



LIFT Perspective

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Cigarette Taxes (CSHB 5): Dedicate Bond Proceeds to Property Tax Relief

The Committee Substitute to House Bill 5 (Hamric, 79S3) increases cigarette taxes by \$.55 cents to \$.96 per pack effective January 1, 2007, to \$1.21 per pack in 2008, and to \$1.46 in 2009. Texas could increase its cigarette taxes in order to raise revenue to lower the property tax, as mandated by the state Supreme Court in *West Orange-Cove*.

CSHB 5 was intended to increase cigarette taxes by \$1.00 per pack (see note at end) over the course of three years. This phase-in approach is preferable to an immediate \$1 per pack increase, which could have negative market effects which in turn impact revenues to the state. Not only could such a steep and sudden increase in the rate drive down taxable sales of cigarettes significantly, it could lead to more black market for sales of cigarettes.

The phase-in brings in less revenue over the first two years compared to an immediate increase. However, CSHB 5 makes up for that by requiring the Texas Economic Development Bank to issue up to \$400 million in bonds to “finance the economic and educational requirements of this state and the political subdivisions of this state.” Bonding covers the initial “losses” in cigarette tax revenues not realized from the full immediate rate increase. Bonding and using the tobacco settlement proceeds as collateral will increase revenue to the state in 2009 and 2010 by over \$122 million.

Fiscal Year	\$1.00	\$.50/\$.25/\$.25	Difference	(\$ thousands)	
2007	\$686,293	\$450,039	-236,254*	BONDED	Paid by \$.05 fee
2008	\$652,998	\$554, 918	-98,080	BONDED	Paid by \$.05 fee
2009	\$696,522	\$778,011	+81,489	Increase due to phase-in	2009-2010: \$122,469 Extra GR
2010	\$604,769	\$645,749	+40,980	Increase due to phase-in	
2011	\$647,974	\$647,974	Break even		

** Depending upon the effective date, the 2007 revenue figure could change, but the bill permits bonding authority up to \$400 million, which would not affect the overall fiscal impact of the bill.*

The additional five cents added to the rate over what HB 5 originally proposed is an anti-bootlegging fee that is dedicated to paying the principal, premium, and interest of bonds issued, and paid for by smokers. With the anti-bootlegging fee used to pay the bonds, this particular aspect of CSHB 5 is a particularly sound policy proposal.

The purpose of the increase in cigarette taxes, and more specifically the timing, is to increase revenues that can be dedicated to property tax reduction. CSHB 5 increases the tax, and thus the revenues, and is a sound policy proposal. Bonding the increase allows the state to slowly increase the cigarette tax rate without shocking the market. CSHB 5 is a vast improvement over the original bill.

NOTE: Because of a problem in the House Committee Report on the overall increase in the cigarette tax, the author will offer a corrective amendment to fix the problem.