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### ***State Ballot Question Issue Brief # 4***

## **SQ 713: Tobacco Tax Increase + Tax Relief + Health Care Initiative**

### **In a Nutshell**

**SQ 713 would increase the state excise tax on cigarettes and other tobacco products while eliminating the sales tax on these products. These tax changes are expected to generate close to \$150 million in additional state revenue, which will be spent on a variety of health care programs. The measure also lowers the income tax on specified capital gains and retirement income and makes certain tax cuts permanent. The full-year impact of the tax cuts is about \$75 million.**

### **Current Law**

The tax on tobacco products depends on whether the purchase is made from a non-tribal or tribal retailer. A person buying a pack of cigarettes from a non-tribal retailer pays \$0.23 in *state excise tax* (or **stamp tax**) plus approximately \$0.25 in state and local **sales tax** (the sales tax amount will depend on the cigarette sales price and county and local tax rates). Tribal retailers collect 25% of the excise tax (\$0.0575) but do not collect any sales tax on cigarette sales. Other tobacco products are taxed at the following rates: \$0.009 per little cigar; \$0.03 per cigar; 40% of factory list price for smoking tobacco; and 30% of factory list price for chewing tobacco.

In 1998, the Legislature approved cuts in the top marginal income tax rate and an expansion in the Sales Tax relief Act, but made these tax cuts contingent on state revenue growth from year to year. In years when the Board of Equalization (BOE) projects revenue in the upcoming year to decrease compared to the current year, “triggers” take effect that suspend the tax cuts. The triggers raise the top marginal rate of the state personal income tax from 6.65% to 7.0. It also lowers the household income limit for the Sales Tax relief Credit from \$20,000 to \$12,000 for an individual and from \$50,000 to either \$20,000 or \$12,000 for a family or senior.

The personal income tax code also exempts \$5,500 of retirement income from income tax for retirees with annual incomes of less than \$25,000 (single filers) or \$50,000 (joint filers). Capital gains are taxed as normal income for state income tax purposes.

### **The Proposal**

HB 2660, the legislation behind SQ 713, enumerates the tobacco tax increases, the distribution of the new revenue, the creation of several revolving funds, and the tax cuts. All tax changes would go into effect on January 1, 2005. Tax collection arrangements between the state and Native American tribes are worked out in compacts between the state and tribes that are not included as part of the actual legislation.

CIGARETTES

The cigarette tax will vary depending on the retailer. There are three main categories of retailers:

- **Non-tribal retailers**
  - Increase the excise tax on a pack of cigarettes by \$0.80 to \$1.03.
  - Remove 100% of the state and local sales tax.
  - The net tax increase would be \$0.55 cents per pack.
- **Tribal retailers who have signed new compacts with the state**
  - Continue to pay 25% of the existing \$0.23 excise tax per pack (\$0.0575)
  - Pay the full \$0.80 per pack tax increase (and 100% of any future excise tax increase).
  - The tribe receives a rebate in the amount of 50% of the increase (\$0.40 per pack).
  - Compacting tribes, then, would pay a total of \$0.86 in tax per pack of cigarettes, with a rebate of \$0.40.
  - The tribes are prohibited from using the rebate to subsidize tribal retailers. The payments must be “devoted to health, welfare, educational, and other governmental purposes of the tribe.”
- **Tribal retailers who have not signed new compacts with the state, and tribal retailers who might be placed at a competitive disadvantage** (specifically, tribal retailers who are located within 20 miles of the border of a state that has not raised its cigarette tax since July 2002, or who have smoke shops within 10 miles of a tribally-owned smoke shop that has been in existence since January 1, 2003 and is still under the old compact)
  - Pay 25% of the new excise tax, or \$0.2575, until new compacts are signed.
  - Currently, about 20-25% of tribal sales are to tribes that will remain at least temporarily under the old compacts.
  - It is not clear how many tribes will benefit from the proximity exceptions.
- In addition, tribal retailers within 20 miles of the border of a state that has raised its cigarette tax since July 2002 will be taxed somewhat differently, depending on the amount of the neighboring state’s tax increase.

	CURRENT		PROPOSED		
	Non-Tribal	Tribal	Non-Tribal	Tribal New Compact	Tribal Old Compact
Excise tax	\$ 0.23	\$ 0.06	\$ 1.03	\$ 0.83	\$ 0.26
State sales tax*	\$ 0.14	-	-	-	-
Local sales tax**	\$ 0.11	-	-	-	-
<b>Total taxes</b>	<b>\$ 0.48</b>	<b>\$ 0.06</b>	<b>\$ 1.03</b>	<b>\$ 0.83</b>	<b>\$ 0.26</b>
Tribal Advantage - \$		\$ 0.42		\$ 0.20	\$ 0.77

\*- Based on \$3.00 pre-tax sales price  
 \*\* - Assumes 3.8% county and local sales tax

#### OTHER TOBACCO PRODUCTS:

- **Little cigars:** Increase tax by \$0.027 to total of **\$0.036** per little cigar.
- **Cigars:** Increase tax by \$0.09 to total of **\$0.12** per cigar.
- **Smoking tobacco:** Increase tax by 40% to total of **80%** of factory list price.
- **Chewing tobacco:** Increase tax by 30% to total of **60%** of factory list price.

The taxes on sales of other tobacco products by *tribal retailers* is also determined by compacts. In general, the tax increases on other tobacco products would affect the tribes in the same fashion as the cigarette tax increases.

#### PERSONAL INCOME TAX:

- **Tax Rate Reduction**
  - Remove “trigger” mechanism and leave top marginal rate at 6.65% permanently.
- **Sales Tax Rebate Eligibility Expansion**
  - Permanently set the income eligibility limit at up to \$50,000 for a family (or an individual aged 65 or older) or \$20,000 for an individual.
- **Increase Deduction of Retiree Income**
  - Increase amount of income eligible for exemption to \$7,500 per year.
  - Increase income threshold to qualify for exemption to \$37,500 for single filers and \$75,000 for joint filers.
- **Eliminate Taxation of Specified Individual Capital Gains Income**

Earnings from specified capital gains would be exempt from the state personal income tax:

  - Capital gains accrued from Oklahoma property held by the taxpayer for at least 5 years;
  - Capital gains earned from the sale of stock or ownership interest in an Oklahoma company (that is, a company whose primary headquarters has been in Oklahoma for at least 3 years) if held by the taxpayer for at least 3 years.

#### Fiscal Impact

The proposed tax changes are projected to have the following fiscal impact during the first full year:

- Total net revenue change: \$76.3 million
  - Cigarette tax increase: +\$128.6 million net of reallocations
  - Other tobacco tax products tax increase: +\$21.5 million net of reallocations
  - Income tax cuts: -\$73.8 million

A portion of the total revenue from increased tobacco stamp taxes will be reallocated to the General Revenue fund for the loss of state sales tax revenues; to local governments for their loss of sales tax revenue; and to tribes as their 50% share of the stamp tax increase.

Over time, the net revenue impact will decrease. Revenue collections from the tobacco tax are likely to remain flat or decline as fewer people smoke. By contrast, the magnitude of the income tax cuts will grow over time as income grows.

In projecting the law’s fiscal impact, several assumptions were made about how tobacco consumption patterns would and would not be affected by the new tax:

- It is assumed that a \$0.55 cent per pack price increase will decrease taxable cigarette sales by 17.4%. Of the decrease, 4/5<sup>th</sup> will be due to a 14% decline in cigarette consumption, while 1/5<sup>th</sup> will result from a shift to the “gray market” of Internet sales. Due to more active legal

enforcement by the Oklahoma Tax Commission, the state is projecting no shift in sales to the black market following the price increase.

The revenue projections assume that the three categories of retailers – non-tribal; tribes that have signed a new compact; and tribes operating under the old compact – will all maintain their existing market share. Under the most recently available data, non-tribal retailers have 58% of the total market, tribes that have signed new compacts have 31% and tribes that have not signed new compacts have 11%.

### **Allocation of New Tobacco Tax Revenue**

HB 2660 allocates new revenue from increased tobacco taxes to specified health care projects on a percentage basis. Based on a total allocation of \$149.3 million from new tobacco tax revenue, state officials project the following:

- \$50 million to assist up to 100,000 uninsured low-income workers buy into employer or public health insurance;
- \$49.3 million to maintain provider rate increases and expanded benefits in the Medicaid program;
- \$17.6 million for the state's trauma care system;
- \$7 million to OU for bond payments on a comprehensive cancer care center;
- \$7 million to OSU-Tulsa for a facility dedicated to telemedicine and for indigent care;
- \$6 million for adolescent substance abuse treatment centers and services;
- \$5 million to increase Medicaid reimbursement to locally-owned hospitals
- \$3 million to boost Medicaid reimbursement for emergency room physicians and ambulance services
- \$2.5 million to implement the Katie Beckett amendment, which provides Medicaid coverage for additional children with developmental disabilities;
- \$1.5 million for tobacco cessation efforts;
- \$1 million for breast and cervical cancer treatment.

Because many of these health care expenditures would be run through the Medicaid program, they would be eligible for matching federal Medicaid funds. State spending of \$149.3 million is projected to leverage an additional \$234.8 million in federal funds, for total health care spending of \$384.1.

### **Project Details**

Cities and counties would be reimbursed for lost sales tax revenue revenues in the proportion which total municipal and county tax revenue was apportioned by the Tax Commission in the preceding month.

The new tobacco compacts give the state legal standing to challenge tribes that attempt to use the 50% rebate to enhance their competitive price advantage instead of using the funds for tribal programs. The proposed tribal gaming compact included in SB 1252 (SQ 712) would allow the state to terminate a tribe's gaming compact if the tribe is found in violation of tobacco compact.

### Some Pros and Cons of SQ 713

Pros	Cons
<p>The increased revenue from raising the tobacco tax will serve multiple vital goals, including increasing health insurance coverage, supporting the state’s health care providers, expanding access to care, and allowing the creation of a world-class cancer center and increased telemedicine services. Failing to support SQ 713 will endanger the economic prospects of hospitals and other medical providers.</p> <p>Smoking takes a dreadful toll on Oklahoma’s population. Raising tobacco taxes will help lower smoking rates among Oklahomans, especially among youth. Since smoking is a voluntary act, taxing smokers is entirely appropriate. Oklahoma’s cigarette taxes are among the lowest in the nation and have been unchanged since the 1980’s.</p> <p>Passage of SQ 713, when combined with the new tribal cigarette compacts, will stop the diversion of tobacco sales to tribal retailers and level the playing field by reducing the price gap between non-tribal retailers and tribes that have signed the new compacts. While some tribes remain under the old compact, their advantage will last only until their contracts expire and are renegotiated.</p> <p>The tax cuts included in SQ 713 will spur economic growth by increasing incentives for seniors to stay in the state and for investors to invest in Oklahoma. Eliminating the tax triggers will eliminate uncertainty about tax rates and avoid increasing taxes during a downturn.</p> <p>If SQ 713 fails, it will signal a strong victory for anti-tax advocates and serve to discourage future efforts to raise taxes to invest in health care or other vital needs.</p>	<p>Passage of SQ 713 will substantially worsen the state’s fiscal strains over time. The ballot measure proposes to fund the most rapidly growing area of state spending – health care – with revenues from a tax source, tobacco, which is flat or declining. The ongoing commitment to fund the health care projects enumerated in the legislation will thus require additional revenue sources beyond the tobacco tax increase contained in this measure. In addition, the permanent cuts to the state income tax will increase the imbalance between spending needs and revenue capacity.</p> <p>The measure would shift more of the state’s tax burden to low-income Oklahomans, who are most likely to smoke, and less to upper-income Oklahomans, who claim the lion’s share of capital gains income.</p> <p>If we want to address the public health problem of smoking, then the tax increase should be even larger and we should not make important ongoing health care programs dependent on taxing an activity we wish to eliminate.</p> <p>There is reason to fear that increased tobacco taxes will lead to a shift of sales to the black market and that tribes operating under the old tobacco compact or under the “proximity exceptions” will find ways to exploit their competitive advantage to gain a larger market share. If so, tobacco revenues will be less than expected and both non-tribal retailers and tribal retailers under new compacts will be harmed.</p> <p>Eliminating the triggers that suspend tax cuts during years of budget shortfalls is shortsighted and will unnecessarily constrain the state’s ability to handle the next major budget crisis. Tax increases are actually less economically harmful during a downturn than are budget cuts.</p>

### **State Question 713**

This measure places a tax on cigarettes. The tax will be 4 cents per cigarette. The measure places a tax on other tobacco products. Monies from both taxes will be given to counties, municipalities, and to several funds for various health-related needs. These needs include health care, building of a cancer center, trauma care, telemedicine, substance abuse, breast cancer, and aid to hospitals and ambulance services. The measure creates the Cigarette and Tobacco Tax Advisory Committee. The measure provides penalties for tribes that break certain compacts. The measure modifies discount for buying tax stamp. The measure ends sales tax on cigarettes and other tobacco products. The measure makes the top income tax rate of 6.65% permanent. The measure increases the amount of certain retirement benefits not subject to income tax. The measure allows certain earnings of an individual to not be taxed. The measure removes the process that suspends certain tax laws when state monies are at a certain level. The taxes will begin on January 1, 2005.

These issue briefs are intended to help Oklahoma voters make informed decisions on the issues before them. For more information, contact Monica Barczak at (918) 382-3354 or [mbarczak@captc.org](mailto:mbarczak@captc.org)

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Community Action Project (CAP) is a comprehensive anti-poverty agency whose mission is to help individuals and families achieve economic self-sufficiency. CAP's public policy department aims to promote policies that will benefit low-income Oklahomans through research, education, and advocacy.