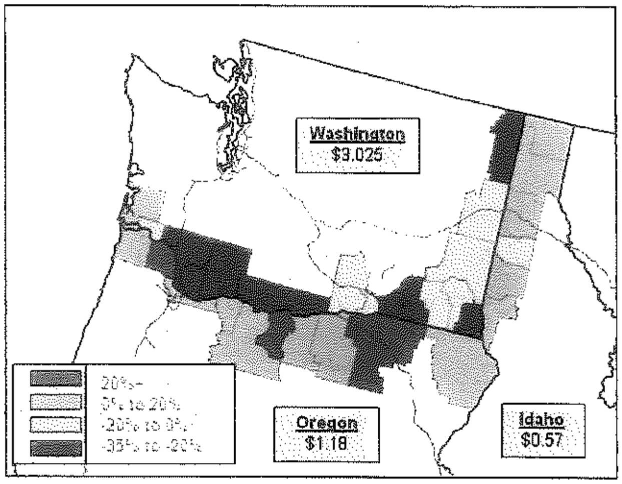
Washington Cigarette Excise Tax:
Cross-Border Purchasing Impacts Retailers

Washington State's increase in state cigarette excise tax has hurt retailers in a time of economic difficulty. States should carefully weigh the effects an increase in the cigarette SET can have on retailers.

On May 1st 2010, Washington increased the cigarette SET by **$1.00 to $3.025**, an **increase of 49%**. Due to this increase, Washington now has a higher cigarette SET than its two bordering states; Idaho and Oregon. The effect of this higher SET is that border counties within Washington have suffered a significant decline in cigarette sales volume which has hurt retailers.

73 weeks following SET increase vs. 73 weeks preceding SET increase[1]

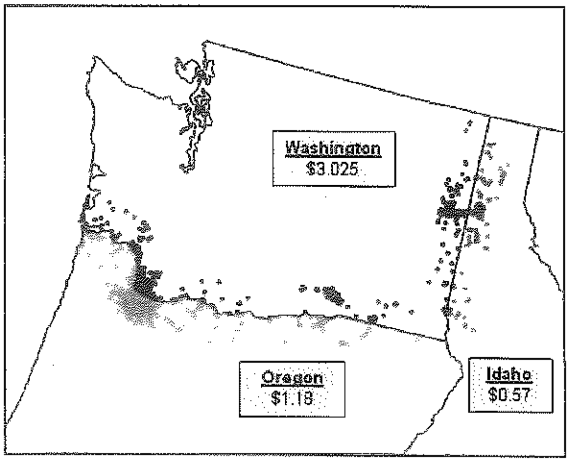
Border Counties	Volume Change (Packs in Thousands)	Volume Change (Percent)	Equivalent SET Revenue[2]
Oregon (6)	13,182.7	+17.3%	$15,555,619
Idaho (10)	3,840.1	+14.2%	$2,188,868
Washington (14)	-10,210.8	-21.8%	($20,676,787)



There are **1,010** Washington retailers who sell cigarettes within 25 miles of the border.[3] Many consumers make purchasing decisions based on the best price. The resulting price differentials between Washington and its neighbors could provide incentives for adult cigarette consumers to cross the border to buy cigarettes. This cross-border purchasing undermines the stability of this revenue source and may be harmful to retailers. The impact of this purchasing shift on retailers becomes even more pronounced when tobacco purchases are bundled with other products, such as gasoline and groceries.

- Retailers within Washington border counties saw an overall **decrease of 21.8%** in cigarette pack volume in the 17 months following the SET increase compared to the 17 months immediately preceding the increase.[4]

- According to the National Association of Convenience Stores, cigarette sales account for **35.9%** of total in-store sales for retailers[5]



[1,3,4] ALCS STARS Database as of 10/29/2011

[2] SET Revenue calculated by Multiplying SET by change in number of packs. Note: for Washington, the SET Revenue is based on the pre-SET increase rate ($2.025 per pack). This calculation does not consider any volume or SET revenues beyond the stated change in volume.

[5] State of the Industry: Convenience Store Totals, Trends & Averages, NATIONAL ASSOCIATION OF CONVENIENCE STORES, 2010.

The Economic Impact of Local Cigarette Taxation on Oregon State Cigarette Revenues

The legislature is considering various proposals that would allow Oregonian localities to tax cigarettes. This change would likely result in lower state cigarette tax revenues. Oregon tax-paid sales could fall due to:

- **Fewer purchases from Washington consumers escaping their state's high-tax rates.** Oregonian merchants on the Washington border sell a considerable number of cigarettes to Washington residents thanks to a large comparative tax advantage over their Washington rivals. The Washington State cigarette excise tax is $3.025 per pack compared with the Oregon tax of $1.18. Oregon merchants also benefit from the state's lack of a sales tax. We estimate that 16% of all Oregon tax-paid cigarette sales come as a result of this cross-border dynamic.

  If just a few key counties around the Portland area imposed a new local tax it is likely that many Washington shoppers could reduce their tobacco business with Oregon. If so Oregon could lose state tax cigarette excise revenue from its $1.18 cigarette tax.

- **Oregon residents along the border shopping in low-tax states such as Idaho (57-cents per pack), Nevada (80-cents per pack) and California (87-cents per pack).**

- **A general fall in demand for Oregon tax-paid cigarettes.**

By opening the door to local taxation, Oregon would effectively lose control over the tax base. The "tail would be wagging the dog," as changes made at the local level would come at the expense of the state of Oregon. Local taxation can create a feeding frenzy of sorts as localities seek to capture more revenue for themselves at the expense of the state. In Virginia, where local cigarette taxation is allowed, just 4 cities (Hampton, Newport News, Norfolk, and Virginia Beach) raised cigarette taxes 16 times between 2000 and 2012.

The state of Oregon earmarks much of its tax revenue. **For each state cigarette excise dollar lost to as a result of local taxation**:

- Nearly 73-cents would be taken out of the Health Plan;
- Nearly 19-cents would be lost from the state General Fund;
- Nearly 3-cents would be taken from tobacco cessation programs;

- And, ironically, approximately 4-cents would be taken out of funds dedicated to city and county governments. Senior and disabled transit funds would lose 2-cents on each dollar lost to the state.[1]

The Impact of Limited Local Cigarette Excise Tax Adoption along the Washington Border

While opening the door to local cigarette taxation offers a variety of possible scenarios, this scenario assumes that only the counties in the populous Portland area (Clackamas, Multnomah, and Washington) take advantage of the option. Oregon state cigarette revenues would fall since some Oregon consumers would reduce their consumption. In addition, some Washington shoppers may reduce their purchases in Oregon due to the higher local tax and the inconvenience of traveling to another Oregon county.

In FY2012 Oregon tax-paid per capita sales (44.0 packs) were 116% greater than such sales in Washington (20.3 packs). This has occurred even though adult smoking prevalence in Oregon (19.7%) is relatively close to the same measure in Washington (17.7%). This suggests that Oregon merchants sell a considerable amount of tobacco products to Washington consumers. Most likely the largest portion of such activity takes place in the relatively populous Portland-Vancouver area. It is estimated that approximately 20-million packs of cigarettes are sold by merchants in the tri-county area (Clackamas, Multnomah and Washington counties) to out-of-state customers.[2]

For every 20-cents worth of local tax in the three counties, we estimate that **Oregon would lose approximately $2 million in state excise tax revenue.**[3] Thus, a 60-cent local tax, for example, would mean a $6 million loss to the Oregon state treasury.

The Impact of Broad-based Adoption of Local Cigarette Excise Taxes

Assuming that all Oregon counties adopt a local cigarette tax, Oregon tax-paid sales would fall as the tax advantage with Washington diminishes and consumers seek lower priced product in low-tax neighboring states on the

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[1] Oregon Legislative Revenue Office, 2013 Oregon Public Finance Basic Facts, Research Report #1-13, 21 February, 2013. Online at: http://www.leg.state.or.us/comm/lro/2013BasicFacts.pdf. Oregon's OTP tax is also earmarked, though less heavily than the cigarette tax.

[2] While Oregon tax-paid per capita sales were 44 packs in FY2012, we estimate that approximately 16% of tax-paid sales are "exports" to Washington. This makes the resident per capita sales equal to 37 packs, and exported per capita sales about 7 packs. The number of exported packs in the tri-county area would be higher due to its proximity to Washington. Its export share is estimated at about 25% of all tax-paid sales, or about 20 million packs.

[3] The current excise and sales tax difference advantage with Washington is $2.35 per pack. Every 20-cent increase reduces this advantage by 8.5%, or in pack terms 1.7 million packs. However, we assume other Oregon counties would capture 50% of this business so the loss to the state would 850,000 packs. In addition some Oregonians may consume less and we use a standard consumption elasticity (.4) to derive another 810,000 packs. Thus the total Oregon pack loss would be about 1.7 million packs, which equal to approximately $2 million in state excise tax revenues.

southern and eastern borders. For every 20-cents worth of tax (assuming all counties tax equally):

- **Oregon would see state cigarette excise taxes fall 3.6%, or by 6.2 million packs.**

- **Oregon would lose $7.3 million in state excise tax revenues.** The Health Plan would lose $5.3 million for each 20-cents worth of local tax assessed.

OREGON – CIGARETTE TAX RECEIPT HISTORY

Receipts based on fiscal years concluding June 30

1990 / 1991	$79,578,151	
1991 / 1992	$81,092,627	1.90%
1992 / 1993	$79,630,393	(-1.80%)
1993 / 1994[1]	$95,224,881	19.58%
1994 / 1995	$110,062,143	15.58%
1995 / 1996	$103,676,786	(-5.80%)
1996 / 1997[2]	$138,247,338	33.34%
1997 / 1998	$183,510,680	32.74%
1998 / 1999	$173,400,494	(-5.51%)
1999 / 2000	$163,960,272	(-5.44%)
2000 / 2001	$157,909,508	(-3.69%)
2001 / 2002	$154,981,172	(-1.85%)
2002 / 2003[3]	$221,962,038	43.22%
2003 / 2004[4]	$240,069,021	8.16%
2004 / 2005	$217,784,751	(-9.28%)
2005 / 2006	$238,695,926	9.60%
2006 / 2007	$240,164,142	0.62%
2007 / 2008	$222,203,100	(-7.48%)
2008 / 2009	$215,331,515	(-3.09%)
2009 / 2010	$201,863,281	(-6.25%)

1 Tax rate increase from $0.28 to $0.33 November 1, 1993 and from $0.33 to $0.38 January 1, 1994
2 Tax rate increase from $0.38 to $0.68 effective February 1, 1997
3 Tax rate increase from $0.68 to $1.28 effective November 1, 2002
4 Tax rate decreased from $1.28 to $1.18 effective January 1, 2004 (BM #30)

2010 / 2011	$211,645,072	
		4.84%
2011 / 2012	$203,486,635	
		(-3.85%)
July – December 2012	($104,153,686)	

Other Tobacco Products Tax

2001/02	**$20,053,176**
2002/03	**$20,933,588**
2003/04	**$25,278,884**
2004/05	**$25,961,261**
2005/06	**$31,226,297**
2006/07	**$30,936,052**
2007/08	**$32,755,866**
2008/09	**$32,873,951**
2009/10	**$37,390,367**[5]
2010/11	**$51,154,246**
2011/12	**$52,167,233**
July – December	**($30,646,220)**

Tax rate modified for moist snuff to $1.78 / ounce (HB 2672)