plaid pantry
convenience stores
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February 11, 2014

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 Jesica Vega Pederson

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

Dear Chair Barnhart and Vice-Chairs Bailey and Berger:

Plaid Pantry owns and operates 108 convenience stores in the Northwest, with the majority of our stores being here in Oregon. We have been locally owned and operated for over 50 years and we employ over 700 Oregonians. Plaid is also a member of the Oregon Neighborhood Store Association (ONSA), which provides legislative and regulatory representation for Oregon's 2,900 smaller, mostly family-owned and operated convenience food stores.

Tobacco revenue is a critical revenue stream for the State. Cigarette taxes, other tobacco product taxes, and Master Settlement Agreement payments total $334 million annually; 50% more than the annual liquor revenue from OLCC. But tobacco revenue is a declining and fragile revenue stream that calls for delicate management. More than doubling the current tax will severely damage this revenue source and will not produce near the incremental revenue expected. Plaid and ONSA oppose HB 4129 and its $1.50 per pack state excise tax increase on cigarettes as well as the additional taxes on electronic cigarettes and cigars. Such a huge increase would be devastating for small businesses, harmful to retail workers' jobs, pay, and benefits, and very bad for a minority of consumers.

1. **More than doubling 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.

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

Very high cigarette taxes 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 1). Most recent data reports the fact that smuggling rates rise in States after they adopt large cigarette tax increases.

3. **<u>Higher cigarette taxes will decrease significant cross-border cigarette purchases and tax revenues from Washington consumers.</u>**

Washingtonians avoid/evade taxes on a quite astonishing 48.5% of cigarettes consumed (Exhibit 1), which represents 135 million untaxed packs annually. Data indicate that about 47 million of these packs are purchased in Oregon. This amounts to over $62 million in Oregon tax revenue currently 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 $2.67 in non-tobacco products per pack of cigarettes.

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

In 2013, nationwide consumption of cigarettes averaged 48 packs per year per-capita. Oregon taxable cigarette sales in 2011 were 42 packs per-capita, while Washington collected taxes on only 19 packs per-capita. Oregon collected tax on 168 million packs with a population of 4 million while Washington collected tax on only 135 million packs with a population of 7 million. Washington's incidence of smoking is not half that of Oregon.

5. **<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 two primary factors affecting the reduced expected tax revenue from Oregon 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>

Cross-border sales are very sensitive to the tax differential. Raising Oregon's cigarette tax $1.50 per pack to $2.81 would narrow the cross-border gap to only 22 cents per pack . This means that 88% of the current price gap would be closed, resulting in the loss of approximately 40 million Oregon taxable packs (4 million cartons) formerly sold to Washington consumers.

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

Oregon cigarette excise tax receipts for the first half of fiscal year 2013/14 indicate an expected 162 million taxable packs (16.2 million cartons) for the full year. Subtracting the cross-border loss of 40 million packs leaves 122 million packs (12.2 million cartons) subject to increased tax avoidance/evasion due to the proposed tax increase. Oregon stands to lose an additional 28 million packs from tax avoidance and evasion based on the experience from our neighbor to the

North. Washington's $1.00 per pack increase in 2010 resulted in a 23% decrease in taxable sales. Conservatively, if an increase of $1.50 in Oregon has the same 23% loss effect, Oregon will lose 28 million taxable cartons (.23 x 122 million).

The combined effect of the two major factors will leave less than 100 million packs (9.4 million cartons) available to be taxed in the future (162 – 40 – 28 = 94). With taxable packs being reduced to less than 100 million, we can only expect $52 million from the new tax ((94 x $2.81 = $264) – (162 x $1.31 = $212) = $52). But this would be more than offset by reductions in consumer spending in other areas caused by such a punitive additional tax, and the devastating effect on legitimate small businesses and their employees.

The average retail price of a pack of cigarettes today is $5.41, and with the aforementioned additional non-tobacco sales of $2.67 per transaction, the average tobacco customer transaction amounts to $8.08. This proposed tax increase will wipe out 68 million legal pack transactions between legitimate businesses and law-abiding customers, and will transfer $550 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.

6. **Underlying Trend Loss to Un-Taxed, Lower-Taxed and Alternative Products**

Aside from the effects of the currently proposed tax increase, cigarette taxes are a declining revenue source. Twenty years ago Oregon collected taxes on nearly twice the number of cigarettes as today. Taxable cigarette volumes have a well-established and predictable 3.5% annual trend decline. Even with no changes in the current tax structure we can be certain of an underlying decrease of about six 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.

7. **Higher cigarette taxes hurt Oregon small businesses and Oregon's economy.**

Higher cigarette taxes don't hurt "Big Tobacco" as much as they hurt consumers and small businesses. Oregon retailers collect $1.01 per pack of cigarettes in Federal excise taxes. Oregon retailers also collect $1.31 per pack in Oregon excise taxes. By comparison, a retailer realizes only about $0.65 in gross margin on the sale of a pack of cigarettes and wholesalers realize only about $0.10. Retailers also realize about a 30% margin on the $2.67 non-tobacco purchase that goes with it, or $0.80 in additional margin. Most of this $1.55 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 in the form of wages and employee benefits. Plaid and similar small retailers spend most of what is left with many hundreds of companies, mostly Oregon small businesses, which provide maintenance, repairs, supplies, transportation, and other services to our retail operations. Businesses then pay income taxes on what is left, and retain only a very small percentage. Retailers staff their stores based on sales volumes. When sales go down, employers have no choice but to cut hours, eliminate jobs, and reduce other expenses.

Combining direct tobacco margin dollars, plus margin on complimentary sales, a total of $105 million ($1.55 margin x 68 million lost packs), more than double the expected incremental tax revenue of $52 million, is destroyed. This beneficial economic activity is transferred to illegal tax evasion entrepreneurs, creating liabilities for the State to be made up in unemployment payments, SNAP benefits, and Oregon Health Plan benefits formerly paid by private employers. Oregon stands to lose net revenue in the tens of millions of dollars, after the carnage inflicted upon employees, customers, and law-abiding owners of small businesses. A loss of $105 million in gross income primarily hitting Oregon's 2,900 convenience stores would be enough to cause literally hundreds of these mostly small family stores to go out of business.

8. **The proposed tax on Electronic Cigarettes will price these less harmful products out of the market**

The proposed tax on electronic cigarettes of 87% will almost double the current average retail price of $9 for a two pack equivalent product. From an economic point of view this will raise very little tax revenue as we expect the tax to eliminate most current sales and curtail any growth. From a social point of view, pricing a less harmful product that Oregonians are using to reduce their personal health risk out of their price range does not make sense.

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. The State should not establish programs that rely on funding that will not be realized.

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

TAX FOUNDATION Since 1937

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

[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

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