

CIGARETTE EXCISE TAX STAMP DISCOUNT & TOBACCO PRODUCTS EXCISE TAX VENDOR ALLOWANCE



JANUARY 2020
2020-TE6

EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

	CIGARETTE STAMP DISCOUNT	TOBACCO VENDOR ALLOWANCE
YEAR ENACTED	1964	1986
REPEAL/ EXPIRATION DATE	None	None
REVENUE IMPACT (CALENDAR YEAR 2018)	\$1.43 million	\$760,000
NUMBER OF TAXPAYERS	24	126
AVERAGE TAXPAYER BENEFIT	\$59,419	\$6,029
IS IT MEETING ITS PURPOSE?	Yes, to some extent	Yes, to some extent

WHAT DO THESE TAX EXPENDITURES DO?

The Cigarette Stamp Discount allows cigarette wholesalers to purchase cigarette stamps from the Department of Revenue at a 0.9524 percent discount of their face value. Wholesalers pay the cigarette excise tax by purchasing stamps, which provide evidence the taxes have been paid.

The Tobacco Vendor Allowance allows tobacco products distributors to retain 1.665 percent of the tobacco products excise taxes.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute [Section 39-28-104(1)(a), C.R.S.] states that the purpose of the Cigarette Stamp Discount is “to cover the licensed wholesaler’s expense in the collection and remittance of such [cigarette excise] tax.”

Statute [Section 39-28.5-106(2), C.R.S.] states that the purpose of the Tobacco Vendor Allowance is “to cover the distributor’s expense in the collection and remittance of said [tobacco products excise] tax.”

WHAT DID THE EVALUATION FIND?

We determined that the Cigarette Stamp Discount and Tobacco Vendor Allowance are likely meeting their purposes, to some extent, because they cover a portion of the cigarette wholesalers' and tobacco products distributors' excise tax collection and remittance costs. However, based on stakeholder feedback, it is unlikely that these tax expenditures cover the entire excise tax collection and remittance cost for all cigarette wholesalers and all tobacco products distributors.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to these tax expenditures.

CIGARETTE EXCISE TAX STAMP DISCOUNT & TOBACCO PRODUCTS EXCISE TAX VENDOR ALLOWANCE

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers two similar cigarette and tobacco products excise tax expenditures provided to licensed cigarette wholesalers and tobacco products distributors: (1) Cigarette Excise Tax Stamp Discount (Cigarette Stamp Discount) [Section 39-28-104(1)(a), C.R.S.] and (2) Tobacco Products Excise Tax Vendor Allowance (Tobacco Vendor Allowance) [Section 39-28.5-106(2), C.R.S.].

- **CIGARETTE STAMP DISCOUNT**—allows cigarette wholesalers to purchase cigarette stamps from the Department of Revenue at a 0.9524 percent discount of their face value when the wholesaler pays for the cigarette stamps on or before the 10th day of the month following the month in which the cigarette stamps were ordered. Wholesalers pay the cigarette excise tax by purchasing cigarette stamps, which provide evidence that the taxes have been paid. The face value of the cigarette stamps is the total amount of cigarette excise taxes owed on a pack of cigarettes, which is \$0.84 on a pack of 20 cigarettes and \$1.05 on a pack of 25 cigarettes.
- **TOBACCO VENDOR ALLOWANCE**—allows tobacco products distributors to retain 1.665 percent of the tobacco products excise taxes remitted when they file their tobacco products excise tax return on time.

CIGARETTE STAMP DISCOUNT

Statutes [Sections 39-28-103 and 103.5, C.R.S.] require cigarette wholesalers to pay excise taxes on sales of cigarettes at a total rate of \$0.042 per cigarette, which is \$0.84 per pack of 20 cigarettes or \$1.05 per pack of 25 cigarettes. The total cigarette excise tax comprises a \$0.01 tax per cigarette levied pursuant to Section 39-28-103, C.R.S., and an additional \$0.032 tax per cigarette levied pursuant to Section 39-28-103.5, C.R.S., which was approved by a voter constitutional amendment in 2004. The Cigarette Stamp Discount is only allowed on the \$0.01 cigarette excise tax that is levied pursuant to Section 39-28-103, C.R.S., which makes the effective Cigarette Stamp Discount rate 0.9524 percent of the face value of the cigarette stamps, calculated as follows:

$$\begin{array}{r}
 \text{STATUTORY CIGARETTE STAMP DISCOUNT (4\%)} \\
 \times \\
 \text{CIGARETTE TAXES LEVIED PURSUANT TO SECTION 39-28-103, C.R.S.} \\
 \text{(\$0.20 ON A PACK OF 20 CIGARETTES)} \\
 = \\
 \text{CIGARETTE STAMP DISCOUNT ON SECTION 39-28-103, C.R.S. TAXES} \\
 \text{(\$0.008)}
 \end{array}$$

$$\begin{array}{r}
 \text{CIGARETTE STAMP DISCOUNT ON SECTION 39-28-103, C.R.S. TAXES} \\
 \text{(\$0.008)/TOTAL CIGARETTE TAXES (\$0.84 ON A PACK OF 20 CIGARETTES)} \\
 = \\
 \text{EFFECTIVE CIGARETTE STAMP DISCOUNT (0.9524\%)}
 \end{array}$$

Although cigarette excise taxes are typically passed on to consumers, cigarette wholesalers are responsible for paying the tax. Cigarette wholesalers indicate that they have paid the tax by affixing a stamp purchased from the Department of Revenue to each pack of cigarettes.

The Cigarette Stamp Discount was enacted in 1964 with the same legislation [House Bill 64-1086] that created the cigarette excise tax in Colorado. Since its enactment, the Cigarette Stamp Discount rate has fluctuated between 10 percent and 0.7 percent of the total cigarette excise taxes. There are three main reasons for the large rate range in the discount over time: (1) each time the General Assembly increased the cigarette excise tax rate, it decreased the Cigarette Stamp Discount rate correspondingly so that cigarette wholesalers received the same

discount amount; (2) the Cigarette Stamp Discount does not apply to the cigarette excise tax levied since 2005, pursuant to Section 39-28-103.5, C.R.S., which makes up 76 percent of the total cigarette excise taxes; and (3) from July 1, 2003, to June 30, 2005, the General Assembly temporarily decreased the Cigarette Stamp Discount rate.

When the cigarette excise tax was enacted, cigarette wholesalers were required to pay for the cigarette stamps when they were purchased. In 1986 [House Bill 86-1340], the General Assembly amended the Cigarette Stamp Discount provision to allow cigarette wholesalers to pay for cigarette stamps up to the 20th day of the month following the month in which the cigarette stamps were purchased and still receive the discount, and in 1988 the General Assembly reduced it to the 10th day.

The Department of Revenue requires that wholesalers file monthly cigarette excise tax returns electronically through Revenue Online, the Department of Revenue's online tax filing system, even if no tax is due. The Cigarette Tax Return (DR 0221) is used to pay for cigarette stamps that were purchased in the previous month. The Cigarette Stamp Discount is claimed on Line 7 of the Cigarette Tax Return.

TOBACCO VENDOR ALLOWANCE

Statutes [Sections 39-28.5-102 and 102.5, C.R.S.] require tobacco products distributors to pay excise taxes on tobacco products at a total rate of 40 percent of the manufacturer's list price when they bring tobacco products into the state to sell; make, manufacture, or fabricate tobacco products in the state for sale in the state; or ship or transport tobacco products into the state to retailers to be sold in the state by those retailers. Tobacco products are any products made completely or partially from tobacco, with the exception of cigarettes, which are taxed separately from tobacco products. The total tobacco products excise tax comprises a 20 percent excise tax levied pursuant to Section 39-28.5-102, C.R.S., and an additional 20 percent excise tax levied pursuant to Section 39-28.5-102.5, C.R.S., which was approved by a voter constitutional amendment in 2004. The Tobacco Vendor Allowance is

only allowed on the 20 percent tobacco products excise tax that is levied pursuant to Section 39-28.5-102, C.R.S., which makes the effective Tobacco Vendor Allowance rate 1.665 percent of the total tobacco products excise taxes remitted, calculated as follows:

STATUTORY TOBACCO VENDOR ALLOWANCE (3.33%)
X
TOBACCO PRODUCTS TAXES LEVIED PURSUANT TO SECTION 39-28.5-102, C.R.S. (20%)
=
TOBACCO VENDOR ALLOWANCE ON SECTION 39-28.5-102, C.R.S. TAXES (0.67%)

TOBACCO VENDOR ALLOWANCE ON SECTION 39-28.5-102, C.R.S. TAXES (0.67%)
/
TOTAL TOBACCO PRODUCTS TAXES (40%)
=
EFFECTIVE TOBACCO VENDOR ALLOWANCE (1.665%)

Although tobacco products excise taxes are typically passed on to consumers, tobacco products distributors are responsible for paying the tax.

The Tobacco Vendor Allowance was enacted in 1986 with the same legislation [House Bill 86-1340] that created the tobacco products excise tax in Colorado. Since its enactment, the Tobacco Vendor Allowance rate has fluctuated between 3.33 percent and 1.165 percent of the total tobacco products excise taxes. There are two main reasons for the rate range in the Tobacco Vendor Allowance over time: (1) the Tobacco Vendor Allowance does not apply to the tobacco products excise tax levied since 2005, pursuant to Section 39-28.5-102.5, C.R.S., which makes up 50 percent of the total tobacco products excise taxes; and (2) from July 1, 2003, to June 30, 2005, the General Assembly temporarily decreased the Tobacco Vendor Allowance rate.

The Department of Revenue requires that distributors file quarterly tobacco products excise tax returns electronically through Revenue Online, even if no tax is due. The Tobacco Vendor Allowance is claimed on Line 11 of the Tobacco Products Tax Return.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly identify the intended beneficiaries of the Cigarette Stamp Discount or the Tobacco Vendor Allowance. Based on the language in statute regarding who is responsible for paying Colorado cigarette and tobacco products excise taxes, we inferred that the intended beneficiaries of these tax expenditures are cigarette wholesalers and tobacco products distributors that pay cigarette and/or tobacco products excise taxes. According to Department of Revenue data, as of September 2019, there were 26 licensed cigarette wholesalers and 207 licensed tobacco products distributors operating in Colorado.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute [Section 39-28-104(1)(a), C.R.S.] states that the purpose of the Cigarette Stamp Discount is “to cover the licensed wholesaler’s expense in the collection and remittance of such [cigarette excise] tax.”

Statute [Section 39-28.5-106(2), C.R.S.] states that the purpose of the Tobacco Vendor Allowance is “to cover the distributor’s expense in the collection and remittance of said [tobacco products excise] tax.”

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSES AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Cigarette Stamp Discount and Tobacco Vendor Allowance are likely meeting their purposes, to some extent, because they cover some of the cigarette wholesalers’ and tobacco products distributors’ excise tax collection and remittance costs. However, based on stakeholder feedback, it is unlikely that the Cigarette Stamp Discount and Tobacco Vendor Allowance cover the entire excise tax collection and remittance costs for all cigarette wholesalers and tobacco products distributors. Statute does not provide quantifiable performance measures for these tax expenditures. Therefore, we created and applied the following performance measure to determine the extent to which they are meeting their purposes:

PERFORMANCE MEASURE: *To what extent does the CIGARETTE STAMP DISCOUNT and TOBACCO VENDOR ALLOWANCE cover licensed cigarette wholesalers' or tobacco products distributors' expenses incurred in the collection and remittance of Colorado cigarette and tobacco products excise taxes?*

RESULT: We did not identify any studies or other sources of information to estimate the typical costs of cigarette and tobacco products excise tax collection and remittance.

We spoke with five licensed cigarette wholesalers and/or tobacco products distributors in Colorado, as well as a trade association that represents distributors in Colorado, and they reported that they incur the following types of unique costs in collecting and remitting cigarette and tobacco products excise taxes:

- License fees (e.g., first-time licensing and annual renewal of cigarette and tobacco products licenses, which are required to sell cigarettes and distribute tobacco products in the state).
- Cigarette and tobacco products excise tax research (e.g., researching rates and tax requirements).
- Surety bond premium, for cigarette taxes only. The State requires that cigarette wholesalers obtain a surety bond in the amount of the wholesaler's anticipated total monthly purchase of cigarette stamps, though a wholesaler is exempt from this requirement if they have not been delinquent in payment of cigarette taxes in the most recent 5 years.
- Cigarette stamp purchasing.
- Shipping costs for the Department of Revenue to send cigarette stamps to the cigarette wholesaler.
- Lease or purchase of cigarette stamping machines, which attach the cigarette stamps to the packs. According to one cigarette stamp machine distributor that we spoke with, machines range from

\$55,000 to \$200,000 to purchase, and generally require between \$1,500 and \$15,000 in annual maintenance costs (not including parts), depending on the size of the cigarette wholesaler's operation.

- Excise tax return filings.
- Staff time spent conducting inventory of cigarettes.
- Staff time spent to evaluate the taxable value of tobacco products (since the tobacco products excise tax is based on the manufacturer's list price, exclusive of any discounts or other reductions).

Three of the four cigarette wholesalers that we spoke with reported that, in general, they do not believe the Cigarette Stamp Discount covers their cigarette excise tax collection and remittance costs and estimated that it covers between 1 and 85 percent of their costs, though none of them had conducted an analysis of their actual costs and provided only rough estimates. The other cigarette wholesaler that we spoke with was unsure whether the Cigarette Stamp Discount covers their costs. These stakeholders emphasized that the cigarette excise tax system is complicated and outdated, which makes it expensive to comply with.

Two of the five tobacco products distributors that we spoke with reported that they do not believe the Tobacco Vendor Allowance covers their tobacco products excise tax collection and remittance costs, two reported that they believe it does cover their costs, and one was unsure. However, none of the distributors that we spoke with had conducted an analysis of their actual costs.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

According to Department of Revenue data, the Cigarette Stamp Discount resulted in approximately \$1.43 million in foregone revenue to the State in Calendar Year 2018. The revenue impact of the Cigarette Stamp Discount has been gradually decreasing since 2014.

According to Department of Revenue data, the Tobacco Vendor Allowance resulted in approximately \$760,000 of foregone revenue to the State in Calendar Year 2018. In contrast to the Cigarette Stamp Discount, the revenue impact of the Tobacco Vendor Allowance has been gradually increasing since 2014. The revenue impact of the Cigarette Stamp Discount and Tobacco Vendor Allowance and the total cigarette and tobacco products excise tax revenue from 2014 to 2018 are presented in EXHIBIT 1.1.

EXHIBIT 1.1. CIGARETTE STAMP DISCOUNT AND TOBACCO VENDOR ALLOWANCE REVENUE IMPACT AND TOTAL STATE TAX REVENUE FROM CIGARETTE AND TOBACCO PRODUCTS EXCISE TAXES 2014 THROUGH 2018

	2014	2015	2016	2017	2018
Cigarette Stamp Discount Revenue Impact (Calendar Year) (Millions)	\$1.561	\$1.555	\$1.53	\$1.48	\$1.43
Tobacco Vendor Allowance Revenue Impact (Calendar Year)	\$596,000	\$643,000	\$689,000	\$736,000	\$760,000
TOTAL CIGARETTE AND TOBACCO PRODUCTS EXCISE TAX REVENUE (FISCAL YEAR)(MILLIONS)	\$186.68	\$194.72	\$198.53	\$196.12	\$178.05

SOURCE: Office of the State Auditor analysis of Department of Revenue taxpayer data and Legislative Council data on cigarette and tobacco products excise tax revenue provided to them by the Office of the State Controller and the Department of the Treasury.

Since the Cigarette Stamp Discount and Tobacco Vendor Allowance are based on the amount of cigarette and tobacco products excise taxes remitted, in general, the revenue impact of these tax expenditures will correspond to increases and decreases in cigarette and tobacco products excise tax revenue, provided that cigarette wholesalers and tobacco products distributors file their excise tax returns and pay the excise taxes due on time.

A decrease in the revenue impact of the Cigarette Stamp Discount may indicate a decrease in the volume of cigarettes purchased since the tax is levied on a per cigarette basis. However, this is not necessarily the case with tobacco products since the tobacco products excise tax is based on the manufacturer's list price rather than the volume of tobacco

products sold. Therefore, if the manufacturer's list price of tobacco products increases, tobacco products excise tax revenue and the Tobacco Vendor Allowance revenue impact could increase despite there being the same or a lower volume of tobacco products being purchased in Colorado. However, stakeholders told us that the increase could be due to consumers substituting other tobacco products for cigarettes since there are now more restrictions on where cigarettes are allowed to be smoked.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If the Cigarette Stamp Discount and Tobacco Vendor Allowance were eliminated, it would result in cigarette wholesalers and tobacco products distributors being financially responsible for all of their cigarette and tobacco products excise tax collection and remittance costs. Stakeholders with small-scale cigarette and tobacco products distribution operations reported that they generally cannot pass on these costs to consumers because of the competitive nature of the market.

In Calendar Year 2018, 24 cigarette wholesalers claimed approximately \$1.43 million in Cigarette Stamp Discounts, but five of the 24 cigarette wholesalers claimed 94 percent (\$1.35 million) of the total discounts. These five taxpayers each received an average discount of approximately \$269,000. The remaining 19 cigarette wholesalers received, on average, a discount of about \$4,200. Therefore, eliminating the Cigarette Stamp Discount would impact a few cigarette wholesalers significantly, but the majority would be impacted less significantly.

In Calendar Year 2018, 126 tobacco products distributors claimed approximately \$760,000 in Tobacco Vendor Allowances, but five of the 126 tobacco products distributors claimed 80 percent (\$606,000) of the total allowances. These five taxpayers each received an average Tobacco Vendor Allowance of approximately \$121,000. The remaining 121 tobacco products distributors received, on average, an allowance of about \$1,270, with 94 of them receiving an allowance of under \$1,000. Therefore, eliminating the Tobacco Vendor Allowance would impact a

few tobacco products distributors significantly, but the majority would be impacted less significantly.

In addition, cigarette wholesalers and tobacco products distributors that do not file their excise tax returns or remit the excise taxes due on time, do not receive the Cigarette Stamp Discount or Tobacco Vendor Allowance and are subject to penalties and interest. Therefore, these provisions may benefit the State by acting as an additional incentive to ensure that the State receives timely and complete cigarette and tobacco products excise tax collections from cigarette wholesalers and tobacco products distributors. If the provisions were eliminated, the State may have more difficulty receiving timely and complete cigarette and tobacco products excise taxes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Every other state and the District of Columbia levies excise taxes on cigarettes and tobacco products. We examined the tax laws of the other 49 states and the District of Columbia and found that:

- 46 other states (excluding Colorado) and the District of Columbia have a cigarette stamp discount/vendor allowance for their cigarette excise tax. When calculated on a per pack of cigarettes basis, 35 states and the District of Columbia provide a larger vendor discount/allowance to cigarette wholesalers than Colorado.
- 26 other states (excluding Colorado) have a vendor allowance for their tobacco products excise tax. When calculated based on \$1,000 (wholesale/manufacturer price) of tobacco products, nine states provide a larger vendor allowance to tobacco products distributors than Colorado.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

Cigarettes and tobacco products are subject to state sales tax, in addition to the cigarette and tobacco products excise taxes. Some cigarette wholesalers and tobacco products distributors are also

retailers that sell cigarettes and tobacco products to consumers. To the extent that the cigarette wholesaler or tobacco products distributor is also a retailer, they can claim the Sales Tax Vendor Allowance [Sections 39-26-105(1)(c)(I) and (d)(I), C.R.S.], which allows retailers to retain 4 percent, up to \$1,000 per filing period, of the sales tax they collect to cover their sales tax collection and remittance costs when they remit the sales tax due on time.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

Because neither the State, nor a third party has conducted a study on the cost of cigarette and tobacco products excise tax collection and remittance in Colorado, we did not have this information. This information would allow us to more accurately compare the Cigarette Stamp Discount and Tobacco Vendor Allowance amounts to the costs they are intended to cover.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Cigarette Stamp Discount or the Tobacco Vendor Allowance.