plaid pantry
convenience stores
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April 25, 2013

Chair Ginny Burdick
Vice-Chair Larry George
Senator Mark Hass
Senator Diane Rosenbaum
Senator Brian Boquist

Senate Finance and Revenue Committee
900 Court St. NE, S-213
Salem, OR 97301

Dear Chair Burdick, Vice-Chair George, and Committee Members:

Plaid Pantries, Inc. owns and operates 107 convenience stores with 800 employees, mostly in the tri-county Portland Metro area. Fully one-third of our stores are located in districts represented by members of your Committee. Plaid is also a member of the Oregon Neighborhood Store Association (ONSA), which provides legislative and regulatory representation for Oregon's 2,500 smaller, mostly family-owned and operated convenience food stores.

Plaid and ONSA oppose legislation which changes Oregon's current law prohibiting counties and other municipalities from imposing a tobacco tax in addition to the Federal and State excise taxes. Such a measure would not only be horrible for Oregon small businesses, but also very bad for State finances, the Oregon Health Plan, and it will kill jobs and hurt the economy.

As you are well aware, tobacco is already a declining and very fragile source of revenue. Please refer to Exhibit 1 for an illustration of Oregon and Washington taxable cigarette carton history.

The danger in allowing counties or other municipalities the ability to tax tobacco is that every dollar raised would be new-found money for the counties, with no responsibility for any effects on the State's finances, the Oregon Health Plan, Oregon small businesses, or Oregon's overall economy and jobs. This is not meant to be critical of the counties and their very real fiscal difficulties, but it is important to recognize a natural incentive to tax at higher rates versus taking a more moderate approach.
This issue is not just about helping counties with their budget challenges. The much bigger question is whether the State should risk losing control of a $330 million annual revenue stream for the State. County tobacco taxes will drive consumers to readily available sources of untaxed tobacco products, placing funding for statewide programs in serious jeopardy.

Higher taxes will drive even higher rates of tax avoidance by consumers. Tax avoidance and outright evasion is already high; Oregon is currently at 15%, and Washington is at a pretty astonishing 50%. Please refer to Exhibit 2. New York State has the highest tobacco tax in the nation, at $4.35, and they are experiencing a 61% smuggling rate. Unfortunately there are plenty of illegal entrepreneurs to meet the increased demand when taxes on tobacco are increased, regardless of the source of the taxing authority.

Allowing counties to tax tobacco is the first step in the very real possibility that we could quadruple tobacco taxes by the end of this legislative session. The current bill passed by the House gives the counties the authority to tax up to the current State tax of $1.18, but more importantly it also gives them the authority to raise taxes even further, as the State raises its tobacco excise taxes. Any future State excise tax increases would probably be matched in short order with a corresponding county tax, which limits your ability to realize the revenue needed for State programs.

In fact there are currently pending bills to increase the State excise tax an additional dollar, thus allowing the counties to raise their tax further as well. This would put the total tobacco tax at $4.36 in a county that took the maximum allowed, which many counties probably will, making Oregon the highest in the nation. At such a high tax rate, it is not unreasonable to expect to see smuggling numbers similar to New York, creating dramatic shortfalls in funding for State programs, and devastating retail businesses that sell much more than tobacco.

We modeled just a $1 tax increase by counties and found that it knocks $44 million out of the State's excise tax revenue, most of which goes to the Oregon Health Plan. Please see Exhibit 3 for the analysis behind this number. Such a tax increase will drive $300 million in currently taxed tobacco sales and related non-tobacco items sold by legitimate retailers into the illegal black market. This would wipe out $60 million in private business funding of retail jobs and employee benefits. When sales go down, employers have no choice but to adjust labor staffing, which means fewer work hours, fewer employees, and less benefits. At the margin, many stores will have to close.

There is an additional economic "multiplier effect" as well. For example, our company supports over 300 companies, mostly Oregon small businesses, which rely on us to pay them for products, services, repairs, maintenance and so on. The combined effects mean that county tax increases could easily wipe out as much state funding and other economic activity as it raises in taxes for the counties.

There are other problems with increasing tobacco taxes. Such taxes are regressive and selective. There is no question that the counties need financial help, but we should not single out a minority of the population that is already heavily taxed, and double their tax on any product. The burden of increased taxes should be shared fairly, with smaller new tax rates on everyone, and holding to Oregon's established principle that taxes be progressive, not regressive. Our customers are mostly working folks, they do not have high incomes. They have bills to pay and are suffering in this soft economy like everyone else, probably more so, given the high unemployment situation.

County taxes would create winners and losers. With a patchwork of various different county taxes we would have a logistical and an enforcement nightmare. Law-abiding consumers lose. Law-abiding small businesses lose, especially those just inside the borders of a very high-tax county. Workers lose…

fewer hours worked, many jobs eliminated, and benefits and health insurance are reduced or lost. It is also a very bad idea to sacrifice significant funding of the Oregon Health Plan to help the counties with their financial difficulties.

There is a much better solution. The State should keep control as the sole taxing authority, and increase the tobacco revenue allocation to the counties, if the Legislature finds this appropriate. Only you can keep the appropriate balance among all other competing needs for these declining dollars, as well as consider the fiscal impacts on small businesses and Oregon's overall economy.

We strongly urge you <u>not</u> to relinquish the State's sole authority to tax tobacco products.

Respectfully submitted,

Chris Girard
President & CEO – Plaid Pantries, Inc.
Chairman – Oregon Neighborhood Store Association

Exhibit 1

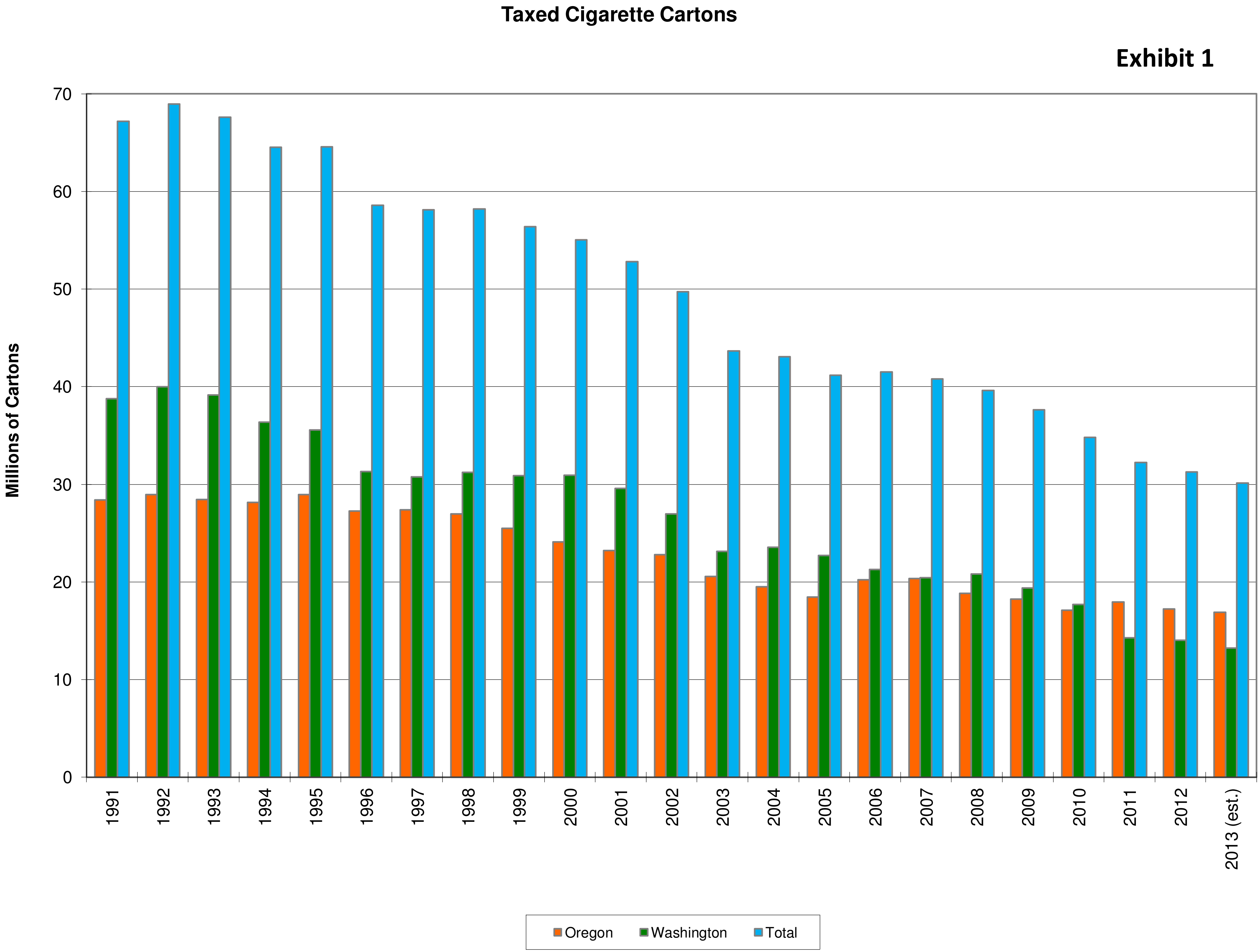
Taxed Cigarette Cartons
Millions of Cartons
0
10
20
30
40
50
60
70
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013 (est.)
Oregon
Washington
Total

Exhibit 2

TAX FOUNDATION

January 10, 2013
No. 351

Fiscal Fact

Cigarette Taxes and Cigarette Smuggling by State

By
Joseph Henchman & Scott Drenkard

Public policies often have unintended consequences that outweigh their benefits. One consequence of high state cigarette tax rates has been increased smuggling, as criminals procure discounted packs from low-tax states to sell in high-tax states. Growing cigarette tax differentials have made cigarette bootlegging both a national problem and a lucrative criminal enterprise.

Every two years, scholars at the Mackinac Center for Public Policy, a Michigan think tank, use a statistical analysis of available data to estimate smuggling rates for each state.[1] Their most recent report uses 2011 data and finds that smuggling rates generally rise in states after they adopt large cigarette tax increases. Smuggling rates have dropped in some states, however, often where neighboring states have higher cigarette tax rates. Table 1 shows the data for each state, comparing 2011 and 2006 smuggling rates and tax changes.

New York is the highest net importer of smuggled cigarettes, totaling 60.9 percent of the total cigarette market in the state. New York also has the highest state cigarette tax ($4.35 per pack), not counting the local New York City cigarette tax (an additional $1.50 per pack). Smuggling in New York has risen sharply since 2006 (+170 percent), as has the tax rate (+190 percent).

Smuggling takes many forms: counterfeit state tax stamps, counterfeit versions of legitimate brands, hijacked trucks, or officials turning a blind eye.[2] The study's authors, LaFaive and Nesbit, cite examples of a Maryland police officer running illicit cigarettes while on duty, a Virginia man hiring a contract killer over a cigarette smuggling dispute, and prison guards caught smuggling cigarettes into prisons. Policy responses

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[1] *See, e.g.*, Michael LaFaive & Todd Nesbit, *Higher Cigarette Taxes Create Lucrative, Dangerous Black Market*, MACKINAC CENTER FOR PUBLIC POLICY (Jan. 2013), http://www.mackinac.org/18128; Michael LaFaive, *Cigarette Taxes and Smuggling 2010: An Update of Earlier Research*, MACKINAC CENTER FOR PUBLIC POLICY (Dec. 2010), http://www.mackinac.org/14210; Michael LaFaive, Patrick Fleenor, & Todd Nesbit, *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review*, MACKINAC CENTER FOR PUBLIC POLICY (Dec. 2008), http://www.mackinac.org/10005.

[2] *See, e.g.*, Scott Drenkard, *Cigarette Smuggling Can Make You $4 Million Richer*, TAX FOUNDATION TAX POLICY BLOG, Sept. 27, 2012, http://taxfoundation.org/blog/cigarette-smuggling-can-make-you-4-million-dollars-richer.

have included banning common carrier delivery of cigarettes,[3] greater law enforcement activity on interstate roads,[4] differential tax rates near low-tax jurisdictions,[5] and cracking down on tribal reservations that sell tax-free cigarettes.[6] However, the underlying problem remains: high cigarette taxes that amount to a "price prohibition" of the product in many U.S. states.[7]

Table 1: 2011 Cigarette Tax Rates, Smuggling Percentages, and Changes Since 2006

State	2011 Cigarette Tax Rate (per pack)	2011 Consumption Smuggled (positive is inflow, negative is outflow)	2006 Consumption Smuggled (positive is inflow, negative is outflow)	2011 Smuggling Rank (1 is most smuggling, 50 is least)	Smuggling Rank Change Since 2006 (e.g., NY changed from #5 to #1, so rank changed +4)	Cigarette Tax Rate Change, 2006-2011
New York	$4.35	60.9%	35.8%	1	+4	+190%
Arizona	$2.00	54.4%	32.1%	2	+5	+69%
New Mexico	$1.66	53.0%	39.9%	3	-1	+82%
Washington	$3.025	48.5%	38.2%	4	+0	+49%
Rhode Island	$3.46	39.8%	43.2%	5	-4	+41%
Wisconsin	$2.52	36.4%	13.1%	6	+12	+227%
California	$0.87	36.1%	34.6%	7	-1	No Change
Texas	$1.41	33.8%	14.8%	8	+8	+244%
Utah	$1.70	32.0%	12.9%	9	+11	+145%
Michigan	$2.00	29.3%	31.0%	10	-1	No Change
Montana	$1.70	28.7%	31.2%	11	-3	No Change
South Dakota	$1.53	28.6%	5.3%	12	+16	+189%
Maryland	$2.00	25.8%	10.4%	13	+11	+100%
Connecticut	$3.00	22.2%	12.3%	14	+8	+99%
Iowa	$1.36	21.3%	2.4%	15	+18	+278%
Minnesota	$1.586	19.5%	23.6%	16	-6	No Change
Florida	$1.339	19.1%	6.9%	17	+9	+294%
Kansas	$0.79	18.4%	18.4%	18	-6	No Change
Massachusetts	$2.51	18.1%	17.5%	19	-6	+66%
New Jersey	$2.70	18.1%	38.4%	20	-17	+13%
Colorado	$0.84	16.2%	16.6%	21	-7	No Change
Oregon	$1.18	15.7%	21.1%	22	-11	No Change
Maine	$2.00	13.7%	16.6%	23	-8	No Change
Mississippi	$0.68	10.1%	-1.7%	24	+13	+36%
Arkansas	$1.15	9.6%	3.9%	25	+6	+95%
Ohio	$1.25	9.0%	13.1%	26	-7	No Change
Nebraska	$0.64	5.4%	12.0%	27	-4	No Change

[3] *See, e.g.*, Curtis Dubay, *UPS Decision Unlikely to Stop Cigarette Smuggling*, TAX FOUNDATION TAX POLICY BLOG, Oct. 25, 2005, http://taxfoundation.org/blog/ups-decision-unlikely-stop-cigarette-smuggling.

[4] *See, e.g.*, Gary Fields, *States Go to War on Cigarette Smuggling*, WALL STREET JOURNAL, Jul. 20, 2009, http://professional.wsj.com/article/SB124804682785163691.html?mg=reno64-wsj.

[5] *See, e.g.*, Mark Robyn, *Border Zone Cigarette Taxation: Arkansas's Novel Solution to the Border Shopping Problem*, TAX FOUNDATION FISCAL FACT NO. 168 (Apr. 9, 2009), http://taxfoundation.org/article/border-zone-cigarette-taxation-arkansass-novel-solution-border-shopping-problem.

[6] *See, e.g.*, Joseph Henchman, *New York Governor Signs Law to Tax Cigarettes Sold on Tribal Lands*, TAX FOUNDATION TAX POLICY BLOG, Dec. 16, 2008, http://taxfoundation.org/blog/new-york-governor-signs-law-tax-cigarettes-sold-tribal-lands.

[7] *See also* Patrick Fleenor, *Tax Differentials on the Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States*, TAX FOUNDATION BACKGROUND PAPER NO. 16 (Oct. 1, 1996), http://taxfoundation.org/article/tax-differentials-interstate-smuggling-and-cross-border-sales-cigarettes-united-states.

Louisiana	$0.36	5.1%	6.4%	28	-1	No Change
Oklahoma	$1.03	4.6%	9.6%	29	-4	No Change
Pennsylvania	$1.60	3.3%	12.9%	30	-9	+19%
Illinois	$0.98	2.3%	13.7%	31	-14	No Change
North Dakota	$0.44	-1.6%	3.0%	32	+0	No Change
Tennessee	$0.62	-2.4%	-4.5%	33	+5	+210%
South Carolina	$0.57	-2.5%	-8.1%	34	+7	+14%
Indiana	$0.995	-3.1%	-10.8%	35	+8	+79%
Georgia	$0.37	-4.1%	-0.3%	36	-1	No Change
Kentucky	$0.60	-7.2%	-6.4%	37	+3	+100%
Alabama	$0.425	-7.7%	0.5%	38	-4	No Change
Missouri	$0.17	-12.3%	-11.3%	39	+5	No Change
Vermont	$2.24	-16.9%	4.5%	40	-10	+25%
Idaho	$0.57	-19.9%	-6.0%	41	-2	No Change
Nevada	$0.80	-20.0%	4.8%	42	-13	No Change
Wyoming	$0.60	-20.4%	-0.6%	43	-7	No Change
West Virginia	$0.55	-20.8%	-8.4%	44	-2	No Change
Delaware	$1.60	-23.0%	-61.5%	45	+2	+191%
Virginia	$0.30	-24.7%	-23.5%	46	-1	No Change
New Hampshire	$1.68	-26.8%	-29.7%	47	-1	+110%
Alaska	$2.00	N/A	N/A	N/A	N/A	+25%
Hawaii	$3.20	N/A	N/A	N/A	N/A	+129%
North Carolina	$0.45	N/A	N/A	N/A	N/A	+50%
District of Columbia	$2.86	N/A	N/A	N/A	N/A	+186%

Note: Alaska, Hawaii, North Carolina, and the District of Columbia are not included in the study. Cigarette tax rates have changed for some states since 2011.
Source: Mackinac Center for Public Policy; Tax Foundation.

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About the Tax Foundation
The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

HB 2870 Implications for the Oregon Health Plan, Oregon's Economy, and Small Business

The provisions of House Bill 2870 would allow Oregon counties express authority to impose a local tax on cigarettes and other tobacco products. Inasmuch as the Oregon Health Plan (OHP) receives the largest percentage of State cigarette excise tax revenues, the impact of the imposition of a local tax by one or more Oregon counties would have significant negative financial implications for the Oregon Health Plan.

The potential impacts to the funding of the Health Plan are a loss of $16.0 MILLION annually from reduced cross-border Washington consumers, and an equal amount or more from increased tax evasion by Oregon consumers. The total potential loss to the Oregon Health Plan would be over $30 million annually.

Washington tobacco consumers purchase approximately 47 million packs of cigarettes in Oregon annually, providing over $40 million in funding for the Oregon Health Plan ($1.18 tax x 47 million x 72.6%). Washington's $1 additional excise tax increase in 2011 generated nearly half of these sales, or 23 million packs. Of this incremental 23 million packs, most are purchased in the following border counties:

County	Packs
Multnomah County	8.2 million
Columbia County	3.5 million
Clackamas County	1.2 million
Clatsop County	.9 million
Umatilla County	2.4 million
Washington County	2.3 million
Estimated total packs	**18.5 million**
Estimated revenue @ $1.18 / pack	$21.9 million
Revenue stream to OHP (72.6%)	$15.8 million

If these six counties established a local $1 per-pack tax, most of these recent incremental cross-border purchases would disappear overnight, and the funding stream to the OHP would be reduced by approximately $16 million per year.

In addition, analysis indicates that many more Oregon consumers will switch to untaxed sources of product when county taxes are imposed. Currently about 16% of Oregon tobacco consumers avoid state tobacco excise taxes. By comparison, Washington state collects taxes on less than half of its cigarette sales. (Tax Foundation Fiscal Fact 1/10/13). A $1 county tax would place Oregon's tax about mid-point between these two data points, so it is conservative to expect an additional loss of 15% of Oregon consumer pack sales, or 18 million packs; 169 million total less Washington's 47 million = 122 million x 15% = 18.3 million lost to non-taxed sources.

Using the same math for the OHP, 18.3 million x $1.18 = $21.6 million lost state excise tax x 72.6% = an additional $15.7 million lost revenue to the OHP.

Total impact of $43.5 million lost state excise taxes, of which $31.5 million would be lost for OHP.

We must also consider future State and County tax increases, and this yet additional impact on the OHP. If there is a state increase of an additional $1 per pack, the counties could also add an additional $1 per pack, placing Oregon well above Washington's tax, and potentially in the 60%-plus tax evasion range with New York State.

Losses to Oregon's Economy

The average retail price for a pack of cigarettes is $5.03, with additional "marketbasket" sales of other items of $2.59 per pack, for a total of $7.62 for each transaction. The combined pack sales losses of 36.8 million (18.5 cross border + 18.3 to black/gray market) result in a loss of legitimate taxable retail sales of $280 million.

At an approximate combined margin of 21.1% (12% tobacco, 39% marketbasket) this tax destroys $59.2 million in margin dollars. Margin dollars pay employees, employee benefits, supplier companies, and further multiply throughout Oregon's economy. These payments to employees and Oregon small businesses sustain jobs, and are critical to maintaining and growing Oregon's currently fragile economy.

Counties might collect the assumed $1.00 tax, but it will be on reduced sales of only 132 million packs (169 million packs today, less 36.8 million packs lost as shown above), resulting in tax collections of about $132 million.

Here is a summary of the effects of a $1.00 county tax:

132.0 million in county revenue
-43.5 million in lost state excise tax
-59.2 million in lost in retail employee pay, benefits, and supplier jobs
----
29.3 million net new tax revenue

For each dollar of tax raised, this proposed taxing authority will transfer or destroy 78 cents of other economic benefits, which is a very expensive and disruptive way to attempt to help counties balance their budgets.