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Proposed Tobacco Excise Tax Changes in H.R. 5376, the Reconciliation Bill

Federal tobacco excise taxes are a continuing interest for many in Congress seeking to improve public health and to raise revenue. Today, the tobacco tax is one of the largest federal excise taxes. In FY2020, it raised \$12.4 billion for the General Fund.

A range of tobacco tax increases are included in H.R. 5376, commonly known as the reconciliation bill. In addition to increasing most of the currently existing tobacco tax rates, H.R. 5376 would levy a tax on other products containing nicotine, such as e-cigarettes. The Joint Committee on Taxation estimates that the proposed tobacco tax increases would raise \$96.8 billion from FY2022 to FY2031.

Economic research suggests that a tobacco tax increase is an effective way to decrease consumption of tobacco products. At the same time, a tobacco tax increase would most likely be regressive, meaning that people with lower incomes would pay a higher share of their income in tax than people with higher incomes. This is largely because people with lower incomes are more likely to consume tobacco products. Also, a federal tax increase would likely reduce the revenue that state and local governments receive from their own tobacco taxes, due to reduced demand.

Comparing Current Law with Proposed Changes

The current federal excise tax rates on tobacco products took effect in April 2009. Tobacco excise taxes were increased as a “pay-for” in the Children’s Health Insurance Program Reauthorization Act of 2009 (P.L. 111-3). Current tobacco taxes cover a variety of tobacco products, with covered products defined in 26 U.S.C. §5702. This section includes definitions for cigarettes, cigars, smokeless tobacco (including snuff and chewing tobacco), pipe tobacco, and roll-your-own tobacco.

H.R. 5376 would increase the tax rates applicable to each of these tobacco products. **Table 1** compares the current-law tax rates with the proposed changes in H.R. 5376. Taxes on small and large cigarettes and small cigars would double. For example, taxes on small cigarettes would increase from \$50.33 per 1,000 cigarettes (\$1.01 per pack of 20) to \$100.66 per 1,000 cigarettes (\$2.01 per pack of 20).

Large cigars would be taxed differently under H.R. 5376. Currently, a large cigar is subject to a 52.75% sales tax, not to exceed \$0.4026 per cigar. H.R. 5376 changes the rate to \$49.56 per pound, and not less than \$0.1006 per cigar. For example, a 5 gram cigar would have \$0.5463 in taxes.

Table 1. Federal Tobacco Excise Tax Rates: Current Law and H.R. 5376

| Type of Product | Current Law | H.R. 5376 |
|--|--|---|
| Small cigarettes | \$50.33 per 1,000 (\$1.01 per pack of 20) | \$100.66 per 1,000 (\$2.01 per pack of 20) |
| Large cigarettes | \$105.69 per 1,000 (\$2.11 per pack of 20) | \$211.39 per 1,000 (\$4.22 per pack of 20) |
| Small cigars | \$50.33 per 1,000 (\$1.01 per pack of 20) | \$100.66 per 1,000 (\$2.01 per pack of 20) |
| Large cigars | 52.75% of sales price but not to exceed \$0.4026 per cigar | \$49.56 per pound, but not less than \$0.1006 per cigar |
| Pipe tobacco | \$2.8311 per pound | \$49.56 per pound |
| Chewing tobacco | \$0.5033 per pound | \$10.70 per pound |
| Snuff | \$1.51 per pound | \$26.84 per pound |
| Roll-your-own tobacco | \$24.78 per pound | \$49.56 per pound |
| Cigarette papers | \$0.0315 per 50 | \$0.0315 per 50 |
| Cigarette tubes | \$0.0630 per 50 | \$0.0630 per 50 |
| Discrete single-use units ^a | <i>Not taxed unless snuff or chewing tobacco</i> | \$100 per 1,000 |
| Other nicotine products ^b | <i>Not taxed</i> | \$100.66 ^c per 1,810 milligrams of nicotine |

Source: Table created by CRS. Current law from 26 U.S.C. §5701. H.R. 5376, “To Provide for Reconciliation Pursuant to Title II of S.Con.Res. 14,” from the version reported in the U.S. House of Representatives on Sept. 27, 2021.

- Snuff or roll-your-own tobacco products would be taxed as discrete single-use units instead if they meet that definition.
- Tobacco products meeting the definition of one of the other taxable classes (e.g., a large cigar) would be taxed at that rate, without regard to the nicotine content.
- This rate would be statutorily tied to the tax rate on small cigarettes.

H.R. 5376 would tax discrete single-use units, defined as a product that is not intended to be smoked and is in the form of a lozenge, tablet, pill, pouch, dissolvable strip, or other

form, at a rate of \$100 per 1,000 units. Under current law, these products are not taxed unless they meet the definition of another tobacco product.

H.R. 5376 would also tax other products containing nicotine, such as e-cigarettes. The tax would be equal to the rate on 1,000 small cigarettes (\$100.66) per 1,810 milligrams of nicotine in the product. Any product containing nicotine approved by the Food and Drug Administration for use in a drug (such as cessation therapies) would be excluded. Products meeting the definition of another tobacco product would be taxed at that product's rate, regardless of nicotine content.

Economic Research on the Effect of Tobacco Taxes on Smoking

Economic studies have found strong evidence that increases in tobacco excise taxes that cause an increase in price lead to reduced tobacco consumption. This is true for adults and younger consumers, and for people starting to smoke as well as continuing smokers. Higher prices also reduce consumption of noncigarette tobacco products.

Economists typically measure changes in the quantity demanded due to price changes using elasticities. An elasticity measures the percentage change in quantity demanded due to a given percentage change in price. If a good has an elasticity of -0.5, then a 10% increase in price would be expected to reduce the quantity demanded by 5%. Most studies of cigarette demand find an elasticity between -0.2 and -0.6. Elasticities for noncigarette tobacco products vary by product, but are generally similar. Estimated price elasticities for e-cigarettes vary widely; some studies find elasticities near -0.4 while others find an elasticity of -1.3.

Empirical evidence of the elasticity of demand for tobacco products can be used to evaluate how much the proposed tax increase might affect demand for tobacco products. Suppose a pack of cigarettes costs \$5 before taxes. Under current federal law and using the median state tax, the pack would have \$2.79 in taxes (\$1.01 federal and \$1.78 state). The final retail price would be \$7.79. H.R. 5376 would raise the federal tax rate on a pack of 20 small cigarettes to \$2.01. The new retail price of the pack of cigarettes would be \$8.79, a 12.8% increase in price. Using the consensus estimate for cigarette elasticity of -0.2 to -0.6, a simple estimate is that the federal tax rate increase may be expected to decrease the quantity of cigarettes consumed by between 2.6% and 7.7%.

Equity Considerations

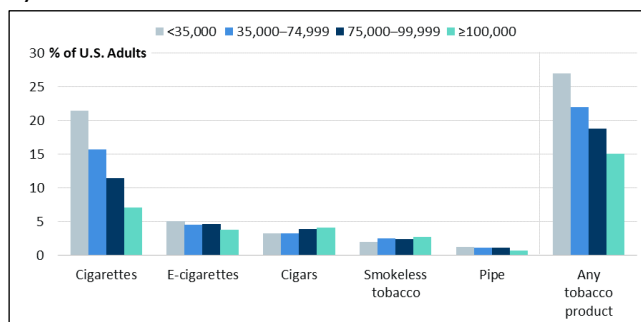
Tobacco taxes, like many other excise taxes, tend to be regressive. This means that people with lower incomes pay a larger share of their income in taxes. The Centers for Disease Control and Prevention stated that, in the case of tobacco products, people with lower incomes pay a larger share of their income in taxes because people with lower incomes are more likely to use tobacco products.

Figure 1 shows the percentage of U.S. adults with different levels of household income in 2019 who reported using tobacco products every day or some days. Cigarettes are the most commonly used tobacco product and also showed the

largest difference in use by income. In households with an income of less than \$35,000, 21.4% of adults report smoking cigarettes, a rate about three times higher than among adults in households with an income of \$100,000 or more (7.1%). Use of other tobacco products is less impacted by annual household income.

Figure 1. Percentage of U.S. Adults Who Reported Tobacco Product Use, 2019

By Annual Household Income



Source: Monica E. Cornelius et al., “Tobacco Product Use Among Adults—United States, 2019,” Centers for Disease Control and Prevention, *Morbidity and Mortality Weekly Report* 69(46): 1736-1742.

While tobacco taxes are regressive, some studies demonstrate that the health benefits of reduced smoking are progressive. These studies argue that if people do not fully consider their own future health when smoking, they may smoke too much relative to their long-term “optimal” level of smoking. Tobacco taxes could then be a self-control tool due to the higher price faced by consumers, with a disproportionate share of the benefits of stopping or reducing tobacco consumption going to people with lower incomes because they are more likely to smoke.

Interactions with State and Local Government Tobacco Taxes

Every state and the District of Columbia levies its own excise tax on cigarettes and other tobacco products. Nationally, the median state excise tax rate is \$1.78 per pack of cigarettes in 2021. The highest is \$4.50 per pack in the District of Columbia, while the lowest is \$0.17 per pack in Missouri. Some localities in Alabama, Illinois, Missouri, New York, Tennessee, and Virginia levy additional local excise taxes. The 1998 Master Settlement Agreement also effectively imposes an additional state excise tax across all states that is currently over \$0.50 per pack.

E-cigarette taxes are less common; 29 states and the District of Columbia levy an excise tax on e-cigarettes. The form of these taxes varies, with some taxes being a per-unit tax and others a percentage of the price or volume.

The effect of a federal tobacco tax increase on state and local government revenues would depend upon state and local tax rates. Following a price increase due to higher federal taxes, the quantity purchased would most likely decrease, meaning revenue that state and local governments receive from tobacco taxes would likely fall, unless those governments take action to raise their own rates.

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