



# Pricing Policy

a Tobacco Control Guide

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Tobacco Control  
Legal Consortium



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Systems Science

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GEORGE WARREN BROWN  
SCHOOL OF SOCIAL WORK

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Laura Brossart, Sarah Moreland-Russell, Heidi Walsh, Anne Wachtel, Laura Edison, Laura Bach, Sarah Schell, Kendre Israel, Anneke Mohr, Jennifer Cameron, Douglas Luke

## Valuable input was provided by:

Ann Boonn, Campaign for Tobacco-Free Kids  
Kerry Cork, Tobacco Control Legal Consortium  
Maggie Mahoney, Tobacco Control Legal Consortium  
Kurt Ribisl, University of North Carolina Gillings School of Public Health

## Valuable input for the case studies was provided by:

Russ Sciandra, American Cancer Society  
Jeff Willett, Kansas Health Foundation (formerly with New York State Tobacco Control Program)

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# Guide to the Reader

## Purpose

The purpose of this guide series is to assist state and local tobacco control staff in building effective and sustainable comprehensive tobacco control programs. Each guide will address particular strategies and interventions that are part of state and local tobacco control programs and that have strong or promising evidence supporting their effectiveness.<sup>1</sup>

## Content

This guide focuses on the role pricing policies can play as part of a comprehensive tobacco control program. Raising the cost of tobacco products is the single most effective method for decreasing smoking prevalence and initiation, reducing consumption, and encouraging cessation.<sup>2</sup> Policies that effectively raise the cost of tobacco products include excise tax increases, non-tax price-related policies, and enforcement measures. Implementation of these policies reduces the social acceptability of tobacco use and strengthens the fight against pro-tobacco influences. This guide will provide tobacco control partners with information on developing and implementing pricing policies as part of a comprehensive tobacco control program.

## Organization

This guide is organized into seven sections:

- ▶ **Making the Case** – a brief overview of how tobacco control efforts benefit from implementing pricing policies
- ▶ **A Brief History** – how pricing policies have been used in tobacco control
- ▶ **How to** – ways to implement pricing policies
- ▶ **Providing Support** – how state tobacco control programs can support efforts to implement pricing policies
- ▶ **Case Studies** – real world examples of how to implement pricing policies or improve existing policies
- ▶ **Conclusion: Case for Investment** – information needed to raise awareness of the effectiveness of pricing policies
- ▶ **Resources** – publications, toolkits, and websites to help in planning efforts

## Why Implement Pricing Policies?

Policies that raise the price of tobacco products and prevent tobacco tax evasion (e.g., excise tax increases, non-tax pricing policies, and enforcement measures) are essential components of a comprehensive tobacco control program. Implementation of these policies reduces the affordability of tobacco and can also generate revenue to fund comprehensive tobacco control programs, improving states' and communities' ability to counter pro-tobacco influences. Though some states and localities have achieved higher taxes, low tax rates in other states create price differences that can encourage cross-border smuggling.<sup>2</sup> Low-tax areas also have higher smoking rates.<sup>3</sup> In addition, some Tribal lands provide access to untaxed cigarettes in retail outlets and via the Internet.<sup>4</sup> As compared to cigarettes, low tax rates on other tobacco products (OTPs) are also a concern, because their use is becoming more common in the U.S. The tobacco industry also utilizes price discounts to reduce the success of tobacco taxes. These issues highlight the need for increases in pricing policies across products and communities. Benefits of these policies include:

- ▶ **Pricing policies reduce overall tobacco use.** Raising the price of tobacco products improves public health outcomes by preventing initiation, reducing consumption, encouraging cessation, and preventing relapse.<sup>5,6</sup>
- ▶ **Pricing policies reduce tobacco-related health care costs.** Pricing policies are proven to decrease tobacco use prevalence and prevent initiation.<sup>5,6</sup> This reduces tobacco-related illness, saving states millions of dollars in tobacco-related health care costs.<sup>12</sup>
- ▶ **Pricing policies generate revenue for states.** Every significant increase in federal and state cigarette taxes has resulted in a substantial increase in cigarette tax revenues.<sup>7,8</sup> States that effectively implement pricing policies and allocate revenues to tobacco control efforts are able to fund more programs to fight pro-tobacco influences and promote cessation.
- ▶ **Pricing policies prevent youth initiation.** While price increases have an effect on adult smokers, they have an even greater effect on youth smokers, because youth typically have smaller incomes and are more sensitive to changes in price. Pricing policies reduce the likelihood that youth will start smoking or become daily smokers.<sup>9-11</sup>
- ▶ **Pricing policies garner strong public support.** Public support for cigarette tax increases and other pricing policies is strong across regions, political parties, and demographic groups. Polls have shown that people want a portion of the revenue generated from tax increases to be used to fund tobacco control efforts.<sup>13</sup> In fact, ballot measures that devote a substantial portion of the revenues to tobacco control activities are more likely to pass than those that give priority funding to medical services.<sup>14</sup>

# A Brief History

Taxation of tobacco products has been a reliable source of revenue in the U.S. since colonial times.<sup>15</sup> Over the years, the rationale for tobacco taxation and other pricing policies has expanded from simply a way to raise funds to a highly effective tobacco control strategy that reduces initiation and encourages cessation.<sup>15</sup>

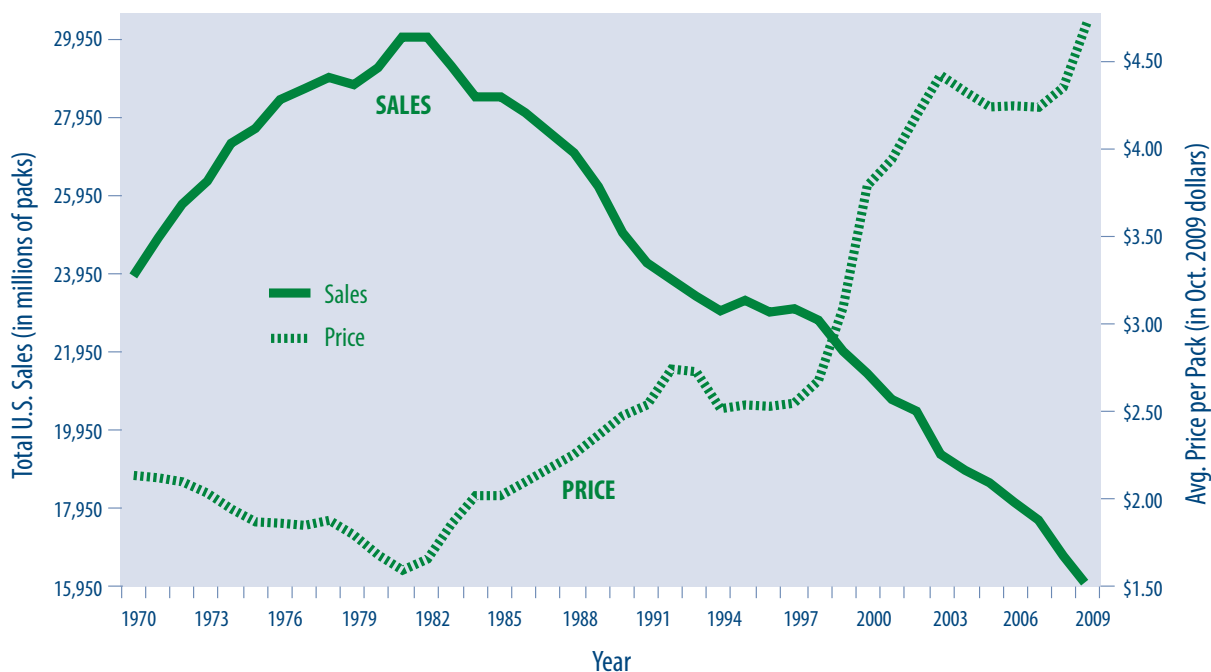
The first state cigarette tax (\$0.02) was passed in Iowa in 1921, and the first state tax on other tobacco products (OTPs) was passed two years later.<sup>16</sup> As evidence of the negative health consequences of smoking emerged in the 1950s and 1960s, many states began to realize that small increases in their tobacco taxes enhanced their efforts to curb usage.<sup>5</sup> As tobacco became more expensive, individuals purchased less. Since 1970, all states have imposed a cigarette tax. As of 2013, all states also tax OTPs except Pennsylvania, where the only OTP taxed is little cigars.<sup>16,17</sup> In recent decades, pressure from public health groups has resulted in further tax increases.<sup>18</sup> A 1988 ballot initiative in California increased the cigarette excise tax by \$0.25 per pack and allocated 20% of the revenues for tobacco control. In 1997, Alaska became the first state to reach the \$1.00 per pack threshold.<sup>19</sup>

As of 2013, 14 states, Washington, D.C., Puerto Rico, and Guam had state cigarette excise tax rates of at least \$2.00 per pack, meeting the *Healthy People 2010*

goal.<sup>20,21</sup> New York leads this group with a \$4.35 per pack tax.<sup>20</sup> *Healthy People 2020* recommends that each state increase its taxes by at least \$1.50 per pack.<sup>22</sup> While not all local governments have the authority to implement a cigarette tax, many have been able to layer significant local taxes on federal and state taxes. Excise tax rates in New York City, Chicago, and several Alaskan cities are among the highest for local governments.<sup>23</sup> In 2013, New York City set the minimum price for cigarettes and 20-pack little cigars at \$10.50, as well as increasing penalties for retailers who evade tobacco taxes.<sup>24</sup> Significant progress has also been made at the federal level. In 2009, the federal excise tax on cigarettes increased from \$0.39 to \$1.01 per pack.<sup>2</sup> Small cigars and roll-your-own (RYO) tobacco are now taxed at an equal rate to cigarettes at the federal level.<sup>25</sup>

Despite the recent success of some states and localities in achieving higher taxes, the persistence of low tax rates in other states creates dramatic price differences that can encourage cross-border smuggling.<sup>2</sup> These low-tax regions also experience higher smoking rates.<sup>3</sup> Because the use of OTPs is on the rise in the U.S., low tax rates on OTPs (as compared to cigarettes) are also concerning. In addition, the tobacco industry uses price discounting to reduce the success of tobacco taxes. These conditions all highlight the need for increases in pricing policies across jurisdictions and products.

## Impact of Cigarette Price Increases on U.S. Cigarette Sales (1969-2009)



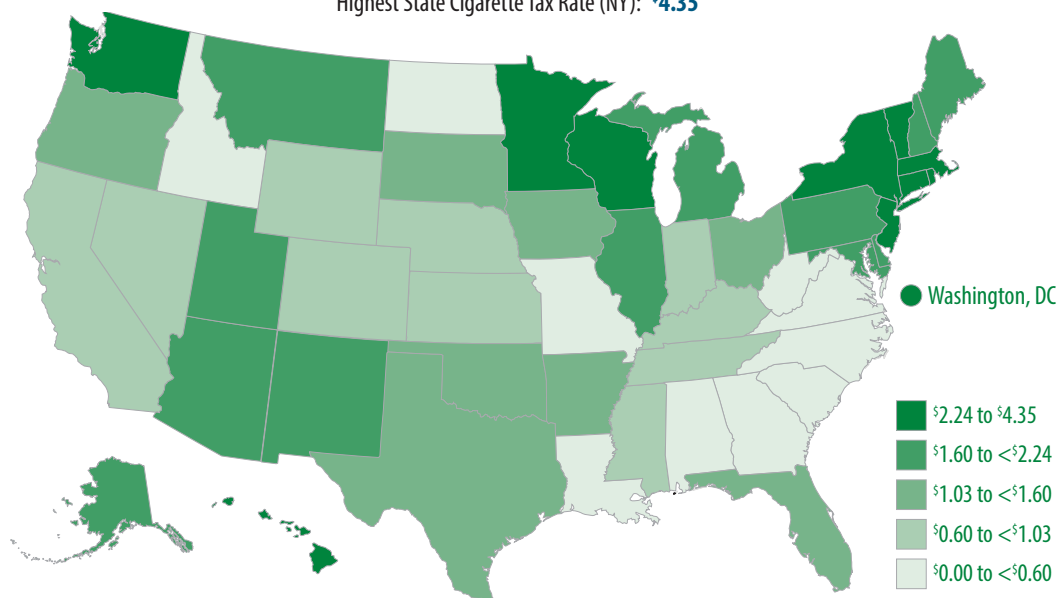
Sources: *Cigarette Smoking Prevalence and Policies in the 50 States: An Era of Change—The Robert Wood Johnson Foundation Impact Teen Tobacco Chart Book*,<sup>26</sup> *Tax Burden on Tobacco*,<sup>16</sup> and *Pricing Strategies for Tobacco, Healthy Eating, and Physical Activity*<sup>27</sup>

# How to: Implementing Pricing Policies

## State Cigarette Tax Rates

(per pack of 20 cigarettes, as of November 1, 2013)

Average State Cigarette Tax Rate: **\$1.53**  
Lowest Cigarette Tax (MO): **\$0.17**  
Highest State Cigarette Tax Rate (NY): **\$4.35**



Source: Campaign for Tobacco-Free Kids, 2013<sup>28</sup>

## Implementing Pricing Policies

Research demonstrates that raising the price of tobacco products, either by increasing taxes and manufacturers' prices, implementing retail policies that keep the price of products high, or improving enforcement, leads to a reduction in tobacco use.<sup>29</sup> Price hikes provide a financial incentive for smokers to quit, discourage youth from starting to smoke, and generate revenue that can help fund comprehensive tobacco control programs.<sup>5,6,18</sup>

Implementation of pricing policies can take place at the local, state, and federal levels. Pricing policies have strong public support<sup>13</sup> and are relatively simple to implement. Tobacco control partners can play a major role in the development of pricing policies, which are a key part of comprehensive tobacco control programs. Depending on state or community readiness and capacity, various approaches can be used to implement pricing policies. These include:

- Educating decision makers;
- Developing partnerships with local, state, and national coalitions;
- Closing loopholes in existing policies;
- Countering pro-tobacco influences; and
- Improving enforcement.

Since 2002, 47 states, Washington, D.C., and several territories have increased their cigarette tax rates more than 105 times.<sup>20</sup> At least five of these increases occurred through ballot measures.<sup>13</sup> Though it can be difficult, costly, and is not an option in all states, introducing ballot measures can give tobacco control partners an opportunity to build a broad base of public support. Because laws passed via ballot measure often cannot be changed for a period of time, technical assistance providers recommend carefully preparing before pursuing ballot measures. A ballot measure can provide a perfect opportunity to strengthen definitions, link taxes on OTPs to cigarette taxes, increase penalties and fines, and fund enforcement. Research shows that successful tax ballot initiatives feature:<sup>14</sup>

# How to: Determining and Prioritizing Options

- A strong base of public support before the campaign;
- Effective engagement of grassroots partners;
- A campaign that is framed to provide clear justification for a tobacco tax increase; and
- Allocation of significant funds for tobacco control.

States that effectively implement pricing policies improve public health outcomes through decreased consumption, increased cessation, and reduced initiation. In addition, every significant increase in federal and state cigarette taxes has resulted in a substantial increase in revenues.<sup>7,8</sup> These revenue gains significantly outweigh losses from the reduced number of packs sold.<sup>8</sup> Price increases work best when tax revenues provide sustained funding for tobacco control programs that include 100% smoke-free policies in workplaces and public places, hard-hitting earned and paid media campaigns, and evidence-based cessation services.<sup>31,32</sup> The use of revenues to fund these components of a comprehensive tobacco control program contributes to program sustainability.

## Determining and Prioritizing Options

Pricing policies fall into two categories: tax-related (e.g., increasing tobacco product taxes) and non-tax price-related (e.g., implementing or increasing licensing fees, implementing minimum price laws, banning price discounting/multi-pack offers, and taking steps to prevent and reduce tobacco product tax evasion). Because tax-related policies are the most effective way to decrease consumption,<sup>5</sup> tobacco control programs should first focus their efforts on increasing taxes on all tobacco products. Tobacco control partners can also work to implement non-tax price-related policies and close existing loopholes, especially for communities that lack taxing authorities or are faced with strong opposition to tax increases.

### TAX-RELATED POLICY OPTIONS

Increasing tobacco taxes has strong public support, because it is seen as an acceptable way to generate

### What Are Other Tobacco Products (OTPs)?

OTPs are all products other than cigarettes that contain tobacco. Examples of OTPs:

- ▶ **Little cigars** are rolls of tobacco, wrapped in leaf tobacco or in any substance containing tobacco, that weigh less than three or four pounds per thousand. Little cigars are frequently manufactured and branded to be almost indistinguishable from cigarettes.
- ▶ **Large cigars** are rolls of tobacco, wrapped in leaf tobacco or in any substance containing tobacco, that weigh more than three or four pounds per thousand.
- ▶ **Loose tobacco** is used for roll-your-own (RYO) cigarettes, traditional pipes, and water pipes (hookahs).
- ▶ **Smokeless tobacco products** include snuff (finely ground tobacco that can be dry, moist, or in bag-like pouches) and chewing tobacco (available in loose leaf, plug, or twist form).
- ▶ **Low-weight smokeless tobacco products** are smokeless tobacco products that come in single-dose units (e.g., Snus, Ariva or Stonewall Dissolvable Tobacco; and Camel Orbs, Strips, and Sticks).





# How to: Determining and Prioritizing Options

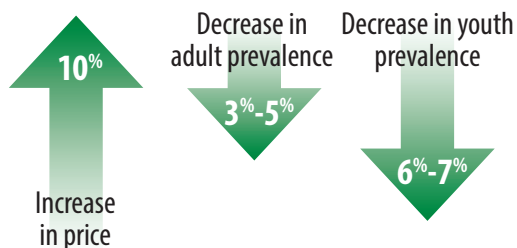
tax revenue while also improving health.<sup>13</sup> Taxes on tobacco products can be implemented at the state and federal levels, and in some instances at the local level,<sup>2</sup> and can be applied in a number of ways, including: 1) per item or pack, 2) as a percentage-of-price, 3) as a percentage of weight, and 4) as a percentage-of-price with an additional minimum tax based on weight or dose. While most tobacco tax increases are implemented at the state level, many local communities have also raised tobacco product taxes. Tax increases have the greatest potential impact when they are large and when taxes for different tobacco products are implemented simultaneously. When implementing tax increases, it is important to:

- Impose similar tax rates on all tobacco products;
- Complement state tax increases with local tax increases (where allowed); and
- Dedicate a portion of revenue to tobacco control.

## Cigarette Taxes

Raising the price of cigarettes by applying state excise taxes increases state revenues and reduces smoking rates.<sup>8</sup> The general consensus from research shows that a 10% price increase reduces adult smoking prevalence by 3%-5%, and reduces youth smoking prevalence by 6%-7%. Low-income adult smoking rates, as well as Hispanic, African American, and male smoking rates, would likely experience even sharper declines. The same price increase also reduces the number of pregnant women who smoke by 7%.<sup>31,32</sup>

### Effects of Cigarette Price Increases on Smoking Prevalence



Cigarettes are taxed at the federal, state, and local level on a per pack basis. As of 2013, the federal cigarette tax is \$1.01/pack. State cigarette taxes range from a low of

\$0.17/pack (Missouri) to a high of \$4.35/pack (New York). More than 460 jurisdictions also apply their own local cigarette taxes.<sup>34</sup> As of 2013, the highest combined state-local tax rate is \$5.85 in New York City.<sup>34</sup>

The Institute of Medicine's Committee on Tobacco Use recommends that both state and federal taxes be indexed to inflation.<sup>35</sup> Adding an inflation adjustment (a per pack tax linked to the Consumer Price Index) would help avoid erosion of the impact of the tax over time and help maintain tobacco-related revenues as cigarette consumption decreases.<sup>36</sup> While a handful of states have considered this strategy, as of 2013 only Minnesota has actually implemented a yearly inflation adjustment to its state cigarette tax.<sup>37</sup>

## Cigar Taxes

While cigarette smoking has declined over recent years, cigar use has dramatically increased, especially among youth.<sup>38</sup> This is partly due to the lower rate at which cigars are taxed by almost every state.<sup>39</sup> In fact, as of 2013, three states still have very limited cigar taxes: Florida does not tax cigars at all; Pennsylvania does not tax large cigars; and New Hampshire does not tax premium cigars.<sup>40</sup> The undertaxation of cigars may increase the numbers of youth who try cigars and may also prompt adult smokers who might otherwise quit smoking cigarettes to turn to less expensive cigars. In addition, some cigarettes slip through loopholes in state tax law definitions to qualify as "little cigars" or "filtered cigars" and therefore face lower tax rates. States can take several steps to prevent smokers from switching to less expensive cigars, prevent youth initiation, and increase state tax revenues. These include:<sup>40</sup>

- **Matching the state's cigar tax rate, for both large and small cigars, to the cigarette tax rate.** For example, a \$2.00-per pack tax on cigarettes is roughly equal to a 70% of wholesale price cigar tax. Little cigars in packs of 20 should be taxed at the same rate as cigarettes, or should be classified as cigarettes.
- **Raising the cigar tax rate when other tobacco product tax rates are increased.**
- **Setting the cigar tax rates to a percentage-of-price.** Unlike cigarettes that come in packs of 20, cigars

# How to: Determining and Prioritizing Options

come in different sizes and weights, with wide variation in the number of cigars per pack. A percentage-of-price tax ensures that all cigars, regardless of package size or weight, will be taxed at the same rate.

- **Eliminating caps on cigar tax rates.**

A cap on state cigar taxes (e.g., no more than \$1.00 per cigar) reduces the price for those who smoke the most expensive brands and results in a revenue loss for states.

## Roll-Your-Own (RYO) and Other Smoking Tobacco Taxes

Smoking RYO cigarettes is much cheaper than smoking cigarettes, due to lower taxes on RYO tobacco.<sup>41,42</sup> While the federal tobacco tax increases of 2009 brought the federal tax on RYO tobacco in line with the federal cigarette tax, pipe tobacco tax rates were left untouched. In reaction to the increases, several

### Strong Public Support for Tobacco Tax Increases<sup>13</sup>

- The public strongly supports increasing tobacco taxes, even in states that have recently implemented a tobacco tax increase.
- Minority and low-income groups strongly support tobacco tax increases, especially when revenues go to tobacco control efforts.
- A significant number of smokers support tobacco tax increases.
- Support for tobacco tax increases is strong regardless of amount. To meet the *Healthy People 2020* goal, each state should increase its tax by at least \$1.50 per pack.<sup>22</sup>
- There is strong support for using a portion of tobacco tax revenue to fund tobacco prevention and cessation efforts.

RYO companies relabeled their RYO tobacco as “pipe tobacco” in order to avoid paying the higher federal RYO tax rate.<sup>42</sup> As a result, in the year following the federal tax increases, nationwide RYO sales dropped by 61% while “pipe tobacco” sales increased by 233%.<sup>43</sup> In order to maximize state revenues and public health benefits, states should not only tax RYO tobacco at the same rate as cigarettes, but should also set similar taxes on pipe and other smoking tobacco. Some states have even considered a ban on RYO sales; as of May 2012, Vermont no longer allows any commercial RYO sales.<sup>44</sup> States can also take other steps to prevent smokers from switching to RYO cigarettes, including:<sup>41</sup>

- **Strengthening the state definition of RYO and smoking tobacco.**

A new definition could include “any loose tobacco sold for roll-your-own cigarettes or cigars or otherwise intended or expected to be smoked.” This would prevent RYO sellers from avoiding proper taxation by relabeling their RYO tobacco as tobacco for RYO cigars or pipes.

- **Matching the state’s RYO and smoking tobacco tax rate to the cigarette tax rate.**

For example, a \$2.00-per-pack tax on cigarettes is roughly equal to a tax of 70% of wholesale price RYO or smoking tobacco tax. In Illinois, RYO tobacco is taxed at the same amount as company-manufactured cigarettes.<sup>45</sup>

- **Establishing a minimum tax on RYO and smoking tobacco.**

To ensure that the “per cigarette” price of RYO tobacco equals the “per cigarette” price of regular cigarettes, states can add a minimum tax, based on weight, that takes into account the amount of RYO tobacco needed to make a pack of 20 cigarettes.<sup>41</sup>

## Smokeless Tobacco Product Taxes

As with cigarettes, raising the price of smokeless tobacco products through state tax increases or other means will likely prompt a reduction in smokeless tobacco use, especially among adolescents and young adults. One study found that a 10% increase in smokeless tobacco prices reduced adult consumption by 3.7% and reduced male youth consumption by 5.9%.<sup>46</sup> As of 2009, 15% of high school boys and 2.2% of girls nationwide used smokeless tobacco.<sup>47</sup> In West

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Virginia (where male teenagers are twice as likely to use smokeless tobacco as male teenagers in other states), a survey showed that an increase in smokeless tobacco prices would prompt more than half of the survey participants to quit.<sup>48</sup>

## Smokeless Tobacco Products

Smokeless tobacco products include all non-combustible products containing tobacco.

- ▶ **Moist snuff** is also known as dipping tobacco or chewing tobacco. It is a finely ground or shredded moistened tobacco product that is consumed by placing a chunk between the lip and the lower gum. Examples include Grizzly, Skoal, Copenhagen, and Longhorn tobacco.
- ▶ **Nasal snuff** is a finely ground or pulverized tobacco product that can be moist or dry. It is consumed by inhaling through the nose. Nasal snuff is commonly used in European countries.
- ▶ **Snus**, also known as Swedish snuff, is a moist powder tobacco product that comes in teabag-like pouches. It is consumed by placing it under the upper lip for extended periods of time. Examples include Camel and Marlboro Snus.
- ▶ **Dissolvable products** are lightweight, spitless, often prepackaged tobacco products that dissolve in the mouth. Examples include Camel Orbs, Sticks, and Strips, and Ariva and Stonewall Tablets.



Every state except Pennsylvania taxes smokeless tobacco products, though approaches vary. Most states use a simple percentage-of-price tax, with taxes ranging from 5% in South Carolina to 100% in Wisconsin.<sup>17,49</sup> A percentage-of-price tax establishes an identical percentage tax rate (or flat tax) for all the different types, brands, weights, and packages of smokeless tobacco. This type of tax keeps up with inflation and product pricing over time.<sup>50</sup>

Some states have implemented simple weight-based taxes for moist snuff and OTPs.<sup>49</sup> Tobacco manufacturers have promoted weight-based taxes because the more common percentage-of-price taxes can subject higher-priced products to higher per product taxes than brands with much lower prices.<sup>49</sup> The practice of using a simple weight-based tax has several problems:

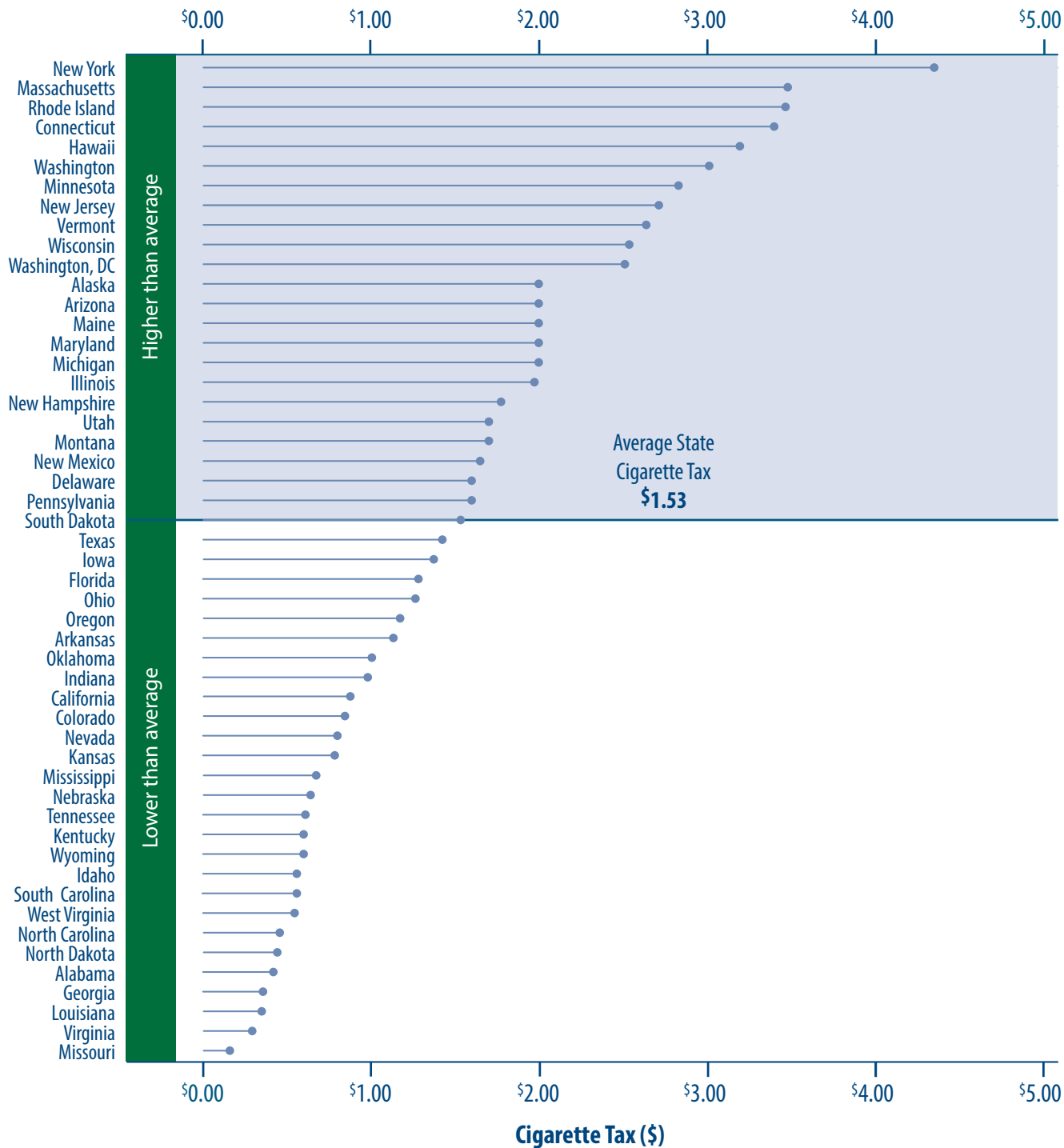
- A weight-based tax will not keep up with inflation or product price increases. As a result, a weight-based tax will erode over time, bringing states lower revenue than percentage-of-price taxes.<sup>49</sup>
- A weight-based tax results in the undertaxation of the new generation of super lightweight tobacco products, thereby reducing state revenue. Low-weight, pre-packaged products (e.g., UST's Skoal Dry; Philip Morris's Marlboro Snus; and RJ Reynolds Camel Snus and Camel Dissolvable Orbs, Sticks, and Strips) can weigh as little as one-eighth the weight of a can of moist snuff and cost very little under a weight-based tax. States using weight-based taxes can avoid this problem by making sure that any weight-based tax applies only to conventional moist snuff (e.g., moist snuff that has a moisture content no lower than 45%) and not to any smokeless tobacco products that come in discrete, single-use units or doses.<sup>49</sup>

The optimal way to tax smokeless products is through a percentage-of-price tax combined with a minimum tax that is based on dose, package size, or weight.<sup>50</sup> Supplementing a state's percentage-of-price tax with a minimum tax covers the range of smokeless tobacco products, keeps up with inflation, and addresses the issue of low-priced smokeless brands. It also counters the tobacco industry strategy of creating new products that are extremely lightweight. For example, an effective tax law could state that any smokeless product with a wholesale price of less than \$2.50 per ounce shall be taxed as if its price were \$2.50 per ounce.

# How to: Determining and Prioritizing Options

## State Cigarette Taxes Per Pack

as of November 1, 2013



Source: Campaign for Tobacco-Free Kids<sup>28</sup>

# How to: Determining and Prioritizing Options

## Advantages and Disadvantages of Different Tobacco Taxation Approaches

Tobacco Product	Taxation Approach	Advantages	Disadvantages
<b>Cigarettes</b>	Per pack tax*	<ul style="list-style-type: none"> <li>Is simple and effective.</li> <li>Ensures that all cigarettes (regardless of size, weight, or price) are taxed at the same rate.</li> </ul>	<ul style="list-style-type: none"> <li>Does not keep up with inflation and product price increases.**</li> </ul>
	Percentage-of-price tax that matches the cigarette tax rate and has no per-cigar cap*	<ul style="list-style-type: none"> <li>Ensures that all cigars (regardless of # per pack, size, or weight) are taxed at the same rate.</li> <li>Eliminates reductions in price for those who buy and smoke the most expensive brands.</li> </ul>	<ul style="list-style-type: none"> <li>Taxes cigars at lower rates than cigarettes.</li> <li>Results in revenue loss for states.</li> </ul>
<b>RYO and other smoking tobacco</b>	Percentage-of-price tax plus minimum tax based on pack or weight*	<ul style="list-style-type: none"> <li>Makes other smoking tobacco taxes parallel with cigarette taxes.</li> <li>Keeps up with inflation and product pricing.</li> <li>Addition of minimum tax makes RYO and other smoking tobacco tax equal to cigarette tax on “per cigarette” basis.</li> </ul>	
	Percentage-of-price tax that parallels the state cigarette tax rate	<ul style="list-style-type: none"> <li>Makes other smoking tobacco taxes parallel with cigarette taxes.</li> <li>Keeps up with inflation and product price increases.</li> </ul>	<ul style="list-style-type: none"> <li>RYO and other smoking tobacco could still be taxed at a lower “per cigarette” rate than regular cigarettes.</li> </ul>
<b>Smokeless tobacco</b>	Percentage-of-price tax plus minimum tax*	<ul style="list-style-type: none"> <li>Is simple and effective.</li> <li>Keeps up with inflation and product price increases.</li> <li>Taxes higher-priced products at higher rates.</li> <li>Addresses the problem of very low-priced smokeless products.</li> </ul>	
	Percentage-of-price tax (flat tax on all OTPs, regardless of type, brand, weight, and packaging)	<ul style="list-style-type: none"> <li>Is simple and effective.</li> <li>Keeps up with inflation and product price increases.</li> <li>Taxes higher-priced products at higher rates.</li> </ul>	<ul style="list-style-type: none"> <li>Does not adequately tax very low-priced products.</li> </ul>
	Simple weight-based tax		<ul style="list-style-type: none"> <li>Does not keep up with inflation and product price increases.</li> <li>Grossly undertaxes new super-lightweight products.</li> <li>Does not sufficiently tax higher-priced premium smokeless products.</li> </ul>

\* Tax approach with maximum public health impact

\*\* Can be strengthened by indexing cigarette tax to inflation (see IOM recommendations and Minnesota example)<sup>35,37</sup>

## Maximizing Revenue and Public Health Impact of Tobacco Taxes

When raising cigarette or OTP taxes, states can ensure greater public health impact and revenue generation by pursuing the following strategies:<sup>49,50</sup>

► **Raise the state tax rate on cigarettes and all OTPs.**<sup>48</sup>

When raising the state cigarette tax rate, states should also raise tax rates of OTPs to levels that parallel the new cigarette tax rate. *Healthy People 2020* recommends that OTP tax increases match cigarette tax increases.<sup>22</sup> When tax rates are raised on all tobacco products, state revenues increase and smokers inclined to quit are discouraged from switching to a cheaper tobacco product and delaying cessation attempts.<sup>51</sup> Without parallel tax rates, tobacco companies have an incentive to label tobacco products so that they are put in the lower-tax category (e.g., cigarettes being called small cigars and cigarette RYO tobacco being labeled as cigar RYO tobacco or pipe tobacco).

► **Establish minimum tax rates on OTPs that will increase automatically whenever the cigarette tax rate is increased.**<sup>50</sup>

These minimum tax rates will promote and sustain tax equity and ensure that state OTP tax rates are not left behind when cigarette tax rates are increased. By keeping OTP tax rates parallel to each other and to cigarette tax rates, minimum tax rates make it harder for smokers faced with higher tobacco product taxes to switch to lower-tax alternatives instead of quitting or reducing consumption.

► **Eliminate caps on tobacco tax rates or amounts.**<sup>50</sup>

States can remove restrictions (e.g., a maximum tax on a single cigar) so that prices are raised evenly across all products. If a restriction (or cap) cannot be eliminated on OTPs, it should at

least be set to an amount equal to the total state tax on a pack of 20 cigarettes. This will result in a higher tax on OTPs that will automatically increase when cigarette taxes are increased.

► **Apply state sales tax to the full price of all tobacco products.**<sup>50</sup>

States should apply their sales tax to the full retail price of all tobacco products, after all applicable excise taxes have been applied. While the vast majority of states do this, as of 2013 there are exceptions in states where the sales tax either does not apply to tobacco products (Oklahoma), does not apply to cigarettes (Minnesota and Washington, D.C.), or does not apply to the state excise tax portion of the retail price (Alabama, Georgia, and Missouri).<sup>50,52</sup>

► **Tax existing inventories.**<sup>51</sup>

When a new tax rate goes into effect, it is standard practice for states to apply the tax increase to all existing retailer and wholesaler inventories. Failing to do so could open the door to stockpiling by retailers and wholesalers who wish to avoid the increase, which could substantially reduce state revenue.

► **Adjust tax stamper discounts.**<sup>50</sup>

Percentage-of-tax discounts are often given to wholesaler tax stampers to help cover the cost of applying the tax stamps (small stamps that stick to cigarette packs as proof of tax payment). Failing to adjust (lower) the tax stamper discount when taxes are raised will increase tax discounts even though the cost of applying the stamps will not change. For example, a tax stamper with a 0.25% discount for a tax of \$0.50 would receive \$0.125 in savings. If the tax increased to \$1.50, their savings would triple to \$0.375.

# How to: Determining and Prioritizing Options

## NON-TAX PRICE-RELATED POLICY OPTIONS

Non-tax price-related policy options are useful alternatives when raising taxes is not feasible. These types of policies also serve as strong complementary policies when implemented with tax increases. Non-tax price-related policies can be carried out at the state level, and often at the local level, too. Options include:

- Banning price discounting/multi-pack offers;
- Implementing minimum price laws; and
- Preventing and reducing smuggling and other types of tobacco tax evasion.<sup>50</sup>

Often, these types of policies overlap with the roles of state offices such as departments of agriculture, revenue, and commerce. Tobacco control staff should seek input from and collaborate with these partners to develop and implement effective policies.

### Ban Price Discounting and Multi-Pack Offers

The tobacco industry uses price discounting to encourage potential consumers who would otherwise be deterred from purchasing tobacco products due to price increases. Such schemes include cents-off or dollar-off promotions, redemption of coupons, buy-one-get-one-free deals, and multi-pack discounts (e.g., two-for-one deals).<sup>53</sup> Price-discounting schemes weaken the effect of tobacco tax increases and minimum price laws.<sup>18,54,55</sup> Extensive use of price discounts by the tobacco industry has led to higher rates of smoking among young people, and has a particular impact on youth progressing from experimental to established smokers.<sup>55,56</sup> Discount offers are used most frequently by youth<sup>54</sup> and increased exposure to cigarette discounts increases the likelihood that youth will smoke.<sup>56</sup> Youth are the most price-sensitive shoppers, as they generally have less income and are less likely to be nicotine dependent.<sup>18</sup>

It is estimated that if price-discounting schemes were banned across the U.S., the number of current established smokers would decrease by more than 13%.<sup>55</sup> A smoking decrease due to discounting bans could help reduce tobacco use in populations that are

heavily targeted by tobacco companies. For example, African Americans are more likely to take advantage of pricing discounts and multi-pack offers than other racial and ethnic groups, regardless of income.<sup>57</sup> Additionally, price promotions for menthol cigarettes are more prevalent in neighborhoods with higher concentrations of African American youth.<sup>57</sup> Banning price discounting could counteract one of the tobacco industry's tactics for targeting this population.

In January 2012, the city of Providence, Rhode Island banned price-discounting schemes and the redemption of coupons by amending its existing tobacco retailer licensing ordinance.<sup>58</sup> Violations of the law are punishable by fines or revocation of the tobacco retail license.<sup>59</sup>

### Implement or Strengthen Minimum Price Laws

In 2010, cigarette manufacturers spent over \$6.4 billion to reduce the price of cigarettes at the point of sale.<sup>60</sup> Cigarette manufacturers use trade discounts, coupons, and other strategies to counteract the effects of excise tax increases and decrease the overall cost of cigarettes.<sup>18</sup> Cigarette minimum price laws, which were initiated by states in the 1940s and 1950s, have the potential to counteract trade discounting.<sup>61,62</sup> While excise tax increases remain the most direct way for states to increase the price of cigarettes, creating or strengthening minimum price laws can also be used to increase cigarette prices.<sup>5</sup>

Typically, minimum price laws require that a minimum percentage markup be added to the wholesale and/or retail price of cigarettes. The result establishes the minimum retail price charged to the consumer.<sup>61,63</sup> Most minimum price laws currently in place are ineffective for tobacco control because they allow for tobacco industry discounts.<sup>63</sup> These discounts can actually lead to a lower minimum price.<sup>61</sup> For minimum price laws to be effective, they should expressly exclude trade discounts when calculating minimum price.<sup>63</sup> Minimum prices can also be set at much higher specific amounts and can be tied to inflation. States can partner with their tax departments or other agencies for assistance in adopting, strengthening, and enforcing minimum price laws.

# How to: Determining and Prioritizing Options

## Take Steps to Prevent and Reduce Tobacco Product Smuggling and Tax Evasion

States can work to update laws to increase fines and penalties for tobacco tax evasion and violations of other tobacco-related state laws. State laws regarding such fines are often several years old and not as effective as they could be.<sup>64</sup> The fines can be tied to inflation, so generated revenue does not shrink over time. Updating laws could increase state revenue, through penalty payments and the recovery of unpaid tobacco taxes, especially if the laws are well-enforced. It is helpful if some of the revenues generated from these fines and penalties are directed to enforcement agencies and tobacco control efforts. States can also remove penalty caps so that meaningful fines can be levied against large economic forces involved in smuggling. The public health benefit of reducing tobacco product smuggling and tax evasion is significant. These measures help to:

- Increase prices, which reduces tobacco use (especially among youth);
- Ensure that fewer tobacco products evade state and federal labeling, health, and safety requirements; and
- Increase the amount of tobacco-related government revenues available for tobacco prevention and other public health uses.

In addition to strengthening fines and penalties, states can take other measures to prevent and reduce tobacco product smuggling and tax evasion, such as:

- **Ban or restrict Internet sales.** Effective June 29, 2010, the Prevent All Cigarette Trafficking Act (PACT Act) significantly restricted the sale of cigarettes, RYO, and smokeless tobacco products online.<sup>65,66</sup> The Act requires retailers to pay all applicable federal, state, and local taxes, register with the state, and check age and identification of customers.<sup>66</sup> In addition to this Federal law, eight states (Arizona, Arkansas, Connecticut, Maryland, Ohio, New York, Vermont, and Washington) ban direct-to-consumer shipment of cigarettes as of 2013.<sup>67-70</sup> At least 34 states have some sort of cigarette delivery law in place addressing requirements such as minimum age, payment, shipping, vendor licensure, tax collection/remittance, and penalties/enforcement.

- **Perform surveillance and enforce policies.** States can conduct purchase surveys of Internet tobacco vendors to assess compliance with tax collection, youth access, and other laws. If high noncompliance is found, enforcement actions can be taken in accordance with the PACT Act.
- **Implement high-tech cigarette stamps.** Traditional tax stamp technology, used by nearly every state, helps ensure that tax revenue is properly collected. It does not, however, eliminate counterfeiting.<sup>64</sup> Newer, high-tech stamps are easier to distinguish, more difficult to counterfeit, and contain useful encrypted tracking information that can be scanned by enforcement officials. By implementing high-tech stamps, and thus minimizing tax evasion, states can reduce tobacco product trafficking and also protect their excise tax revenues.<sup>64</sup>

### Anti-Counterfeiting Features of High-Tech Tax Stamp



Twenty months after California implemented its new high-tech stamp and increased enforcement efforts, it announced a 37% drop in cigarette tax evasion. This resulted in \$110 million in additional annual cigarette tax revenue, without an increase in the tax rate.<sup>64</sup>



## Allocating Revenues

Adequate time and effort must go into developing a strategy and budget plan *prior* to a tobacco pricing policy campaign. Careful planning and organization of revenues can help maximize the public health impact. A portion of the revenues from tobacco taxes and fees can be allocated to tobacco prevention and cessation. The public is more likely to support tobacco product tax increases when the funds are directed toward efforts to treat tobacco-related illness and prevent and reduce tobacco use.<sup>13</sup> If a portion is allocated to cessation, it can lessen the financial burden of the tax on low-income smokers. The strongest public support exists for allocating new revenues for strategies that prevent youth initiation.<sup>13</sup>

Tobacco control programs can use revenue support to enhance their programs in a manner consistent with *Best Practices*.<sup>1</sup> Tax revenue dedicated to tobacco control can have a large impact in reducing the burden of tobacco use. For example, the Louisiana Campaign for Tobacco-Free Living (a private, statewide tobacco control program that complements the public program) is funded by just 2¢ per pack of Louisiana's latest cigarette excise tax increase.<sup>71</sup> Revenues collected from the adoption of pricing policies can be used in many ways, including:

- Expanding tobacco program reach;
- Helping fund local and state policy development efforts;
- Countering pro-tobacco influences;

### Preserving Tobacco Control Funding by Dedicating a Portion of Tobacco Tax Revenues to Tobacco Control

Since 2002, 47 states, Washington, D.C., Guam, and Puerto Rico have enacted over 105 cigarette tax rate increases.<sup>72</sup> Twenty-nine of those states and D.C. passed more than one tax increase during that time period.<sup>73</sup> Unfortunately, widespread increases in tobacco taxes have been accompanied by decreases in tobacco control program funding. In 2012, the states collected near-record levels of revenue from the tobacco settlement and taxes. Despite this, overall state spending on tobacco control efforts has decreased by 36% since 2008.<sup>73</sup>

While increasing tobacco taxes is an effective method for raising state revenues and a critical part of tobacco control program efforts, the full benefits will only be realized if some of the money is allocated for tobacco control. Research has shown that comprehensive, multi-component programs have a substantial impact on smoking rates.<sup>1</sup> By raising the tobacco tax and expanding funding for tobacco control efforts, states will be more successful in the long term at reducing health care spending on tobacco-related illness and decreasing tobacco use prevalence, morbidity, and mortality.

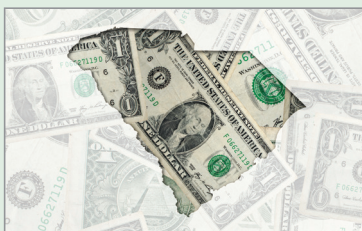
Important Elements of a Tax Campaign:

- **Let the public decide.**  
A study by the Campaign for Tobacco-Free Kids found that two-thirds of voters support a \$1 increase in state tobacco taxes.<sup>13</sup> In every state in which the question was asked, voters overwhelmingly chose to dedicate a portion of the tax revenue to fund tobacco prevention and cessation.<sup>13</sup>
- **Educate the community and decision makers.**  
Clear messages and accurate statistics about the effects of tobacco use on the state will help garner support.
- **Build partnerships.**  
Working with other tobacco control proponents, such as voluntary health organizations (*e.g.*, American Cancer Society and American Lung Association) and youth organizations, allows communities to engage more people. Working with tax, finance, and commerce departments helps to craft a unified and comprehensive approach to tobacco taxation.

## How States Maximize Tobacco Control Funding

### South

**Carolina:** With encouragement from tobacco control advocates, South Carolina lawmakers overrode a



gubernatorial veto in 2010, increasing the state's tobacco tax from \$0.07 to \$0.57.<sup>70</sup> South Carolina successfully allocated \$5 million from the tobacco tax revenue to fund the state tobacco control program each year.<sup>74,75</sup> According to the CDC, more than 60% of the annual revenue generated from the state tobacco tax will directly fund the state program.<sup>76</sup>

One reason for South Carolina's success was strong grassroots support. The South Carolina Tobacco Collaborative organized grassroots efforts that encouraged individuals and organizations to educate decision makers about the importance of tobacco control funding.<sup>75</sup>



### South Dakota:

In 2006, South Dakota increased its cigarette tax by \$1 per pack and placed a 10-35% tax on other tobacco

products.<sup>13</sup> Despite a limited state budget, South Dakota stayed true to its commitment to fund tobacco control efforts and spent more than \$5 million on tobacco control in 2010.<sup>77</sup> As a result of this sustained funding, the state has almost doubled quitline usage, decreased the number of high school smokers by 5%, and reduced the adult smoking prevalence by 2.8%.<sup>78</sup>

To keep the spotlight on tobacco, the South Dakota Department of Health launched the "Be Tobacco

Free South Dakota" campaign.<sup>79</sup> This campaign promotes the quitline, encourages worksites to adopt smoke-free policies, and focuses on teen tobacco use prevention. Because of the continued focus on tobacco, South Dakota passed a smoke-free policy in November 2010, which included all restaurants, bars, package liquor stores, casinos, and video lottery establishments.<sup>80</sup>

### Montana:

Montana is ranked fourth best in the nation by the American Lung Association for its funding of tobacco



prevention and control programs. In 2011, total state spending on tobacco control reached nearly 70% of the CDC-recommended level.<sup>74</sup> Montana used almost 7% of its \$122 million in tobacco tax revenue to fund tobacco prevention programs.<sup>81</sup> Montana also passed the Montana Clean Indoor Air Act, which requires enclosed public places and workplaces to be smoke-free.

Despite a budget deficit in 2009, tobacco control program proponents persuaded lawmakers to sustain funding to the Montana Tobacco Use Prevention Program (MTUPP), which seeks to eliminate tobacco use, especially among children.<sup>82</sup> The Montana Department of Public Health and Human Services, along with partners such as the American Cancer Society, the Boys and Girls Clubs of Montana, county health departments, and Tribal nations, increased awareness about the effects of tobacco and garnered support across the state.<sup>83,84</sup> Together, these partners educated decision makers about the effects of tobacco on the health of Montana citizens and the importance of continued funding for tobacco control programs.

# How to: Preventing Loopholes

- Running paid media campaigns with adequate frequency and exposure;
- Funding tobacco control program and enforcement staff; and
- Supporting evidence-based cessation strategies.

The way that revenues are allocated in the first year after enacting a successful pricing policy often sets the stage for how future revenues will be used.<sup>85</sup> In California, revenues from Proposition 99 supported a tobacco education and prevention program, resulting in an overall decrease in tobacco consumption. As a result, the rate of decline in California was three times greater than in the rest of the U.S. from 1988 to 1993.<sup>86-89</sup> In Colorado, revenue from a tobacco tax increase funded tobacco prevention and other efforts aimed at preventing cancer, heart, and lung disease.<sup>90</sup> States can also direct tobacco tax revenue to the state Medicaid program and receive federal matching funds.<sup>91</sup> Virginia, Idaho, West Virginia, and South Carolina have all considered using tobacco tax revenue to increase Medicaid funding in order to achieve a greater impact.<sup>92-99</sup> Impact is greatest when revenue is used for Medicaid-funded tobacco cessation efforts, such as quitlines and increased access to cessation medications for Medicaid enrollees.

## Preventing Loopholes

The effectiveness of pricing policies is only as strong as their wording and implementation. Opponents of proposed or existing pricing policies often try to include exceptions or ambiguous language that weaken policies. Such loopholes create future challenges in enforcement and usually require legislation to correct. Loopholes can exist in tax and non-tax tobacco pricing policies. Examples of common loopholes include:

- Vague definitions of tobacco products;
- Absence of language regarding enforcement; and
- Tobacco product exceptions.

Tobacco control partners can work to prevent exceptions and ambiguities through strong policy development and implementation. They can also fight pro-tobacco influences by closing existing loopholes and avoiding compromises when developing new policies.

## Responding to Changes in Behavior by Consumers and Retailers

After pricing policies are implemented, smokers and retailers often change the way they buy and use tobacco products, at least in the short-term. Tobacco control program staff must be proactive and prepare for the following challenges:<sup>100,101</sup>

- Changes in smoker behavior to compensate for a loss of nicotine (*e.g.*, switching to cigarettes that are full-flavored, longer/wider, or have higher tar content);<sup>102-104</sup>
- Tax avoidance by individual smokers (*e.g.*, taking advantage of discounts, switching to OTPs or discount brands, and choosing cheaper retail outlets);
- Tax avoidance by tobacco sellers (*e.g.*, Internet vendors);
- Sales of smuggled, untaxed tobacco products by otherwise legally operating retailers; and
- Criminal behavior of individuals and entities involved in smuggling.

Avoidance of required payment of local, state, and federal tobacco product taxes is a major concern of tobacco control partners and law enforcement agencies. Because the environment of tax avoidance and tax evasion changes rapidly and varies widely among states, the cooperation of local, state, and federal authorities and tobacco control staff is critically important.

## CIGARETTE SMUGGLING IN THE U.S.

Though cigarette smuggling is a serious issue that results in large revenue losses, the problem in the U.S. has not been as widespread as in other countries, and has not been significantly affected by cigarette taxes. Studies have established that sales from organized cigarette smuggling (smuggling that involves wholesaler or retailer participation) accounts for just 3-5% of all cigarettes purchased in the U.S.<sup>7,41</sup> Cross-

## Why Are Definitions So Important?

In order to avoid taxes, tobacco companies design products to fall under the definitions of products that are taxed at a lower rate. Precise product definitions

therefore increase the effectiveness of pricing policies and prevent a decrease in revenue. For example, several types of “little cigars” are identical in size to cigarettes, contain similar content, and have filters. In fact, the only differences are the color and composition of the wrapping paper and the tax rate. Almost every state taxes cigars at a much lower rate than cigarettes, and three states do not tax them at all.<sup>13</sup>

To address this issue, the definition of “cigarette” could be modified in the tax code. This would ensure that all cigarettes are defined appropriately and prevent some cigarettes from being inaccurately labeled as “cigars.” The definition of “cigar” should also clearly exclude any cigarettes by referencing the “cigarette” definition. “Cigarette” could be defined as “any roll of tobacco, however wrapped, that weighs no more than 4.5 pounds per thousand, unless it is wrapped in whole tobacco leaf and does not



have a filter.”<sup>40</sup> An alternative approach would be to match the cigar tax to the cigarette tax for both large and small cigars.

Definitions in state tobacco tax laws should be designed

to reach all of the new low-weight smokeless tobacco products (e.g., Snus; Ariva or Stonewall Dissolvable Tobacco; and Camel Orbs, Strips, and Sticks) that have not been approved as cessation aids or authorized for marketing by the U.S. Food and Drug Administration (FDA) as modified risk products. Definitions of “smokeless tobacco” and “tobacco products” should specify that they include any product containing tobacco that is intended or expected to be consumed. This definition should clearly exclude FDA-approved cessation products and/or FDA-authorized modified risk products.<sup>105</sup>

RYO tobacco often escapes proper taxation because it is labeled for use in cigars or pipes, while many state definitions refer only to “tobacco used for RYO cigarettes.” RYO tobacco should be defined as any tobacco, however labeled, that is intended or expected to be used for RYO cigarettes or cigars.<sup>41</sup>

border purchases by consumers who travel into lower-tax areas to purchase their cigarettes may account for an additional 1% of all cigarette sales; the sum of all smuggling, cross-border purchases, and Internet purchases accounts for only 8% of all cigarette sales.<sup>7,106</sup>

Although some of the tobacco industry and its allies have claimed that cigarette smuggling increases as a result of higher tobacco taxes, partners should keep in mind that most initial tax-avoidance efforts quickly fade away, and that every state that has increased

its cigarette taxes has increased its cigarette tax revenues.<sup>7,107</sup> Overall, tobacco price increases have resulted in revenue gains for states; they have not prompted a significant increase in cigarette smuggling or black market sales. International experience also shows little correlation between a country’s cigarette prices and its smuggling levels.<sup>108</sup>

Nonetheless, cigarette smuggling does result in significant revenue losses, and should be limited by states. While calculating the exact amount of revenue

## Strategies to Counter Consumer Responses to Pricing Policies

Response to Policies	Tobacco Control Strategy
Take advantage of promotional offers <sup>109</sup>	<ul style="list-style-type: none"> <li>Implement a large tax increase that would be more difficult for tobacco companies to offset with discounts.<sup>18</sup></li> <li>Pair excise tax increases with stringent minimum price laws or discounting prohibitions to restrict tobacco company promotions and buydowns (or rebates).<sup>62</sup></li> </ul>
Switch to cigars	<ul style="list-style-type: none"> <li>Match state cigar tax rate to cigarette tax rate.</li> <li>Raise cigar tax rate when other tobacco product tax rates are increased.</li> <li>Set cigar tax rates as a percentage-of-price.</li> <li>Eliminate any caps on cigar tax rates.</li> <li>Make sure no cigarettes can qualify as “cigars” under state law.</li> </ul>
Switch to RYO cigarettes	<ul style="list-style-type: none"> <li>Tax all RYO tobacco.</li> <li>Make all RYO tax rates equal to states’ regular cigarette tax rates.</li> </ul>
Switch to OTPs	<ul style="list-style-type: none"> <li>Use a hybrid system that includes both a percentage-of price tax set to roughly equal the state cigarette tax rate, plus a minimum tax on all OTPs directly linked to the state’s cigarette tax on a per-unit, per-package, or per-dose basis.</li> </ul>
Switch to discount cigarette brands (e.g., “trade-down”)	<ul style="list-style-type: none"> <li>Implement strong minimum price laws.</li> </ul>
Choose cheaper retail outlets (e.g., vendors on the Internet, on Tribal lands, and in neighboring states) <sup>102</sup>	<ul style="list-style-type: none"> <li>Forbid sale of cigarettes without payment of applicable state taxes.</li> <li>Work with Tribes to implement a Tribal tax equal to the state tax rate.</li> </ul>

lost due to tax evasion is difficult, the Department of Treasury estimates that, in 2008, national losses were over \$2 billion.<sup>110</sup> To address this problem, many states and local jurisdictions have collaborated with federal authorities like the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF) to target large-scale trafficking of tobacco products. Research shows that states could increase their tobacco tax revenues by an additional 5-10% if they took measures to reduce organized, illegal cigarette smuggling and tax avoidance by smokers.<sup>109</sup>

### INTERNET SALES

The sale of cigarettes on the Internet has increased during the past decade. While it is difficult to determine exact numbers, it is estimated that hundreds of Internet vendors in both the U.S. and overseas are selling to U.S. customers. Cigarette prices on the Internet have typically been much lower than prices in regular retail

outlets because many have failed to charge local, state, and/or federal excise taxes.<sup>13</sup> These low prices make Internet cigarettes attractive to both adult and underage smokers and may mitigate the impact of price increases from taxes.<sup>7,111</sup> Internet vendors are easily accessible and provide convenient purchasing methods, multiple payment options, and even anonymity for the purchaser. Internet sales to youth are also an area of concern because youth are particularly price sensitive and most Internet vendors provide no effective safeguards to prevent sales to minors.<sup>112</sup>

Some domestic Internet cigarette vendors appear to have American Indian affiliation.<sup>35</sup> Internet sites are often visually attractive, appeal to ethnic pride, and offer inexpensive off-brand cigarettes (e.g., Native, Omaha, Smokin’ Joes, and Seneca).<sup>4</sup> These brands can be purchased on the Internet for as little as one-fifth the cost in a traditional retail outlet.<sup>4</sup> Name-brand cigarettes are also discounted on many of these sites and can be sold for as little as half the retail outlet price.<sup>4</sup>

# How to: Responding to Changes in Behavior

The PACT Act<sup>109</sup> significantly restricts the sale of cigarettes, RYO, and smokeless tobacco products online.<sup>65</sup> Cigarettes and smokeless tobacco products are now considered non-mailable items, with the following exceptions:<sup>113</sup>

- Shipments entirely within Alaska and Hawaii;
- Shipments to and from authorized business/government agencies (after verification of authorization);
- Certain infrequent and lightweight shipments by adults for noncommercial purposes, including product returns and shipments of care packages to soldiers overseas;
- Shipments of cigarettes sent by verified and authorized manufacturers to verified adult smokers over age 21 for consumer testing purposes; and
- Shipments sent by federal agencies to consumers for public health purposes.

Unlike previous laws regulating Internet sales, the PACT Act has strong enforcement provisions and penalties.<sup>65</sup> Additionally, local, state, and Tribal governments now have equal enforcement rights, new enforcement tools, and the authority to stop deliveries of cigarettes and smokeless tobacco sold illegally. In situations in which the shipment of cigarettes and smokeless tobacco is allowed, the PACT Act mandates that Internet retailers:<sup>65</sup>

- Pay all applicable federal, state, local, or Tribal tobacco taxes and attach location-specific tax stamps;
- Comply with local and state laws where the products are being shipped;
- Register with the state and prepare reports for state tax collectors; and
- Verify the age and identification of the buyer at purchase and delivery.

## Steps States Can Take to Limit Tobacco Tax Evasion<sup>50</sup>

- Require state cigarette tax stamps or improve existing stamps. All states can use new technologies to make their stamps larger, more distinctive, and harder to counterfeit.<sup>64</sup>
- Require tax stamps on all OTPs.
- If not all tobacco products are taxed, require tax-exempt stamps on all cigarettes and OTPs sold that are not subject to the state's tobacco taxes. Several states already have this requirement, which makes it more difficult to illegally route tax-exempt cigarettes into non-tax-exempt sales.
- Forbid the sale, purchase, or possession of any tobacco products not marked with state tobacco tax stamps, tax-exempt stamps, or other visible proof of payment.
- Educate smokers about existing state laws restricting smuggling and tax avoidance.
- Block retail sales clearly not for personal use. For instance, place a maximum sale amount of 2,000 cigarettes (10 cartons) for any single sale to a consumer in the state.
- Publicize toll-free hot lines to encourage reports of smuggling or tax avoidance.
- Protect employees of retailers, distributors, wholesalers, importers, exporters, manufacturers, and delivery services from being fired or otherwise penalized if they notify authorities about tax evasion.
- Encourage neighboring states to make cigarette taxes equal and coordinate efforts to minimize smuggling and other tax avoidance.
- Enter into compacts with American Indian Tribes to create tax equity between sales on Tribal lands and sales outside of Tribal lands.

# How to: Combating Tobacco Industry Responses

## TRIBAL LAND SALES

Tobacco retailers on Tribal lands have the right to sell tobacco products to members of the same Tribe without the addition of state tobacco taxes. This right derives from Tribes' sovereign nation status which allows Tribes to govern themselves. The reality is that some smokers and smugglers visit American Indian reservations to purchase tobacco products in order to avoid paying state taxes.<sup>114</sup> To address this issue, a number of states (including Washington) have entered into special agreements with Tribes within their state borders.<sup>115</sup> In these agreements, Tribes agree to collect the state's tobacco tax (or a similar Tribal tax) on all cigarette or tobacco product sales on the Tribe's land, thereby making Tribal prices comparable to state prices, while eliminating double taxation. In return, the state agrees that the Tribe can keep all of the revenues.<sup>116</sup> This solution makes Tribal prices comparable to prices charged elsewhere in the state and eliminates a source for contraband cigarettes.<sup>117</sup>

## Combating Tobacco Industry Responses

In order to offset existing taxes or anticipated pricing increases, the tobacco industry has used retail value-added strategies and merchant incentives. These strategies comprise more than 90% of tobacco company promotional expenditures<sup>60</sup> and include:

- Advertising discount brands that provide a quality product for a better value;
- Adding coupons and discounts on multi-packs; and
- Creating toll-free numbers smokers can call to receive coupons.<sup>18</sup>

With strong policies, states can combat these industry tactics. Tobacco control partners can take simple and effective steps, including:

- Implementing large tax increases that are more difficult to offset with discounts; and
- Pairing excise tax increases with restrictions on tobacco company discounts and buy-downs.<sup>47</sup>

## Addressing Industry Arguments Against Pricing Policies

Industry Argument	Tobacco Control Response
Tax increases reduce state revenues because fewer people will smoke.	The increased revenue the state collects on each pack sold significantly outweighs the revenue loss from the reduced number of packs sold. <sup>106</sup> Over time, the goal is to eliminate tobacco use, tobacco tax revenue, and the costs associated with treating tobacco-related disease.
Higher tobacco taxes result in job losses.	Money not spent on tobacco will be spent on other goods and services, creating alternative employment or even net gains in employment. <sup>113</sup>
Tobacco tax increases unfairly burden tobacco users.	State tobacco tax revenues are significantly lower than state tobacco-related costs. To reduce the burden of these costs, states should allocate a portion of new tax revenue to comprehensive tobacco control programs with cessation assistance for tobacco users. <sup>118</sup>
Tobacco tax increases are regressive and target low-income tobacco users.	Lower-income communities suffer disproportionately from tobacco-related diseases and costs. Raising tobacco taxes encourages people to quit, which will reduce those regressive harms and costs. <sup>106</sup> Allocating a portion of the revenue for cessation assistance better ensures that those who want to quit will be successful.
Tax increases and resulting price differences encourage smuggling, black markets, and tobacco tax avoidance.	The incidence and amount of revenue lost due to tax avoidance is not as large as the industry claims. <sup>119</sup> However, enforcing existing taxes and raising low taxes should be a priority. <sup>120</sup> To minimize tax avoidance, states can use high-tech tax stamps, increase fines and penalties for tax avoidance and smuggling, and improve enforcement.

## How Can Tobacco Control Programs Support Pricing Policies?

Here are some ways that tobacco control proponents can support tobacco pricing policies as part of comprehensive tobacco control programs:

### COORDINATION & COLLABORATION

- ✓ Communicate to decision makers and key stakeholders the benefits of increasing the price of tobacco products (*e.g.*, prevents youth initiation, leads to cessation, supports tobacco control programs, and increases state revenues).
- ✓ Work with policy makers to update tobacco product definitions in existing laws and regulations. Definitions of cigarettes, cigars, and roll-your-own products should be precise to prevent loopholes and maximize public health impact.
- ✓ Help support and coordinate local media campaigns (*e.g.*, campaigns supporting tax increases) to avoid duplication of efforts. Make sure to communicate a clear and unified message that ties in with youth, cessation, and other tobacco control program components.
- ✓ Bring the right people together to garner public support.
- ✓ Continually educate coalition members and other key stakeholders. Proactive education ensures the development of strong laws that relate directly to state tobacco control goals and that avoid compromise.

### ADMINISTRATIVE SUPPORT

- ✓ Perform state- and community-level assessments to determine public support for pricing policies and disseminate results. These assessments often show strong bipartisan support for increasing tobacco taxes, especially when a portion of revenue generated is dedicated to tobacco control programs.
- ✓ Support or perform evaluation (*e.g.*, perform economic analyses and utilize models that simulate the impact of laws on health care costs and tobacco control efforts).
- ✓ Provide evaluation results in a timely manner.



# Case Study #1: Indiana

## Tobacco control program, Health Commissioner, and Governor join forces to increase state cigarette tax and maximize public health benefits.

Tobacco control partners had already set the stage for change when Indiana Governor Mitch Daniels proposed a cigarette excise tax increase from 44¢ per pack to 99.5¢ per pack.<sup>121</sup> The short but difficult campaign for the tax increase encountered many hurdles, which were overcome with the help of the state tobacco control program's efforts in education, data dissemination, media advocacy, and grassroots coalition building.

### Governor identifies a “win-win” initiative

Governor Daniels officially unveiled his plan for a cigarette tax increase during a press conference in November 2006. Armed with data from the state program and the State Health Commissioner, Governor Daniels understood the “win-win” nature of a cigarette tax increase. Revenues from the tax would help expand state health programs and decrease smoking rates. Under the Governor's proposed Healthy Indiana Plan (HIP), 100% of proceeds would go toward improving the health of Indiana residents.

Early in the legislative process, the Governor gathered broad-based support for the tax increase by assembling representatives from both state and national voluntary health organizations, as well as other key tobacco control partners such as the Hoosier Faith and Health Coalition. Despite the Governor's leadership and strong support from the public health community, the bill was defeated in the House in January 2007.

### Public health prevails

Undeterred, tobacco control advocates initiated a call to action to public health advocates and concerned citizens. They joined Governor Daniels at the capitol to voice support for HIP and the cigarette tax increase. Organizers utilized the strength of the existing network of grassroots tobacco control coalitions and relied heavily on the state program's technical assistance to

prepare quickly for the gathering. On March 12, 2007, hundreds of citizens from across the state converged at the State House.<sup>121</sup>

Media coverage reinforced the momentum generated by the rally and organizers followed up with local coalitions across the state. The *Healthy Indiana Plan 2007 Community Report* was a key publication that provided smoking, insurance coverage, and immunization data for all counties and conveyed the urgency of resurrecting the Governor's bill. According to former state program director Karla Sneegas, “The number one thing is to always be preparing for increasing the price [of tobacco products] so that when the political opportunity is there, you're ready to seize it.”

These combined efforts resulted in reconsideration by both the House and Senate, and eventually, passage of the new 99.5¢ per pack tax. The revenue allocation plan included funding for uninsured Hoosiers and childhood immunizations, along with a \$1.2 million allocation for tobacco control cessation efforts for the following two years.<sup>122</sup> Although not ideal because it was time-limited, the allocation enabled the tobacco control program to demonstrate the value of increased funding.

### Tobacco control advocates exact maximum benefit from tax increase

According to Sneegas, “working the tax” after enactment was very important. Tobacco control partners quickly implemented a strong cessation campaign which included public relations, earned media, and paid media components. Advocates also sponsored statewide events and coordinated on-the-ground activities through community partners. The state saw a substantial decrease (nearly 3%) in the number of adult and youth smokers in the two years following the cigarette tax increase.<sup>121,123</sup> As of 2013, the adult smoking prevalence in Indiana was at its lowest historical rate.<sup>123</sup>

# Case Study #2: New York

## Creative legislative proposal is designed to reduce the number of New York State tobacco retail outlets.

The New York State Tobacco Control Program (NYTCP) seized an opportunity to advance its policy goals and bring in revenue for the state by proposing a dramatic increase in the licensing fees for tobacco retailers. The retail licensing fee increase gained political support because of innovative policy recommendations and strong support from the State Health Commissioner.

### Tobacco control partners propose and guide innovative legislation

In 2008, New York, like many states, suffered from a large budget deficit and was looking for ways to create revenue. When Governor David Paterson sent out a request to all departments for revenue-raising proposals in late 2008, NYTCP prepared a creative solution. When the former NYTCP Director Jeff Willett, the Center for a Tobacco Free New York Director Russ Sciandra, RTI International researchers, and others developed strategies to decrease tobacco use, the idea to increase tobacco retailer license fees emerged. The partners recognized that retail outlets are one of the few remaining venues for tobacco advertising.<sup>124</sup> They were also concerned about the impact of the number of retail outlets on tobacco product accessibility to youth. Increasing the licensing fees would thus have a two-fold benefit: improving public health and addressing the state budget gap.

The NYTCP proposed legislation to increase fees substantially: from \$100 to \$1,000 for stores with gross annual revenue of less than \$1 million, \$2,500 for stores with revenue between \$1 million and \$10 million, and \$5,000 for stores with \$10 million or more in revenue.<sup>125</sup> According to Willett, this new increase had the potential to reduce the number of retailers and limit access to tobacco products. The retail license fee increase survived the internal legislation selection process because of strong support from the Health Commissioner and its expected positive impact on public health. The proposal was included in the 2009-2010 state budget and was enacted in April 2009.

### Tobacco retailers organize and take legal action

A group of nine retailer associations, led by the New York Association of Convenience Stores (NYACS), joined efforts to oppose the fee increase. Their campaign, “Operation Rollback,” sought to eliminate or reduce the increase in license fees.<sup>125</sup> Retailers argued that fees should reflect the states’ administrative costs associated with the registration. Retailers also asserted that increased fees would further disadvantage tax-paying retailers during a time of unregulated sales on American Indian reservations and unchecked black market activity. In September 2009, the legislation’s implementation was put on hold when a state Supreme Court judge issued a temporary restraining order resulting from a lawsuit by the group of retailer associations. Governor Cuomo compromised in the spring of 2011 by increasing the fee from \$100 to \$300, rather than \$1,000, \$2,500, or \$5,000.<sup>126</sup> As a result, the tax department was directed to refund those retailers who overpaid in 2010. Though the retailer associations considered this compromise a victory, tobacco control partners can also benefit by learning from NYTCP’s experience.

### Compromise provides lessons for future efforts

Based on the New York experience, Willett determined that any future attempt to establish or increase a retail license fee should present the fee as necessary to support the costs of administering and enforcing the licensing system. New York’s proposal did not adequately detail how the fee increase was related to administrative/enforcement costs, thereby subjecting the proposal to industry claims that the increase was excessive. Willett also believed that the proposed increase should have been designed to fund enforcement activities and a health communication campaign to reduce youth access to tobacco products and exposure to tobacco marketing. Tools designed to assist with determining suitable tobacco retail license fees are available through tobacco control legal centers (*see Resources page*).

# Conclusion: Case for Investment

## Why Invest in Pricing Policies?

Pricing policies are an essential component of a comprehensive tobacco control program. Through advocacy and education, tobacco control leaders play an important role in developing and implementing pricing policies. Such policies (*e.g.*, excise tax increases, non-tax pricing policies, and enforcement measures) effectively raise the price of tobacco products and help account for their overall cost to public health and productivity. Implementation of these policies contributes to behavior change by making tobacco less desirable, less acceptable, and less accessible.

### HISTORY AND ADOPTION

Policies that increase the price of tobacco are the most effective way to reduce tobacco use.<sup>5,15,29</sup> When they were first implemented, tobacco taxes were viewed only as a source of revenue for governments. For the past twenty years, public health professionals have encouraged the strategic use of excise taxes and other non-tax policies to reduce tobacco prevalence and increase cessation. Because the overwhelming evidence shows the positive health impact of increased prices, pricing policies have become a popular strategy both for public health officials wanting improved outcomes and lawmakers searching for funds to fill budget gaps. Decision makers realize that there are few political costs to supporting tobacco taxes, which are widely popular.<sup>13</sup> They also recognize the public health benefits.

Adoption of these pricing policies is widespread and continues to grow. All states and many localities employ tax-related policies to drive down tobacco use. Nationally, more than 450 local jurisdictions apply their own cigarette taxes.<sup>23</sup>

### SCIENTIFIC EVIDENCE

According to the Institute of Medicine, “the single most direct and reliable method for reducing consumption is to increase the price of tobacco products, thus encouraging cessation and reducing the level of initiation of tobacco use.”<sup>29</sup> A variety of other sources also confirm that pricing policies are effective at reducing tobacco use.<sup>1,5,6,127</sup> Increasing the price of tobacco products is the most effective way to reduce consumption,<sup>29</sup> especially among youth,<sup>13,128</sup> low-income groups,<sup>33</sup> and pregnant women.<sup>18</sup> Pricing policies are also very effective at reducing tobacco-related disparities.<sup>48</sup> By reducing consumption and access to tobacco products, pricing policies lead to behavior changes and reduce the social acceptability of tobacco use.<sup>29</sup>

# Conclusion: Case for Investment

## COST

The cost of implementing pricing policies depends on the nature of the policy, but the health and financial payoffs are substantial. Research has shown that every significant increase in federal and state cigarette taxes has resulted in a substantial increase in cigarette tax revenues.<sup>7,8</sup> In 2011, cigarette taxes generated \$17.3 billion in state revenue and \$15 billion in federal revenue.<sup>7,8</sup> In addition to increasing state revenues, tobacco pricing policies result in a decrease in smoking prevalence and discourage initiation, which reduces tobacco-related illness.<sup>5,6</sup> This reduction in tobacco use and tobacco-related illness and death translates to a great return on investment, saving states millions of dollars in tobacco-related health care costs. From 2000-2004, it was estimated that smoking accounted for \$193 billion annually in direct medical and lost productivity costs in the U.S.<sup>129</sup> These economic costs amount to \$10.47 per pack of cigarettes sold in the U.S. Pricing policies that raise the cost of cigarettes will help narrow the gap between the health-related costs of smoking cigarettes and their purchase price.<sup>29</sup>

## SUSTAINABILITY

Pricing policies are a vital component of sustainable tobacco control efforts. When tax revenues are allocated to tobacco control, pricing policies can have a direct and dramatic impact on a program's effectiveness and sustainability.

Sustainability is more than just funding; it is tied to a program's ability to leverage resources to most effectively implement evidence-based policies and activities.<sup>30,31</sup> The processes of developing coalitions, educating decision makers, and engaging grassroots partners as part of policy development all increase a program's influence and visibility. After a tobacco pricing policy has been implemented, states can maintain support by showing the value of pricing policies from a public health and economic perspective. Furthermore, states can always be preparing for the next tax increase or opportunity to implement alternative pricing policies. Continuous education and policy promotion can help a program maintain the levels of financial, political, and organizational support necessary to sustain the program.

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Centers for Disease Control and Prevention Tobacco Statistics  
[http://www.cdc.gov/tobacco/data\\_statistics/index.htm](http://www.cdc.gov/tobacco/data_statistics/index.htm)

Change Lab Solutions  
<http://changelabsolutions.org/tobacco-control>

Counter Tobacco  
<http://www.countertobacco.org>

Legacy Tobacco Documents Library, University of California, San Francisco  
<http://www.legacy.library.ucsf.edu>

Robert Wood Johnson Foundation  
<http://www.rwjf.org>

Tobacco Control Legal Consortium  
<http://www.publichealthlawcenter.org>

Toolkit for Implementing Smoke-Free Laws  
<http://goingsmokefree.org>

World Health Organization  
<http://www.who.int/en>

## CASE STUDY RESOURCES

### Indiana

Indiana Tobacco Prevention and Cessation Agency  
<http://www.in.gov/itpc>

### New York

New York State Department of Health, Tobacco Control  
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