



OHIO WHOLESALE MARKETERS ASSOCIATION

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Testimony on the State Budget (SubHB64)

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Senate Finance Committee

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Chairman Oelslager and members of the Senate Finance Committee, thank you for the opportunity to provide my membership's perspectives on the tax increases being proposed in the Senate rewrite of the state budget (SubHB64).

The Ohio Wholesale Marketers Association's core membership is wholesalers who supply products to convenience stores (c-stores), mom-n-pop corner stores and similar retailers. With few exceptions, the Association's distributor members are Ohio-based family-owned businesses that have served their communities for one or more generations. Wholesalers to c-stores are high volume low profit margin businesses, with the typical wholesaler having a pretax profit margin of about one percent.

These wholesalers sell much more than just tobacco, but the tobacco category-- which includes cigarettes and all other tobacco products--accounts for 70 to 80 percent of a typical wholesalers overall sales volume. For the smallest wholesalers, the category represents about 90 percent of overall sales.

Cigarette and tobacco product taxes are not collected at the point of sale. These taxes are collected and remitted at the wholesale level so consequently, tax increases have an immediate and direct impact on these wholesale businesses.

Wholesaler Costs and Cash Flow Knowing a little about wholesaler cash flow is important to understand how these businesses are uniquely impacted by tobacco tax increases.

Manufacturer Impacts on Wholesaler Cash Flow:

The manufacturer-wholesaler relationship is outside of the scope of your responsibility as policy makers. However, it's important for you to know that the products you are taxing at the wholesale level are also subject to manufacturer mandates that impact the wholesaler's cash flow and overall business.

Major manufacturers require that wholesalers pay for cigarettes before they're delivered to the wholesaler's facility, with payment terms usually being three days in advance of delivery. Popular brands of cigarettes at today's manufacturer list price to the wholesaler cost \$2500/case and a typical small wholesaler is running almost 600 cases of cigarettes through their warehouse each month. Midsize wholesaler volume is about 2000 cases of cigarettes per month.

In addition to prepayment terms, wholesalers deal with minimum quantity requirements on their orders. Increases in quantity requirements and price put an immediate squeeze on cash flow.

The point is, as manufacturers are working to improve their efficiencies and bottom lines, the wholesaler's ability to maintain positive cash flow is constantly challenged. Tax increases on the segment of their business that represents 70 to 90 percent of overall sales mean additional cash flow challenges for wholesalers.

Tax Related Impacts on Wholesaler Cash Flow:

Wholesaler Costs for Tax Stamps: OWMA's wholesalers are the state's tax agents and front end payers of the cigarette tax. The tax is an immediate tax on wholesalers who must buy cigarette excise tax stamps from the state and apply the stamps to each pack of cigarettes before selling the product to retailers. The stamp is proof that the tax has been paid.

At today's tax rate one roll of tax stamps, which stamps only 50 cases of cigarettes, is \$37,500 (*minus the wholesaler stamping compensation*). The Senate proposed tax increase will take one roll of stamps to \$49,500. A midsize wholesaler needing 40 rolls of tax stamps per month will see their monthly cost for tax stamps

jump from \$1.47 million to more than \$1.9 million under the Senate proposal. OWMA's largest wholesaler reports needing more than 150 rolls of tax stamps per month, costing more than \$7.2 million.

May and June Cash with Tax Stamp Orders Requirement: In the first ten months of the fiscal year wholesalers can buy the tax stamps on 30-day credit. However, in May and June they are required by law to pay for the tax stamps at the time they're ordered from the state. In May, wholesalers are paying double, ie paying for the stamps ordered on credit during April and also remitting payment with each stamp order placed in May, and then also remitting payment with stamp orders in June. *For those two month each year, these businesses take interest bearing loans/lines of credit to make sure the state gets its cigarette taxes and can balance the books at the end of the fiscal year.*

Insurance on stamps in transit from the state to the wholesaler and on stamps in the warehouse. The cigarette tax rate increases the value of the cigarettes so insurance for loss due to theft is also impacted.

Risk of loss from unpaid accounts/account receivables: There is no law requiring that wholesalers be paid on delivery for cigarettes or other tobacco products (there is such a law for beer/wine) so based on payment terms with retailers, it's about 14 to 20 days from the time the manufacturer debits the wholesalers bank account for the cost of the products until the wholesaler is paid by the retailer; during this time, the wholesaler carries the entire cost of the product and the excise tax. Increasing the tax increases the value and risk of nonpayment associated of the wholesaler's account receivables. Wholesalers are still obligated to remit the taxes to the state, even if the retailer doesn't pay for the taxed product.

Other Tobacco Products Tax Increase Other tobacco products (OTP) are everything containing tobacco except cigarettes. Because the tax for the entire OTP category is an ad valorem tax (assessed as a percentage of the mfg price to the wholesaler), the state actually sees increases in tax receipts whenever manufacturers increase their prices.

Wholesalers are the front end tax payer and tax agents for the other tobacco products tax. The tax is calculated using the manufacturer price to the wholesaler. The wholesaler remits the tax each month, based on shipments they received from manufacturers the prior month. As with cigarette taxes, if the retailer doesn't pay for the tobacco products the wholesaler is still obligated to remit the tax to the state.

One of the biggest challenges and frustrations when it comes to OTP is the reality of untaxed OTP flooding into Ohio from lower taxed states, primarily from Pennsylvania which does not tax OTP. An OTP trafficker sourcing product from Pennsylvania has an immediate 17% price advantage over Ohio's wholesalers who are abiding by the law and collecting/remitting OTP taxes to the state. These OTP traffickers sell to retailers, who know they are buying untaxed product. They also buy some of the same product from a taxpaying wholesaler, just so they'll have an invoice available if enforcement agents stop by, and they mix the untaxed product in with the taxed product. It's very easy, very profitable and very hard to detect.

Increasing the OTP tax rate to 22.5% -- any increase for that matter -- does nothing more than give the already illegal operators more incentive to come into Ohio, while putting Ohio's taxpaying wholesalers at more of a disadvantage and costing the state tax revenue that should otherwise be collected.

Ohio can increase OTP tax collections without imposing any tax increase by committing funds to hire and support the activities of what we call "boots on the ground" tobacco tax enforcement agents throughout the state. A true investment in this type of enforcement moves sales back into tax paid channels -- Ohio's wholesalers -- and increases tax revenue without increasing taxes. We know this type of enforcement works because at the times when agents are doing active investigations in an area, wholesalers who service accounts in that area see an increase in their OTP sales.

County Cigarette Taxing Authority House Bill 64 as passed by the House allows Stark County to levy a tax on cigarettes to fund arts and cultural projects within the county. OWMA opposes this language. Yes, Cuyahoga County has the same taxing authority which was also opposed by OWMA. County cigarette taxes are also run through wholesalers who have to use a different tax stamp for the county where the tax is levied. All of the cost and cash flow issues cited previously are relevant to the county cigarette tax issue, plus there are added costs for inventory management and required reports.

Beyond all of the wholesale-specific issues, giving more counties the authority to tax cigarettes is simply bad policy. Today it may be one more county included in the bill but other counties will line up to ask for cigarette taxes to fund arts or any number of other issues. What has always been a state revenue source snowballs into county by county revenue sources without the state getting additional revenue but the wholesalers bear additional costs and administrative issues.

OWMA appreciates the goal of reducing income taxes for all Ohioans, but it’s troubling that this goal is being supported through higher taxes on less than a quarter of Ohio’s population and Ohio’s lower income demographic – smokers and consumers of other tobacco products. Cigarette and OTP taxes are regressive and impose a greater burden on the poor. Almost 50 percent of Ohio smokers and more than 40 percent of other tobacco product users have a median annual household income of less than \$25,000. They are already paying over \$1billion in tobacco-related taxes and applicable sales taxes (FY2014).

	Cigarette Tax	Other Tobacco Products Tax*
OHIO (current)	\$1.25	17%
OHIO (proposed)	\$1.65	22.5%
Indiana	99.5cent	26%
Kentucky	60 cents	10%
West Virginia	55 cents	7%
Pennsylvania	\$1.60	No Tax
Michigan	\$2.00	32%

*ad valorem rates shown; Indiana and Kentucky tax moist segment differently

OWMA is part of a broader coalition that includes the Ohio Association of Convenience Stores, Ohio Council of Retail Merchants, Ohio Grocers Association, Ohio Petroleum Marketers and Convenience Stores Association, Associated Food and Petroleum Dealers, manufacturers and others. Based on the experiences of the businesses we deal with, what we know about this industry and how the market responds to higher taxes, we know that Ohio will not see reliable or sustainable levels of revenue from tobacco tax increases.

The state will lose tax paid sales as consumers along the borders go out of state and go online, and this obviously also means reduced sales and profitability for Ohio’s wholesalers and retailers which eventually becomes lost jobs.

When Ohio’s cigarette tax increased by 70-cents/pack in 2005, border counties in Ohio saw a **decrease** in pack sales ranging from 17.9% along the Indiana border to just short of 37% along the West Virginia border. At the same time, sales in Indiana counties that border Ohio **increased** by 14% and in West Virginia by 24%. Ohio sales along the Kentucky border dropped by 18.5%, but sales just over the border in Kentucky increased by 26%.

Keep in mind that “cross border” is not limited to state borders. The internet has broken the border barrier and tax free cigarettes are available from a range from overseas websites. Even with shipping costs, major brands through these sites cost less than 50 percent of the cost from an Ohio store at today’s tax rate. Attached to my testimony are examples of some of these online sources (Attachment 1). Tax free cigars and all other segments of the other tobacco product category are also available online and those tax free resources become more attractive to consumers when taxes are increased.

Examples of Pack Sale Changes Following 2005 Ohio Tax Increase
Ohio Counties v. Corresponding Border State Counties³

County	State		Increase/Decrease in Pack Sales
Darke	Ohio	↓	-26.76%
Mercer	Ohio	↓	-19.04%
Adams	Indiana	↑	10.05%
Wayne	Indiana	↑	15.03%
Randolph	Indiana	↑	8.82%
Jay	Indiana	↑	9.41%
Hamilton	Ohio	↓	-17.97%
Clermont	Ohio	↓	-16.81%
Brown	Ohio	↓	-19.89%
Campbell	Kentucky	↑	118.74%
Kenton	Kentucky	↑	10.07%
Mason	Kentucky	↑	15.90%
Dearborn	Indiana	↑	29.20%
Lawrence	Ohio	↓	-35.16%
Gallia	Ohio	↓	-30.70%
Boyd	Kentucky	↑	24.64%
Greenup	Kentucky	↑	20.99%
Casell	West Virginia	↑	18.80%
Wayne	West Virginia	↑	14.59%
Mason	West Virginia	↑	56.05%

Source: wholesale to retail shipment data reported by wholesalers; wholesaler contracts with mfgs require this data be reported to a third party non-mfg data collection firm. Data above based on quarter prior to 2005 cigarette tax increase compared to same quarter following the tax increase.

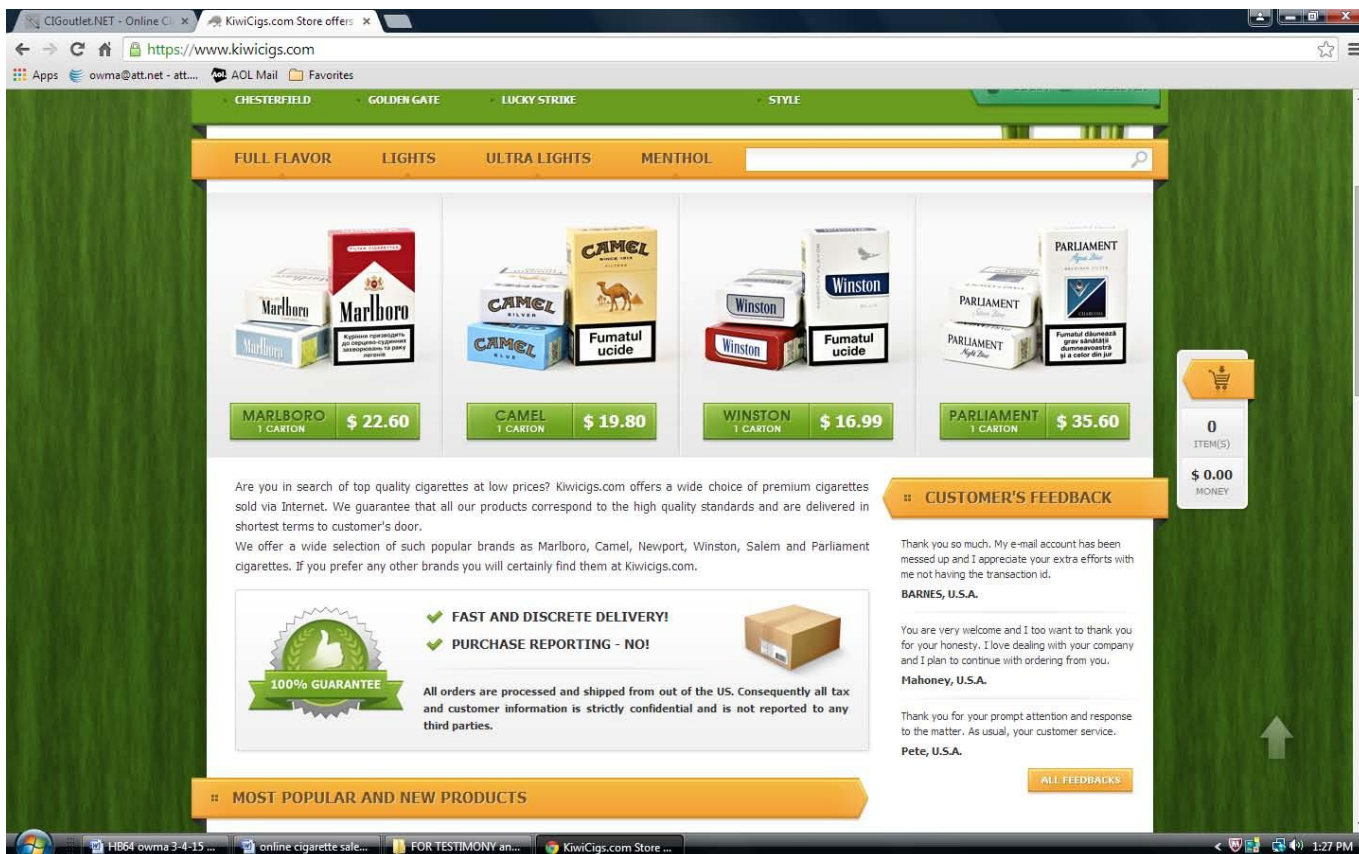
Mr. Chairman and members of the committee, I know I have covered a lot and I thank you for your patience and attention. There is much more that could be said but at this point I will thank you for your time, and I will do my best to answer any questions.

Attachment 1

Re: sample of online resources for tax free tobacco



The screenshot shows the homepage of CIGOUTLET.NET, an online tobacco store. The header includes the site name, a phone number (+1-213-9952968), and operating hours (Mon-Fri 8am - 12pm EST). A navigation bar offers links for Cigarettes, Cigars, Order Status, and Shopping Cart. A search bar is present, along with a 'GO' button. A 'CHOOSE BRAND' section lists various cigarette brands in two columns. The main content area features a 'Cheap Cigarettes Online' banner with a 'LOW PRICES GUARANTEED' badge. Below this, a text block explains the store's mission to provide discount and cheap cigarettes. A 'Safe and Discreet Delivery' section highlights that orders are shipped from outside the US and that purchase reporting is not required. A 'Customers Say' section includes a testimonial. At the bottom, several cigarette packs are displayed with their prices per 200 cigarettes: Marlboro Red Box (\$25.70), Camel Filters Box (\$22.90), Winston Red Box (\$20.09), and others.



The screenshot shows the homepage of KiwiCigs.com. The header features navigation tabs for CHESTERFIELD, GOLDEN GATE, LUCKY STRIKE, and STYLE. Below this, a search bar and a category filter (FULL FLAVOR, LIGHTS, ULTRA LIGHTS, MENTHOL) are visible. The main content area displays four cigarette packs with their prices: Marlboro (\$22.60), Camel (\$19.80), Winston (\$16.99), and Parliament (\$35.60). A 'CUSTOMER'S FEEDBACK' section contains testimonials from BARNES, U.S.A., Mahoney, U.S.A., and Pete, U.S.A. A '100% GUARANTEE' badge is also present. The bottom of the page features a 'MOST POPULAR AND NEW PRODUCTS' section.

<http://www.cigs-shop.net/>

<http://www.mycigaretteshop.net/>

<http://globalcigs.com/>

<http://www.dutyfreedepot.com/buy-duty-free-cigarettes.htm>