State Taxation of Non-Cigarette Tobacco Products

The Tobacco Control Legal Consortium has created this series of legal technical assistance guides to serve as a starting point or as a refresher for organizations and individuals interested in reviewing existing state tobacco tax laws for possible modification or advancing new legislative proposals. We encourage you to consult with local legal counsel before attempting to implement these measures. For additional information on tobacco taxation and other issues related to tobacco pricing, please contact the Consortium.

Overview

From a public health perspective, raising tobacco taxes is one of the most effective ways to reduce tobacco use and initiation, especially among youth, and is one of the most effective strategies to reduce tobacco-related health care costs. State tobacco products tax revenue is also one of the most reliable and predictable sources of state revenue. Generally, tobacco tax revenue spikes following a significant tax increase and then declines gradually as the rates of youth and adult tobacco use drop in direct response to product price increases. However, the gradual decline in revenue remains predictable, tends to be modest, and is more than compensated for by reductions in health care costs and other costs associated with tobacco use.

An influx of new and novel tobacco products into the marketplace, plus recent amendments to federal laws regulating and taxing tobacco, have heightened the need for states to review their tobacco tax laws for possible reform. To review a state’s tobacco tax laws for this purpose, it is essential to examine the state’s entire tobacco control regulatory scheme—analyzing not only the tobacco tax laws affecting cigarettes and non-cigarette tobacco products but also licensing, retail sales, youth access, and other tobacco control measures. It is also essential to understand the federal tobacco excise system and how it impacts states. By conducting a thorough review of all state and federal laws that affect tobacco taxation, states can avoid omitting critical components or making administrative errors that could jeopardize intended revenue and public health outcomes.
Federal Non-Cigarette Tobacco Product Excise Tax Rates

Federal tobacco product excise taxes are imposed and regulated under the Internal Revenue Code (IRC), through the Alcohol and Tobacco Tax and Trade Bureau (TTB). The TTB collects many billions of dollars per year in federal excise taxes on cigarettes, cigars, smokeless tobacco, pipe tobacco, roll-your-own tobacco, and cigarette papers and tubes. Federal excise taxes on tobacco normally are due when a manufacturer removes products from a factory or when an importer retrieves products from customs authorities.

Effective April 1, 2009, the Children’s Health Insurance Program Reauthorization Act of 2009 (Pub. L. 111-3, known as “SCHIP”) significantly increased the federal excise tax rates on all tobacco products and changed the way certain categories of tobacco products are taxed. The TTB is reviewing the distinctions between cigarettes and cigars in other federal laws that are related to the taxation of tobacco products, and plans to promulgate rules to develop objective standards to distinguish between products for federal excise tax purposes and to enhance the administration of related laws. The following chart compares the former federal tobacco excise tax rates with the rates now in effect.

Federal cigarette and non-cigarette tobacco product excise tax rates

<table>
<thead>
<tr>
<th>TOBACCO PRODUCTS</th>
<th>Federal Tax Rates on 3/31/09</th>
<th>Current Federal Tax Rates as of 4/1/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small cigarettes: weigh 3 lbs. or less per 1,000</td>
<td>$19.50 per 1,000</td>
<td>$1.01/pack of 20; $50.33 per 1,000</td>
</tr>
<tr>
<td>Large cigarettes: weigh more than 3 lbs. per 1,000</td>
<td>$40.95 per 1,000</td>
<td>$105.69 per 1,000</td>
</tr>
<tr>
<td>Large cigars: weigh more than 3 lbs. per 1,000</td>
<td>20.719% of mfr. sales price, not to exceed $48.75 per 1,000</td>
<td>52.75% of mfr. sales price, with cap of $0.4026 per cigar; $402.60 per 1,000</td>
</tr>
<tr>
<td>Small cigars: weigh 3 lbs. or less per 1,000</td>
<td>$1.828 per 1,000</td>
<td>$1.01/pack of 20; $50.33 per 1,000</td>
</tr>
<tr>
<td>Roll-your-own tobacco (RYO)*</td>
<td>$1.0969 per pound</td>
<td>$24.78 per pound</td>
</tr>
<tr>
<td>Pipe tobacco*</td>
<td>$1.0969 per pound</td>
<td>$2.8311 per pound</td>
</tr>
<tr>
<td>Loose moist snuff*</td>
<td>$0.585 per pound</td>
<td>$1.51 per pound, or $0.113 per 1.2 oz. can</td>
</tr>
<tr>
<td>Snus and dissolvables*</td>
<td>$0.585 per pound</td>
<td>$1.51 per pound, ranging from $0.016 - $0.032 per pack depending on product’s weight</td>
</tr>
<tr>
<td>Chewing tobacco*</td>
<td>$0.195 per pound</td>
<td>$0.5033 per pound</td>
</tr>
</tbody>
</table>

* The tax rate for each of these products is set per pound and a proportionate tax at the same rate applies to all fractional parts of a pound.

Federal tobacco tax rates for large and small cigars. As described in the chart above, small cigars are now taxed at a rate that is equivalent to the rate on small cigarettes, a substantial increase over the prior rate. Manufacturers have reacted to the increase by manipulating the weight of so-called “little cigars” to slightly over 3 pounds per 1,000, so that they will be taxed at a much lower rate as large cigars for federal excise tax purposes.
Notably, the year before the new rates took effect, the amounts of large and small cigars marked for collection of federal taxes were closely matched, but in the year afterward, the share of small cigars tanked and large cigars swelled to nearly 89 percent of the total.\(^6\)

**Federal tobacco tax rates on roll-your-own (RYO) and pipe tobacco.** Although these two products were taxed at the same rate before SCHIP took effect, the tax on RYO tobacco is now much higher than the tax on pipe tobacco. It is difficult to distinguish between RYO tobacco and pipe tobacco because the products are similar in content and appearance. For this reason, and because the federal excise tax on RYO is now much higher than the tax on pipe tobacco, many consumers have switched to pipe tobacco as a substitute for RYO. In the year after the rate change took effect, pipe tobacco sales grew dramatically and sales of RYO tobacco declined steeply.\(^7\) The TTB is evaluating objective standards for differentiating between RYO and pipe tobacco for federal excise tax purposes and intends to solicit comments on new classification standards.\(^8\)

**Federal tobacco tax rates on smokeless tobacco.** Federal excise tax rates on smokeless tobacco products are weight-based and vary by type of tobacco product, as outlined in the chart above. When the recent rate changes took effect, sales of smokeless products increased markedly and sales of cigarettes slumped.\(^9\) To halt revenue losses, substantially increase tax revenue, and help reduce overall tobacco use and related health care costs, the Campaign for Tobacco-Free Kids has called for all federal tobacco product excise tax rates to be set at levels that parallel the federal cigarette excise tax rate.\(^10\)

**State Non-Cigarette Tobacco Product Excise Tax Rates**

All fifty states are subject to the uniform federal excise tax rates on cigarette and non-cigarette tobacco products. However, there is considerable variation among states in the state-level taxation of non-cigarette tobacco products. All states except Pennsylvania impose state excise taxes on at least some non-cigarette tobacco products, but the tobacco products that are taxed vary from state to state, and the types and rates of taxation that are applied to the product categories vary, too. Generally, states use one or both of the following two types of excise taxes\(^11\) to tax non-cigarette tobacco products:

1. **Specific taxes**, which impose a fixed-dollar tax on a specific quantity of a tobacco product (e.g., $1.00 per ounce) that is added to the base price of the product (i.e., the wholesaler’s invoice price, plus state excise tax and the wholesaler’s or retailer’s mark-up for the cost of doing business); and

2. **Ad valorem taxes** (often called percentage-of-price taxes), which impose a tax set as a percentage of a product’s value (e.g., 35 percent of the wholesale price). Most states—twenty eight, to be specific—apply this type of tax to all non-cigarette tobacco products.\(^12\)

In addition, some states establish a **minimum tax**, essentially a tax floor, for one or more types of tobacco products (e.g., moist snuff), or a **cap**, or ceiling, on the tax rate for certain products (e.g., premium large cigars). Several states apply percentage-of-price
taxes for some product categories (e.g., cigars and other smoked products) and a specific tax for another category (e.g., smokeless products). For example, New York applies a specific tax to moist snuff (currently set at 200 cents per ounce, with a minimum tax), and taxes all other non-cigarette tobacco products by percentage-of-price (currently set at 75 percent of wholesale price).

Because there are many variations in how states tax non-cigarette tobacco products, it can be challenging to track states’ tobacco tax schemes. Practical resources on each state’s current tax rates are available from the Campaign for Tobacco-Free Kids and from the American Lung Association, and attorneys at the Tobacco Control Legal Consortium can respond to specific requests for technical assistance regarding tobacco tax questions. Below are brief summaries of how state excise tax rates apply to key categories of non-cigarette tobacco products, with examples of tax rates in various jurisdictions:

**State tax rates for large and small cigars.** Most states tax large and small cigars at the same rate, but some include a cap (e.g., Connecticut and Iowa tax cigars at 50 percent of the wholesale price, with a 50 cents cap, and Washington taxes cigars at 95 percent of the taxable sales price, with a 75 cents cap). A few jurisdictions exempt premium, large cigars from state excise taxes altogether (e.g., New Hampshire and Washington, D.C.). Although several states apply a weight-based tax to cigars, the majority tax cigars by percentage-of-price, based either on the manufacturer’s price (the price charged to a wholesaler by a manufacturer) or the wholesale price (the price charged by a wholesaler or distributor to a retailer or the price charged by a manufacturer to a wholesaler).

**State tax rates for RYO, pipe tobacco, and chewing tobacco.** Generally, states apply the same type and rate of taxation to RYO and pipe tobacco. Some states apply a weight-based tax (e.g., Arizona, $0.2235 per ounce), but most apply a percentage-of-price tax on the manufacturer’s price or the wholesale price. In addition to leading customers to substitute pipe tobacco for RYO tobacco, the recent federal tax rate increase on RYO tobacco has drawn consumers to retail stores where they can roll cigarettes with loose tobacco purchased from the retailer, using on-site cigarette rolling machines. Because states are not taxing loose tobacco at a rate that is equivalent to the state tax on cigarettes, consumers are able to take advantage of this tax loophole.

Chewing tobacco is taxed like RYO and pipe tobacco in most states, with either a percentage-of-price or a weight-based tax applied to all three product categories; however, there are a few exceptions. North Dakota, for example, taxes chewing tobacco at $0.16 per ounce, but taxes RYO and pipe tobacco at 28 percent of wholesale price. Among states that apply the same type of tax to all three products, a few have established a separate tax rate for chewing tobacco (e.g., in Massachusetts, chewing tobacco is taxed at 90 percent, and RYO and pipe tobacco are taxed at 30 percent, of the wholesale price).

**State tax rates for smokeless tobacco products.** The types and rates of taxation on smokeless products also vary from state to state. While some states apply tax smokeless products by weight, on a per ounce basis, most states tax smokeless products as a
percentage of the wholesale or manufacturer’s price. There is considerable variation among states in rates of taxation. A few states have established a minimum tax on smokeless products (e.g., Maine, New York, Oregon and Texas).23

Policy Rationale

The public health rationale for raising non-cigarette tobacco excise taxes is much the same as the rationale for raising cigarette excise taxes. Increasing the price of tobacco products by raising tax rates reduces the demand for the products, which, in turn, leads to significant reductions in the use of tobacco by current consumers and in the initiation of tobacco use by youths, significant reductions in health care and productivity costs related to tobacco use, and significant increases in state revenue.24 Tobacco tax reforms that raise non-cigarette tobacco tax rates, make them parallel to the tax rates for cigarettes, and improve regulatory mechanisms will help curb this phenomenon, drive down tobacco use and related costs, and increase state revenue.

Policy Options

The following policy options for state taxation of cigars and smokeless tobacco products are designed to advance public health goals by closing tax loopholes and strengthening the health and economic impact of tobacco excise tax policies. To accomplish this purpose, proposals to increase state excise tax rates on non-cigarette tobacco products and cigarettes should be considered at the same time, and options to achieve parallel tax rates should be addressed then, too. For guidance on state policy options for taxing so-called “little cigars” and RYO or other loose tobacco, please see the Consortium’s companion Tips and Tools publication on State Taxation of Cigarettes. For general guidance on tobacco tax policy options, please see the Consortium’s companion Fact Sheet on Tobacco Tax Basics: An Introduction to Key Considerations for States.

- **Raise the tax rate on large and small cigars, match the rate to equal the tax rate on cigarettes, and set the rate to increase automatically in sync with increases to the cigarette tax.**25 Because tax rates on cigars tend to be very low in comparison to state tax rates on cigarettes, price-sensitive consumers, especially youth, experiment with and switch to low-priced products such as fruit-flavored cigarillos. These products, and others that are under-taxed (e.g., snus), are heavily marketed by the tobacco industry as lower-priced alternatives to cigarettes. As a consequence, fewer people succeed in quitting tobacco use and more youth become addicted to tobacco. The under-taxing of cigars diminishes state tax revenue. Bringing cigar tax rates in line with cigarette tax rates and setting them up to increase automatically whenever cigarette taxes are increased will help states achieve public health and revenue goals.

- **Tax cigars at a tax rate that is based on percentage-of-price.**26 Cigars are packaged and sold in many different configurations—as single cigars, in packs of 5 or 10, in boxes of 25, etc. States can ensure that a single tax rate applies to all cigars by setting a tax rate based on percentage of the wholesale or manufacturer’s price.
- **Eliminate caps on cigar tax rates.** Only few states, Connecticut, Iowa, Oregon, Rhode Island, Washington, and Wisconsin, cap the tax on cigars. For example, Rhode Island taxes cigars at 80 percent of wholesale price with a $0.50 cap, whereas New York taxes cigars at 75 percent of wholesale price with no cap. A cap on a state’s cigar tax provides an unjustified tax break to smokers who purchase premium cigars. States will increase tax revenue, and promote tax equity and public health goals, by avoiding caps or eliminating them in jurisdictions where they are already in place.

- **Modernize the definition of “tobacco product” in state non-cigarette tobacco tax laws to ensure that new and novel tobacco products do not escape taxation.** The tobacco industry markets a wide range of smokeless tobacco products, many of which come in child-friendly flavors such as apple, vanilla, and grape and have names that mirror popular cigarette brand names (e.g., R.J. Reynolds’ Camel Snus). In addition to sticks, strips, and orbs, novel tobacco products include electronic delivery devices (e.g., e-cigarettes), gum, tablets, and creams. Because they typically are priced and taxed at much lower rates than cigarettes, smokeless tobacco products are attractive to youth. As such, they pose a danger as gateway products that can lead to habitual tobacco use, including smoking, and long-term addiction to nicotine. Some smokeless products, like snus, do not require spitting, making them easier for youth under 18 to use without detection. Youth access to these products can be curbed using a combination of taxation and pricing strategies.

- **Raise tax rates on smokeless products, apply a percentage-of-price tax rate to smokeless products whenever possible, and set the tax rate to match the tax rate on cigarettes.** Smokeless tobacco products are under-taxed by states, particularly in states with weight-based tax rates. Weight-based taxes paid per pack or per dose on new, very low weight, smokeless tobacco products (e.g., orbs, sticks, strips and lozenges) are much lower than the weight-based tax paid on conventional, loose moist snuff because conventional moist snuff has a much higher moisture content (generally, over 45% water), which adds weight. Weight-based tax rates on smokeless tobacco products cannot keep pace with inflation or price increases because the weight of products remains constant despite price increases. Whether a state taxes some or all smokeless tobacco products by weight or by percentage-of-price, the tax rates can be set to match the cigarette tax rate. Doing so will maximize tax revenue and reduce consumer interest in searching for lower-priced products.

- **Limit any weight-based tax rate on moist snuff to conventional moist snuff only, and apply an equivalent percentage-of-price tax to other, low-weight moist snuff products (e.g., snus, sticks, strips, orbs, lozenges).**

- **Establish a minimum tax rate for percentage-of-price smokeless tobacco products and cigars.** By setting a minimum tax rate, states can ensure that all non-cigarette tobacco products will be subject to reasonable taxation and cannot evade taxation through predatory or other anti-competitive or bargain-basement pricing.
Policy Elements

Tobacco tax policies must be clear and concise. Particularly careful attention must be paid to definitions, which may need to be added or amended to modernize laws and ensure that all non-cigarette tobacco products are taxed appropriately and effectively. Because of the complexities involved in tobacco tax policies, we encourage you to seek further guidance from the Consortium. Below are a few key elements that relate to the policy options discussed above:

- **Modernize Definitions.** Amendments to definitions of “tobacco product” should be unambiguous about the products that are covered, yet broad enough to anticipate the industry’s introduction of new products. One way this can be accomplished is by adding language to include any products that are intended or expected to be consumed without being ignited or smoked. Careful drafting can help avoid the need for frequent amendment. To avoid confusion, definitions of “tobacco product” in state tobacco tax laws should exclude “cigarette.” Products that have been approved by the U.S. Food and Drug Administration as cessation aids, or for harm reduction or other medical purposes, should not be taxed as tobacco products and therefore should be expressly excluded from “tobacco product” definitions.

- **Limit any weight-based tax rate on moist snuff to conventional moist snuff only, and apply an equivalent percentage-of-price tax to low-weight moist snuff products.** The definition of “moist snuff” can be limited to include only conventional, loose moist snuff, by specifying that only moist snuff that has a moisture content of at least 45 percent shall be included, and by specifically excluding all other smokeless products that are intended for use in the oral cavity (e.g., single-dose tablets or lozenges, pouches, orbs, sticks, and strips), taxing them instead by a percentage of their wholesale price.

- **Establish a minimum tax rate for percentage-of-price smokeless tobacco products and cigars to ensure that all such products are subject to an equivalent tax per package or per unit.** There are multiple ways to accomplish this purpose. A law can establish a minimum tax on smokeless tobacco products by specifying that any tobacco product that is subject to the law and that has a taxable sales price of, for example, less than $2.00 per package or per unit, shall be taxed as though its price were $2.00. Alternatively, a law could set the tax rate on cigars and smokeless tobacco products to be the higher of the tobacco product tax rate established for each product or the equivalent cigarette tax rate on a per package or per unit basis.

Policy Challenges

In light of the fact that state taxation of tobacco products is a well-established policy practice throughout the country, the greatest challenges in raising tobacco taxes are often political in nature. For more on this topic, please see the Consortium’s companion Fact Sheet on Tobacco Tax Basics: An Introduction to Key Considerations for States.
Helpful Resources

The website for the Campaign for Tobacco-Free Kids posts timely news, reports and related resources on both cigarette and non-cigarette taxes. For guidance on health and economic harms associated with smoking and other forms of tobacco use, we encourage you to visit the CDC’s website on smoking and tobacco use facts.

Contact Us

Please feel free to contact the Tobacco Control Legal Consortium with any questions about the information included in this guide or to discuss local concerns you may have about the taxation of non-cigarette tobacco products or cigarettes.

Last updated: February 2012

Notes

1. The information contained in this document is not intended to constitute or replace legal advice.
2. U.S. Internal Revenue Code, 26 U.S.C. ch. 52 (1986), as amended. Specifically, section 5701, as amended, sets forth the federal excise tax rates for both cigarette and non-cigarette tobacco products, including small and large cigars, small and large cigarettes, cigarette papers and tubes, snuff, chewing tobacco, pipe tobacco, and roll-your-own tobacco (RYO). 26 U.S.C. § 5701(a)-(h). Section 5702 contains the definitions, for federal excise tax purposes, of each major category of tobacco product. 26 U.S.C. § 5702.
6. Id.
7. Manfreda, supra note 3.
8. Id.
9. Id.
11 See TOBACCO CONTROL LEGAL CONSORTIUM, TAXATION OF TOBACCO PRODUCTS: AN INTRODUCTION TO KEY TERMS & CONCEPTS (2011) [hereinafter TLC, TAXATION OF TOBACCO PRODUCTS].


13 Id.

14 Id.


16 CTFK, STATE EXCISE TAX RATES, supra note 12.

17 Id.

18 Id.

19 Id.


21 See TOBACCO CONTROL LEGAL CONSORTIUM, STATE TAXATION OF CIGARETTES (2012).

22 CTFK, STATE EXCISE TAX RATES, supra note 12.

23 Id.


26 Id.

27 Id.


29 See TOBACCO CONTROL LEGAL CONSORTIUM, PRICE-RELATED PROMOTIONS FOR TOBACCO PRODUCTS: AN INTRODUCTION TO KEY TERMS & CONCEPTS (2011), available at
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30 Id.
31 Id.
32 Id.
33 See CAMPAIGN FOR TOBACCO-FREE KIDS, CAMPAIGN FOR TOBACCO-FREE KIDS TOBACCO TAX RESOURCES (undated), available at http://www.tobaccofreekids.org/winwinwin/toolkit/CFTFK%20Resources%20on%20Tobacco%20Taxes.pdf, for information on obtaining sample language from the Campaign. See also Tobacco Modernization and Compliance Act, 2010 Minn. Session Laws ch. 305; see also Passage of the Tobacco Modernization and Compliance Act, PUBLIC HEALTH LAW CENTER (May 12, 2010), http://www.publichealthlawcenter.org/content/passage-tobacco-modernization-and-compliance-act-2010.

34 CTFK, THE MANY WAYS STATES CAN RAISE REVENUES, supra note 28.
35 Id.