Initiative # 289

Legislative Council Staff
Nonpartisan Services for Colorado's Legislature

INITIAL FISCAL IMPACT STATEMENT

Date: March 13, 2020 **Fiscal Analyst:** Greg Sobetski (303-866-4105)

LCS TITLE: INCREASING TAXES ON CIGARETTES AND TOBACCO PRODUCTS AND ESTABLISHING A NEW TAX ON NICOTINE AND VAPING PRODUCTS

Fiscal Impact Summary*		FY 2020-21	FY 2021-22
Revenue	General Fund	$152.5 million	$328.9 million
	Cash Fund	($5.8 million)	($11.6 million)
	Total	**$146.7 million**	**$317.3 million**
Expenditures	General Fund	up to $1.2 million	up to $2.0 million
	Cash Fund	up to $145.5 million	up to $315.3 million
	Total	**up to $146.7 million**	**up to $317.3 million**
Transfers	General Fund	($151.3 million)	($327.0 million)
	Cash Fund	$151.3 million	$327.0 million
	Total	**$0**	**$0**

**Totals may not sum due to rounding.*

***Disclaimer.** This initial fiscal impact statement has been prepared for the Title Board. If the initiative is placed on the ballot, Legislative Council Staff may revise this estimate for the ballot information booklet (Blue Book) if new information becomes available.*

Summary of Measure

The measure increases state taxes on cigarettes and other tobacco products, imposes taxes on nicotine and vaping products and creates a nicotine and vaping product tax regime, and directs the allocation of revenue from the new taxes and tax rate increases.

Cigarettes and tobacco products. Effective January 1, 2021, the measure increases state taxes on cigarettes and other tobacco products. The tax on cigarettes is increased from $0.84 per pack to $2.84 per pack, and once every four years beginning in 2025 for inflation of up to 2.5 percent per year. The tax on other tobacco products is increased from 40 percent of the manufacturer's list price to 62 percent of the manufacturer's list price.

The measure also eliminates current distributor allowances for the collection of the state taxes on cigarettes and other tobacco products. Under current law, importers and distributors who remit excise taxes in a timely manner are allowed to retain 4 percent of cigarette tax due and 3.33 percent of other tobacco products tax due as compensation for their collection of the taxes. The measure repeals these allowances.

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For products in inventory at the effective date of the tax increase, importers and distributors are required to remit taxes to account for the increased rates. Taxpayers are allowed a 1 percent discount for timely remittance and are assessed interest of 2 percent per month for late payments.

The measure establishes a presumption that all charges included on a tobacco product manufacturer or supplier's invoice are for tobacco products unless separately stated as being for non-tobacco products. The measure clarifies that a tobacco product manufacturer's list price includes all payments received from the distributor in any form and regardless of the time of receipt.

The increased tax revenue is retained and spent in excess of the state TABOR limit as a voter-approved revenue change.

Nicotine and vaping products. Effective July 1, 2021, the measure imposes a retail sales tax of 33 percent on nicotine and vaping products, defined as a product that contains nicotine and vaping and is intended for human consumption. The tax does not apply to cigarettes, other tobacco products subject to the current state tax, or drugs, devices, or combination products authorized for sale by the U.S. Food and Drug Administration.

The measure imposes a tax administration and enforcement regime for the nicotine and vaping products tax. Administration of the nicotine and vaping tax will be similar to administration of the state tax on other tobacco products. Taxpayers are required to be licensed, keep certain records, and remit quarterly tax returns whether or not tax is due. License fees of $10 annually are credited to the state General Fund. The measure imposes fines for noncompliance, which are credited to the Tobacco Tax Enforcement Cash Fund, and empowers the Department of Revenue (DOR) to revoke a taxpayer's license for tax delinquency. Penalty and interest obligations are imposed for late remittance. A tax credit is allowed for tax paid on nicotine and vaping products sold to an out-of-state retailer, returned to the manufacturer, or destroyed. There is no vendor allowance for the tax.

The new tax revenue is retained and spent in excess of the state TABOR limit as a voter-approved revenue change.

Distribution of tax collected. Revenue from the increased cigarette and tobacco products taxes and the new nicotine and vaping products tax is credited to the General Fund. The measure annually transfers most of this revenue as follows:

- first, $15 million in FY 2020-21 and $35 million annually thereafter is transferred to the Tobacco Education Programs Fund in the Department of Public Health and Environment (CDPHE);
- next, $7.5 million in FY 2020-21 and $15 million annually thereafter is allocated to offset decreases in existing tax revenue streams expected to result from the higher after-tax prices of cigarette and tobacco products taxes; of these amounts:
    - 73 percent is transferred to the Tobacco Tax Cash Fund and routed through the distribution for constitutional cigarette and tobacco tax revenue under Amendment 35; and
    - 27 percent remains in the General Fund;
- next, a portion of revenue is allocated for appropriation to the Department of Revenue as is needed for administration of the tax, provided that this amount does not exceed 1 percent of the tax revenue generated as a result of the measure; and

- the remaining amount is transferred to a new Preschool Programs Cash Fund to fund preschool education.

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 16 hours per week of voluntary preschool, free of tuition, to any child in his or her final year before entry to kindergarten, subject to available funding.

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

The measure requires that the State Auditor conduct an annual financial audit of the use of the additional tax revenue allocated and appropriated under the measure.

Background

Tobacco Tax Cash Fund. The measure credits a portion of revenue received to the Tobacco Tax Cash Fund. Under current law, the Tobacco Tax Cash Fund is used to collect and apportion revenue received under the constitutional taxes imposed pursuant to Amendment 35. This revenue is allocated annually as follows:

- 46 percent to the Health Care Expansion Fund in the Department of Health Care Policy and Financing (HCPF) for Medicaid and the Children's Basic Health Plan;
- 19 percent to the Primary Care Fund in HCPF to support primary health care;
- 16 percent to the Tobacco Education Programs Fund in the CDPHE to fund tobacco education, prevention, and cessation programs;
- 16 percent to the Prevention, Early Detection, and Treatment Fund in the CDPHE to fund cardiovascular, pulmonary, and cancer-related programs; and
- 3 percent to state and local governments, of which:
  - 50 percent is appropriated to the HCPF for health-related services for recipients of the state Old Age Pension;
  - 30 percent is appropriated to local governments via the DOR; and
  - 20 percent is appropriated via the state General Fund to fund immunization programs and the Children's Basic Health Plan.

State Revenue

The measure is expected to increase state revenue by $146.7 million in FY 2020-21 and by $317.3 million in FY 2021-22 and subsequent fiscal years. These estimates are the net amounts by which the measure is expected to increase revenue from the new taxes and decrease revenue from the existing taxes because of reduced cigarette and tobacco product consumption. The estimate for FY 2020-21 represents a half-year impact for the first six months of 2021, during which the nicotine and vaping products tax will not yet be in effect. 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 1.

Table 1
Revenue Impact Estimates*

	FY 2020-21	FY 2021-22	FY 2022-23
Cigarette Taxes			
Current Statutory Tax (General Fund)	($1.0 million)	($2.0 million)	($1.9 million)
Constitutional Tax (Tobacco Tax Fund)	($5.2 million)	($10.5 million)	($10.0 million)
New Statutory Tax (General Fund)	$140.7 million	$284.5 million	$276.8 million
Total Cigarette Taxes	**$134.5 million**	**$272.0 million**	**$265.0 million**
Tobacco Product Taxes			
Current Statutory Tax (General Fund)	($0.1 million)	($0.3 million)	($0.3 million)
Constitutional Tax (Tobacco Tax Fund)	($0.5 million)	($1.2 million)	($1.2 million)
New Statutory Tax (General Fund)	$12.9 million	$27.8 million	$29.2 million
Total Tobacco Product Taxes	**$12.3 million**	**$26.4 million**	**$27.7 million**
Nicotine and Vaping Product Taxes			
New Statutory Tax (General Fund)	**$0**	**$18.9 million**	**$19.5 million**
Net General Fund Revenue Impact	$152.5 million	$328.9 million	$323.3 million
Tobacco Tax Cash Fund Revenue Impact	($5.8 million)	($11.6 million)	($11.2 million)
Total Revenue Impact	**$146.7 million**	**$317.3 million**	**$312.1 million**

**Totals may not sum due to rounding.*

Cigarette and tobacco taxes. The estimates in Table 1 assume the December 2019 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 1 represent the net impact of reduced consumption and the discontinuation of the current distributor allowance.

Nicotine and vaping product taxes. The estimates in Table 1 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 and vaping 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.

License fees, fines, penalties, and interest. License fees will generate $10 per taxpayer per year to the state General Fund; relative to the tax impacts in the measure, 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. These provisions are expected to contribute to a minimal increase in revenue relative to that collected from the tax provisions.

State Transfers

The measure credits revenue from the increased cigarette and tobacco products taxes and the new nicotine and vaping products tax to the General Fund. Most of this revenue is transferred to the Tobacco Education Programs Fund, the Tobacco Tax Cash Fund, and the Preschool Programs Cash Fund. In turn, the amounts transferred to the Tobacco Tax Cash Fund are allocated to subordinate cash funds pursuant to current law, as described in the Background section of this fiscal impact statement. Table 2 presents the net transfer impact on the funds to which tax revenue is ultimately credited.

Table 2
Transfer Impact Estimates*

	FY 2020-21	FY 2021-22	FY 2022-23
General Fund	($151.3 million)	($327.0 million)	($321.2 million)
Preschool Programs Cash Fund	$130.8 million	$280.9 million	$275.3 million
Tobacco Education Programs Fund	$14.9 million	$34.9 million	$35.0 million
Tobacco Tax Cash Fund	$5.8 million	$11.6 million	$11.2 million
Health Care Expansion Fund	($0.1 million)	($0.3 million)	($0.1 million)
Primary Care Fund	($0.1 million)	($0.1 million)	($0.04 million)
Prevention, Early Detection, and Treatment Fund	($0.1 million)	($0.1 million)	($0.04 million)
Net Transfer Impact	**$0**	**$0**	**$0**

**Totals may not sum due to rounding.*

The transfer impact on the Tobacco Tax Cash Fund offsets the reduction in revenue to that fund shown in Table 1, such that the measure's net impact on the fund balance is zero in all years. The transfer impacts on the Health Care Expansion Fund, the Primary Care Fund, and the Prevention, Early Detection, and Treatment Fund reflect that the amount annually distributed from the Tobacco Tax Cash Fund to these funds is less under the measure than would otherwise be expected under current law. The transfer impact on the Tobacco Education Programs Fund is less than the amount that the measure directly transfers from the General Fund because the Tobacco Education Programs Fund also receives a portion of moneys distributed via the Tobacco Tax Cash Fund.

State Expenditures

The measure increases state expenditures by up to $146.7 million in FY 2020-21 and up to $317.3 million in FY 2021-22 and subsequent years, the same amounts by which it increases revenue.

Programmatic expenditures. Expenditures will be made from the cash funds to which moneys are credited as shown in Table 2, except that the amount shown as a transfer to the Tobacco Tax Cash Fund offsets the revenue decrease to that fund and has no expenditure impact.

Preschool programs. Revenue credited to the Preschool Programs Cash Fund is required to be expended for preschool programs. The programs funded will be selected by the General Assembly under future legislation or the annual budget process.

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. The amount available for grants is expected to increase by approximately 175 percent relative to current law. When fully implemented beginning in FY 2021-22, the CDPHE will require an estimated 13.2 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.

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 expenditures. Expenditures in the DOR for tax administration are estimated at $325,000 in FY 2020-21 and $250,000 and 2.5 FTE in FY 2021-22 and subsequent years. Start-up costs include computer programming and testing, while ongoing costs include staff in the department's taxpayer services division, reporting, and legal services. Expenditures are expected to fall short of 1 percent of new tax revenue, the cap on administrative costs imposed in the measure, and will be paid from tax revenue credited to the General Fund. These amounts were deducted when computing the expected transfers to the Preschool Programs Cash Fund in Table 2.

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.

Economic Impact

The measure will increase taxes for consumers of cigarettes, tobacco products, and nicotine and vaping products. These consumers will have less after-tax income available to spend or save elsewhere in the economy. Additionally, higher taxes are expected to decrease consumption of these products, which will decrease revenue for manufacturers, distributors, and retailers. This will cause some businesses to reduce or cease their operations.

The measure will increase state government expenditures for preschool education, which will increase employment and/or compensation of early childhood educators in the public sector, private sector, and/or nonprofit sector depending on subsequent policy decisions. Parents and guardians of children admitted to preschool as a result of the measure may choose to seek additional employment.

The measure may result in health and education benefits over the long term.

Taxpayer Impacts

The measure is expected to increase taxes paid by an average of $67 per resident Colorado adult in 2022. The direct tax impact of the measure applies only to individuals who consume cigarettes, tobacco products, and/or nicotine and vaping products. The Centers for Disease Control and Prevention estimate that 14.6 percent of Colorado adults smoke cigarettes. If the percentage of adult smokers remains constant following the measure's enactment, the measure is expected to increase taxes paid by cigarette smokers by an average of $389 in 2022.

Effective Date

If approved by voters at the 2020 general election, this measure takes effect upon proclamation of the Governor, no later than 30 days after the official canvass of the vote is completed.

State and Local Government Contacts

Education
Human Services
Law
Public Health and Environment
State Auditor
Health Care Policy and Financing
Judicial
Legislative Council Staff Economics Section
Revenue

Abstract of Initiative 289: INCREASING TAXES ON CIGARETTES AND TOBACCO PRODUCTS AND ESTABLISHING A NEW TAX ON NICOTINE AND VAPING PRODUCTS

The abstract includes estimates of the fiscal impact of the proposed initiative. If this initiative is to be placed on the ballot, Legislative Council Staff will prepare new estimates as part of a fiscal impact statement, which includes an abstract of that information. All fiscal impact statements are available at www.ColoradoBlueBook.com and the abstract will be included in the ballot information booklet that is prepared for the initiative.

This initial fiscal estimate, prepared by the nonpartisan Director of Research of the Legislative Council as of March 2020, identifies the following impacts:

State revenue. The measure is expected to increase state revenue from cigarette, tobacco product, and nicotine and vaping product taxes by $146.7 million in FY 2020-21 and by $317.3 million in FY 2021-22 and subsequent fiscal years.

State expenditures. The measure increases state expenditures by up to $146.7 million in FY 2020-21 and up to $317.3 million in FY 2021-22 and subsequent years. Ongoing expenditures for tax administration and financial auditing are estimated at $275,000 per year; remaining expenditures are for preschool and for tobacco and nicotine product education and cessation programs.

Economic impacts. Consumers will reduce their consumption of affected products or have less after-tax income available to spend or save elsewhere in the economy. Businesses sell the affected products will have less revenue available for investment, which will cause some to reduce or cease operations. The measure is expected to increase employment of early childhood educators and may increase compensation for these workers. The measure may result in health and education benefits over the long term.

Taxpayer impacts. The measure is expected to increase taxes paid by an average of $67 per Colorado adult in 2022. The direct tax impact of the measure applies only to individuals who consume cigarettes, tobacco products, and/or nicotine and vaping products. If the percentage of adult smokers remains constant following the measure's enactment, the measure is expected to increase taxes paid by cigarette smokers by an average of $389 in 2022.