

IMPOSES ADDITIONAL TAX ON CIGARETTES FOR CANCER RESEARCH. INITIATIVE STATUTE.

- Imposes additional five cent tax on each cigarette distributed (\$1.00 per pack), and an equivalent tax increase on other tobacco products, to fund cancer research and other specified purposes.
- Requires tax revenues be deposited into a special fund to finance research and research facilities focused on detecting, preventing, treating, and curing cancer, heart disease, emphysema, and other tobacco-related diseases, and to finance prevention programs.
- Creates nine-member committee charged with administering the fund.

Summary of Legislative Analyst's Estimate of Net State and Local Government Fiscal Impact:

- Net increase in cigarette excise tax revenues of about \$735 million annually by 2013–14 for research into cancer and tobacco-related disease, and for tobacco prevention and cessation programs. These revenues would decline slightly each year thereafter.
- Increase in excise tax revenues on other tobacco products of about \$50 million annually, going mainly to existing health and tobacco prevention and cessation programs.
- Net increase in state and local sales tax revenues of about \$10 million to \$20 million annually.
- Unknown net impact on other long-term state and local government health care costs.

ANALYSIS BY THE LEGISLATIVE ANALYST

BACKGROUND**Tobacco Taxes**

Existing State Excise Taxes. Current state law imposes excise taxes on the distribution of cigarettes and other tobacco products, such as cigars and chewing tobacco. Tobacco excise taxes are paid by distributors who supply cigarettes and other tobacco products to retail stores. These taxes are typically passed on to consumers as higher cigarette and other tobacco product prices.

The state's cigarette excise tax is currently 87 cents per pack. Figure 1 describes the different components of the per-pack tax. As the figure shows, two voter-approved measures—Proposition 99 in 1988 and Proposition 10 in 1998—are responsible for generating the vast majority of tobacco excise tax revenues. As Figure 1 indicates, total state revenues from existing excise taxes on cigarettes and other tobacco products were just over \$900 million in 2010–11.

Revenues from existing excise taxes on other tobacco products support Propositions 10 and 99 purposes. Under current law, any increase in cigarette taxes automatically triggers an equivalent

increase in excise taxes on other tobacco products, with the revenues going to support Proposition 99 purposes.

Existing Federal Excise Tax. The federal government also imposes an excise tax on cigarettes and other tobacco products. In 2009, this tax was increased by 62 cents per pack (to a total of \$1.01 per pack) to help fund the Children's Health Insurance Program, which provides subsidized health insurance coverage to children in low-income families.

Existing State and Local Sales and Use Taxes. Sales of cigarettes and other tobacco products are also subject to state and local sales and use taxes. These taxes are imposed on the retail price of a product, which includes excise taxes that have generally been passed along from distributors. The average retail price of a pack of cigarettes in California currently is over \$5. More than \$400 million in annual revenues from sales and use taxes on cigarettes and other tobacco products go to the state and local governments.

Figure 1 Existing State Tobacco Excise Taxes <i>(Dollars in Millions)</i>		
Description	Cents Per Pack of Cigarettes	Estimated 2010–11 Net Revenue ^a
State General Fund: Initially enacted by the Legislature in 1959 for general support of the state budget.	10¢	\$96
Proposition 99: Enacted by the voters in 1988 for the purposes of supporting tobacco education and prevention efforts, tobacco-related disease research programs, health care services for low-income persons, and environmental protection and recreational resources. Some Proposition 99 revenues are used to support programs that also receive support from the state General Fund.	25	298 ^b
Breast Cancer Fund: Enacted by the Legislature in 1993 for the purposes of supporting breast cancer screening programs for uninsured women and research related to breast cancer.	2	23
Proposition 10: Enacted by the voters in 1998 for the purposes of supporting early childhood development programs.	50	489 ^b
Totals	87¢	\$905^c

^a Accounts for payments from Proposition 10 to other funds in order to maintain pre-Proposition 10 revenue levels.
^b Total includes excise tax revenue from other types of tobacco products, such as cigars and chewing tobacco.
^c Does not total due to rounding.

Current Health Research and Tobacco Cessation Activities

Across the country, substantial amounts of money are spent on research related to cancer and tobacco-related diseases, such as heart disease. For example, the federal National Institutes of Health provide several billion dollars annually for grants and research in these areas. Private entities and nonprofits also provide funds for such research. In California, the University of California (UC) is one of the primary recipients of these research dollars. In addition, UC uses some state funds for this purpose.

Tobacco prevention and cessation programs are currently conducted by public entities, health insurers, and various other organizations. For example, approximately \$50 million a year from Proposition 99 revenues is used to fund tobacco prevention and cessation programs in California.

For text of Proposition 29, see page 24.

PROPOSAL

This measure increases excise taxes on the distribution of cigarettes and other tobacco products. It uses the additional revenues raised for research on cancer and tobacco-related diseases (such as heart disease and emphysema), as well as for other specified purposes. The major provisions of the measure are described below.

New State Tobacco Tax Revenues

This measure increases—effective October 2012—the existing state excise tax on cigarettes by \$1 per pack. The total state excise tax, therefore, would be \$1.87 per pack. The measure also creates a one-time “floor tax” on the majority of cigarettes that are stored by businesses at the time the new excise tax is levied. Floor taxes are typically used to prevent businesses from avoiding taxes by stockpiling products before a tax goes into effect.

Existing state law requires the Board of Equalization (BOE) to annually set a tax on other tobacco products—such as cigars and chewing tobacco—at an amount equivalent to the tax on cigarettes. Accordingly, this measure would also result in a comparable increase in the excise tax on other tobacco products, with the revenues supporting Proposition 99 purposes.

How New Cigarette Tax Revenues Would Be Spent

Revenues from the cigarette excise tax increase would be deposited in a new special fund, called the California Cancer Research Life Sciences Innovation Trust Fund. These revenues would be dedicated to the support of research on cancer and tobacco-related diseases, as well as for other specified purposes. After compensating existing tobacco tax program funds for any losses due to the imposition of the new tax (as described in the next section), the remaining money would be distributed among five funds:

- **Hope 2010 Research Fund.** Sixty percent of the funds would be used to provide grants and loans to support research on prevention, diagnosis, treatment, and potential cures for cancer and tobacco-related diseases. The measure states that all qualified researchers would have an equal opportunity to compete for these research funds.
- **Hope 2010 Facilities Fund.** Fifteen percent would be used to provide grants and loans to build and lease facilities and provide capital equipment for research on cancer and tobacco-related diseases.
- **Hope 2010 Tobacco Prevention and Cessation Fund.** Twenty percent would be used for tobacco prevention and cessation programs administered by the California Department of Public Health (DPH) and the California Department of Education.
- **Hope 2010 Law Enforcement Fund.** Three percent would be allocated to state agencies to support law enforcement efforts to reduce cigarette smuggling, tobacco tax evasion, and illegal sales of tobacco to minors, and to

otherwise improve enforcement of existing law.

- **Hope 2010 Committee Account.** Two percent would be deposited into an account that would be used to pay the costs of administering the measure, most of which would likely be reimbursing BOE for tax collection costs.

Backfill of Existing Tobacco Tax Programs.

This measure requires the transfer of some revenues from the trust fund to “backfill,” or offset, all revenue losses that are likely to occur to existing state cigarette and tobacco taxes that directly result from the imposition of the additional tax. These revenue losses would occur mainly because an increase in the price of cigarettes and other tobacco products generally reduces consumption and results in more sales for which taxes are not collected, such as Internet purchases and purchases of out-of-state products. This, in turn, would reduce the amount of revenues collected through the existing state excise taxes described above. The amount of backfill payments needed to offset any loss of funding in these areas would be determined by BOE.

Committee Established to Administer Trust Fund

The trust fund would be overseen by a newly created Cancer Research Citizen’s Oversight Committee. The committee would be composed of the following nine members:

- Four members appointed by the Governor, three of whom are directors of one of the ten designated cancer centers in California.
- Two members appointed by the Director of DPH, at least one of whom has been treated for a tobacco-related illness.
- Three chancellors from UC campuses that are members of the California Institute for Quantitative Biosciences Research. (Currently, three UC campuses—Santa Cruz, Berkeley, and San Francisco—are institute members.)

Authority Granted to the Committee. The measure authorizes the committee to administer the trust fund. The funds would have to be expended solely for the purposes described in the act. The funds would be allocated by the committee. Thus, they would not be subject to appropriation by the Legislature. Furthermore, these funds could not be loaned to other state funds.

The measure gives the committee the authority to:

- Develop short- and long-term financial plans.
- Establish a process for soliciting, reviewing, and awarding grants and loans for researchers and facilities.
- Appoint a chief executive officer and other employees.
- Establish policies regarding intellectual property rights arising from research funded by this measure.

Other Major Provisions

Transfers Permitted From Facilities Fund. In the event the committee determines that there is a surplus in the Hope 2010 Facilities Fund, the measure would authorize the committee to transfer the surplus money to the Hope 2010 Research Fund, the Hope 2010 Tobacco Prevention and Cessation Fund, or the Hope 2010 Law Enforcement Fund.

Accountability Measures. The measure requires the committee to issue an annual report to the public that includes information on its administrative expenses, the number and amount of grants provided, and a summary of research accomplishments. The committee would also be required to have an independent financial audit each year. The measure includes conflict-of-interest provisions that govern the conduct of committee members, and includes specific criminal penalties for anyone convicted for the misuse of trust fund monies.

FISCAL EFFECTS

This measure would have a number of fiscal effects on state and local governments. The major impacts are discussed below.

Impacts on State and Local Revenues

Revenues Would Be Affected by Consumer Response. Our revenue estimates assume that the proposed excise tax increase would be passed along to consumers. In other words, we assume that the retail prices of cigarettes and other tobacco products would be raised to include the excise tax increase. This would result in various consumer responses. The price increase would result in consumers reducing the quantity of taxable tobacco products they consume. Consumers could also change the way they acquire tobacco products so that fewer transactions are taxed, such as through Internet purchases or purchases of out-of-state products. While we believe a reasonable projection of consumer response is incorporated into our revenue estimates, they are still subject to some uncertainty.

New Cigarette Excise Tax Revenues. We estimate that the increase in cigarette excise taxes required by this measure would raise about \$615 million in 2012–13 (partial-year effect) and about \$810 million in 2013–14 (the first full-year impact). Our estimate of the allocation of new cigarette excise tax revenues in 2013–14 is shown in Figure 2 (see next page). After backfilling losses in existing tobacco excise tax revenue (described in more detail later), the new cigarette excise tax would generate an estimated \$735 million in net revenue in 2013–14 for the purposes described in the measure. The cigarette excise tax increase would generate somewhat lower amounts of revenue each year thereafter, based on our projections of continued declining cigarette consumption.

Effects on Existing Tobacco Excise Tax Revenues. The decline in consumption of cigarettes and other tobacco products caused by this measure would reduce revenues from the

Figure 2		
How Estimated Revenue From New Cigarette Tax Would Be Allocated		
<i>(Dollars in Millions)</i>		
	Allocation	2013–14 Funding (Full Year)
Estimated Revenue From New Cigarette Tax		\$810
Less backfill to Proposition 99, Proposition 10, General Fund, and Breast Cancer Fund	—	-75 ^a
Estimated Net Revenue		\$735
Allocation of Estimated Net Revenue		
Research Fund	60%	\$441
Facilities Fund	15	110
Tobacco Prevention and Cessation Fund	20	147
Law Enforcement Fund	3	22
Committee Account	2	15

^a LAO estimate. Backfill amounts would be determined by the Board of Equalization.

existing excise taxes that go to support Propositions 99 and 10 purposes, the General Fund, and the Breast Cancer Fund. The measure provides for the backfill of these losses from revenues raised by the new excise tax. We estimate that the amount of backfill funding needed to comply with this requirement would be about \$75 million annually, as shown in Figure 2.

As noted earlier, this measure would have an additional fiscal effect on excise taxes which go to support Proposition 99 purposes. Under current law, any cigarette tax increase triggers an automatic corresponding increase in the taxes on other tobacco products, with the additional revenues going to support Proposition 99 purposes. We estimate that the higher tax on other tobacco products would result in a full-year Proposition 99 revenue gain of about \$50 million, beginning in 2013–14.

Effects on State and Local Sales and Use Tax Revenues. Sales and use taxes are levied on a variety of products, including the retail price of tobacco products. The retail price usually includes the cost of all excise taxes. The higher retail price of tobacco products resulting from the new excise tax, therefore, would increase state and local revenue from the sales and use tax on tobacco products. This effect would be offset somewhat by several factors, including lower spending on other products subject to sales and use taxes. On net, we estimate an increase in revenue of about \$10 million to \$20 million annually.

Effects on Excise Tax Collection. As discussed earlier, the measure would deposit 3 percent of revenues from the new cigarette tax into a Law Enforcement Fund to support state law enforcement efforts. These funds would be used to support increased enforcement efforts to reduce

tax evasion, counterfeiting, smuggling, and the unlicensed sales of cigarettes and other tobacco products. The funds would also be used to support efforts to reduce sales of tobacco products to minors. These activities would have an unknown net impact on the amount of revenues collected through excise taxes.

Impact on State and Local Government Health Care Costs

The state and local governments in California incur costs for providing (1) health care for low-income and uninsured persons and (2) health insurance coverage for state and local government employees and retirees. Consequently, changes in state law such as those made by this measure that affect the health of the general population—and low-income and uninsured persons and public

employees in particular—would affect publicly funded health care costs.

For example, as discussed earlier, this measure would result in a decrease in the consumption of tobacco products. The use of tobacco products has been linked to various adverse health effects by federal health authorities and numerous scientific studies. Thus, this measure would reduce state and local government health care spending on tobacco-related diseases over the long term. This measure would have other fiscal effects that offset these cost savings. For example, the state and local governments would incur future costs for the provision of health care and social services that otherwise would not have occurred as a result of individuals who avoid tobacco-related diseases living longer. Thus, the net fiscal impact of this measure on state and local government costs is unknown.