TOBACCO TAXES

Market Shifts toward Lower-Taxed Products Continue to Reduce Federal Revenue

What GAO Found

Large federal excise tax disparities among similar tobacco products after enactment of the Children’s Health Insurance Program Reauthorization Act (CHIPRA) of 2009 led to immediate market shifts (see figure). Specifically, CHIPRA created tax disparities between roll-your-own and pipe tobacco and between small and large cigars, creating opportunities for tax avoidance and leading manufacturers and consumers to shift to the lower-taxed products. Following the market shifts after CHIPRA, the lower-taxed products have sustained their dominant position in their respective markets.

Market shifts to avoid increased tobacco taxes following CHIPRA have continued to reduce federal revenue. GAO estimates that federal revenue losses due to market shifts from roll-your-own to pipe tobacco and from small to large cigars range from a total of about $2.5 to $3.9 billion from April 2009 through September 2018, depending on assumptions about how consumers would respond to a tax increase.

Federal revenue would likely increase if Congress were to equalize the tax rate for pipe tobacco with the rates currently in effect for roll-your-own tobacco and cigarettes. GAO estimates that federal revenue would increase by a total of approximately $1.3 billion from fiscal year 2019 through fiscal year 2023 if the pipe tobacco tax rate were equalized with the higher rate for roll-your-own tobacco and cigarettes. While equalizing federal excise taxes on small and large cigars should raise revenue based on past experience, the specific revenue effect is unknown because data for conducting this analysis are not available. These data are not collected by the Department of the Treasury because such data are not needed to administer and collect large cigar taxes under the current tax structure.