in the company through facility upgrades, expansion, and other capital improvements, thereby generating a final round of contributions to Oregon businesses, jobs, and the State's economy.

Increasing an already-high direct consumption tax on a product that does not have a legal substitute will drive an increasing percentage of tobacco users to the black/gray market, depriving small businesses and the State of legal economic activity and revenue.

8. **It is bad public policy to raise taxes during the current slow and fragile economic recovery.**

Large tax increases put additional stresses on the already cash-strapped consumer, and on Oregon's economy itself. When faced with significant sales decreases, businesses have no choice but to reduce labor costs, which decreases jobs, benefits, and health insurance coverage for workers. Companies will also cut back on other non-essential expenditures, investment, and growth plans, negatively impacting the entire supply chain and the economy as a whole. If revenues must be raised, it should be approached in a comprehensive and coordinated package that spreads the burden equitably among all Oregonians.

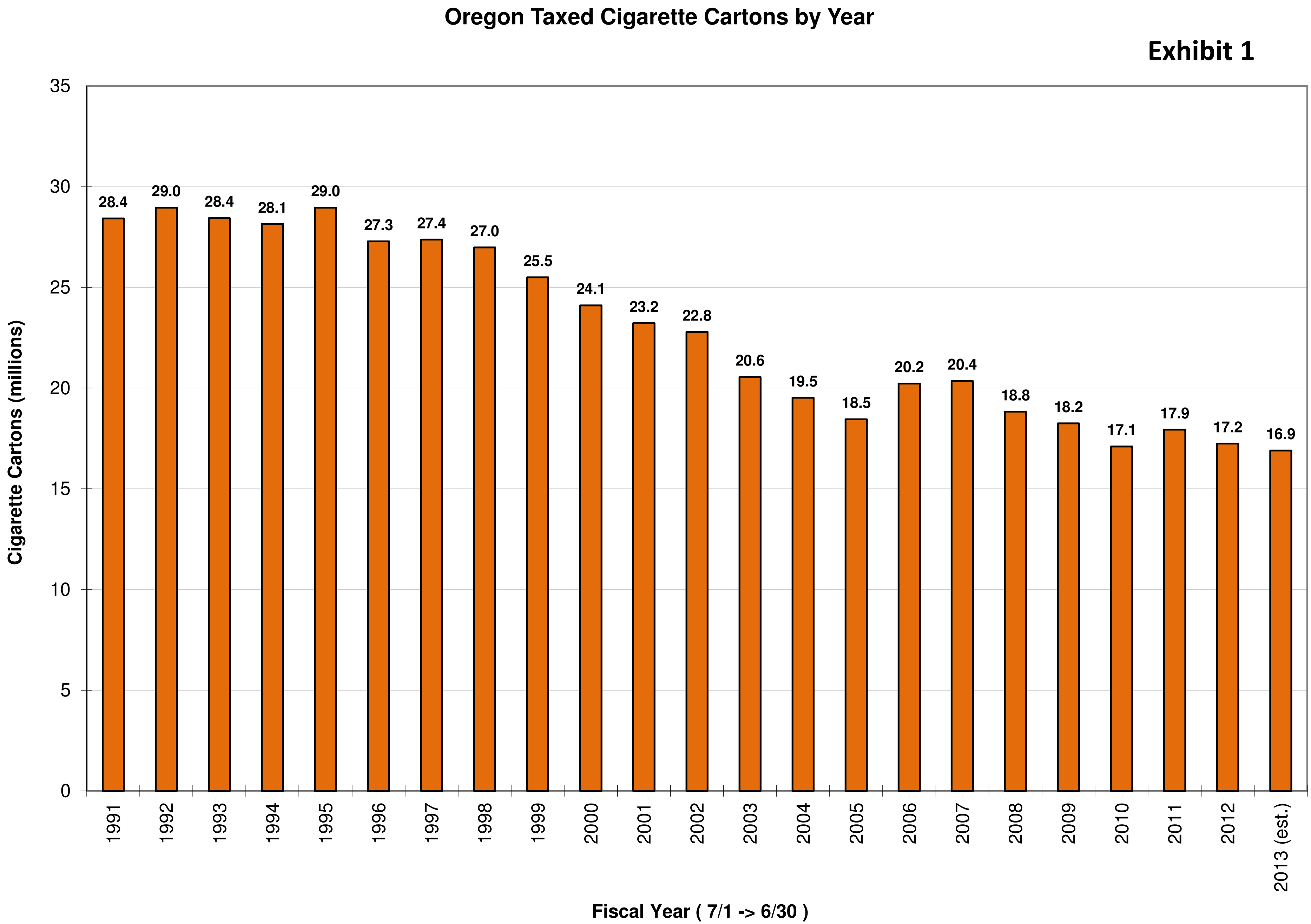
In summary, this proposed tax is grossly unfair to a minority of Oregonians who are already financially stressed. This tax hurts legitimate small businesses, and rewards and encourages illegal enterprises and unlawful activity. The potential revenue that would be realized is increasingly diminished at the margin due to already high levels of taxation on tobacco products and the resultant increase in tax avoidance/evasion schemes. Such a tax inflicts a terrible price on legitimate economic activity, businesses, Oregon jobs, employee benefits, and other business-generated tax revenue streams to cities, counties, and the State.

For all of these reasons, we strongly oppose this bill.

Respectfully,

Chris Girard
President & CEO – Plaid Pantries, Inc.
Chair – Oregon Neighborhood Store Association

Exhibit 1



Oregon Taxed Cigarette Cartons by Year
Cigarette Cartons (millions)
35
30
25
20
15
10
5
0
28.4
29.0
28.4
28.1
29.0
27.3
27.4
27.0
25.5
24.1
23.2
22.8
20.6
19.5
18.5
20.2
20.4
18.8
18.2
17.1
17.9
17.2
16.9
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013 (est.)
Fiscal Year (7/1 -> 6/30)

Exhibit 2

TAX FOUNDATION

Fiscal Fact

January 10, 2013
No. 351

Cigarette Taxes and Cigarette Smuggling by State

By
Joseph Henchman & Scott Drenkard

Public policies often have unintended consequences that outweigh their benefits. One consequence of high state cigarette tax rates has been increased smuggling, as criminals procure discounted packs from low-tax states to sell in high-tax states. Growing cigarette tax differentials have made cigarette bootlegging both a national problem and a lucrative criminal enterprise.

Every two years, scholars at the Mackinac Center for Public Policy, a Michigan think tank, use a statistical analysis of available data to estimate smuggling rates for each state.[1] Their most recent report uses 2011 data and finds that smuggling rates generally rise in states after they adopt large cigarette tax increases. Smuggling rates have dropped in some states, however, often where neighboring states have higher cigarette tax rates. Table 1 shows the data for each state, comparing 2011 and 2006 smuggling rates and tax changes.

New York is the highest net importer of smuggled cigarettes, totaling 60.9 percent of the total cigarette market in the state. New York also has the highest state cigarette tax ($4.35 per pack), not counting the local New York City cigarette tax (an additional $1.50 per pack). Smuggling in New York has risen sharply since 2006 (+170 percent), as has the tax rate (+190 percent).

Smuggling takes many forms: counterfeit state tax stamps, counterfeit versions of legitimate brands, hijacked trucks, or officials turning a blind eye.[2] The study's authors, LaFaive and Nesbit, cite examples of a Maryland police officer running illicit cigarettes while on duty, a Virginia man hiring a contract killer over a cigarette smuggling dispute, and prison guards caught smuggling cigarettes into prisons. Policy responses

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[1] *See, e.g.*, Michael LaFaive & Todd Nesbit, *Higher Cigarette Taxes Create Lucrative, Dangerous Black Market*, MACKINAC CENTER FOR PUBLIC POLICY (Jan. 2013), http://www.mackinac.org/18128; Michael LaFaive, *Cigarette Taxes and Smuggling 2010: An Update of Earlier Research*, MACKINAC CENTER FOR PUBLIC POLICY (Dec. 2010), http://www.mackinac.org/14210; Michael LaFaive, Patrick Fleenor, & Todd Nesbit, *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review*, MACKINAC CENTER FOR PUBLIC POLICY (Dec. 2008), http://www.mackinac.org/10005.

[2] *See, e.g.*, Scott Drenkard, *Cigarette Smuggling Can Make You $4 Million Richer*, TAX FOUNDATION TAX POLICY BLOG, Sept. 27, 2012, http://taxfoundation.org/blog/cigarette-smuggling-can-make-you-4-million-dollars-richer.

have included banning common carrier delivery of cigarettes,[3] greater law enforcement activity on interstate roads,[4] differential tax rates near low-tax jurisdictions,[5] and cracking down on tribal reservations that sell tax-free cigarettes.[6] However, the underlying problem remains: high cigarette taxes that amount to a "price prohibition" of the product in many U.S. states.[7]

Table 1: 2011 Cigarette Tax Rates, Smuggling Percentages, and Changes Since 2006

State	**2011 Cigarette Tax Rate (per pack)**	**2011 Consumption Smuggled** (positive is inflow, negative is outflow)	**2006 Consumption Smuggled** (positive is inflow, negative is outflow)	**2011 Smuggling Rank** (1 is most smuggling, 50 is least)	**Smuggling Rank Change Since 2006** (e.g., NY changed from #5 to #1, so rank changed +4)	**Cigarette Tax Rate Change, 2006-2011**
New York	$4.35	60.9%	35.8%	1	+4	+190%
Arizona	$2.00	54.4%	32.1%	2	+5	+69%
New Mexico	$1.66	53.0%	39.9%	3	-1	+82%
Washington	$3.025	48.5%	38.2%	4	+0	+49%
Rhode Island	$3.46	39.8%	43.2%	5	-4	+41%
Wisconsin	$2.52	36.4%	13.1%	6	+12	+227%
California	$0.87	36.1%	34.6%	7	-1	No Change
Texas	$1.41	33.8%	14.8%	8	+8	+244%
Utah	$1.70	32.0%	12.9%	9	+11	+145%
Michigan	$2.00	29.3%	31.0%	10	-1	No Change
Montana	$1.70	28.7%	31.2%	11	-3	No Change
South Dakota	$1.53	28.6%	5.3%	12	+16	+189%
Maryland	$2.00	25.8%	10.4%	13	+11	+100%
Connecticut	$3.00	22.2%	12.3%	14	+8	+99%
Iowa	$1.36	21.3%	2.4%	15	+18	+278%
Minnesota	$1.586	19.5%	23.6%	16	-6	No Change
Florida	$1.339	19.1%	6.9%	17	+9	+294%
Kansas	$0.79	18.4%	18.4%	18	-6	No Change
Massachusetts	$2.51	18.1%	17.5%	19	-6	+66%
New Jersey	$2.70	18.1%	38.4%	20	-17	+13%
Colorado	$0.84	16.2%	16.6%	21	-7	No Change
Oregon	$1.18	15.7%	21.1%	22	-11	No Change
Maine	$2.00	13.7%	16.6%	23	-8	No Change
Mississippi	$0.68	10.1%	-1.7%	24	+13	+36%
Arkansas	$1.15	9.6%	3.9%	25	+6	+95%
Ohio	$1.25	9.0%	13.1%	26	-7	No Change
Nebraska	$0.64	5.4%	12.0%	27	-4	No Change

[3] *See, e.g.*, Curtis Dubay, *UPS Decision Unlikely to Stop Cigarette Smuggling*, TAX FOUNDATION TAX POLICY BLOG, Oct. 25, 2005, http://taxfoundation.org/blog/ups-decision-unlikely-stop-cigarette-smuggling.

[4] *See, e.g.*, Gary Fields, *States Go to War on Cigarette Smuggling*, WALL STREET JOURNAL, Jul. 20, 2009, http://professional.wsj.com/article/SB124804682785163691.html?mg=reno64-wsj.

[5] *See, e.g.*, Mark Robyn, *Border Zone Cigarette Taxation: Arkansas's Novel Solution to the Border Shopping Problem*, TAX FOUNDATION FISCAL FACT NO. 168 (Apr. 9, 2009), http://taxfoundation.org/article/border-zone-cigarette-taxation-arkansass-novel-solution-border-shopping-problem.

[6] *See, e.g.*, Joseph Henchman, *New York Governor Signs Law to Tax Cigarettes Sold on Tribal Lands*, TAX FOUNDATION TAX POLICY BLOG, Dec. 16, 2008, http://taxfoundation.org/blog/new-york-governor-signs-law-tax-cigarettes-sold-tribal-lands.

[7] *See also* Patrick Fleenor, *Tax Differentials on the Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States*, TAX FOUNDATION BACKGROUND PAPER NO. 16 (Oct. 1, 1996), http://taxfoundation.org/article/tax-differentials-interstate-smuggling-and-cross-border-sales-cigarettes-united-states.

Louisiana	$0.36	5.1%	6.4%	28	-1	No Change
Oklahoma	$1.03	4.6%	9.6%	29	-4	No Change
Pennsylvania	$1.60	3.3%	12.9%	30	-9	+19%
Illinois	$0.98	2.3%	13.7%	31	-14	No Change
North Dakota	$0.44	-1.6%	3.0%	32	+0	No Change
Tennessee	$0.62	-2.4%	-4.5%	33	+5	+210%
South Carolina	$0.57	-2.5%	-8.1%	34	+7	+14%
Indiana	$0.995	-3.1%	-10.8%	35	+8	+79%
Georgia	$0.37	-4.1%	-0.3%	36	-1	No Change
Kentucky	$0.60	-7.2%	-6.4%	37	+3	+100%
Alabama	$0.425	-7.7%	0.5%	38	-4	No Change
Missouri	$0.17	-12.3%	-11.3%	39	+5	No Change
Vermont	$2.24	-16.9%	4.5%	40	-10	+25%
Idaho	$0.57	-19.9%	-6.0%	41	-2	No Change
Nevada	$0.80	-20.0%	4.8%	42	-13	No Change
Wyoming	$0.60	-20.4%	-0.6%	43	-7	No Change
West Virginia	$0.55	-20.8%	-8.4%	44	-2	No Change
Delaware	$1.60	-23.0%	-61.5%	45	+2	+191%
Virginia	$0.30	-24.7%	-23.5%	46	-1	No Change
New Hampshire	$1.68	-26.8%	-29.7%	47	-1	+110%
Alaska	$2.00	N/A	N/A	N/A	N/A	+25%
Hawaii	$3.20	N/A	N/A	N/A	N/A	+129%
North Carolina	$0.45	N/A	N/A	N/A	N/A	+50%
District of Columbia	$2.86	N/A	N/A	N/A	N/A	+186%

Note: Alaska, Hawaii, North Carolina, and the District of Columbia are not included in the study. Cigarette tax rates have changed for some states since 2011.
Source: Mackinac Center for Public Policy; Tax Foundation.

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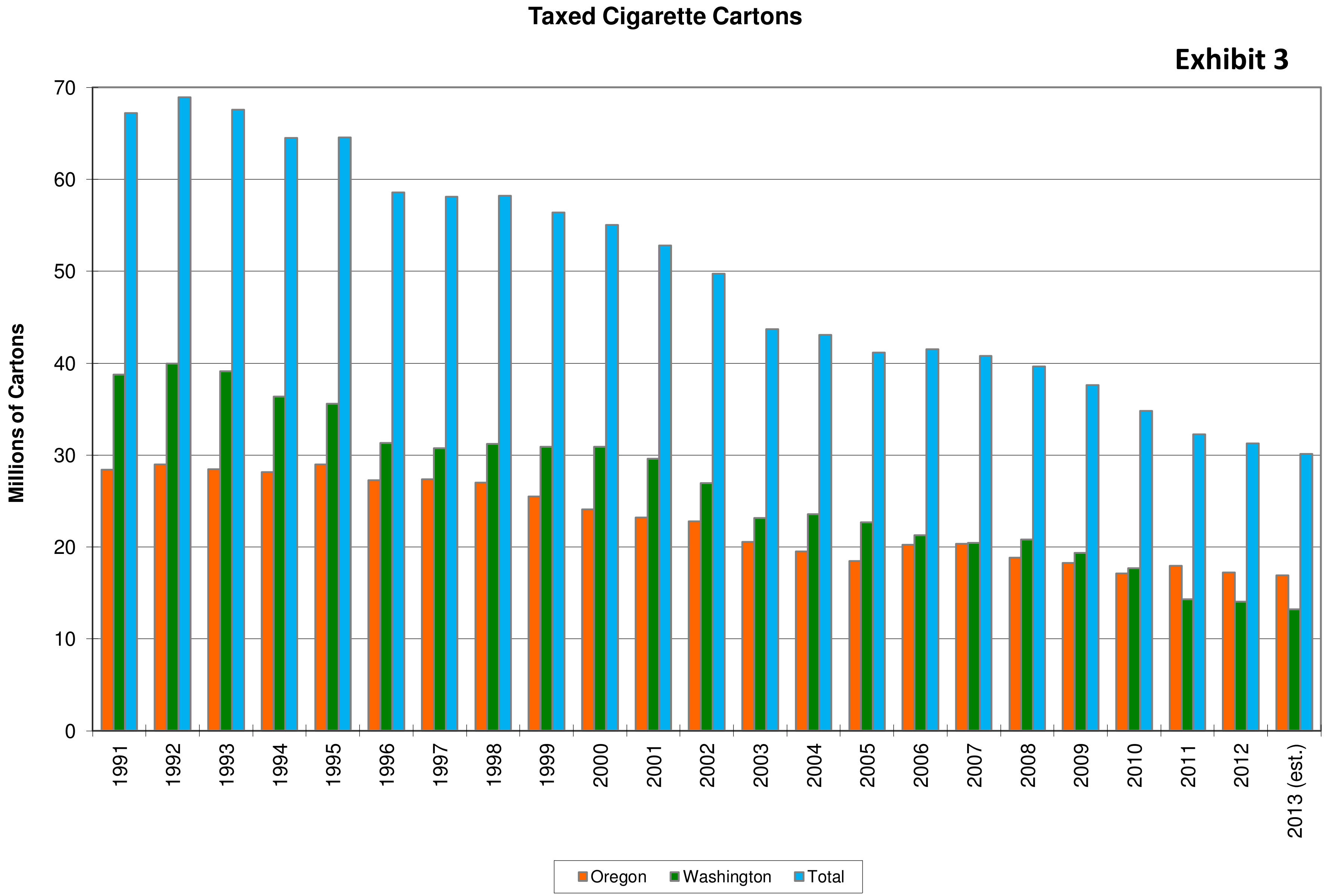
About the Tax Foundation
The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

Exhibit 3



Taxed Cigarette Cartons
Millions of Cartons
0
10
20
30
40
50
60
70
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013 (est.)
Oregon
Washington
Total