

CIGARETTE TAX
Chapter 82.24 RCW

<u>Tax Base</u>	The sale, use, consumption, handling, possession, or distribution of cigarettes; the tax applies to the first such taxable event that occurs within the state.
<u>Tax Rate</u>	<p>The combined state tax rate currently totals \$2.025 per package of 20 cigarettes. (The federal government also levies a tax of \$1.01 per pack upon cigarette manufacturers.) The \$2.025 state rate is comprised of the following:</p> <ul style="list-style-type: none">- 23 cents - state general fund (RCW 82.24.020(1)).- 8 cents – state general fund (RCW 82.24.027). Until July 1, 2009, these receipts were deposited in the water quality account for use in various water-related programs.- 10.5 cents – state general fund (RCW 82.24.020(2)). Until July 1, 2009, these revenues went to the violence reduction and drug enforcement account to fund drug/alcohol programs.- 41 cents – state general fund (RCW 82.24.020(3)). Until July 1, 2009, these receipts were deposited in the health services account to help finance state health care programs.- 60 cents – state general fund (RCW 82.23.028). Pursuant to Initiative 773, until July 1, 2009, these receipts were deposited in the health services account.- 60 cents (RCW 82.24.026 adopted in 2005). Receipts go to:<ul style="list-style-type: none">• 42.9 cents - education legacy account• 17.1 cents - state general fund

NOTE: The state also receives funds from a cigarette tax levied by the Puyallup Indian Tribe. Legislation adopted in 2005 provides for an agreement between the state and this tribe relating to a tribal cigarette tax. Codified as RCW 43.05.465, the tribal tax is currently imposed at a rate of \$17.75 per carton and is in lieu of the state cigarette tax and state/local retail sales taxes. The agreement provides that 30 percent of the tribal receipts go to the state general fund. The tribe first levied the tax in May 2005.

<u>Levied by</u>	State
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Administration

Department of Revenue. The tax is paid via the purchase of stamps which are affixed to each package of cigarettes by stamping wholesalers. Special licenses are required for sellers of cigarettes; fees for these licenses are paid to the Department of Licensing through the Master Business License application. Wholesalers subject to the cigarette tax are allowed compensation for their costs of affixing the stamps in an amount of \$6 per 1,000 stamps. Although the Department of Revenue administers collection of the tax, licensing of wholesalers and retailers and enforcement activities are performed by the Liquor Control Board.

Recent Collections (\$000)

<u>Fiscal Year</u>	<u>Collections</u>	<u>% Change</u>	<u>% of All State Taxes</u>
2009	\$392,429	(6.8)%	2.5%
2008	421,128	1.7	2.5
2007	414,212	(5.0)	2.5
2006	435,813	34.7	2.8
2005	323,580	(3.7)	2.3
2004	336,156	2.0	2.6
2003	329,627	9.0	2.7
2002	302,337	23.6	2.6
2001	244,550	(2.2)	2.1
2000	250,109	(1.9)	2.1

In addition, the state portion of the Puyallup tribal cigarette tax produced \$5.6 million for the state general fund in Fiscal Year 2009.

A breakdown of Fiscal Year 2009 cigarette tax collections by fund and the new allocation, starting on July 1, 2009, is shown below:

	<u>FY 2009 Tax Rate</u>	<u>FY 2009 Receipts (\$000)</u>	<u>FY 2010 Tax Rate</u>
General Fund	\$0.2468	\$47,827	\$1.596
Water Quality	0.0902	17,480	--
Drug Enforcement	0.1188	23,022	--
Health Services	1.1402	220,957	--
Education Legacy	0.4290	83,143	0.429
TOTAL	\$2.0250	\$392,429	\$2.025

Distribution of Receipts

Receipts of the cigarette tax are now distributed to the state general fund and the education legacy accounts as outlined above.

Exemptions, Deductions and Credits

- sales by wholesalers to persons in other states or countries.
- sales to the federal government.
- sales to Indians (via allocation program).
- sales to tribal retailers whose tribe is party to a cigarette contract with the state.

History

The cigarette tax was initially imposed as part of the Revenue Act of 1935 at a rate of 1 cent per package. The rate has been increased 18 times over the past 70 years. These and other major changes are summarized as follows:

- 1935 - Cigarette tax imposed at 1 cent per pack.
- 1939 - Rate increased from 1 to 2 cents per pack.
- 1949 - Rate increased from 2 to 4 cents per pack. Receipts from additional 2 cents earmarked for retirement of bonds issued to pay compensation to war veterans.
- 1955 - Additional tax of 0.5 cents per 10 cents of selling price (then roughly equivalent to 1 cent per pack). Receipts dedicated to public school building bond redemption fund until the bonds were retired, then to the general fund.
- 1959 - Rate increased from 5 to 6 cents per pack.
- 1961 - Rate increased from 6 to 7 cents per pack.
- 1965 - Rate increased from 7 to 11 cents per pack.
- 1971 - Rate increased from 11 to 16 cents per pack.
- 1972 - Bonds for veterans bonuses retired; compensation of \$250 extended to Vietnam veterans funded by the 2 cent rate (1949) until 1977 when the compensation was fully paid and the receipts began going to the general fund.
- 1975 - Previous exemption for possession of two cartons of unstamped cigarettes was repealed, thus strengthening cigarette tax enforcement.
- 1981 - Rate increased from 16 to 20 cents per pack.
- 1982 - Surtaxes increase the rate from 20 to 20.8 cents (5/1/82) and to 23 cents (8/1/82).
- 1983 - Surtaxes adopted in 1982 made permanent.
- 1986 - Rate increased from 23 to 31 cents per pack. Receipts from additional 8 cents earmarked for water quality programs. Revisions to the Unfair Cigarette Sales Act; regulation of cost of cigarettes, to expire in 1991.
- 1989 - Rate increased from 31 to 34 cents per pack. Receipts from additional 3 cents earmarked for drug education and enforcement programs. The additional 3 cent rate was scheduled to expire on July 1, 1995.

- 1993 - Rate increase from 34 to 54 cents per pack. Receipts from the additional 20 cent tax earmarked for health programs; rate increases for the following three years.
- 1994 - Rate increase from 54 to 56.5 cents per pack due to increase in the health services rate. Expiration of drug enforcement rate repealed and the 7.5 cent rate increase effective in 1995 is approved by both the Legislature and the voters.
- 1995 - Rate increased from 56.5 to 81.5 cents per pack due to 17.5 cent increase in the health services rate and 7.5 cent increase in the drug enforcement rate. Technical changes in the administration of the tax, including stamping of untaxed cigarettes for Indian consumption, tighter requirements for transporting cigarettes, and pre-collection of the tax in certain situations by Indian wholesalers.
- 1996 - Rate increased from 81.5 to 82.5 cents per pack due to 1 cent increase in the health services rate.
- 1997 - Enforcement shifted from Department of Revenue to the Liquor Control Board.
- 1999 - One-half of the 8 cent tax for water quality is diverted to a new salmon recovery account for two years and the remainder of the water quality tax goes to the violence reduction and drug enforcement account for two years.
- 2001 - Legislation was adopted allowing the state to enter into contracts with 16 Indian tribal authorities (currently 28 tribes) relating to the imposition of tribal cigarette taxes. The intention is for a tribe to enact a tax equivalent to the state cigarette tax, thereby providing the tribe with revenues for tribal services and also reduce the incentive for evasion of the state tax.
- 2001 - Cigarette stamping allowance is increased from \$4 to \$6 per 1,000 stamps.
- 2001 - Initiative 773, approved in November 2001, imposes an additional 60 cent tax.
- 2005 - Additional tax of 60 cents per pack levied to support higher education and other educational programs, effective July 1, 2005. The overall tax rate becomes \$2.025 per pack. Four new tribal contracts authorized, as well as a unique tribal tax for the Puyallup tribe by which the state receives 30 percent of the proceeds.
- 2008 - A unique tribal cigarette contract is authorized for the Yakama tribe. Except for the Puyallup tribal tax (of which the state receives a portion), all of the other contracts call for a tribal tax “equivalent” to the state tax. The 2008 statute allows a somewhat lower tribal tax rate. However, an agreement has yet to be reached with the Yakamas.
- 2008 - Cigarette tax rates changed from the millage basis to cents.
- 2009 - Administration of cigarette licenses transferred from Department to Liquor Control Board.
- 2009 - Earmarking of cigarette revenues to dedicated accounts is eliminated, except for the education legacy account.

Discussion/Major Issues

Members of Indian tribes are not subject to tax on cigarettes sold on their reservation. The Department provides untaxed (but stamped) cigarettes to recognized tribes in an amount sufficient for the personal use of each tribal member, based on average per capita consumption rates. Non-tribal members have evaded the cigarette tax by purchasing cigarettes from Indian stores. This tax evasion is being addressed through state/tribal

agreements by which tribal governments impose their own cigarette taxes at rates equivalent to state taxes. Presently, state law provides the authority for such contracts with 28 tribes located in the state.

The \$2.025 cigarette tax rate levied in Washington is among the highest in the nation. Currently, six states – led by Rhode Island’s \$3.46 rate - have higher tax rates. New York, New Jersey, Wisconsin, Massachusetts, and Vermont have rates which range from \$2.24 to \$2.75. At the other end of the cigarette tax spectrum, ten states, principally tobacco-producing southern states, have rates of 50 cents or less. The lowest rate is South Carolina's tax of \$0.07 per pack. There is concern that Washington's high tax rate will continue to exacerbate the cigarette tax evasion problem, because most neighboring states have significantly lower tax rates (Oregon, \$1.18; Idaho, 57 cents; California, 87 cents; and Nevada, 80 cents).

The Department estimates that evasion of cigarette tax amounts to roughly \$160 million per year (Fiscal Year 2008) in lost tax revenues, including state/local sales taxes. Evasion is attributable to purchases at non-compact Indian tribal smoke shops by non-Indians, to purchases made in other states, or to purchases via the Internet or mail order. In addition to the loss of revenue due to tax evasion, the long-term trend in cigarette consumption has been declining in Washington and nationwide. According to data released by the state Department of Health in 2006, Washington has the fifth lowest rate of smoking in the nation at 17.8 percent of the adult population.