

Testimony on Impact of Cigarette and Tobacco Tax increases

Ohio Senate Finance Committee

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Chairman Oelslager and members of the committee, thank you for the opportunity to speak with you today about the Senate's plan to put cigarette and tobacco tax increases back in the state budget bill (SubHB64).

I own the Keilson Dayton Company, located in Dayton, OH. My company has 47 employees and is a full service wholesaler to convenience stores throughout Southwest Ohio.

Keilson Dayton is a stamping wholesale dealer of cigarettes and also a wholesaler of other tobacco products. 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.

First concern: Cigarette Tax Increase

Today, Ohio's Cigarette tax rate is \$1.25 per pack, which is already higher than all of our border states except Michigan. 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.

The Senate plan to increase the cigarette tax by 40-cents will take Ohio's rate to \$1.65 per pack. That additional \$4/carton tax (10 packs per carton) will be enough to incentivize smokers along the West Virginia, Kentucky and Indiana border who aren't already going out of state for cigarettes to start going out of state. That's a loss of \$16.50 per carton in excise taxes plus lost sales taxes for Ohio. And the cross border cigarette shoppers won't buy just cigarettes out of state, they'll also buy other products which means even more lost tax revenue for Ohio and lost sales for Ohio businesses.

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 choose to make their cigarette purchases in one of Ohio's border states. Under today's rate of taxation the tax is \$12.50 for one carton and the Senate plan increases the tax to \$16.50 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 \$51.00 at a store 10 miles away, 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, but fortunately for smokers they 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 \$1.65 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.

The state collects the cigarette tax through cigarette tax stamps that wholesalers like myself have to buy from the state and put on every pack of cigarettes. The stamp is proof that the tax has been paid. Just one roll of stamps today (stamps 30,000 packs) is \$37,500 roll of tax stamps and it would increase to \$49,500 under the Senate's tax increase. My inventory carrying costs and receivables would increase approximately \$200,000 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. Cigarette tax increases do not increase my sales, in fact it decreases them, while increasing my cost of doing business.

Second concern: Other Tobacco Product Tax Increase

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. The executive budget looked to raise the OTP rate to 60%, which the House rejected, and now the Senate wants to increase the tax to 22.5%

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 22.5% 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 22.5% 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.

There was nothing in the tax increase proposal to increase the funding for enforcement to combat all of the untaxed other tobacco product issues, so the agents would just 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 will only incentivize an increase in the illicit trade of OTP. 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 that was proposed, Ohio would 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.

Like with a cigarette tax increase, a higher OTP tax rate will increase my inventory carrying costs and receivables. Again this results in no increase in sales, only a decrease in sales.

Third Concern: County Cigarette Taxes

Cuyahoga County is the only county that can tax cigarettes. They have a cigarette tax for the Browns, Cavs and Indians sports facilities, and they have another cigarette tax for arts and culture in the county. The budget bill passed by the House allows Stark County to also tax cigarettes to fund arts and cultural projects in the county. I don't sell into Cuyahoga County and I don't sell into Stark County, nor would I want to because county cigarette taxes mean added costs for my business. For every county that taxes cigarettes, I would have to buy different tax stamps from the state and the stamp can only be used in the taxing county. My costs go up because the county tax because part of the price of the roll of stamps and my account receivables go up. I'd also have to run new inventory controls and have additional reporting requirements to manage the county tax. My company is in Montgomery County and the arts community may want a cigarette tax. The bottom line is that for every county that taxes cigarettes, more will be in line asking for the same thing. The state doesn't benefit from county taxes and wholesalers have to deal with the impacts on business operations and lost profitability due to higher costs.

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.

Increased taxes also makes these products more desirable to criminals. My business was burglarized on January 15th and in just 9 minutes I incurred significant loss of \$57,000 of cigarette inventory. As such, I've had to invest more than \$40,000 this year to upgrade my company's security to protect my cigarette/tobacco inventory.

I know that cigarette and tobacco taxes that take Ohio higher than border states will negatively impact my business in a significant way. If taxes are increased, instead of expanding and creating more jobs in Ohio, I will be 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? Under the executive budget tax increases, I have to ask my lending institution for more 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.