

Testimony of
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Thank you, Mr. Chairman and members of the Senate Finance committee.

My name is Gerald P. Kupris, and I appear before you today as the president of the Pennsylvania Distributors Association. My comments are mine and represent the view of this association and are not necessarily the views of any organization or company I might identify in the context of this presentation, such as manufacturers or retailers, who can most adequately represent their interest far better than I. I intend to present the position of my members in general with respect to tobacco taxation.

About the PDA...

The Pennsylvania Distributors Association is a statewide trade association of businesses that distribute consumer products to retailers throughout this state. Our members distribute these products to the small retailer, grocery stores and large chains.

As such, these member companies are comprised of the small “mom & pop” organizations which are family owned, and medium sized firms and large national companies. They have sales in this state estimated at more than \$7.5 billion.

The Association is celebrating its 64th year in existence. It has helped its members become more efficient in their businesses, comply with state and federal laws and regulations and has provided resources for its members to prepare themselves for the ever-changing business paradigms.

Our members distribute such products as grocery items, health and beauty products, tobacco and confectionery products, snacks, automotive products and most items found in convenience stores and grocery stores.

The Association has been in the forefront in passing and supporting the state’s “Unfair Cigarette Sales Act,” which established a level playing

field for the sale of cigarettes, and it has been a leader in the “Youth Access” issue, establishing a comprehensive business approach to keeping cigarettes out of the hands of youth with education programs and collaborative efforts with other business groups, retailer customers and government. We initially opposed the smoking ban legislation, but our opposition lessened as members of the legislature became aware of the need for legitimate exceptions or exemptions from an originally draconian proposal.

Our wholesale industry is an important commercial partner with more than 10,000 convenience stores that employ an estimated 60,000 Pennsylvanians. Our tobacco trade is very important to all these stores because in the average store, tobacco sales can make up to 30 percent of store profits.

In servicing these thousands of businesses, we collect and pay over \$1 billion in taxes, most of which is paid even before we sell our products. We support our communities, being recognized as local businesses and families who are community team players. And as to the tobacco portion of our business, our members are, as I have stated, the tax collectors for the Commonwealth, being CSA's, or Cigarette Stamping Agents.

You should know that, as CSA's, we undertake many services and incur many expenses, which will increase as a result of any tax increase, such as:

- Receiving the cigarettes,
- Storing and inventorying the unstamped product,
- Arranging to procure and receive indicia,
- Actually securing such indicia,
- Increased cost for bond requirements, if available,

- Purchase/lease of stamping equipment,
- Maintenance of equipment,
- Supplies for equipment,
- Labor to run equipment,
- Taking unstamped product from inventory and returning stamped product to inventory,
- Space and storage expenses,
- Expenses relating to the increased value of the cigarettes as a result of the affixation of the stamp,
- Mercantile tax increase as a result of increased value of the cigarettes,
- Additional capital for purchase of indicia,
- Increased fire and casualty insurance,
- Additional record keeping resulting from the above,
- Additional risk of loss or spoilage of such indicia,
- The increased risk of hijacking or theft of the stamps,
- Increased costs of labor, federal taxes, state taxes, pensions costs, workers comp. Costs, etc.
- Accounts receivables will increase, together with the likelihood of retailer default
- And the well-known resulting loss of sales due to the excessively high tax

And the burden will increase more so if a tax were extended to OTP, or other tobacco products. Members who sell products in other states where these taxes are imposed have described the whole process as “a nightmare.” No real benefit is accomplished; on the contrary, a real business evil will result.

For years, anti-tobacco organizations and interest groups seeking to squeeze more taxes out of tobacco have attempted to raise the cigarette tax and extend any kind of tax to OTP, even a small tax, if necessary, to be raised even higher at a later date. These attempts have not been successful, not because of the so-called monolithic “Big Tobacco,” but because legislators understand the unintended consequences of what passing such a tax would really mean.

In Pennsylvania, any legislation to enact new taxes must make sense. For example, it makes no sense to tax a product like pipe tobacco which has decreased in sales by nearly 60% in the last fifteen years or cigars which saw their hey-days in PA decades ago.

As an association executive who has observed the workings of the Pennsylvania legislature for many years, I have found that it is very rare when an issue is absolutely “black-and-white” and where there is not some sort of compromise. That compromise occurred decades ago and each year since, when, in the wisdom of the legislature, a policy decision was made not to tax cigars and smokeless tobacco or other OTP.

Reasonable people should always be governed by reasonable officials who make reasonable judgments based upon a reasoned assessment of those facts that culminate in a reasoned public policy. Those reasonable officials years ago, like the ones who should be representing us today, saw that cigars were a PA product whose saleable units have decreased over the years and would be a poor commodity to burden with taxes. So, too, for smokeless tobacco, which, along with the little cigars produced in this state, are consumed by people of lesser income or retirees on limited income.

HAS SOMEONE DECLARED WAR?

A tax on tobacco, any tax, would exacerbate to the point of business ruin, what happened a mere half-dozen years ago.

The 2002 Cigarette Tax Hike:

- **Hit** the 10,400 PA retailer and wholesaler jobs directly involved in-state tobacco sales. Directly and indirectly, the tax cost 1700 jobs.
- **Sent** more than 15% of all cigarette sales to the Internet and made wholesalers and retailers vulnerable to cross-border sales to lower tax states. Wholesalers report taxable sales losses of between 15% and 27% in border areas. This tax hike reduced taxable sales by our licensees by about 18% for FY 2003.
- **Cost** the state more than \$190 million in lost collectible excise taxes.
- **Volume.** Cigarette volume has fallen from 120 million cartons in 1998 to less than 77 million cartons currently. Cross-border, mail-order and Internet companies and Indian reservations thank you.
- **Gross profits lost** to PA wholesalers and retailers have been about \$220 million.
- **Convenience-store** cigarette sales fell by 110 million packs. On average, C-store losses were about \$120,000.00 in cigarette sales, plus about \$34,000.00 in sundry sales. Gross profit losses average about \$22,000.00 per store.

- **Stamping Agent** costs for bonding have risen more than 200% with the tax increase, putting some licensees at risk.
- **Banks** were and are reluctant to extend more credit to stamping agents and wholesalers due to the increased risk in undertaking the business.
- **Security Costs.** The higher value of the product makes it a ready object of employee theft and hijacking. Already the wholesaler is delivering the product in unmarked trucks.
- **Property and Casualty insurance costs** have gone through the roof; to pay the insurance, employees have been let go.
- **According to a 2005 Bureau of Labor Statistics** report, the annual expenditures on tobacco were \$582.00 per consumer unit for construction workers and mechanics, \$482.00 for operators and laborers, and \$377.00 for service workers. By contrast, tobacco expenditures for managers and professionals were \$251.00. There is a 131% difference between the white collar manager and the blue collar construction worker... a discrimination that will only be worse if a cigarette tax is passed, not to say how bad it would be to extend a tax against OTP, which has been the province of blue collar workers, the elderly and retired for years.
- **Let's be clear:**

**THE NEW TAX PROPOSALS ON CIGARETTES, CIGARS,
SMOKELESS AND OTHER TOBACCO PRODUCTS WILL REPLICATE**

AND EXASPERBATE THE FINANCIAL FIASCO YOU IMPOSED UPON US LAST TIME!

Having placed the tax issues somewhat in perspective let me suggest that the problem looms even larger than just a PA tax. The Federal government is in the process of passing, with President Obama's promise to sign, a radical extension of the Children's Health Insurance Program, funded by an outrageous tax on all tobacco products. Without commenting on the need to assure the health of our children, consider what this funding source amounts to...

For many tobacco manufacturers, stamper/wholesalers, and those selling to the consumer, the biggest problem with the SCHIP bill is that it puts a national insurance program on the back of a struggling industry, one that has seen a decline in cigarette sales at a rate of 2% to 4% per year. Yet the SCHIP funding requires, in the case of cigarettes, a 61-cent increase, from 31 cent per pack to one dollar, meaning that the federal tax on cigarettes will go from \$3.90 per carton to \$10.00 per carton. It is highly likely that such a "small tax increase" will result in a decline in sales that could accelerate from the current 2-4% per year to 6-8% per year.

Tobacco as a whole is becoming, if it has not already become, an unstable and unreliable source for funding government as a whole or for ear-marking for any program in particular.

With this new federal tax in place, there is no doubt that the manufacturers will scramble to scoop up the dwindling sales for their own product brands, causing a war which will see many distributors and retailers fall by the wayside.

I am told that the federal law increases the roll-your-own tobacco tax increase to \$23.53 per pound. The federal tax alone, without any Pennsylvania tax, will kill the roll-your-own business, a source of gross profit for my members.

Ron Tully of the Council of Independent Tobacco Manufacturers of America released a statement about a week ago calling for federal legislators to reconsider their position on the RYO tax rate.

Tully said, "Specialty roll-your-own manufacturers will be forced to close their doors, specialty wholesalers and retailers who focus on these types of products will go out of business, unemployment lines will expand, states will lose vital excise tax and MSA revenues, and the SCHIP program itself may have to expand further to accommodate 10,000 new client families." He was talking about the families who work in the roll-your-own business.

This federal tax increase, even before you as Pennsylvania legislators consider a state tax proposal, has caused undeserved anxiety among my members, even to the point of one member saying it would be better if government simply banned tobacco products rather than taxing it to a slow and excruciating death, and with it the small businesses who have served their customers over the years. And to heap insult onto injury, these small businesses, due to the long-term financial outlook for them and their product, are not even viable entities to be sold out to competitors. I have some members simply waiting for other small distributors to hit the financial wall, at which point they will pick up the pieces for nothing. "Why buy the business when I'll get what's left over for free next year," a member told me recently.

And as to a state tax, it has become apparent that the hue and cry by some legislators about the need to tax a product with such deleterious effects on people and to which the poor masses have become addicted is merely a gloss for the reality: it is not the point that consumers are addicted to tobacco, it's that the legislators have become addicted to the revenues and will use any ploy available to continue the assault on the product.

Part of this ploy has been to decry the "unfairness" of a cigarette tax when other tobacco products go untaxed. Besides the so-called "unfairness," it is pointed out that so many other states tax OTP, why not us? It goes without saying that such "logic" could only be sanctioned by a mind of questionable depth. The fact that "others do it" is not reason to undertake an action. It is akin to the logic used when I was in college and a fellow student castigated me for my criticizing his use of heroin. "Don't knock it unless you've tried it," was his retort. I don't know...I've never tried suicide, and I still knock that.

And as to the so-called "loophole" ploy to ease one's conscience in demanding this other tobacco products tax.... Supporters of a new tax on OTP have said that taxing cigarettes and not OTP is a "loophole." The sales pitch is that we are not putting on a new tax, we're merely closing a "loophole."

What about the myriad of "loopholes" in the state sales tax system? If I recall correctly, during the huge-deficit/tax increase period of the early 1990's, there was a proposal to extend the sales tax to all commodities and to sales of services. I recollect that the amount to be collected would

be in the billions. But there was no stomach for that. They were loopholes, but they were acceptable loopholes among “polite society,” which I gather from the tobacco tax enthusiasts, we are not.

As I stated earlier in my testimony, there have been reasons over the years not to tax these products, and one of the most obvious is that there isn’t enough money in it to overcome the economic harm to be created by passing the tax.

Again, consider the tax-equity argument:

Let’s take a product, beer, for example.

Imagine a person standing in front of 50+ cases of beer holding one carton of cigarettes. Under present law, you’d have to drink those 50+ cases of beer before you’d equal the tax on smoking one carton of cigarettes. You tax a carton of cigarettes in excess of 50 times more than one case of beer. Increasing the tax on cigarettes will only add another dozen or so cases of beer to the picture... is that equity?

Extending this to snuff and chew, consider the governor’s proposal over the years: at a 30+ cents per ounce tax on OTP while there is currently less than 1 cent on a can of beer, the beer “loophole” would have OTP being taxed at more than 300 times the same amount of beer.

And consider... while I am not asking you to tax alcohol, when was the last time someone excessively smoked or otherwise used tobacco and got in his car had had an accident... something which happens much too frequently with alcohol users.

Of course, I have been told that this is a tax the governor wants. Well, I can’t lie down simply because the governor wants this.

He is doing what he feels he must do; he feels he is right, we feel we are right.

The only problem for us is.... he is the governor and we are not.

That is why we have come to you for help.

To conclude, passing any tax on tobacco, be it cigarettes, cigars, snuff, chew, roll-your-own or any combination therein, would not only be ill-advised in this economically uncertain climate, but, given the certain disaster looming with the federal SCHIP action, any tax by Pennsylvania would be totally irresponsible.

Thank you for your time.