

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** TOBACCO, Amend definition of cigars

**BILL NUMBER:** SB 1230, Proposed HD-1

**INTRODUCED BY:** House Committee on Finance

**BRIEF SUMMARY:** Amends HRS section 245-1 by adding a definition of large cigar to mean any roll for smoking made wholly or in part of tobacco if such product is wrapped in any substance containing tobacco, which weighs more than four pounds per thousand.

Amends the definition of "little cigar" to mean any roll for smoking made wholly or in part of tobacco if such product is wrapped in any substance containing tobacco, other than natural leaf tobacco, which weighs not more than four pounds per thousand.

Amends HRS 245-3 to clarify that the tax on tobacco products other than cigarettes and large cigars as defined shall be 70% of the wholesale price and the tax on large cigars shall be 50% of the wholesale price.

**EFFECTIVE DATE:** July 1, 2010

**STAFF COMMENTS:** This measure attempts to bring the Hawaii tax on other tobacco products in line with the way other states and the federal government tax these products. It should be noted that basing the tobacco tax on cigars on the basis of ring size or circumference of the product could not be found in any other statute taxing these products. It should be noted that this peculiar definition was added at the last minute in the waning days of last year's session without any public discussion of the appropriateness of using this definition to distinguish between types of cigar products. The federal law uses the weight basis in distinguishing between types of products and, therefore, the rate applied to the specific product.

It should be noted that when Act 58, SLH 2009, was approved by the legislature last year, it changed the way other tobacco products are taxed and increased the rate of the ad valorem tax on other tobacco products other than cigars to 70% of the wholesale value and imposed an ad valorem tax equal to 50% of the wholesale value on cigars that had a "ring gauge" of more than 30 (approximately a half inch circumference). In the latter case, those cigars of less than that ring gauge known as "little cigars" were thrown into the same rate schedule as cigarettes. This provision appeared in the last draft of the bill with little or no public discussion and more than likely took care of a certain constituency.

It would seem highly inequitable that product that is known as a little cigar be treated like cigarettes as opposed to "other tobacco products" subject to an ad valorem tax instead a per unit tax. There is no reason to believe that little cigars don't compete with cigars with a larger circumference and should, therefore, be taxed like all other cigars. Given the substantial rate on all other cigars, one might suspect that placing "little cigars" in the same rate schedule as cigarettes confers a preference on this particular

product, imposing a lesser tax burden and, therefore, foregone revenues to the state general fund. Thus, if lawmakers want to generate additional revenue for the state general fund, they may want to consider taxing all cigars, whether little or big, the same way based on value.

That said, as noted earlier, while quitting smoking any tobacco product will have an adverse impact on state tax collections, trading down to a more inexpensive tobacco product other than cigarettes will also have an adverse impact as the tax on those other tobacco products is based on the value of the product. This was the very reason the state made the switch to taxing cigarettes on a per cigarette basis. This is the problem with the ad valorem approach to taxing other tobacco products.

Lawmakers should consider restructuring the way other tobacco products are taxed to insure stability in the collection from the sales of these products. Instead of continuing to set the tax as a percent of the wholesale value, consideration should be given to moving to a per unit approach like the taxing of cigarettes. A review of what other states impose indicates that while some products, such as cigars continue to be taxed on an ad-valorem basis, smokeless tobacco products are taxed on the basis of weight. This would insure that all such tobacco products are taxed in the same manner regardless of their wholesale price. Such is the case with the cigarette tax that is levied on a per unit basis. There are some 14 states that already employ the weight approach for smokeless tobacco. In the most recent conversion to weight based taxes on smokeless tobacco products, New Jersey experienced a 19% increase in revenues from this product.

In making the conversion to so many cents per ounce, lawmakers may want to utilize the current tax collected on the most expensive product and divide that amount by the number of ounces. While this will result in an initial bump in collections as the tax on less costly product will see an increase, it will bring parity to these types of products and stabilize collections as users migrate to less costly brands or products as the cost rises.

Digested 3/29/10

State of Hawaii  
House of Representatives  
Committee on Finance

Testimony of  
Gary Slovin  
In Support of SB1230 SD2 Proposed HD2  
*A Bill to Amend the Definition of Large Cigar*

March 29, 2010

Mr. Chairman and Members of the Committee:

My name is Gary Slovin, and I am offering testimony to the Committee today in support of SB1230 SD2 Proposed HD2. I am representing my client, Altria Client Services Inc., on behalf of its affiliate John Middleton Company.

ALCS and John Middleton supports legislation in Hawaii that taxes all "Large Cigars" the same – currently 50% Ad Valorem. While we support efforts to equalize the tax between cigarettes and little cigars, there is no public policy benefit in using a ring gauge to tax Cigars. By properly differentiating between little and large cigars using a weight-based standard, Hawaii can realize more revenue and create greater tax equity for the adult consumer.

Last year, Hawaii changed how it taxed cigars, by adopting an approach that uses ring gauge to determine if a cigar is taxed as a little cigar or as a large cigar. Hawaii is the only state to use a ring gauge to determine taxation of cigars, and this current taxation structure mistakenly classifies some Large Cigars as "Little Cigars." As opposed to the ring gauge measurement, the federal government and many states define Little Cigars based on weight.<sup>1</sup> Because many Large Cigars sold in Hawaii have less than a 30 Ring gauge but weigh more than the 4 pounds per thousand, Hawaii is unintentionally taxing these products at the lower little cigar excise tax rate, when the products should be properly taxed at the large cigar rate

Thus, by using a ring gauge standard, Hawaii is currently losing revenue by misclassifying large cigars as little cigars. The adoption of this bill will correct this unintended consequence and will lead to greater large cigar revenues. Currently some Large Cigars are taxed at the Little Cigar rate of \$0.11 per cigar while other Large Cigars are taxed at 50% Ad Valorem. While little cigars most often come in packs of 20, large cigars are usually sold either as a single cigar or packages containing far less than 20. Therefore, the small number of cigars per purchase or package results in a lower tax than a 50% ad valorem tax would generate.

<sup>1</sup> See 7 C.F.R. § 40.11 (defining *small cigars*) (2009), available at <http://ecfr.gpoaccess.gov> (as of May 27, 2009). See, e.g., MASS. GEN. LAWS ANN. ch. 64C § 1 (2008) (providing weight-based definition of *little cigars*); N.H. REV. STAT. ANN. § 78:1 (2009) (same); R.I. GEN. LAWS § 40-20.2-1 (2008) (same).



Because all Large Cigars are not taxed the same, the Hawaii government is losing an estimated \$460,000 in revenue each year this issue is not corrected.<sup>2</sup> Thus, by adopting SB1230 SD2 Proposed HD2, Hawaii could raise an estimated \$460 thousand dollars in additional revenue simply by properly taxing all Large Cigars at the same 50% Ad Valorem rate.

I strongly urge you to approve SB1230 SD2 Proposed HD2 and tax all large cigars the same. Thank you for your time.

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<sup>2</sup> Altria price list effective November 2, 2009 and Swedish Match price list effective April 1, 2009 and Swisher International, Inc. price list effective January 8, 2010 and John Middleton Co. price list effective January 6, 2010; Ring gauges estimated using CigarCyclopedia.com <http://www.cigaryclopedia.com/webapp/content/view/230/366>; Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 43 (February 2009); funded in part by Altria Client Services Inc.; Hawaii excise tax for Large Cigars with less than 30 Ring Gauge calculated by multiplying the number of Large Cigars with less than 30 Ring Gauge sold by \$0.11; Hawaii Ad Valorem excise tax revenue calculated by multiplying the number of Large Cigars sold times the manufacturer list price per cigar times the Ad Valorem rate of 50%; ALCS STARS geographic aggregate database, 52-weeks ending June 27, 2009; Note: Sales at Military locations not included.





COALITION FOR A  
TOBACCO-FREE HAWAII

To: The Honorable Marcus R. Oshiro, Chair, Committee on Finance  
The Honorable Marilyn B. Lee, Vice Chair, Committee on Finance  
Members, House Committee on Finance  
From: Trisha Y. Nakamura, Policy and Advocacy Director  
Date: March 29, 2010  
Hrg: House Committee on Finance; March 29, 2010 in Rm 308 at 7:00 p.m. (Agenda #6)  
Re: **Comments regarding SB 1230, SD 2, Proposed HD 1  
Relating to Taxation**

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Thank you for the opportunity to offer comment on SB 1230, SD 2, Proposed HD 1 Relating to Taxation, which would create a definition for large cigars and amend the definition of little cigars.

The Coalition for a Tobacco Free Hawaii (Coalition) is the only independent organization in Hawaii whose sole mission is to reduce tobacco use through education, policy and advocacy. Our organization is a small nonprofit organization of over 3,000 organizations and members that work to create a healthy Hawaii through comprehensive tobacco prevention and control efforts.

The Coalition supports increasing the cost of tobacco products to reduce tobacco use. Of concern is the increased use of other tobacco products by Hawaii's youth.

The Coalition recommends that the definition of "large cigar" be based on a weight of more than four and a half pounds per thousand. And that the definition of a "little cigar" be based on a weigh of not more than four and a half pounds per thousand, and that the definition of its wrapping be "other than natural whole leaf tobacco."

**Thank you for the opportunity to testify on this matter.**



*The Official Sponsor of Birthdays*

March 28, 2010

Committee on Finance  
Representative Marcus R. Oshiro, Chair  
Representative Marilyn B. Lee, Vice Chair

**Hearing:**

7:00 P.M., Monday, March 29, 2010  
Hawaii State Capitol, Room 308

**RE: SB1230, SD2 – Relating to Taxation**

**Testimony in Support with Amendments**

Chair Oshiro, Vice Chair Lee, and members of Committee on Finance. Thank you for the opportunity to provide testimony in support regarding definition changes for large cigars, little cigars and tobacco products.

As the committee knows the American Cancer Society supports tobacco tax measures that are substantial and deter individuals from smoking or using chewing or moist tobacco products. We know that cigar smoking is just as deadly and addictive as cigarette smoking. Although cigar smoking has been on a general decline in the United States over the last few years, sales of cigars have been rising fast especially among kids.

We would respectfully offer the following amendments to enhance the deterrence the tax will have in discouraging cigar smoking, while at the same time increasing revenues to the State of Hawaii.

**In SECTION 2.1, page 1, line 12, we recommend reducing the weight from four pounds to three pounds per thousand, as well changing the weight for small cigars from four pounds to three pounds per thousand [Section 2.2, page 2. lines 3 and 4].**

**In addition we recommend clarification of the wrapping for small cigars to include the words, "...other than natural whole leaf, which weighs..." [Page 2, lines 2 and 3].**

Thank you for the opportunity to testify on the measure.

Respectfully,

A handwritten signature in black ink, appearing to read "G. Massengale".

George S. Massengale, J.D.  
Director of Government Relations

**Radcliffe & Associates, LLC**  
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March 29, 2010

Representative Marcus R. Oshiro, Chair  
Representative Marilyn B. Lee, Vice Chair  
Committee on Finance  
Hawaii State Capitol, Room 308  
Honolulu, HI 96813

**RE: SB1230 SD2 HD1 Proposed, Relating to Taxation**

Dear Chair Oshiro, Vice Chair Lee and Members of the Committee:

My name is John Radcliffe, representing RAI Services Company and we submit that SB1230 SD2 HD1 Proposed should be amended to make sure that "little cigars" are taxed as cigarettes. "Little cigars" are called that for a reason, and the reason is that they are created to take advantage of a tax loophole. Cigars are, and ought to be, taxed at a different and lower rate than cigarettes. Over the past decade, the consumption of these so-called "little cigars" that compete directly with cigarettes, have grown by over 240%.

Other cigarette companies, most notably, Altria/Phillip Morris, have been pushing for a complicated weight based formula to solve this problem, but a far simpler and a more straight forward solution exists. Cigarettes all have a cellulose acetate filter integrated right onto the tobacco product. So does every so-called "little cigar." Therefore, the only amendment necessary, and the one that makes the most sense, is to define "little cigars" as cigarettes as follows:

**PROPOSED LITTLE CIGAR AMENDMENT**

**§245-1 Definitions.** As used in this chapter, unless a different meaning is indicated by the context:

.....

"Little cigar" means any roll for smoking made wholly or in part of tobacco if such product is wrapped in any substance containing tobacco, with a ~~ring gauge of less than thirty (less than .467 inches in diameter), of any length~~ cellulose acetate or other integrated filter.

Representative Marcus R. Oshiro, Chair  
Representative Marilyn B. Lee, Vice Chair  
Committee on Finance  
March 29, 2010  
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These products are sold like cigarettes and ought to be classified that way too. The alternative, to re-label products based upon weight is confusing and will lead to manufacturers fiddling with the weight of tobacco products to avoid the consequences of taxation. The loophole is best closed by the simplest, most direct solution.

If it looks like a cigarette, has a filter like a cigarette, is sold in packs like cigarettes, tax it just like a cigarette.

Thank you for this opportunity to submit written comments.

Sincerely,

John H. Radcliffe  
President