plaid pantry
convenience stores
Plaid Pantries, Inc. • 10025 SW Allen Blvd. • Beaverton, Oregon 97005 • Telephone: 503.646.4246 • Facsimile: 503.646.3071

March 15, 2013

Chair Phil Barnhart
Vice-Chair Jules Bailey
Vice-Chair Vicki Berger
Representative Cliff Bentz
Representative Jason Conger
Representative John Davis
Representative Sara Gelser
Representative Tobias Read
Representative Jessica Vega Pederson

House Revenue Committee
900 Court St. NE, Room 143
Salem, OR 97301

Dear Chair Barnhart and Vice-Chairs Bailey and Berger:

Plaid Pantries, Inc. owns and operates 107 convenience stores in the Northwest, with the majority of our 800 employees working here in Oregon. 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 HB 2870 which changes Oregon's current law prohibiting Counties and Cities from imposing a tobacco tax in addition to the Federal and State excise taxes. This bill does not include any language regarding the amount of tax that can be imposed, apparently leaving that to the discretion of each individual county.

1. **Cigarette taxes are selective and regressive.**

About eighteen percent of Oregon's adult population uses tobacco. A higher percentage of lower-income citizens use tobacco, compared to high-income Oregonians. Tobacco taxes therefore target a minority of the population, and disproportionately impact lower income citizens as a percentage of disposable income, whether imposed by the state or by counties and cities.

2. **Increasing taxes on a small group of citizens to benefit the overall population is not fair.**

Tobacco products are already heavily taxed at both the Federal and State level, and tobacco users are already paying considerably more in taxes than other citizens. It is not fair or equitable to single out only a fifth of Oregon's citizens with additional taxes, and not ask all other citizens to help with a county or city's current budget challenges. Tobacco users are going through what the rest of the population is facing in their personal finances. They are mostly working people who have bills and mortgages or rent to pay. Some of them have lost their jobs and are struggling to make ends meet while seeking employment. Those that are fortunate enough to have jobs have just been hit with the reinstatement of the 2% payroll tax, which put a very significant dent in their disposable income.

Tobacco customers are just like everyone else.... except they use tobacco and pay more taxes. This is not justification to single them out as the only relatively small group of citizens being asked to pay even higher taxes.

3. **<u>Higher cigarette taxes hurt Oregon small businesses and Oregon's economy.</u>**

Higher cigarette taxes don't hurt "Big Tobacco"; they hurt consumers and small businesses. Legitimate, law-abiding businesses in Oregon counties and cities that sell tobacco retain only the slimmest of net profit margins from this product. Oregon retailers collect $1.01 per pack of cigarettes in Federal excise taxes. Oregon retailers also collect $1.18 per pack in Oregon excise tax. By comparison, on average a retailer realizes only $0.58 in gross margin on the sale of a pack of cigarettes. Most of this retailer gross margin goes directly to generating an interrelated stream of Oregon economic activity.

Well over half of these margin dollars go directly to support jobs, wages, and employee benefits. Plaid and similar small retailers contract with many hundreds of companies, mostly Oregon small businesses, which provide maintenance, repairs, supplies, transportation, and other services to our retail operations. Wholesale and retail companies pay rent to Oregon landlords, property taxes, and income taxes. Only a very tiny percentage of sales goes to the bottom line, but our industry's economic contribution still does not stop there. Most of a company's after-tax net profit is re-invested in the company with facility upgrades, expansion, and other capital improvements, thereby generating a final round of contributions to Oregon businesses and the state's economy.

Allowing counties to impose cigarette taxes will have the result of increasing an already-high direct consumption tax on a product that does not have a legal substitute. This will drive more tobacco sales to the black/gray market, reduce Oregon excise tax collections, and harm the state budget.

4. **<u>Relinquishing sole State cigarette taxing authority to local and municipal entities threatens important State revenue needs, in particular the Oregon Health Plan.</u>**

It is very risky for the State to relinquish authority and control over such an important revenue source. Cities, counties, and other taxing authorities should not be permitted to tap this source of funds to the inevitable detriment of other statewide revenue needs. The Oregon/Washington Western border counties of Clatsop, Columbia, Washington, Multnomah, Clackamas and Hood River ("Border Counties") could change the flow of a large portion of cross-border traffic, and significantly reduce the State's excise tax revenue. Proponents of a county tax on cigarettes have speculated in the past that tobacco users probably will not go out of their way to purchase lower-taxed product. Their argument is that since prices are already different among competing stores, prices must not matter. But the fact is that prices are competitively different precisely because prices <u>do</u> matter.

The most striking example of this is the cross-border shopping between Oregon and Washington. Approximately 4.7 million cartons of cigarettes annually, over a fourth of Oregon's taxable cigarette sales, are purchased by Washington residents. This represents over $55 million in tax revenue paid by non-Oregon residents. Giving counties and cities the authority to impose taxes jeopardizes this tax revenue stream, and would adversely affect retail and wholesale economic activity for Oregon small businesses and the State overall. Tobacco customers purchase other retail products, lottery, and fuel on the same trips, all of which provide significant Oregon taxes and revenue. Marketing data shows that on average a tobacco customer purchases $2.59 in non-tobacco products per pack of cigarettes. More important, from a tax revenue standpoint, city and county taxes would permanently reduce the taxable base for future revenue from the lost sales.

A tax increase of $1 by the most populated counties would wipe out 45 million legal pack transactions between legitimate businesses and law-abiding customers, and would transfer $343 million in economic activity to the untaxed underground economy. Such losses ripple through the entire supply chain, damaging wholesale and transportation trade activity, and reducing jobs and benefits for those working in our industry.

5. **Such taxation will also create winners and losers among consumers, businesses, and other taxing authorities with a patchwork of different boundaries and tax rates.**

A serious business concern is that the counties and cities will get really carried away with this new taxing authority. Likely large tax increases, especially in today's very soft economy, primarily will impact three areas most significantly... the already cash-strapped consumer, Oregon's overall economy, and State tax receipts, in particular those allocated to the Oregon Health Plan. Further increased tax fraud would also be a significant problem.

Businesses will react by cutting costs. When faced with significant sales decreases, businesses have no choice but to reduce expenses. The single largest controllable expense in retail is labor costs, and cuts here will cost jobs, benefits, and health insurance coverage for workers. Companies will also cut back on other non-essential expenses and growth plans, which negatively impacts our supplier and contractor partners, and the state's economy as a whole.

6. **Higher tobacco taxes do not significantly reduce consumption, but drive consumers to avoid/evade taxes.**

Oregon relies on tobacco revenue to meet its budget needs, and this revenue stream is declining (Exhibit 1). Consumption is decreasing, but the larger factor is tax avoidance and outright evasion. Continual tax increases have driven a very significant amount of the formerly collectible taxes underground, to gray and black-market sources, untaxed Native American outlets, Organized Crime operations, the internet, and "roll-your-own" cigarettes using lower-taxed bulk tobacco.

Allowing counties and cities to raise the tax on Oregon cigarette purchases will boost the migration of the existing tax paying cigarette tax base. Oregon's neighboring states' tobacco taxes, except for Washington, are lower than Oregon.

Growing cigarette tax differentials have made cigarette bootlegging both a national problem and a lucrative criminal enterprise. The top cigarette tax rate states lose half of their expected revenue to smuggling, according to a recent study by The Tax Foundation (Exhibit 2). Their most recent data reports that smuggling rates rise in states after they adopt large cigarette tax increases.

Higher local taxes will only drive these trends further in that direction, resulting in the tax burden increasingly falling only on remaining law-abiding consumers and law-abiding retailers; again unfair to a small minority of Oregon citizens.

7. **Washington State is a noteworthy example of extreme excise tax evasion.**

Exhibit 3 shows historical taxable cigarette carton sales for Oregon and Washington. In 2011, nationwide consumption of taxed cigarettes averaged 52 packs per year per-capita. Oregon taxable cigarette sales in 2011 were 46 packs per-capita, while Washington collected taxes on only 21 packs per-capita. Washington's incidence of smoking is not half that of Oregon, and estimates are that Washington fails to collect excise taxes and sales tax on about 16 million cartons annually. About 4.7 million cartons go to Oregon, the largest portion of that to the Border Counties, with the remaining 11 million cartons going to other States and other non-taxed sources of supply.

If the Border Counties impose a tobacco tax it will hurt the State's excise tax revenues.

8. **Oregon state excise tax revenue from tobacco would be particularly adversely impacted by additional taxes imposed by the Border Counties.**

The Border Counties are the most populous in the state, and contain Portland, the highest population city in the state. More important, it is Portland's border to the north with the state of Washington with extensive breadth that dominates all major trade within the I-5 Columbia River crossing. Because of this huge effective barrier between most of the commerce with Washington and the rest of Oregon, the Border Counties would be a dominant driver of the cross-border shopping described above. While new taxes for these counties would be incremental new-found money for those entities, regardless of the overall reduction in unit sales, it would be very dangerous to ignore the loss to Oregon of the $11.80 per carton on cross-border and local sales that would be lost to the black/gray market.

In summary, HB2780 is grossly unfair to a minority of Oregonians who are already financially stressed. It will hurt legitimate small businesses eliminating jobs & benefits for Oregonian's, and reward and encourage illegal enterprises and unlawful activity. If passed, this Bill will jeopardize a very important existing Oregon revenue base.

For all of the above reasons, we strongly oppose relinquishing the State's sole taxing authority on tobacco.

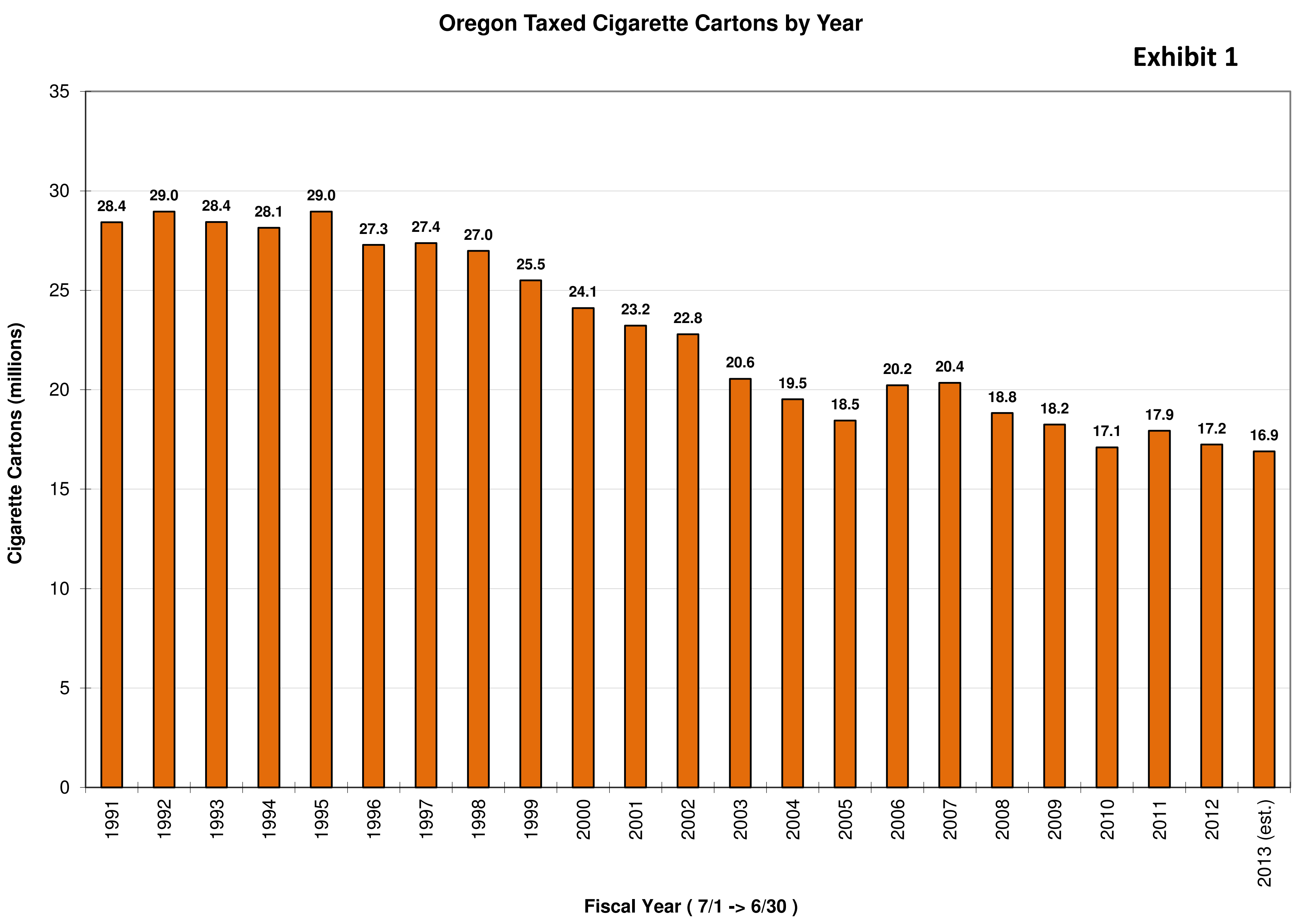
Respectfully submitted,

Mark Conan

Mark Conan
Chief Financial Officer and Vice-President of Finance

Jonathan Polonsky

Jonathan Polonsky
Executive Vice-President



Oregon Taxed Cigarette Cartons by Year
Exhibit 1
Cigarette Cartons (millions)
0
5
10
15
20
25
30
35
28.4
29.0
28.4
28.1
29.0
27.3
27.4
27.0
25.5
24.1
23.2
22.8
20.6
19.5
18.5
20.2
20.4
18.8
18.2
17.1
17.9
17.2
16.9
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013 (est.)
Fiscal Year (7/1 -> 6/30)

Exhibit 2

TAX FOUNDATION Since 1937

Fiscal Fact

January 10, 2013
No. 351

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

---

[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.

National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045

202.464.6200
www.TaxFoundation.org

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.

Taxed Cigarette Cartons

Exhibit 3