

## **Testimony on H.B. 64 Impact of Cigarette and Tobacco Tax increases**

Ohio House of Representatives Finance Committee

March 26, 2015

Gregory Wellinghoff, President  
Keilson Dayton Company

Chairman Ryan Smith  
Vice Chairman Kirk Schuring  
Ranking Member Denise Driehaus

Chairman Smith and members of the committee, thank you for allowing me the opportunity to speak with you today about Governor Kasich's budget bill and the proposed tax increases to cigarettes & tobacco. I own the Keilson Dayton Company, located in Dayton, OH. Keilson Dayton is a stamping wholesale dealer of cigarettes and also a wholesaler of other tobacco products. My company is a full service wholesaler to convenience stores throughout Southwest Ohio. We sell much more than just tobacco, but the cigarette and tobacco category represents 85.7% of our overall revenue. Cigarette and tobacco taxes paid to the State of Ohio today account for 21% of my total revenue. I have 47 employees. Today I will talk to you about three primary areas of concern I have regarding language in the budget bill.

### **First concern:**

We are a licensed cigarette stamping wholesaler dealer in the State of Ohio. We buy our cigarettes direct from the manufacturers, unstamped. We purchase State of Ohio Cigarette Tax stamps from the Tax Department and we affix these stamps to all of the cigarettes that come into our building. In order to affix these stamps, we purchase stamping equipment from one of the two manufacturers in the country who make this equipment. These stamping machines are very expensive. A new machine today is in excess of \$100,000. We pay for the labor to operate this machinery. We have to maintain these machines through maintenance agreements with the manufacturers in order to ensure that our machine is affixing the tax stamp at a level of quality that is acceptable to the Tax Department. We have to allocate significant floor space in our warehouse for the machinery and to facilitate the stamping process. We have to insure the tax stamps, while they are in transit from the state to our warehouse and while they are in our warehouse, and are responsible for any shortages on tax stamps. We file a reconciliation report with the tax department every six months on cigarette tax stamps. If we are out of balance in the states favor, we owe additional tax to the state. If we are out of balance in our favor, we do not get a refund or credit. As the agent responsible for collecting and remitting the tax to the State of Ohio, the tax stamp is part of the product we sell, and as a result we carry a receivable with retailers whom we extend credit on the tax stamp. If the retailer does not pay us, we are unable to recoup the tax. In effect, the State of Ohio takes no risk in the process as they have passed the work and risk on to the stamping wholesale dealers.

To help offset our costs associated with stamping cigarettes as tax agents for the state, we receive stamping compensation at a rate of 1.8% of the value of the tax stamps --- this is only 2.25 cents per pack. The budget bill strikes the language that provides us this compensation. Now the state expects us to do this work and incur these costs for free? I have attached a number of appendices to my testimony. Please see appendix 1 for a full breakdown of the cost

to Keilson Dayton Co. for providing the stamping service to the State of Ohio. I welcome any of you who wish to make the trip to Dayton to view this process for yourselves as Senator Beagle has done in the past, and hopefully better understand that we as wholesalers are performing a service for the state that should only rightfully be compensated.



**Second concern:**

Today, Ohio's Cigarette tax rate is \$1.25 per pack. Today, Ohio is ranked 29<sup>th</sup> highest nationally with regards to cigarette tax rates. Today, Ohio is taxing cigarettes at a rate that is competitive with most of its border states. Kentucky taxes cigarettes at \$.60 per pack. Indiana taxes cigarettes at \$.995 per pack. West Virginia taxes cigarettes at \$.55 per pack. Pennsylvania taxes cigarettes at \$1.60 per pack. Michigan, the state with which Ohio shares the smallest border,

taxes cigarettes at \$2.00 per pack. Under the budget bill Ohio's cigarette tax rate will increase to \$2.25 per pack. This rate will make Ohio higher than any of its border states with regards to cigarette taxation.

According to the US Census Bureau, in 2014 Ohio's population was 11,594,163. Of that population the US Census Bureau estimates that 3,239,159 Ohioans live in one of Ohio's border counties. The CDC estimates that 25.1 % of Ohio's adult population smokes. What do all of these statistics have to do with the tax increase? How many of Ohio's adult smokers who reside in border counties will now choose to make their cigarette purchases in one of Ohio's border states. One carton of cigarettes is 10 packs. Under today's rate of taxation that's \$12.50 for 1 carton. Under the proposed taxation it will be \$22.50 per carton. Kentucky will still be \$6.00 per carton. If you were going to make a weekly purchase of an item, let's say a tank of gas, and that tank of gas cost you \$67.50 at a store that was local and convenient to you but only cost you \$51.00 at a store 10 miles away from you, would you adjust your travel pattern to save \$16.50 a week? Most people probably would and would probably build other spending errands into the trip. Unfortunately you can only fill up your gas tank once, you can stockpile cigarette cartons. The ability to buy the product cheaper across the border and stockpile in order to reduce cross border trips makes this tax much more costly for the State of Ohio. A study done by Harvard University estimated that a consumer is willing to travel 2.7 miles to save \$1.00. Today Hamilton County and Clermont County cigarette smokers travel to Kentucky to make their cigarette purchases, under the proposed increase, this will extend into Warren County, Montgomery County, Miami County, Preble County, Clark County and greatly impact my business as these counties are my backyard.

Tax rate differences do lead to smokers driving a little further for their cigarettes. Most of Ohio's adult smokers are at the lower end of the income spectrum. As a result, a greater portion of their disposable income is going to be eaten up by the tax increase. \$16.50 means a lot more to these folks. I think they would strongly consider the road trip. Are any of Ohio's bordering states going to remit their increased cigarette tax revenue from Ohioans back to Ohio?

Why are we looking at increasing cigarette taxes in the first place? To fund an income tax cut. How much benefit do you think the average low income smoker is going to receive from an income tax cut? A pack a day smoker will actually pay \$365 more a year, and that doesn't include the added sales tax. So who does benefit from that income tax cut? I do not think it is a good idea to fund an income tax cut that most benefits those at the highest end of the income spectrum with a tax increase on those at the lowest end. A tax cut that affects all Ohioans should be funded by a tax that in turn affects all Ohioans universally, which is in effect a zero sum gain. As smokers choose to travel out of their way to make their cigarette purchases, how is Ohio receiving increased cigarette tax revenue to fund this income tax cut? \$1.25 of purchases made in Ohio is much better for the states revenue than \$2.50 of nothing due to that purchase being made outside of Ohio.

The argument is often made that increasing taxes lowers consumption. At the federal level, where a tax increase is not as susceptible to cross border stockpiling, I would agree with this. However where tax differences vary significantly over a relatively small geographic area, the consumption will not decrease as drastically as if the cross border variance did not exist. Instead Ohio smokers will make their purchases in lower tax border states, thus reducing the projected cigarette tax revenue increase the budget bill argues will be achieved.

It is imperative that you as legislators make recommendations regarding this budget that keep Ohio competitive with its border states regarding taxation if you want to maximize Ohio's cigarette tax revenue. This tax increase does not keep Ohio competitive as it makes Ohio higher than any of its border states.

For my company, a roll of tax stamps that costs my \$37,500.00 today would cost me \$67,500.00 moving forward. This is a box about the size of a large flashlight (pictured above). My inventory carrying costs increase by approximately \$260,000 under this bill. My receivables increase approximately \$130,000 under this bill. My lending institution likes to see these increases as it means I have to borrow more money from them. They do not however like to see these increases, when they are not tied to an increase in sales. This bill does not increase my sales, in fact it decreases them, while increasing my cost of doing business.

**Third concern:**

Ohio's other tobacco products rate, or OTP rate is at 17% on all other tobacco products except little cigars. In 2013 Ohio raised the tax rate on little cigars to 37%. That caused a fairly drastic decline in my little cigar sales. Now the budget bill is looking at raising the OTP rate up to 60%. When I as a wholesaler sell an OTP product to a retailer I make about 4% today. Smugglers who come into Ohio from Pennsylvania with untaxed OTP product are able to make in excess of 17% today and undercut my prices. If the OTP rate goes to 60% would you guess that the amount of smuggling coming into Ohio would increase, decrease, or remain the same? OTP is vastly different than cigarettes. There is no tax stamp marking on the product to indicate that the tax has been paid and a roll of Copenhagen sold in Ohio looks identical to a roll of Copenhagen sold in Pennsylvania. A State of Ohio enforcement agent in a retail store has no true way to tell if a retailers OTP product came from a legitimate taxpaying Ohio Wholesale Dealer, or from a smuggler who brought it in from Pennsylvania. The retailer can buy a few rolls of Copenhagen from a legitimate wholesaler to have an invoice on hand that satisfies a tax enforcement agent, while buying cases of rolls from a smuggler.

Taking the OTP tax rate in Ohio to 60% would have a dramatic impact on my business. It would also have a dramatic impact on the smuggling business. Even though tobacco tax enforcement is active in the marketplace, Ohio does not have enough enforcement agents to stop the smuggling problem altogether under today's rates. As the incentive to smuggle OTP into Ohio increases, more and more product will come in to Ohio. I have not seen anything in the budget bill that is going to increase the funding for enforcement to combat this, so these agents are going to be burdened with an increased workload while I see declining revenues. Additionally the danger for these agents increases as the incentive to smuggle increases. Not all criminals surrender peacefully when caught. Additionally the penalties for smuggling OTP into Ohio are minor in comparison to the penalties for other illicit trades such as drug dealing. Making smuggling more profitable in Ohio with the potential penalties for a conviction being minor will only incentivize an increase in the illicit trade of OTP. My company paid \$864,443 in OTP taxes in 2014. Under the new proposed 60% rate, all things being equal, I would pay \$3,050,975. This assume my volume remains the same and is not impacted by consumers going across the border, or my retailers purchasing product smuggled out of Pennsylvania. I am sure the smugglers are looking at that number also. It would not take a smuggler to long making that kind of profit to retire comfortably. When Ohio can stop OTP smuggling 100% of the time, then Ohio can consider raising the OTP tax rate, until then, raising the rate will only lead to lower OTP revenues for Ohio.

As I discussed with cigarette taxation, the same border issues will apply with an OTP tax increase. Right now Ohio is pretty close to parity with all of its border states except Pennsylvania which does not tax OTP. Under the tax increase to OTP proposed in the budget bill, Ohio will have a higher rate than all of its border states.

Again, 17% of something is better than 0% on smuggled product, or products purchased across the border. I cannot stress enough how such a high OTP tax rate will negatively impact my business, burden underfunded enforcement and negatively impact Ohio.

Again, all things being equal, a 60% OTP tax rate will increase my inventory carrying costs by approximately \$180,000. My receivables increase by approximately \$75,000. Again this results in no increase in sales, only a decrease in sales.

**In conclusion:**

I still have to run a business in Ohio. I still have to provide jobs that support 47 families. In Ohio there are other wholesalers like me that also have to run profitable businesses despite continued attempts at putting up roadblocks to our being able to do so. Our product category's usage declines each year, as such the cigarette and tobacco category is not a sustainable long term revenue source for the State of Ohio or any other state. Increased taxation in Ohio only speeds up the eventual elimination of cigarette and tobacco tax as a revenue source for Ohio.

Increased taxation also makes these products more desirable to criminals. My business was burglarized on January 15<sup>th</sup> and in 9 minutes I incurred a significant loss (Appendix2). As such I have had to invest a little over \$40,000 this year in upgrading my company's security.

I have held off on expansion plans (Appendix 3) in Ohio for the last few years due to the continued uncertainty surrounding taxation. How can I justify expansion that leads to new jobs, when I am faced with tax policy that threatens the existence of my business? I know that tax rates on cigarettes and tobacco that take Ohio higher than its border states will negatively impact my business in a significant way. If these cigarette and tobacco taxes that are proposed in the budget bill go through, instead of expanding and creating more jobs in Ohio, I will end up cancelling expansion plans and laying off employees as sales decline. If business declines enough, I close the doors in Ohio and move to a state that is much friendlier to my type of business. How many of my 47 employees do you think will be able to make that move with me? I have attached just one of a few of the expansion projects that I have put off due to the uncertainty in Ohio. These projects create other jobs an opportunity in Ohio, that are being delayed or potentially cancelled. Why would I expand my infrastructure for declining sales? Under this bill I have to ask my lending institution for \$645,000 in working capital for no increase in sales.

Thank you for your time and I hope you will take my testimony into account when making the decision that is right for Ohio.

**Appendix 1 – Cigarette stamping costs**

Initial machine cost amortized over 7 year useful life. (6 year old machine = \$60,764.71)	\$8,680.67
Annual maintenance cost of machine.	\$7,012.04
Labor cost of 1 full time stamping employee.	\$21,877.77
State unemployment insurance cost of stamping employee. (assuming good history)	\$54.00
Federal unemployment insurance cost of stamping employee.	\$42.00
Workers compensation insurance cost of stamping labor.	\$419.08
Social Security employer on stamping labor.	\$1,349.84
Medicare employer on stamping labor.	\$315.69
Benefits provided to stamping labor.	\$702.75
Shipping on stamps.	\$1,527.22
Insurance on stamps in warehouse.	\$5,000.00
Interest charged by bank for funds borrowed during May and June COD period with the state.	\$3,566.25
Rent on 3600 sq ft space allocated for stamping @ \$3.50 / sq ft.	\$12,960.00
Professional labor allocated to tax stamp reporting to Ohio each month.	\$4,624.61
UPS insurance on tax stamps shipped under new rules requiring wholesalers to insure their shipments for face value of the tax stamps.	\$78,975.00
Total annual cost to Keilson Dayton to act as a tax stamping agent for the State of Ohio.	\$147,106.92

## Appendix 2

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Posted: 11:51 a.m. Friday, Jan. 16, 2015

## **\$57K worth of cigarettes stolen from business**

By Breaking News Staff

**DAYTON** — Dayton police are investigating after \$57,000 worth of cigarettes were stolen from a local business.

Police responded to Keilson Dayton Company up the 100 block of Commerce Park Drive at 8:50 p.m. Thursday on a breaking and entering report.

**More News**



2201 Embury Park Road  
Dayton, OH 45414-5574  
Phone: 937-274-1173  
Fax: 937-277-1379

February 11, 2015

Keilson Dayton  
107 Commerce Park Dr.  
Dayton, OH 45404

Attention: Greg Wellinghoff

Re: Office Addition and Connector Revised  
FCC Estimate No.: 15-D5008

Mr. Wellinghoff:

We are pleased to provide our budgetary proposal for an office addition and building connector at your Dayton, OH facility based on Ferguson Construction Co. (FCC) drawings dated 2/6/15.

**Option 1: Office Addition**

For the sum of . . . \$ 222,428<sup>00</sup>.

The following work is included:

1. Saw cut and remove 1,314 SF of existing concrete pad as shown on Ferguson Construction (FCC) drawing A-1.
2. Saw cut and remove 865 SF of asphalt parking lot as shown on FCC drawing A-1.
3. Excavate for new perimeter spread footings.
4. Form and pour new concrete footings. Concrete shall be 4,000 psi, air entrained with #5 rebar reinforcing at 12" on center (O.C.).
5. Form and pour new 4" thick slab on grade. Concrete shall be 3,500 psi, air entrained reinforced with one layer of 21# welded wire fabric (WWF).
6. Form and pour new 4"x4'x5' concrete apron. Concrete shall be 4,000 psi, air entrained reinforced with one layer of 21# WWF.
7. Patch back removed asphalt around new building addition.
8. 8" thick concrete block walls with reinforcing and foam insulation from top of foundation to 48" above finished floor (AFF) on north, east and west sides of office addition. Exterior of block wall will be painted.
9. 8" thick concrete block walls with reinforcing and foam insulation from top of foundation wall to deck on south side of office addition to create 3 hour fire wall.
10. Remove existing windows on north side of existing building and enlarge openings for new 3'-0" x 7'-0" doors and frames.





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Office Addition and Connector  
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**Option 3:** 1,271 SF connector per FCC drawing A1-1.

Add . . . \$ 90,197<sup>00</sup>.

The following work is included:

1. Includes the same scope of work as the above connector with the below modifications.
2. Remove existing 3'-0" x 7'-0" door and frame, infill opening and paint.
3. Windscreen will be removed but will not be reinstalled.
4. No modifications to the existing storm line are included.
5. (1) existing wallpack to be relocated.
6. (6) 4' 6-lamp fluorescent high bays.
7. (1) battery pack combination LED exit/emergency light.
8. (2) three way switches.
9. (1) fire alarm pull station.

**Alternate 1:** LED fixtures in lieu of florescent. New LED fixtures to match LED fixtures in existing warehouse.

Add . . . \$ 4,445<sup>00</sup>.

Notes & Clarifications:

1. This proposal is based upon a standard forty (40) hour workweek.
2. No fire suppression is included.
3. No modifications to the existing facility as may be required by code are included.
4. No additional parking requirements due to zoning regulations have been included.
5. Security system modifications, phone, and data are to be by owner.
6. The cooler relocation is by owner.
7. Due to the nature of the cooler, minimum conditioning only is provided to the cooler room.
8. All electrical circuits are to be fed from existing service, no new panels are included.
9. Design drawings and building permits are included.
10. Sales tax is included.

We sincerely appreciate the opportunity of submitting our proposal and look forward to serving you on this project. Should you have any questions, please do not hesitate to call our office.

Yours truly,

FERGUSON CONSTRUCTION COMPANY

Anna Hedley  
Project Manager, Special Project



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**Alternate 1:** Level 1 bullet resistant glass in all new 4'-0" x 4'-6" office windows.

Add . . . \$ 15,752<sup>00</sup>.

**Alternate 2:** LED fixtures in lieu of florescent. New LED fixtures to match LED fixtures in existing office area.

Add . . . \$ 3,301<sup>00</sup>.

**Option 2:** 360 SF connector per FCC drawing A-1.

Add . . . \$ 70,332<sup>00</sup>.

The following work is included:

1. Saw cut and remove 588 SF of asphalt.
2. Remove 10' x 10' section of wall panel from existing out building, frame in opening and patch back panels as required.
3. Remove overhead door and track from existing building and turn over to owner.
4. Form and pour new 6" thick slab on grade. Concrete shall be 3,500 psi, air entrained reinforced with one layer of 21# WWF.
5. Four (4) new 6" schedule 40 bollards, with concrete fill.
6. 8" thick concrete block walls with reinforcing and foam insulation to deck on north and south sides of new concrete slab.
7. 8" thick concrete block walls with reinforcing and foam insulation to deck at east wall of existing building within the bounds of the new concrete slab to create a 3 hour fire wall.
8. New metal roofing system, gutters, downspouts, flashing and trim at connector.
9. Modify existing storm line as required to accommodate new construction and tie in new downspouts.
10. Patch asphalt around new connector.
11. New 10' x 10' 3 hour rated, rolling steel door with fusible link, manually operated.
12. Paint all new concrete block walls.
13. (1) existing wallpack to be relocated.
14. (2) 4' 6-lamp fluorescent high bays.
15. (1) battery pack combination LED exit and emergency light.
16. (2) three way switches.
17. (1) fire alarm pull station.



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11. New pre-engineered framing, metal siding panels, metal roofing, gutters, downspouts, flashing and trim on north, east and west walls of new building addition to match existing building.
12. Modify existing downspouts to drain onto new addition roof.
13. Modify existing storm line as required to accommodate new construction and tie in new downspouts.
14. Remove wood door from frame on west wall of Room 102, File Room and give to owner.
15. Fur out new 3 hour fire wall with 1 1/2" zee furring. Hang and finish 1/2" drywall to 6" above ceiling.
16. Hang and finish 1/2" drywall on 3 5/8" metal studs to 6" above ceiling on north, east and west walls of new addition. Box around columns as required.
17. Frame, hang and finish new drywall walls above ceiling in office addition. Studs shall be 3 5/8" with 1/2" drywall on both sides of walls.
18. New metal grid and 2' x 2' acoustic ceiling pads in new offices, conference room and hallway.
19. Paint all new interior and exterior masonry, drywall walls, cooler room, hollow metal doors and frames. Wood doors will be stained unless specified otherwise.
20. New carpet and 4" rubber base in all new offices, conference room and hallway. Only 4" rubber base to be installed in cooler room.
21. (1) three ton gas fired, packaged rooftop unit for heating and cooling.
22. Condensate drain piping from new to new unit to floor drain near new cooler location.
23. Gas piping from near meter to rooftop unit.
24. Seven diffusers and seven ducted return grilles with programmable thermostat for the new offices, conference room and hallway.
25. Relocate (3) existing wallpacks.
26. (21) new 2'x4' recessed florescent troffers for offices and hallway.
27. (6) LED can lights in conference room.
28. (2) 8' 4-lamp florescent strip lights in cooler room.
29. (2) battery pack combination LED exit and emergency lights.
30. (1) battery pack emergency light.
31. (1) weatherproof remote mount emergency head.
32. (5) single pole switches.
33. (4) three way switches.
34. (24) duplex receptacles.
35. (10) boxes with conduit stub to above ceiling for telephone and data outlets.
36. (1) each connection to gas fired furnace, condensing unit and relocated cooler.
37. (7) smoke detectors.
38. (2) horn/strobes.
39. (2) pull stations.