HB 20-1427

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

FISCAL NOTE

Drafting Number:	LLS 20-1329	**Date:**	June 11, 2020
Prime Sponsors:	Rep. Caraveo Sen. Fields; Moreno	**Bill Status:**	House Finance
		Fiscal Analyst:	Elizabeth Ramey | 303-866-3522 Elizabeth.Ramey@state.co.us

Bill Topic: **CIGARETTE TOBACCO AND NICOTINE PRODUCTS TAX**

Summary of Fiscal Impact:

☒ State Revenue *(conditional)*
☒ State Expenditure *(conditional)*
☒ State Transfer *(conditional)*
☐ TABOR Refund
☐ Local Government
☐ Statutory Public Entity

Conditional on voter approval, this bill raises taxes on cigarettes and tobacco products and establishes a new tax on nicotine products. Revenue from the taxes is distributed to fund health care, tobacco education, preschool, and other programs. With voter approval, the bill increases state revenue and expenditures on an ongoing basis.

Appropriation Summary: No appropriation is required. See State Appropriations section.

Fiscal Note Status: This fiscal note is preliminary and reflects the introduced bill. The fiscal note will be updated if more information becomes available.

Table 1
State Fiscal Impacts Under HB 20-1427

		FY 2020-21	FY 2021-22
Revenue	General Fund	$90.0 million	$181.3 million
	Cash Funds	($4.1 million)	($7.9 million)
	Total	**$85.9 million**	**$173.5 million**
Expenditures	General Fund	$84.0 million	$169.3 million
	Cash Funds	$2.0 million	$4.1 million
	Centrally Appropriated	$0.01 million	$0.03 million
	Total	**$85.9 million**	**$173.5 million**
	Total FTE	**0.4 FTE**	**1.3 FTE**
Transfers	General Fund	($6.0 million)	($12.0 million)
	Cash Fund	$6.0 million	$12.0 million
	Total	**$0**	**$0**
TABOR Refund		-	-

**Totals may not sum due to rounding.*

Summary of Legislation

This resolution refers a ballot measure to voters at the November 2020 statewide election to increase cigarette and tobacco taxes and create a new tax on nicotine products. Table 2 lists cigarette, tobacco product (excluding modified risk tobacco products), and nicotine product tax rates under current law and the bill, beginning January 1, 2021. The tax rate increases and new tax are phased in over a period of seven years. Revenue from the new taxes is exempt from TABOR as a voter-approved revenue change.

Table 2
Cigarette, Tobacco Product, and Nicotine Product Tax Rates Under HB 20-1427

	Cigarettes (per pack)			Tobacco Products* (% of MLP)		Nicotine Products (% of MLP)
Current Law						
Statutory Tax	$0.20			20%		None
Amendment 35 Tax	$0.64			20%		None
Current Law Total	**$0.84**			**40%**		None
				Tobacco and Nicotine Products* (% of MLP)		
	2021 - 2024	2024 - 2027	2027 and beyond	2021 - 2024	2024 - 2027	2027 and beyond
Statutory Increase Under HB 20-1427	$1.10	$1.40	$1.80	10%	16%	22%
Total Taxes Under Bill	**$1.94**	**$2.24**	**$2.64**	**50%**	**56%**	**62%**

MLP = Manufacturer's list price.
** Excludes modified risk tobacco products*

Colorado assesses an excise tax on each cigarette sold and on the manufacturer's list price (MLP), or invoice price, of non-cigarette tobacco products. Cigarette taxes are assessed when cigarettes are sold by wholesalers. Tobacco product taxes are assessed when the products are manufactured, brought into the state, or shipped to retailers. No tax is currently assessed on nicotine products.

Cigarette tax increase. The bill increases the cigarette tax by $0.055 per cigarette or $1.10 per pack in the first four fiscal years, by $0.07 per cigarette or $1.40 per pack in fiscal years five through seven, and by $0.09 per cigarette or $1.80 per pack thereafter.

Tobacco products tax increase. The bill increases the tobacco products tax by 10 percent of the MLP in the first four fiscal years, by 16 percent of the MLP in fiscal years five through seven, and by 22 percent of the MLP thereafter.

Nicotine products tax. The bill establishes a new tax on nicotine products, defined as any ingestible product containing nicotine that is not a cigarette, a tobacco product, or a drug or device authorized for sale by the U.S. Food and Drug Administration. The tax is assessed at a rate of 50 percent of the MLP in the first four fiscal years, 56 percent of the MLP in fiscal years five through seven, and 62 percent thereafter, and is modeled upon the tobacco products tax.

Modified risk tobacco products. The bill establishes separate tax rates for modified risk tobacco products (MRTP), which must be certified by the U.S. Food and Drug Administration for use to reduce harm or the risk of tobacco-related disease associated with commercially marketed tobacco products. MRTP are taxed at half the tax rate of regular cigarette, tobacco, and nicotine products.

Moist snuff. The bill establishes a minimum tax for moist snuff. Moist snuff is defined as any finely cut, ground, or powdered tobacco that is not intended to be smoked but does not include any finely cut, ground, or powdered tobacco that is intended to be placed in the nasal cavity. For the first four fiscal years, moist snuff is to be taxed at a minimum rate of $1.48 per 1.2 ounce can. For fiscal years five through seven, moist snuff is taxed at a minimum rate of $1.84 per 1.2 ounce can. Thereafter, it is taxed at a minimum rate of $2.26 per 1.2 ounce can.

Inventory tax. For products in inventory at the effective date of tax increases, importers and distributors are required to remit taxes to account for the increased rates.

Vendor fee. Under current law, tobacco and cigarette distributors who file taxes on time are allowed to retain a portion of the tax due as a vendor allowance to cover the cost of tax collection. The measure reduces this allowance from 3.33 percent to 1.6 percent for tobacco distributors, and 4 percent to 0.4 percent for cigarette distributors. This vendor allowance applies to statutory taxes only. Nicotine distributors are permitted a vendor allowance of 1.1 percent for timely tax remittance.

Regulation of nicotine product distribution. The bill directs the DOR to license nicotine tax distributors and to administer similar regulatory requirements as those that exist for tobacco product distributors, including a $10 annual license fee, quarterly tax filings, late payments, and penalties. A distributor who is willfully noncompliant with the tax regime or who falsifies a tax return is guilty of class 5 felony tax evasion, subject to the tax evasion criminal penalty statute in existing law.

Sales to Colorado consumers by out-of-state sellers. The bill requires that out-of-state cigarette wholesalers and tobacco and nicotine product distributors who sell to Colorado consumers remit the appropriate taxes. Correspondingly, Colorado distributors who sell tobacco and nicotine products to out-of-state consumers are allowed a tax credit equal to the amount of tax paid when the products were brought into the state.

Minimum price for cigarettes. The bill establishes a minimum price for cigarettes of $7 per pack and $70 per carton until July 1, 2024, and $7.50 per pack and $75 per carton on and after July 1, 2024.

Distribution of tax collected. Via the Old Age Pension Fund, the revenue from the new and increased taxes is credited to the General Fund. From the General Fund, for the first three fiscal years, a portion of the new revenue is transferred to the newly created 2020 Tax Holding Fund, and then distributed to the Tobacco Tax Cash Fund and General Fund. Funds in the General Fund are used to offset COVID-related revenue losses. In subsequent years, the new revenue is transferred to the Tax Holding Fund and distributed to the Tobacco Tax Cash Fund, the General Fund, the Tobacco Education Programs Fund, and the Preschool Cash Fund. The additional sales tax revenue from the minimum cigarette price is deposited in the Preschool Cash Fund (73 percent) and the General Fund (27 percent).

Preschool funding. The measure requires that revenue credited to the Preschool Programs Cash Fund be expended to expand and enhance the Colorado Preschool Program or a successor program in order to offer at least 10 hours per week of voluntary preschool, free of tuition, to any child in his or her final year before entry into kindergarten, subject to available funding.

Tobacco education programs. The permissible uses of money deposited in the Tobacco Education Programs Fund are broadened to allow their use for education, prevention, and cessation programs related to nicotine products.

Audit. The Office of the State Auditor (OSA) is required to conduct an annual financial audit of tax revenue collected and allocated under the bill.

State Revenue

Contingent upon voter approval, the bill is expected to generate about $85.9 million in FY 2020-21, and $173.5 million in FY 2021-22, the first full fiscal year under the measure, with higher amounts in future years as tax rates increase and consumption changes. These estimates are net amounts by which the measure is expected to increase revenue from new taxes and decrease revenue from existing taxes because of reduced cigarette and tobacco product consumption. For example, in FY 2021-22, the measure increases taxes by $182.6 million, but reduces existing taxes by $1.3 million. The estimate for FY 2020-21 represents a half-year impact. Increased tax revenue is retained and spent in excess of the state TABOR limit as a voter-approved revenue change. Revenue impact estimates are summarized in Table 3.

Table 3
State Revenue Impacts Under HB20-1427

	FY 2020-21	FY 2021-22	FY 2022-23
Cigarette Taxes			
Current Statutory Tax (General Fund)	($0.7 million)	($1.2 million)	($1.0 million)
Constitutional Tax (Tobacco Tax Fund)	($3.8 million)	($7.3 million)	($6.4 million)
New Statutory Tax (General Fund)	$75.3 million	$150.4 million	$143.7 million
Total Cigarette Taxes	**$70.8 million**	**$141.8 million**	**$136.3 million**
Tobacco Product Taxes			
Current Statutory Tax (General Fund)	($0.03) million	($0.06 million)	($0.06 million)
Constitutional Tax (Tobacco Tax Fund)	($0.2 million)	($0.5 million)	($0.5 million)
New Statutory Tax (General Fund)	$5.8 million	$12.6 million	$13.1 million
Total Tobacco Product Taxes	**$5.5 million**	**$12.0 million**	**$12.5 million**
Nicotine Product Tax			
New Statutory Tax (General Fund)	**$8.8 million**	**$18.2 million**	**$18.8 million**
Net General Fund Revenue Impact	**$90.0 million**	**$181.3 million**	**$175.5 million**
Tobacco Tax Cash Fund Revenue Impact	**($4.1 million)**	**($7.9 million)**	**($6.9 million)**
Total Sales Tax Revenue	**$0.8 million**	**$1.4 million**	**$1.0 million**
Total Net Revenue Impact	**$85.9 million**	**$173.5 million**	**$168.6 million**

**Totals may not sum due to rounding.*

Cigarette and tobacco taxes. The estimates in Table 3 assume the May 2020 Legislative Council Staff forecast for cigarette and tobacco product statutory and constitutional tax revenue. Based on observed changes in consumption following the enactment of Amendment 35, it is assumed that tax rate increases will decrease cigarette and tobacco product consumption by 0.28 percent for each percentage point by which the after-tax retail price is increased. To the extent that consumption is less than or greater than assumed, the revenue impact of the measure will be correspondingly lower or higher. For the current statutory taxes, the estimates in Table 3 represent the net impact of reduced consumption and the decrease of the current distributor allowance.

Nicotine product tax. The estimates in Table 3 are based on 2018 retail sales data for nicotine products. Consumption of nicotine products is expected to grow by between 5 percent and 10 percent annually between 2018 and 2022. Additionally, modifications were made to accommodate online sales, which are believed to be underrepresented in available retail sales data. Demand for nicotine products is assumed to be more sensitive to changes in price than demand for cigarettes and other tobacco products. It is assumed that the imposition of the new tax will decrease nicotine product consumption by 0.37 percent for each percentage point by which the after-tax retail price is increased.

Data from which to base an estimate of new nicotine tax revenue from the measure are limited. States that have enacted nicotine product taxes report tax revenues that suggest significantly different levels of consumption across states even after adjusting for differences in state populations and economic activity. Data from other states suggest that consumption grew significantly from year to year even after taxes were enacted. However, the market for nicotine and vaping products is expected to continue to evolve in coming years, and the pace of increasing consumption is expected to slow as federal, state, and local regulations on the industry tighten.

Sales tax revenue. Sales tax revenue is expected to increase due to the bill's imposition of a minimum per pack price on cigarettes.

License fees, fines, and penalties. License fees will generate $10 per taxpayer per year to the General Fund; relative to the tax impacts of the bill, fee impacts are assumed to be minimal. This revenue is subject to TABOR. Fines, penalties, and interest will depend on taxpayer compliance and DOR enforcement processes.

Modified Risk Tobacco Products. Tax rate increases for MRTP products are lower than for other cigarette, tobacco, and nicotine products under the bill. There is currently only one line of tobacco products designated as MRTP by the U.S. Food and Drug Administration. This fiscal note assumes that MRTP do not constitute a significant market share, and that revenue impacts from the lower taxation of these products will be minimal. Future designations of new MRTP would reduce revenue relative to the estimates in this fiscal note.

State Transfers

Conditional on voter approval, the bill requires that a portion of new cigarette, tobacco, and nicotine products tax revenue be transferred to the Tobacco Tax Cash Fund and that a portion of the increased sales tax revenue from the minimum cigarette price be transferred to the Preschool Programs Cash Fund. The transfers to the Tobacco Tax Cash Fund are estimated at $5.5 million in FY 2020-21 and $10.95 million in FY 2021-22. Sales tax transfers to the Preschool Programs Cash Fund are estimated to be $0.6 million in FY 2020-21 and $1.0 million in FY 2021-22. Transfers of new cigarette, tobacco, and nicotine product tax revenue to the Preschool Programs Cash Fund begin in FY 2023-24 and are estimated at $143 million in FY 2023-24 and $186 million in FY 2024-25.

Revenue transferred to the Tobacco Tax Cash Fund is distributed to programs administered in Health Care Policy and Financing (HCPF) and Department of Public Health and Environment (CDPHE), including Medicaid, CHP+, primary care programs, tobacco education programs, and various other healthcare programs. Specific transfers to individual programs have not been estimated at this time; however, it should be noted that these funds may be distributed differently during a declared fiscal emergency.

State Expenditures

The measure increases state expenditures by $85.9 million in FY 2020-21 and $173.5 million in FY 2021-22. Expenditures increase in subsequent years. This fiscal note assumes that expenditures increase by the same amounts by which the bill increases revenue. Most of the additional revenue in fiscal years 2020-21 through 2022-23 will remain in the General Fund and be spent as determined by the General Assembly. The remaining revenue will be spent as discussed below.

Programmatic expenditures. Expenditures will be made from cash funds to which moneys are credited.

Preschool program. Revenue in the preschool programs fund must be spent to provide at least 10 hours a week of free preschool to children in the year before they start kindergarten. This amount is estimated at $143 million in FY 2023-24.

Tobacco education programs. Revenue credited to the Tobacco Education Programs Fund will be expended for tobacco and nicotine education, prevention, and cessation grants and for grant making administration. When tobacco education programs funding is made available beginning in FY 2023-24, the CDPHE will require an estimated 13.1 FTE to administer additional grants. Expenditures for staff salaries and attendant operating, capital, and travel costs will be paid from the amounts transferred to the cash fund.

Health care. Revenue credited to the Health Care Expansion Fund and the Primary Care Fund will be expended for Medicaid, Children's Basic Health Plan, and primary care programs in HCPF. The specific amount has not been estimated.

Cancer and chronic disease detection and treatment. Revenue credited to the Prevention, Early Detection, and Treatment Fund will be expended for the cancer, cardiovascular, and chronic pulmonary disease program, the health equity program, and the breast and cervical cancer screening program in the CDPHE.

Administrative expenses. Expenditures in the DOR for tax administration are estimated at $286,000 and 0.4 FTE in FY 2020-21 and $71,000 and 1.0 FTE in FY 2021-22. Start-up costs include computer programming and testing, while ongoing costs include staff in the department's Taxpayer Services Division, reporting, and legal services. Beginning in FY 2021-22, the Office of the State Auditor will require an estimated $25,000 and 0.3 FTE to conduct an annual financial audit of tax revenue collected and expended as a result of the measure.

Election expenditure impact—existing appropriations. This bill includes a referred measure that will appear before voters at the November 2020 general election. While no additional appropriation is required in this bill, certain election costs are incurred by the state when ballot measures are referred to voters, including reimbursements to counties from the Department of

State Cash Fund in the Secretary of State's Office and newspaper publication of text and titles and inclusion in the statewide ballot information booklet, paid from the Ballot Analysis Revolving Fund in the Legislative Department.

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature, except that, conditional upon voter approval at the November 2020 general election, Sections 2 through 23 take effect upon proclamation of the Governor, or January 1, 2021, whichever is later.

State Appropriations

No appropriation is required. If the measure is approved by voters, funding will be addressed through the annual budget process

State and Local Government Contacts

Education
Human Services
Public Health and Environment
Counties
Health Care Policy and Financing
Law
Revenue
Municipalities