

# QUESTIONS ABOUT TAX EVASION AND SMUGGLING

## Do Higher Tobacco Taxes Lead To Lower Cigarette Consumption?

Smokers respond to changes in the price of cigarettes. A price increase is the most cost-effective way to reduce demand and thus consumption. It is estimated that for every 10 percent increase in the price of cigarettes, consumption is reduced by about 4%.<sup>1</sup> This means that fewer youth will initiate smoking and more current smokers will attempt to quit. Consequently, fewer people will suffer from smoking related illnesses and exposure to deadly secondhand smoke.

## Do Higher Tobacco Taxes Hurt the Economy?

Tobacco tax increases lead to increased revenue, which directly benefits smokers and nonsmokers alike. Higher tobacco prices reduce the demand for cigarettes. The resulting lower consumption does not hurt our economy or small businesses such as convenience stores. Smokers will shift expenditures from tobacco products to other goods and services.<sup>2</sup> This shift will likely have a positive impact on the economy. The jobs lost in tobacco farming and manufacturing will be offset by new jobs created in other sectors of the economy, resulting in no job losses.<sup>2</sup>

## Do Higher Tobacco Taxes Hurt the Poor?

Higher tobacco taxes do impact a higher portion of smokers' with lower income; however, low-income consumers are usually more responsive to price changes. Therefore, they are more likely to quit or at least reduce their cigarette consumption following a tax increase. Reducing cigarette consumption will lower an individual's financial burden as well as potentially improving health outcomes.

## Who Pays the Cigarette Tax?

Unlike the sales tax that everyone pays on goods and services, the cigarettes tax is an excise or "user" tax paid solely by the smoker. However, the cost of smoking is paid for by all the taxpayers. In California, the tax on a pack of cigarettes is 87¢, but the costs caused by smoking are \$15.10 per pack.<sup>3</sup> Smoking leads to increased health care costs to treat smoking-related diseases. Loss of productivity results from disability or death caused by the exposure to first-, or secondhand smoke. A cigarette tax is known as a Pigovian tax. This is a tax on cigarettes that offsets the societal costs of smoking.

## Do Higher Tobacco Prices Lead to Tax Evasion and Smuggling?

Following a tax increase, many smokers will find a way to buy cheaper cigarettes. Some smokers will try to find cheaper cigarettes on the internet; others will buy their cigarettes on Indian reservations and in casinos or even travel across state lines. This type of individual "casual" evasion does not have a significant fiscal impact on the illicit cigarette market whereas, large-scale bulk tobacco smuggling can be a problem. California is uniquely positioned to prevent large-scale tobacco smuggling because it is the only state in the nation that has a high-tech cigarette tax stamp which is counterfeit-proof. Additionally, California's Cigarette and Tobacco Products Licensing Act of 2003 provides numerous checks and balances to prevent smuggling and a robust enforcement program to catch tobacco tax fraud and smuggling.<sup>4</sup>

---

<sup>1</sup> Chaloupka F, Hu T, Warner KE, Jacobs R, Yurekli A. The taxation of tobacco products. In: Jha P, Chaloupka F, editors. Tobacco control in developing countries. New York: Oxford University Press, Inc.; 2000.

<sup>2</sup> Jha P, Chaloupka F. Curbing the Epidemic: Governments and the Economics of Tobacco Control. Washington, USA: World Bank, 1999.

<sup>3</sup> Campaign for Tobacco-Free Kids. New revenues, public health benefits & cost savings from a \$1.00 cigarette tax increase in California. Available from: [http://www.californiansforacure.org/fs/global:file/blog/ykrsjlu9s4lwu4\\_files/file/id/ziwh5vhr469vfu?\\_c=zkbnnwlt4lxrcw](http://www.californiansforacure.org/fs/global:file/blog/ykrsjlu9s4lwu4_files/file/id/ziwh5vhr469vfu?_c=zkbnnwlt4lxrcw).

<sup>4</sup> Cigarette Distributor Licensing and Tax Stamp Guide. Board of Equalization. Publication 63. January 2011 <http://www.boe.ca.gov/pdf/pub63.pdf>.

### What is California Doing to Prevent Cigarette Smuggling?

California is leading the way in high-tech tax stamp efforts. Its digitized cigarette tax stamp contains encrypted information, micro text and complex background detail with a visible serial number. Additionally, the stamp is made from tamper evident label stock and is capable of being scanned and verified digitally. Together, these features make California's tobacco tax stamp virtually counterfeit proof and significantly deter smuggling. In the 20 months following the introduction of the stamp, California saw the cigarette tax revenues increase by roughly \$100 million.<sup>5</sup> Retailers who knowingly purchase and sell contraband cigarettes are subject to seizure and forfeiture of illegal cigarettes and to stiff fines and penalties which is a further deterrent.



### How Are Tobacco Laws Enforced?

In addition to local law enforcement, there are a number of state agencies in California that monitor and/or enforce tobacco control laws: the Board of Equalization (BOE), the Food and Drug Branch (FDB) of the Department of Public Health, and the Tobacco Litigation and Enforcement Section of the Office of the Attorney General of the State of California. The United States Attorney and the Bureau of Alcohol, Tobacco, Firearms and Explosives are federal agencies also involved in the effort.

The BOE licenses tobacco manufacturers; tobacco distributors, wholesalers and importers; and tobacco retailers. Additionally, it sells cigarette tax stamps, monitors tobacco tax evasion and smuggling and conducts educational programs for tobacco retailers. The FDB administers the Stop Tobacco Access to Kids Enforcement (STAKE) Act. This Program regulates the sale of tobacco products to children and youth under the age of 18 by tobacco retailers. The Office of the Attorney General's Tobacco Litigation and Enforcement Section holds the tobacco industry accountable for strict compliance with the 1998 Master Settlement Agreement (MSA). They also enforce a number of state laws and programs that regulate the promotion and sale of cigarettes and other tobacco products in the state. Currently, the Offices of the United States Attorneys and the California Attorney General's Office have a joint task force which actively prosecutes tax evasion cases.

### Does the Tobacco Industry Support Higher Tobacco Taxes?

The tobacco industry maintains that tax increases are not effective. The industry asserts that smuggling is caused by high taxes, and to combat smuggling, taxes must be reduced.<sup>6</sup> However, according to the World Bank, the tobacco industry itself benefits from the existence of smuggling in many ways.<sup>2</sup> Smuggling stimulates consumption through the street sale of cheaper cigarettes, which results in indirect pressure on retail stores to lower cigarette prices as well. When cigarettes are cheaper, more people smoke and fewer try to quit. In addition, when a cigarette is sold, irrespective of whether a tax has been paid or not, the tobacco industry is still making profit. In fact, several court cases in different parts of the world have accused the tobacco industry of supplying the smuggled cigarettes or being aware of the illegal markets and assisting in the smuggling operations.<sup>1</sup>

<sup>5</sup> State Board of Equalization News Release. Betty T. Yee Announces New Cigarette, Tobacco Tax Estimates. Shows Enforcement Has Cut Down Sales of Counterfeit and Black-Market Cigarettes. June 27, 2007.

<sup>6</sup> Globalink. Tobacco Control Factsheets. Tobacco Smuggling. <http://www.globalink.org/en/smuggling.shtml>.