MISSOURI STATE AUDITOR'S OFFICE
FISCAL NOTE (14-128)

Subject

Initiative petition from Khristine Heisinger regarding a proposed statutory amendment to Chapter 149. (Received March 11, 2014)

Date

March 31, 2014

Description

This proposal would amend Chapter 149, RSMo.

The amendment is to be voted on in November 2014.

Public comments and other input

The State Auditor's office requested input from the **Attorney General's office,** the **Department of Agriculture,** the **Department of Economic Development,** the **Department of Elementary and Secondary Education,** the **Department of Higher Education,** the **Department of Health and Senior Services,** the **Department of Insurance, Financial Institutions and Professional Registration,** the **Department of Mental Health,** the **Department of Natural Resources,** the **Department of Corrections,** the **Department of Labor and Industrial Relations,** the **Department of Revenue,** the **Department of Public Safety,** the **Department of Social Services,** the **Governor's office,** the **Missouri House of Representatives,** the **Department of Conservation,** the **Department of Transportation,** the **Office of Administration,** the **Office of State Courts Administrator,** the **Missouri Senate,** the **Secretary of State's office,** the **Office of the State Public Defender,** the **State Treasurer's office, Adair County, Boone County, Callaway County, Cass County, Clay County, Cole County, Greene County, Jackson County Legislators, Jasper County, St. Charles County, St. Louis County, Taney County,** the **City of Cape Girardeau,** the **City of Columbia,** the **City of Jefferson,** the **City of Joplin,** the **City of Kansas City,** the **City of Kirksville,** the **City of Kirkwood,** the **City of Mexico,** the **City of Raymore,** the **City of St. Joseph,** the **City of St. Louis,** the **City of Springfield,** the **City of Union,** the **City of Wentzville,** the **City of West Plains, Cape Girardeau 63 School District, Hannibal 60 School District, Rockwood R-VI School District, Linn State Technical College, Metropolitan Community College, University of Missouri** and **St. Louis Community College.**

Assumptions

Officials from the **Attorney General's office** indicated

The proposal would artificially deem the payment of a new tax as compliance with the state's tobacco escrow laws. However, while such taxes would be deemed compliance with state law, it would not be deemed compliance with certain conditions of the Tobacco Master Settlement Agreement (MSA). The MSA is a contractual agreement between the state and certain tobacco product manufacturers, the terms of which cannot be altered or avoided by statute. Accordingly, the result of the proposal would be that certain tobacco product manufacturers would be deemed in compliance with state law even though they had not in fact complied with state law.

Because certain tobacco product manufacturers would be able to avoid actual compliance with existing state laws, the state would be powerless to diligently enforce its existing state laws on this subject, which enforcement is necessary to avoid a substantial reduction in annual MSA payments known as the "NPM adjustment." Although it is impossible to predict with precision the exact amount of future NPM adjustments, it could be up to the full amount of Missouri's annual MSA payment (approximately $130 million annually at present). However, as disputes over annual NPM adjustments are presently being resolved several years in arrears, NPM adjustments incurred in the current and immediately upcoming fiscal years may not actually be realized until several years into the future.

In sum, the proposal would result in a substantial loss of state revenue, in perpetuity, in the form of either a substantial reduction or possible elimination of the state's annual MSA payments, though the precise amount of loss and the exact fiscal year in which such loss would first be realized cannot be accurately predicted at this time

As noted, the proposal would change the manner in which tobacco manufacturers can comply with certain state laws, but would not eliminate the existing requirements nor the AGO's obligation to enforce them. Moreover, the proposal would not adjust any of the AGO's other duties and obligations under the MSA or related state laws. Accordingly, the AGO would not realize any savings from the proposal but assumes that any increased costs for the AGO associated with the proposal could be absorbed with existing resources.

Officials from the **Department of Agriculture** indicated no fiscal impact on their department.

Officials from the **Department of Economic Development** indicated no impact for their department.

Officials from the **Department of Elementary and Secondary Education** indicated:

Tobacco Master Settlement Agreement

FY 2014 estimated allocations of revenues from the Tobacco Master Settlement Agreement are summarized below:

Estimated Tobacco Master Settlement Agreement	$59,800,000
Allocations	
Life Science Research	$15,000,000
ECDEC	$35,000,000
HFTR	$9,800,000
	$59,800,000

The $35 million portion allocated to ECDEC (Early Childhood Development Education and Care Fund) is further allocated to DESE and the Dept of Social Services.

As indicated in the chart below, DESE uses these funds for First Steps, PAT, MPP, and Early Childhood Special Education. Any decrease in funding to the master settlement agreement will likely result in a reduction to these programs.

	FY 2014
First Steps	$578,644
Foundation - Parents as Teachers	$5,000,000
Foundation - Early Childhood Spec. Ed	$7,412,900
MPP	$11,754,429
	$24,745,973

Tobacco Tax Revenues

A query of SAM II revealed the following revenues from the cigarette tax revenue code (1057):

	FY 2014
Health Initiatives Fund	$20,432,467
State School Moneys Fund	$45,973,051
Fair Share Fund	$20,432,467
St. Louis County Cigarette Tax	$3,155,725
Jackson County Cigarette Tax	$2,316,945
	$92,310,655

Specific to DESE's budget are the revenues in the State School Moneys fund and the Fair Share fund totaling $66,405,518.

This proposal will likely have an impact on these revenues; however, the officials said they have no means to calculate such impact. They deferred to another agency regarding the extent of any impact to tobacco tax revenues as a result of this proposal.

Officials from the **Department of Health and Senior Services** indicated this initiative petition is a no impact note for their department.

Officials from the **Department of Insurance, Financial Institutions and Professional Registration** indicated this petition, if passed, will have no cost or savings to their department.

Officials from the **Department of Mental Health** indicated this proposal creates no direct obligations or requirements to their department that would result in a fiscal impact.

Officials from the **Department of Natural Resources** indicated they would not anticipate a direct fiscal impact from this proposal.

Officials from the **Department of Corrections** indicated no impact to their department.

Officials from the **Department of Labor and Industrial Relations** indicated no fiscal impact to their department.

Officials from the **Department of Revenue** indicated the proposal will have no fiscal impact on the department, but it will impact state revenues.

Based upon information reported for 2013, there were 10.29 million sticks of cigarettes stamped for sale in Missouri. Imposing an additional tax of $0.015 per stick would generate $154 million annually. The department cannot provide an estimate for the amount of revenue that would be generated on Roll-Your-Own as the tax is imposed on the manufacturers invoice price and this information is not tracked.

Although the tax established within this petition will increase revenues, the state may lose by as much as $135 million annually if it can no longer comply with the terms of the Master Settlement Agreement.

The petition increases state revenue. However, the increased tax may reduce sales, eventually reducing revenues. The state may also lose revenues that would have been received from the Master Settlement Agreement.

The petition proposes a tax on the sale of cigarettes and roll-your-own (RYO) tobacco equal to one and one-half cents per cigarette and 10.25 percent of the manufacturer's invoice prices on the RYO tobacco products of any tobacco product manufacturer electing such taxation in lieu of the requirements of sections 196.1003 and 196.1020 to 196.1035. However, as a result of this petition, the state may not be in compliance with the Master Settlement Agreement, which may result in a loss of revenues up to $135 million annually.

Administrative Impact:
Excise Tax:
Currently, tobacco product manufacturers must comply with the Master Settlement Agreement, under which they are required to become a participating manufacturer (PM) and perform financial obligations under the Master Settlement Agreement or place funds in an escrow account based upon units sold in the state. Under sections 196.1020 to 196.1035, PM's are required to certify their brands each year to the department in order to be placed in the state tobacco directory.

RYO tobacco is taxed in the same manner as other tobacco products at 10 percent of manufacturers invoice price before discounts and deals. The additional tax being imposed only applies to RYO tobacco. This will require new reporting forms and schedules to separate RYO tobacco from other tobacco products.

Notification of the tax increase and changes to the reporting of RYO tobacco will need to be sent to 250 licensed cigarette and other tobacco product wholesalers.

The department assumes that the additional taxes being imposed would be for the sales of cigarettes sales beginning January 1, 2015. This legislation does not provide for a floor stocks tax on stamped product or un-affixed stamps in the electing licensed wholesalers' inventory. There also is no language prohibiting stockpiling of stamps. The absence of a floor stock tax and limits on purchase of stamps prior to the increase would not only deplete the department's inventory of stamps, and but would also provide for a windfall for wholesalers purchasing the stamps prior to the increase.

NPMs making escrow deposits on April 15, 2014 for 2013 sales are expected to place an amount based upon $0.0299790 a stick into escrow.

Comments:

If the initiative petition becomes law, Non Participating Manufacturers (NPM) would not be required to make the escrow payments required by the Master Settlement Agreement. This would mean the state would not comply with the terms of the agreement which likely would result in the potential loss of the settlement payments from Participating Members.

Subsection 149.018.1 provides that a tobacco product manufacturer shall have been deemed to meet all the Chapter 196 requirements for cigarettes & Roll-Your-Own (RYO) tobacco when the additional tax of $0.015 per cigarette (30 cents per pack of 20) or the additional tax of 10.25% on RYO tobacco is levied upon the sale.

If PM's were required to make payments under the Agreement, the initiative petition would still put the PM's at a disadvantage compared to non-participating manufacturers (NPM) because both PM and NPM cigarettes would have the additional tax on them.

Unless section 196.1023 is repealed, the department will still be required to maintain the tobacco directory. Thus, the department would still need the ability to require tobacco manufacturers to provide a list of their brands each year. The department suggests language be added that would require the filing of brand reports by tobacco product manufacturers or add language to 149.018 so the director may promulgate rules for administration of this section.

Subsection 149.018.2 imposes the additional tax on cigarettes & RYO tobacco but does not designate where the funds are to be deposited. Subsection 3 does state that the additional tax is to be collected in the same manner as the current taxes imposed under Chapter 149, however the current cigarette taxes are deposited into three separate funds by statute (Health Initiatives, Fair Share and the State School Moneys Fund) and the tax on RYO tobacco is deposited into the Health Initiatives Fund by statute. Clarification is needed on where the additional revenue being imposed is to be deposited.

Subsection 149.018.3 requires the additional taxes be collected in the same manner as the current tax imposed upon the sale of cigarettes & RYO tobacco. The department assumes this would then include any allowances currently allowed as well as refunds.

The additional tax being imposed on cigarettes will require changes to the decal ordering form, minor changes to the accounting system and changes to the cashiering procedures. Because manufacturers would have the option of having the additional tax imposed, this would require the department to have two different sets of each cigarette stamp; one for the current tax rate and one for the additional tax rate. Additionally, if the new tax applies to the current inventory of manufacturers making the election, this would require language providing for a floor stocks tax. Since cigarette stamps for the entire fiscal year are purchased prior to beginning of a fiscal year, there may not be adequate funds budgeted for the purchase of additional stamps. This legislation is to be put to a vote of the people on November 4, 2014 and would become effective upon certification of the votes cast. If new stamps are needed, there may not be sufficient time to obtain them prior to the effective date of January 1, 2015.

Please note this does not include retailers. The department is not sure how all retailers would be reached as they are not required to be licensed. The department recommends that the following language be added:

> Each licensed wholesaler shall make a final actual inventory of all stamped cigarettes and all unapplied stamps in the licensee's possession. This final actual inventory shall be taken at the end of the day prior to the effective date of the tax increase and shall be certified to the department within 10 days. The director shall discontinue selling stamps to any licensee that fails to certify the actual inventory within the 10-day period and will resume selling when the certification is received.
>
> The increased tax amount shall apply to the final actual inventory and payment of the additional amount shall be paid within sixty days of the effective date of the

tax increase. The director shall discontinue selling stamps to any licensee that fails to remit the additional amount due within the 60-day period and shall assess the licensee for the additional tax due.

The increased tax amount shall apply to all stamps sold by the department beginning on the effective date of the new tax increase.

For a period up to six months prior to the effective date of a tax increase, each licensee shall not be allowed to purchase stamps in an amount greater than 110 percent of the amount that was purchased during the same period during the previous year.

Officials from the **Department of Social Services** indicated there is no direct fiscal impact to the department. Since the budget of any state agency is dependent upon the appropriations process, the department cannot predict whether the department might be affected if this proposal were to result in a change in the total amount of General Revenue available to fund state government.

Officials from the **Governor's Office** indicated there should be no fiscal impact to their office.

Officials from the **House of Representatives** indicated no fiscal impact to their office.

Officials from the **Department of Conservation** indicated no adverse fiscal impact to their department would be expected as a result of this proposal.

Officials from the **Office of Administration** indicated:

This proposal creates, upon voter approval, additional taxes on cigarettes and roll-your-own tobacco products. IP 14-127 lets tobacco product manufacturers meet the requirements of the Master Settlement Agreement (MSA) through paying increased sales taxes. IP 14-128 allows tobacco product manufacturers the choice of paying increased sales taxes on tobacco products or paying the required amounts into the MSA. IP 14-129 eliminates the MSA and increases the tax on tobacco products. Below are estimates of the increased revenue to the state from the increased tax on tobacco products.

The MSA has provided the following revenue to the state by year over the last three years: FY 2011-$132.6M, FY 2012-$135.2M, FY 2013-$135.2M. The estimate of revenues from the MSA in FY 2014 is $59.8M. Funds from the MSA are used to support the Early Childhood Development and Education Fund, the Life Sciences Research Trust Fund and the Healthy Families Trust Fund.

There should be no cost to the Office of Administration.

Budget & Planning (BAP) provides these estimates:

Cigarette Tax (all versions)
The proposals create an additional cigarette tax of $0.30 per pack of twenty. BAP notes that cigarette tax revenues in FY13, at $0.17 per pack of twenty, totaled just over $86.8M. If the number of packs sold remains constant, this would generate over $153M in additional revenues. However it is likely the additional tax would reduce the number of units sold. BAP estimates this additional tax would generate $141.2M of revenues.

Tax on Roll-Your-Own Tobacco Products
These proposals create an additional tax of 10.25% of the invoice price on Roll-Your-Own Tobacco products. While these products are currently taxed as an "Other Tobacco Product," BAP does not have data on what portion of "Other" products may be subject to additional tax under this proposal. BAP notes that "Other Tobacco Product" revenues in FY13, at 10% of the invoice price, totaled just under $16.9M.

These proposals amend Chapter 149. BAP assumes the new revenues above would be deposited to the credit of the State Schools Money Fund, pursuant to RSMo. 149.065.

BAP also notes this proposal may make changes to Missouri's participation in the Master Settlement Agreement. The Attorney General may be able to provide additional information on this issue.

Officials from the **Office of State Courts Administrator** indicated there is no fiscal impact on the courts.

Officials from the **Secretary of State's office** indicated their office is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article XII, Section 2(b) of the Missouri Constitution and Section 116.230-116.290, RSMo. The Secretary of State's office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with $1.3 million historically appropriated in odd numbered fiscal years and $100,000 appropriated in even numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In FY 2013, at the August and November elections, there were 5 statewide Constitutional Amendments or ballot propositions that cost $2.17 million to publish (an average of $434,000 per issue). Therefore, the Secretary of State's office assumes, for the purposes of this fiscal note, that it should have the full appropriation authority it needs to meet the publishing requirements. However, because these requirements are mandatory, we reserve the right to request funding to meet the cost of our publishing requirements if the Governor and the General Assembly change the amount or eliminate the estimated nature of our appropriation.

Officials from the **Office of the State Public Defender** indicated this initiative petition will not have any substantial impact on the State Public Defender System other than if revenues are significantly changed.

Officials from the **State Treasurer's office** indicated no fiscal impact to their office.

Officials from **Cole County** indicated they cannot determine the fiscal impact of this initiative.

Officials from the **City of Kansas City** indicated they are unable to estimate the fiscal impact of the initiative petition.

Officials from the **City of Raymore** indicated no fiscal impact.

The State Auditor's office did not receive a response from the **Department of Higher Education,** the **Department of Public Safety,** the **Department of Transportation,** the **Missouri Senate, Adair County, Boone County, Callaway County, Cass County, Clay County, Greene County, Jackson County Legislators, Jasper County, St. Charles County, St. Louis County, Taney County,** the **City of Cape Girardeau,** the **City of Columbia,** the **City of Jefferson,** the **City of Joplin,** the **City of Kirksville,** the **City of Kirkwood,** the **City of Mexico,** the **City of St. Joseph,** the **City of St. Louis,** the **City of Springfield,** the **City of Union,** the **City of Wentzville,** the **City of West Plains, Cape Girardeau 63 School District, Hannibal 60 School District, Rockwood R-VI School District, Linn State Technical College, Metropolitan Community College, University of Missouri,** and **St. Louis Community College**.

Fiscal Note Summary

State government revenue will increase by an unknown amount up to approximately $150 million annually depending on how many entities choose the additional tax option in the proposal. State government revenue from the Master Settlement Agreement may decrease by an unknown amount annually up to approximately $135 million depending on dispute and litigation outcomes.