

TAX AS COMPETITIVE TOOL

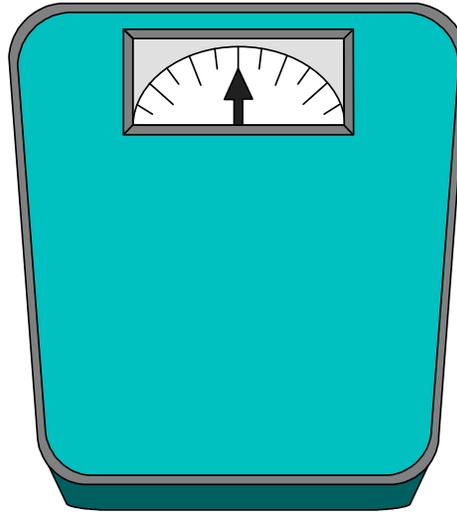
Stanley R. Arnold

Overview

- What the issue is.
- Why I am concerned.
- What should be considered by the eventual decision makers.



WEIGHT?



OR

VALUE?

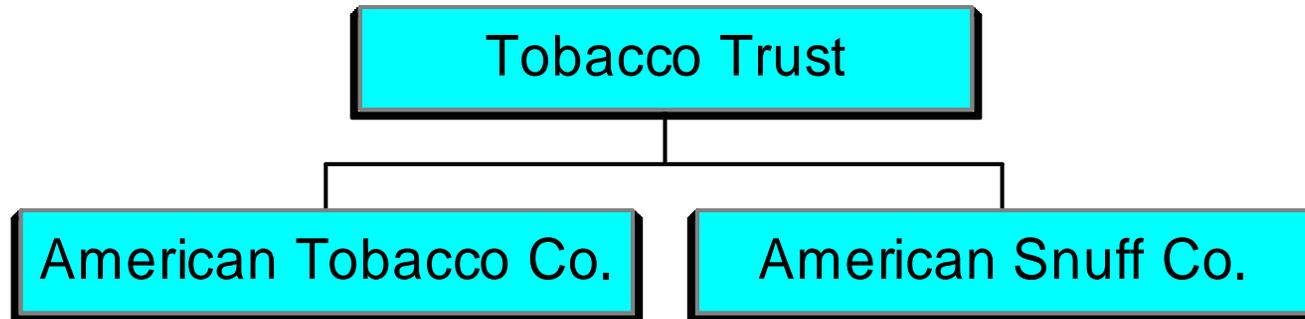


History Of The Industry

- 1880-1900 James B. Duke acquired tobacco companies, both cigarette and snuff.
- 1900 formed a giant “tobacco trust” organized as two companies; American tobacco company and American snuff company.

History

1900

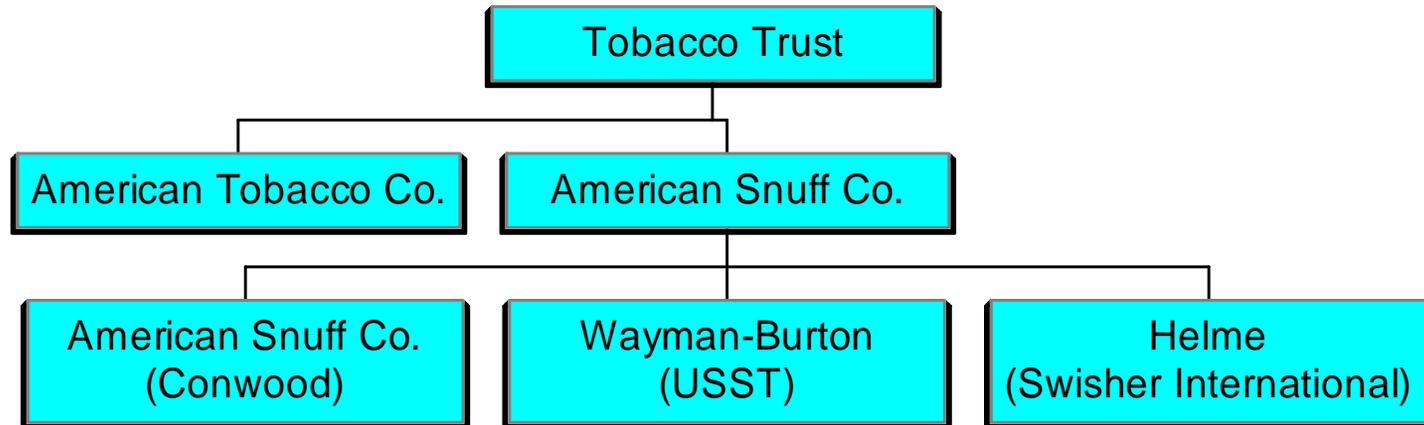


HISTORY OF THE INDUSTRY

- In 1907, President Teddy Roosevelt had the Justice Department file an antitrust lawsuit under the Sherman Act to cause the break up of American Snuff Company.
- In 1911, the government mandated the separation of American Snuff into three companies.

History Of The Industry

1911



HISTORY

1911-1990

- 1911 until 1970-UST was the only seller of moist snuff (also called “wet snuff”).
- Alabama and Arizona are first states to convert tax to weight based.
- 1970 until 1990 Several competitors enter market and UST’s market share drops to 87%.

HISTORY

1990-present

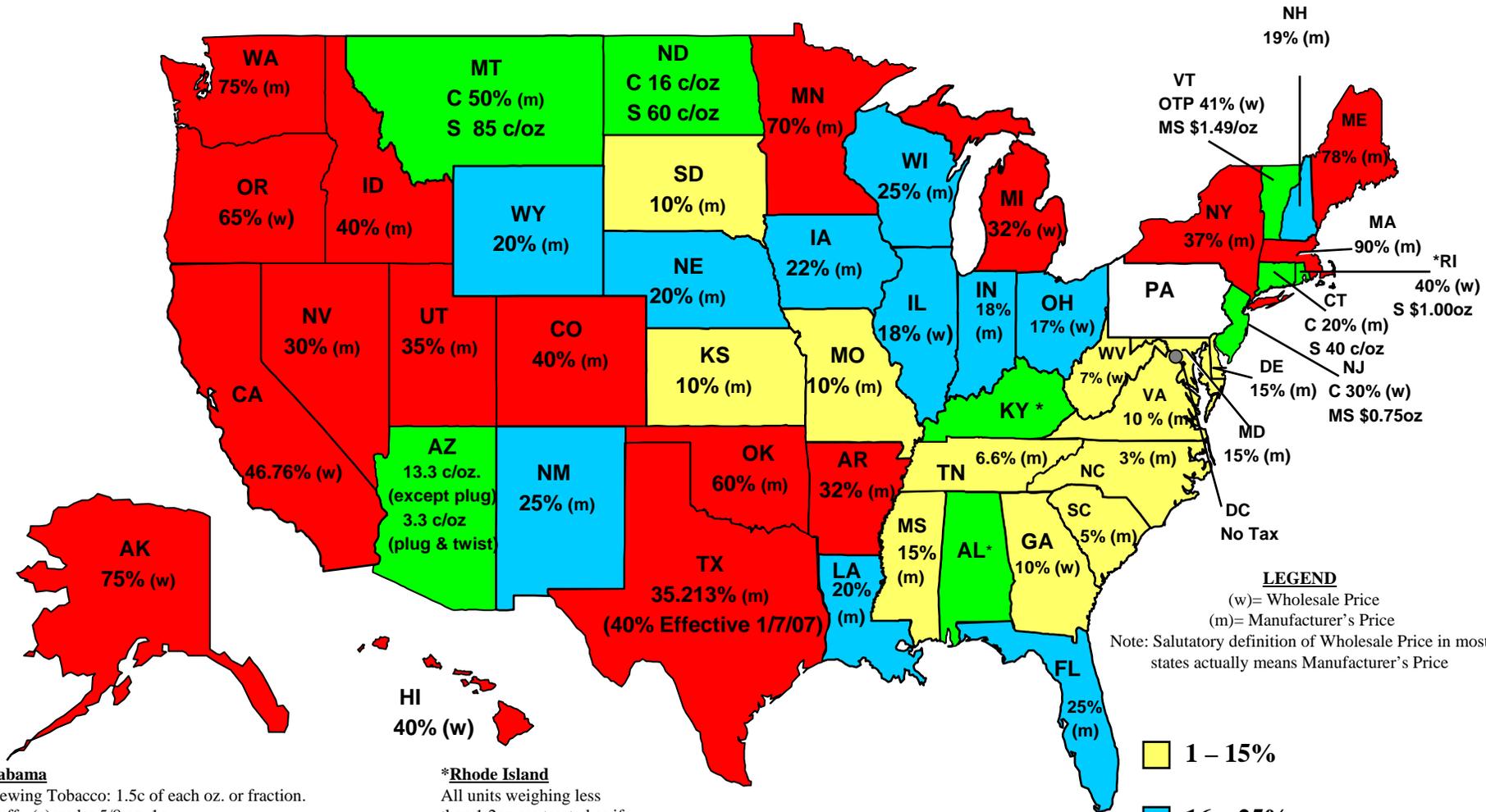
- 1994 first price-value product is introduced.
- Four healthy competitors in the smokeless field with UST share continuing to fall but still maintaining a 70+ market share.
- Numerous new products introduced.
- Increasing customer base as cigarette users adopt use of smokeless products.
- Clear strategy of premium vs. Value.

A Changing System Of Taxation

- 2000-2005 new focus on state taxes.
- January 1, 2006.
 - 43 states tax smokeless tobacco based on value.
 - 6 states tax based on weight.
 - 1 state does not tax smokeless tobacco.

Excise Taxes on Smokeless Tobacco by State

As of 7/14/2006



LEGEND

(w)= Wholesale Price
(m)= Manufacturer's Price

Note: Salutatory definition of Wholesale Price in most states actually means Manufacturer's Price

- 1 – 15%
- 16 – 25%
- 26% and above
- Based on weight, unit or a combination
- No Tax

***Alabama**
Chewing Tobacco: 1.5c of each oz. or fraction.
Snuff: (a) under 5/8 oz. 1c
(b) > 5/8 oz – 1.58oz. 2c
(c) >1.58oz – 2 1/2oz. 4c
(d) >2 1/2oz – 5oz. (cans packs & gullets) 6c
(e) 3oz – 5oz. (bottles glasses tumblers) 7c
(f) >5oz – 6oz. 8c
(g) >6oz. 12c or fraction thereof

***Rhode Island**
All units weighing less than 1.2oz are treated as if they weighed 1.2oz.

***California** Rate is adjusted annually
***Kentucky** Snuff: 9.5 cents per unit. Chewing Tobacco 7.5% of the wholesale price.

2006 CHANGES

- To Weight Based
 - Vermont
 - Rhode Island
 - New Jersey
- Unsuccessful
 - New Mexico
 - Idaho
 - New Hampshire

Tax Policy Considerations

Characteristics of a “good” tax.

- Economic neutrality.
- Revenue matches growth in expenses.
- Ease of administration for taxpayer and revenue agency.

Economic Neutrality

- Price or value is the common denominator for competing in economic markets.
- Proportionality-all products being sold under a sales tax bear the same proportional burden.
- If “price discrimination” is present, it is there before and after tax is imposed. It is not caused by the tax.

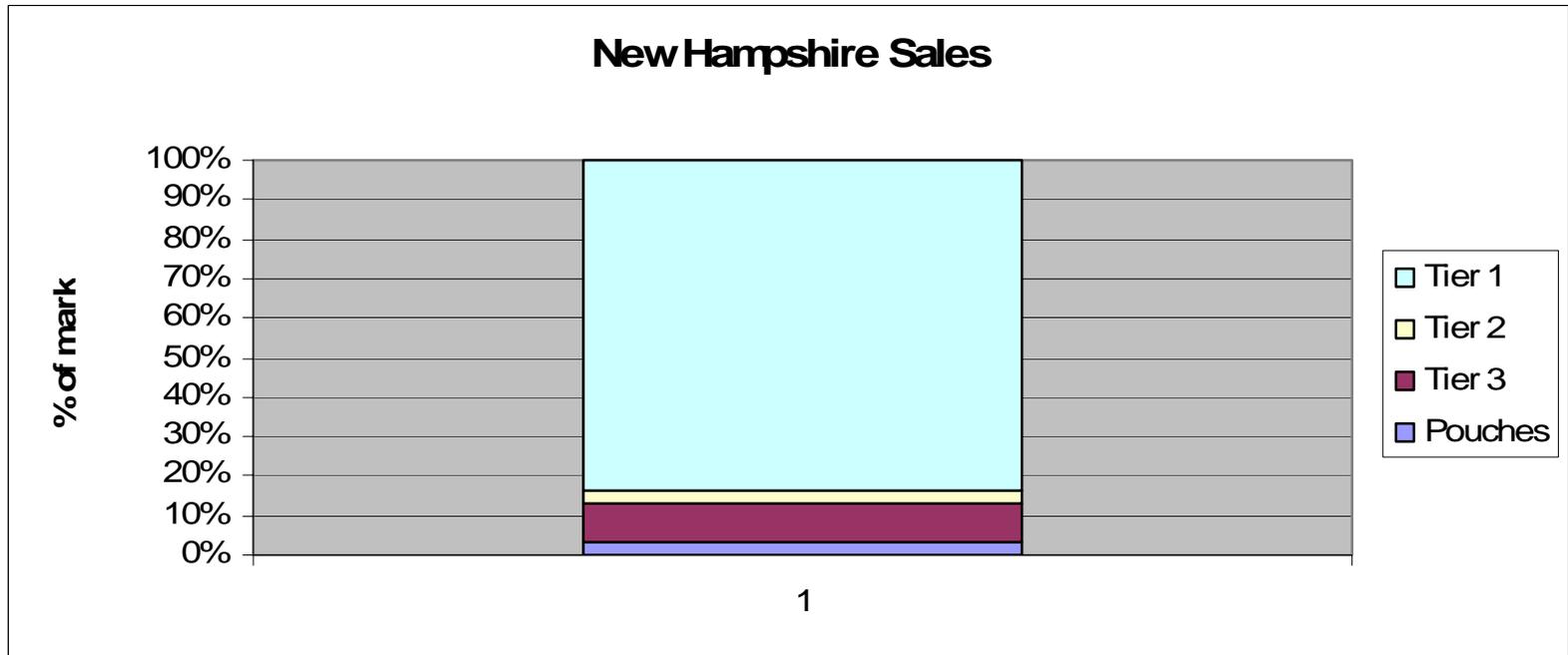
FORD vs. MERCEDES



Growth In Revenues

Math 101

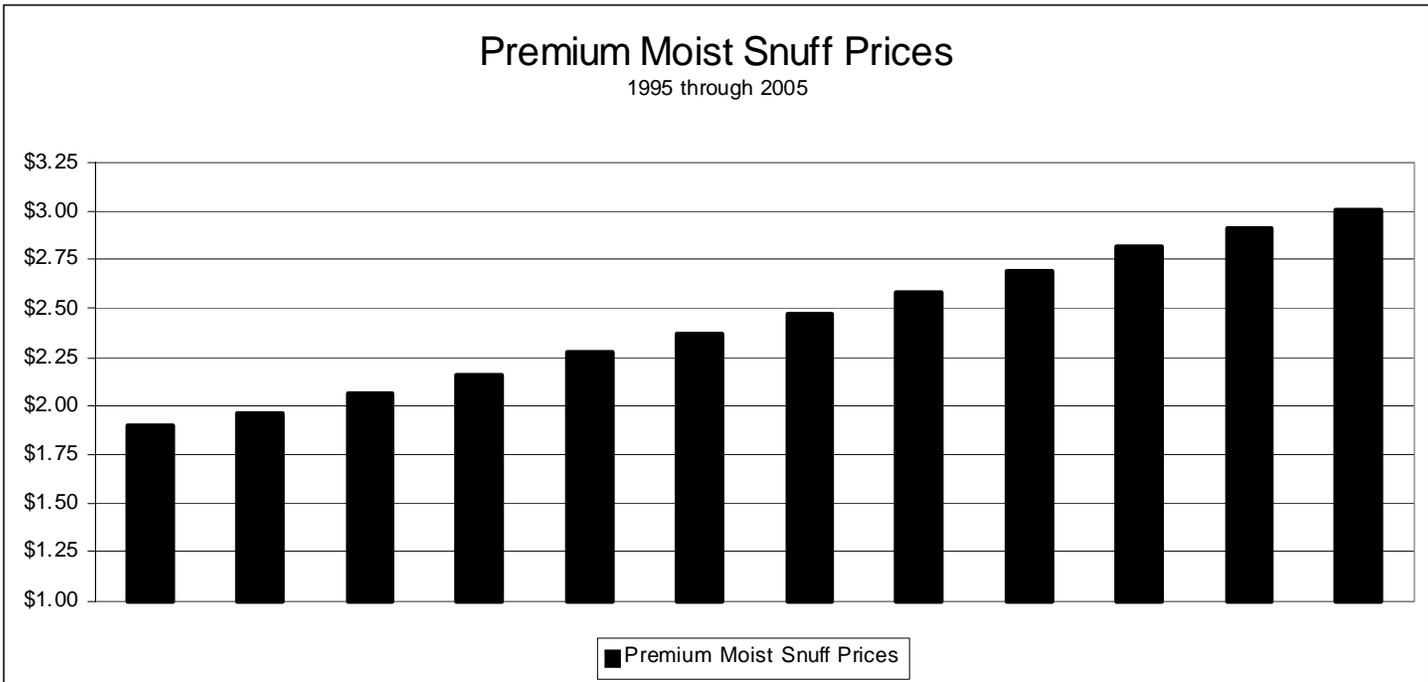
Capping The Growth of 80% of The Revenue Base
Simply Doesn't make sense!



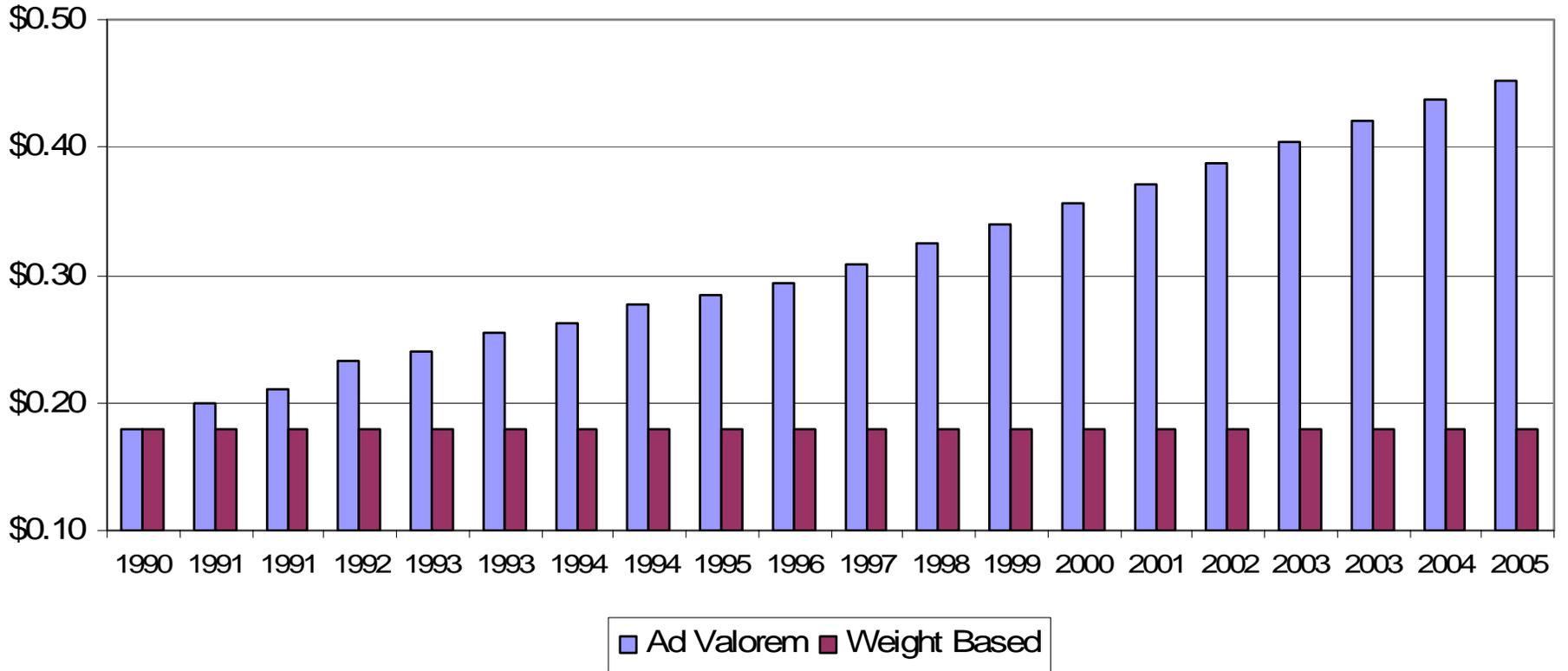
Where Is Revenue Growth Occurring?

- Cigarette smokers adopting smokeless (volume). UST has reported to its shareholders that 9 out of 10 new adult consumers enter using premium product.
- UST has also reported that moist snuff grew at 5% last year and is up 8% so far this year.
- Price increases. While price elasticity must be considered, public companies need to show annual growth to keep investors happy.

GROWTH IN REVENUES



Ad Valorem vs. Weight Based (Generic for Illistration)



Administrative Complexity

- Why only moist snuff? If arguments are valid they would apply to all “other tobacco products” category.
- Growth of new products is accelerating and each would require new analysis before it was introduced in a state.
- Wholesalers will be required to change their systems-at what cost?
- State systems would need to be modified.

Summary

- Why is moist snuff the target? The only conclusion I can reach is that an attempt is being made to use the tax system as a competitive tool. One segment of the industry wants to increase the cost of competitors product by imposing greater taxes and reducing its own tax burden.

Summary (Continued)

- The change to a weight based system of taxes does not meet any of the criteria for a “good” tax.
- The change is bad policy and sets a precedent that tax administrators should be very concerned with.

What Should Happen?

- Open debate before the tax writing committees of the legislature;
- Valid revenue estimates, certified by the revenue agencies; And
- Answers to the increased administrative burdens for revenue agencies and wholesalers.

Your Role

- Provide objective information to be used in decision making.
- Determine realistic assumptions as to continued price increases and volume growth. (10-K reports and the internet).
- Consider information from both proponents and opponents of change and verify claims.

Any Questions?

