



# CIGARETTE TAX RESTRICTED ACCOUNT

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ISSUE BRIEF

## SUMMARY

Under current conditions, receipts to the Cigarette Tax Restricted Account will likely be about \$2.4 million (32%) lower than anticipated in FY 2012 and \$1.2 million (17%) short in FY 2013. Three factors contribute to the shortfall: (1) none of the revenue from an FY 2011 tax rate increase is being deposited into the account and instead is being deposited in the General Fund; (2) the Tax Commission is changing from accrual to cash accounting for deposits (FY 2012 only); and (3) consumers are buying fewer cigarettes. Further, appropriations from the Cigarette Tax Restricted account are not congruent with statutory distributions. The Analyst recommends amending statute to clarify allocation of revenue to the account and distribution of appropriations from the account.

## DISCUSSION AND ANALYSIS

### *What is the Cigarette Tax Restricted Account (UCA 59-14-204)?*

The Cigarette Tax Restricted Account receives revenue from two sources: (1) \$250,000 from an FY 1999 cigarette tax change (HB 404 1998 GS) and (2) 58% of an FY 2002 cigarette tax rate increase (HB 238 2002 GS). As per UCA 59-14-204, these revenues are distributed as follows via appropriations for FY 2012:

1. All \$250,000 of the FY 1999 tax increase to Health for a tobacco prevention and control media campaign targeted towards children
2. 22% of the FY 2002 tax increase to Health for tobacco prevention and control programs (\$2,881,700)
3. 21% of the FY 2002 tax increase for medical education the University of Utah School of Medicine (\$2,499,300)
4. 15% of the FY 2002 tax increase for cancer research the Huntsman Cancer Institute (\$1,785,200)

The appropriations above are used as follows:

1. **Health - alcohol, tobacco and drug prevention programs:** the Tobacco Prevention and Control Program includes community-based efforts that prevent tobacco initiation, strengthen tobacco-free policies, and link tobacco users to quitting services (e.g. - Utah Tobacco Quit Line and QuitNet). The Program includes media messages to prevent and reduce tobacco use as well as assistance for businesses in complying with youth tobacco sales restrictions and the Utah Indoor Clean Air Act.
2. **University of Utah - in-state research and educational activities:** for medical education at the University of Utah School of Medicine and for cancer research at the Huntsman Cancer Institute.

UCA 59-14-204 states that the Legislature should consider appropriating the other 42% of the 2002 tax increase “to enhance Medicaid provider reimbursement rates and medical coverage for the uninsured.”

Ongoing appropriations from the account have remained flat since FY 2004. As revenue grew, the difference between revenue and appropriations accrued to the account. The Legislature used \$8,299,200 of the account’s balance during the September 2008 Special Session. This resulted in the account ending FY 2009 with a balance of \$0. Table 1 shows the details for the account from FY 2000 through FY 2013.

**Table 1 - Cigarette Tax Restricted Account Balance Sheet**

| <b>Cigarette Tax Restricted Account Balances</b> |                 |                  |                       |
|--|-----------------|------------------|-----------------------|
| <u>Fiscal Year</u>                               | <u>Revenues</u> | <u>Transfers</u> | <u>Ending Balance</u> |
| 2000   | \$250,000       | -\$250,000       | \$0                   |
| 2001   | \$250,000       | -\$250,000       | \$0                   |
| 2002   | \$1,508,502     | -\$250,000       | \$1,258,502           |
| 2003   | \$7,975,372     | -\$7,152,900     | \$2,080,974           |
| 2004   | \$8,216,794     | -\$7,566,000     | \$2,731,768           |
| 2005   | \$8,410,558     | -\$7,416,000     | \$3,726,326           |
| 2006   | \$8,187,942     | -\$7,416,000     | \$4,498,268           |
| 2007   | \$8,647,757     | -\$7,416,200     | \$5,729,825           |
| 2008   | \$8,478,705     | -\$7,416,200     | \$6,792,330           |
| 2009   | \$7,780,573     | -\$14,572,903    | \$0                   |
| 2010   | \$7,690,338     | -\$7,416,200     | \$274,138             |
| 2011   | \$6,153,701     | -\$7,416,200     | -\$1,262,499*         |
| 2012(e)  | \$5,053,700     | -\$7,416,200     | -\$2,362,500*         |
| 2013(f)  | \$6,174,800     | -\$7,416,200     | -\$1,241,400*         |

\* When there is a shortfall, Finance will reduce transfers to make the ending balance \$0 each year.

***What is the Shortfall in the Account?***

In FY 2012, the Legislature appropriated \$7,416,200 from the account. Due to statute interpretation and economic conditions, we anticipate a shortfall of \$2.4 million or 32%. The Department of Finance has indicated that it will implement the reductions across the board according to appropriation. This would mean a \$1.0 million reduction for the Department of Health and \$1.4 million for the University of Utah.

For FY 2013, the base budget includes appropriations of \$7,416,200 from the account. The Analyst anticipates a shortfall of \$1.2 million or 17% in FY 2013. As with FY 2012, one way to address the shortfall is to have reductions across the board according to appropriation. This would mean a \$0.5 million reduction for the Department of Health and \$0.7 million reduction for the University of Utah.

There are three reasons for the FY 2012 shortfall:

1. Based upon the Tax Commission’s interpretation of statute, the restricted account is experiencing all of the quantity decrease and none of the rate increase associated with a 2011 tobacco tax change (\$1.0 ongoing reduction).
2. Change from accrual to cash accounting (\$1.1 million one-time reduction in FY 2012)
3. Consumers are buying fewer cigarettes (\$0.3 ongoing reduction)

Each of these items is listed below in more detail.

***None of the FY 2011 Tax Increase is Going to the Account***

The current interpretation of statute explains about \$1 million of the decline in revenue. The 2002 tax rate increase was \$0.18 per pack of cigarettes. For FY 2011 the tax rate on packs of cigarettes increased from \$0.695 per pack to \$1.70 per pack. Before the FY 2011 tax rate increase, the Cigarette Tax Restricted Account would receive \$250,000 plus  $0.58 \times (0.18 / 0.695) = 15.02\%$  of total, after fixed earmark cigarette tax revenue. For the FY 2011 tax increase, the Cigarette Tax Restricted Account is receiving \$250,000 plus  $0.58 \times (0.18 / 1.70) = 6.14\%$  of total, after fixed earmark cigarette tax revenue. The decline from 15.02% of cigarette tax revenue to 6.14% of cigarette tax revenue together with a smaller sales volume is the reason behind \$1 million of the decline in

revenue to the Cigarette Tax Restricted Account (see Tables 2 and 3). Because the \$1 million decline to the Cigarette Tax Restricted Account is going to the General Fund in excess of the amount estimated, shifting the revenue from the General Fund to the Cigarette Tax Restricted Account would not have any associated cost.

**Table 2 - Cigarette Tax Restricted Account Formula Allocation**

|                |   |
|----------------|---|
| <b>FY 2010</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = 0.58 \cdot \frac{0.18}{0.695} \cdot (Total\ Cig.\ Tax\ Rev. - \$250,000)$ |
| <b>FY 2011</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = 0.58 \cdot \frac{0.18}{1.7} \cdot (Total\ Cig.\ Tax\ Rev. - \$250,000)$   |

**Table 3 - Cigarette Tax Restricted Account Year over Year Comparison**

|                |   |
|----------------|---|
| <b>FY 2010</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = 0.58 \cdot \frac{0.18}{0.695} \cdot (Total\ Cig.\ Tax\ Rev. - \$250,000) = \$7,458,340$ |
| <b>FY 2011</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = 0.58 \cdot \frac{0.18}{1.7} \cdot (Total\ Cig.\ Tax\ Rev. - \$250,000) = \$6,481,450$   |

An alternative interpretation of “revenue from the tax increase imposed during the 2002 General Session” is that the revenue would be known and be unaffected by the 2011 tax increase. In practice, the Tax Commission would need to establish a baseline. Because the tax rate increased in 2011, the baseline would be total revenue in FY 2010 (see Table 4). New revenue from any new tax increase would be deposited into the General Fund. Following this interpretation would shift deposits from the General Fund to the Cigarette Tax Restricted Account by about \$1 million.

**Table 4 - Alternative Interpretation of 59-14-204(5)(d)**

|                |   |
|----------------|---|
| <b>FY 2010</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = 0.58 \cdot \frac{0.18}{0.695} \cdot (\$49,900,800 - \$250,000) = \$7,458,340$ |
| <b>FY 2011</b> | $Revenue_{Cig.Tax\ Restr.\ Acct.} = x \cdot (\$105,540,818 - \$250,000) = \$7,458,340$                            |
| <b>FY 2011</b> | $x = \frac{Revenue\ from\ 2002\ General\ Session\ Tax\ Increase = \$7,458,340}{Total\ Revenue = \$105,290,818}$   |

*The Analyst recommends amending statute so that deposits to the Cigarette Tax Restricted Account are not adversely impacted by the 2011 tax rate change.*

**Change from Accrual to Cash Accounting**

During the conversion to a new computer system, the Tax Commission became aware that the revenue in the Cigarette Tax Restricted Account was being distributed based on when stamps were sold instead of when the payment was made. UCA 59-14-206 allows 60 days for a vendor to make a payment for stamps. Payers usually

take the 60 days to make their payments. In FY 2011 the Tax Commission changed the accounting of revenue to the account from an accrual system to cash accounting. Because of the accounting system switch there are two months in FY 2011 without any revenue recorded. The Tax Commission, in coordination with Finance, held FY 2011 harmless by making a one-time adjustment with two months of revenue from FY 2012. In FY 2012 this created a one-time revenue shortfall of \$1.1 million.

### ***Consumers are Buying Fewer Cigarettes***

The Cigarette Tax Restricted Account revenues are affected by the sales volume of tobacco products. The following issues have impacted sales volume:

1. **Increased State tax** – effective July 1, 2010, the State raised tobacco products taxes by about 144% (SB 259 “Amendments to Tobacco Tax” from the 2010 General Session). As of June 2011, this has reduced consumption by about 15%.
2. **Increased federal cigarette tax** – The cost of cigarettes increased about 25% nationwide effective March 31, 2009 from the federal government’s increased tax of \$1 per pack. This reduced consumption by about 10%.
3. **Economic downturn** – As personal incomes have decreased, the purchasing of cigarettes also decreased.

### ***Why do Current Appropriations Not Match the Statutory Distribution?***

Current appropriations to the Department of Health and the University of Utah have not matched the statutory distribution since FY 2003. By statute, the Health Department should receive \$0.61 for every \$1 that the University of Utah receives of the 2002 tax increase. This only happened the first year (FY 2003) of revenues from the tax increase. In FY 2004 Health received a \$263,100 increase in appropriations from the Cigarette Tax Restricted Account. The University of Utah received no increase in FY 2004. This change means that Health has received at least \$0.67 for every \$1 the University of Utah receives since FY 2004. The \$0.61 for every \$1 discussion above excludes the \$250,000 to Health from the 1998 tobacco tax increase. The Legislature may want to change the appropriations to match the statutory distributions. A shift of \$166,500 from the Department of Health to the University of Utah would make the FY 2012 appropriations match the statutory distributions.

*The Analyst recommends that statute be amended to take out the percentage allocations or the appropriations be adjusted to match statute.*

### **LEGISLATIVE ACTION**

1. **Do nothing and allow each agency to address the shortfalls** – If no action is taken, then in FY 2012 affected programs will have to meet the projected \$2.4 million in reductions. This amount may be more or less depending on actual consumer behavior in buying tobacco products.
2. **Clarify legislative intent** – Amend UCA 59-14-204(5) so that the Cigarette Tax Restricted Account is not adversely impacted by the FY 2011 tax rate change (recommended).
3. **Fix statutory percentages** - Amend statute to take out the percentage allocations or adjust the FY 2012 and FY 2013 appropriation to match statute (recommended).
4. **Find another funding source to address the shortfall** – The Legislature may be interested in identifying a source to fund some or the entire shortfall of \$2.4 million in FY 2012. The ongoing shortfall beginning in FY 2013 is about \$1.2 million.
5. **Some combination of the action items above**