



TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

States' Growing Interest in "Sins" Despite Shrinking Sin Tax Revenues

National Tax Association
49th Annual Spring Symposium

May 17, 2019

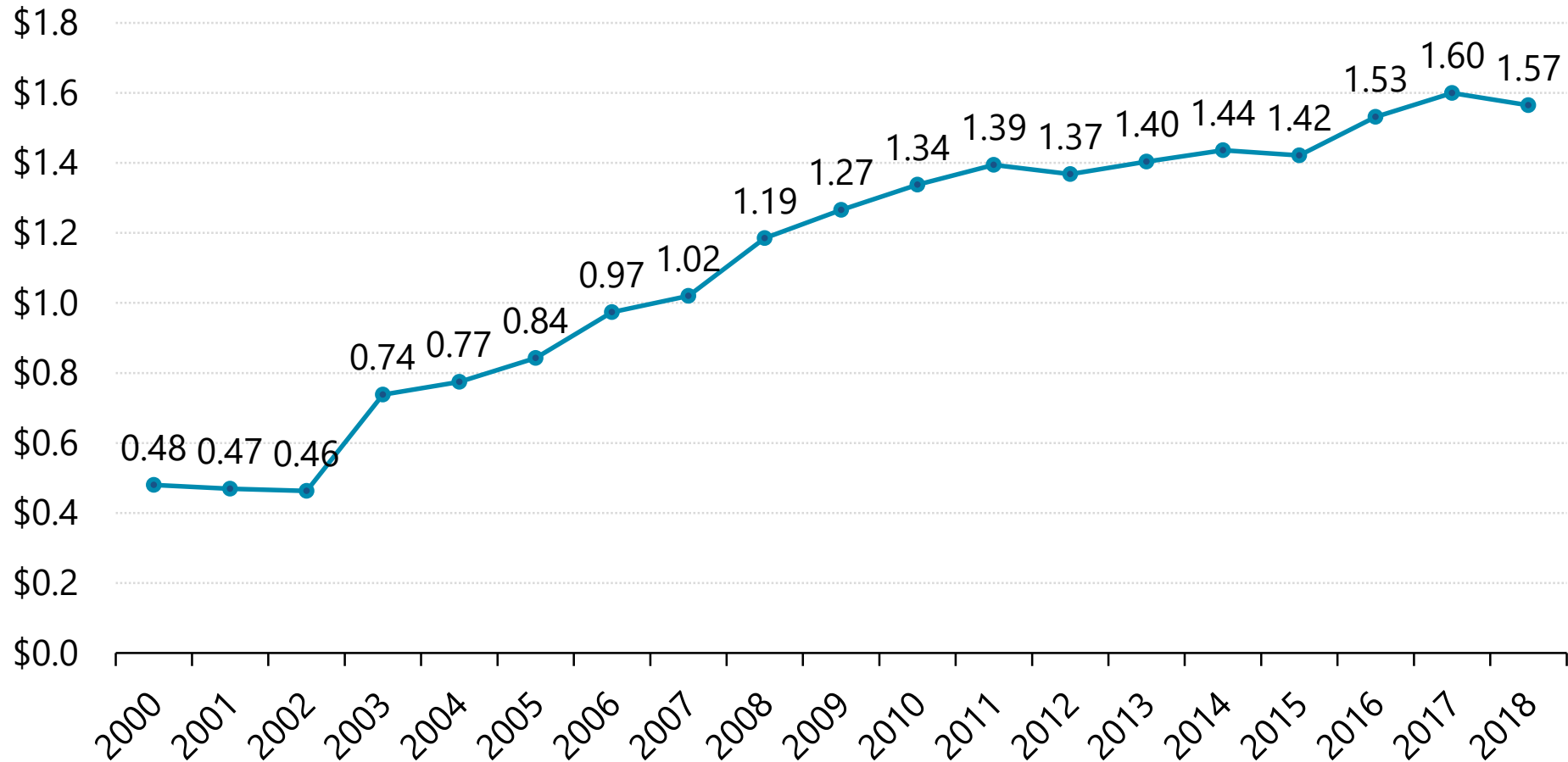
Lucy Dadayan and Richard Auxier

Cigarette / tobacco taxation

- 1864 – Federal government enacted cigarette taxes as a Civil War revenue measure
- 1921 – Iowa became the first state to enact state-level cigarette excise tax
- States levy tax on cigarettes, as well as other tobacco products.
- Some local governments in six states — Alabama, Illinois, Missouri, New York, Tennessee, and Virginia — also levy tax on cigarettes.
- There are large tax disparities among various tobacco products (i.e., cigarettes, roll-your-own tobacco, small cigars, large cigars, pipe tobacco, etc.) as well as across states or even within the states, which trigger market shifts and tax avoidance.

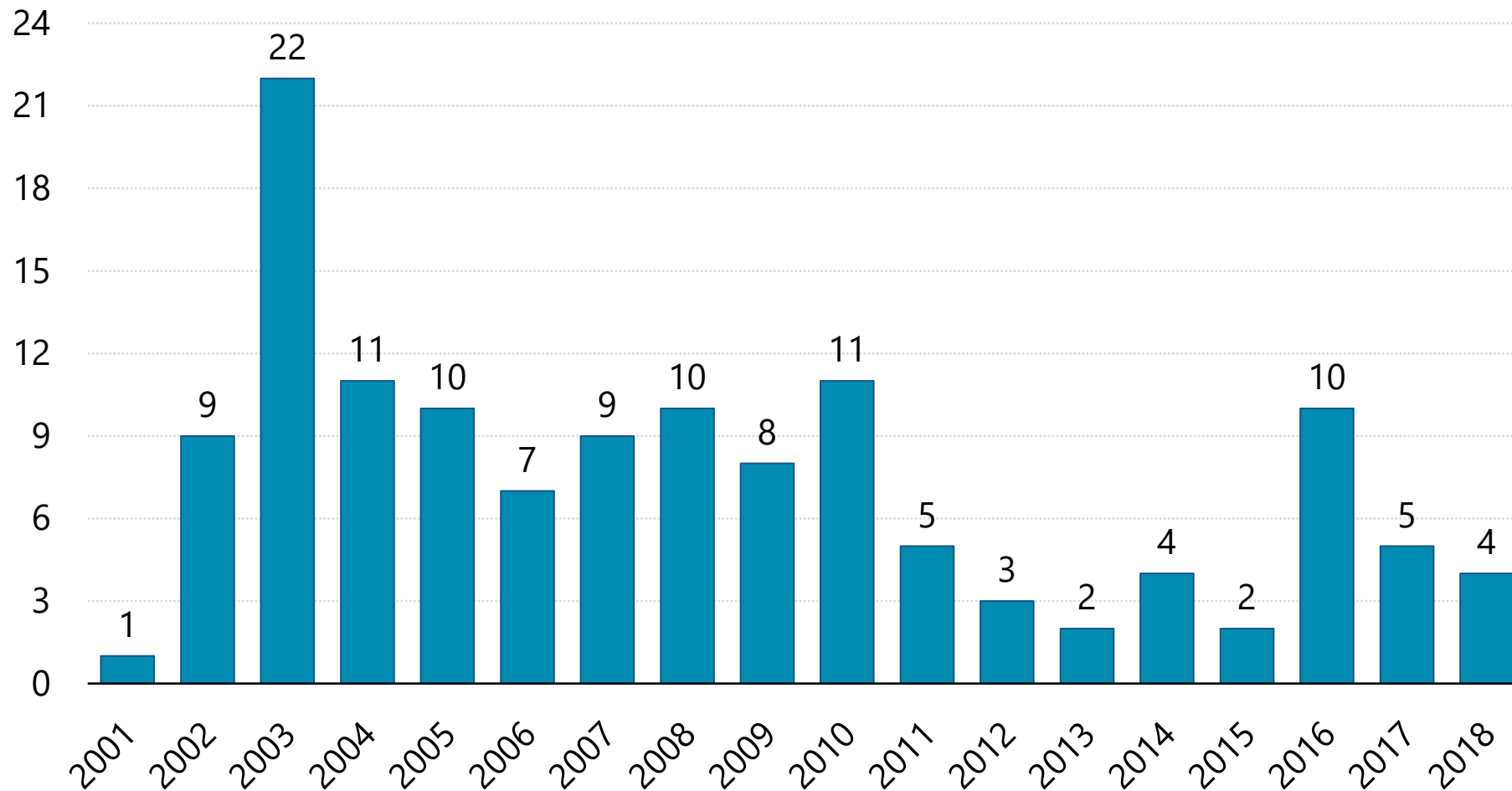
Substantial growth in median state cigarette tax rates

Median state cigarette (pack of 20) inflation-adjusted tax rate



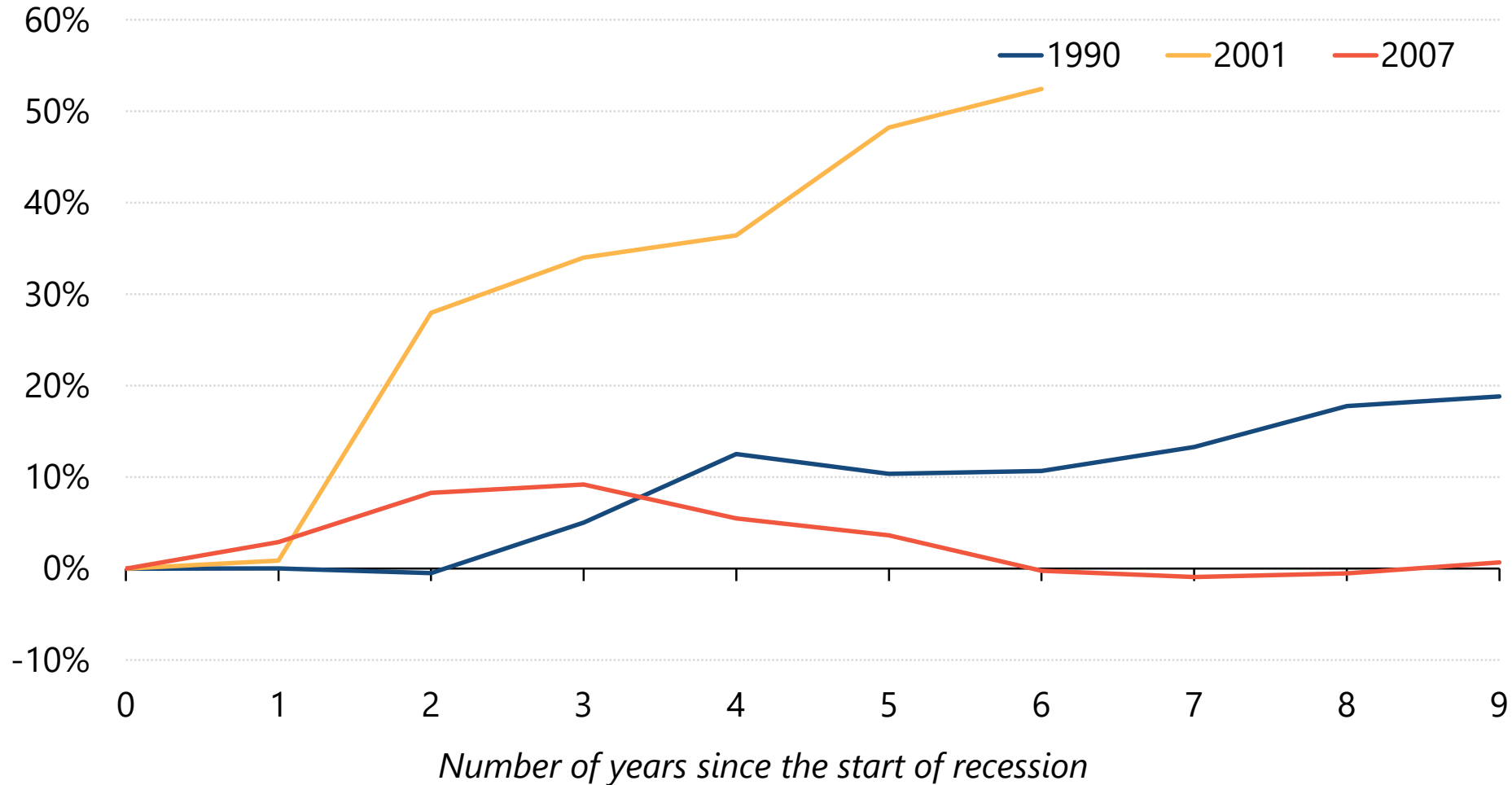
States often increase cigarette tax rates, particularly during economic downturns

Number of states increasing cigarette tax rates



Downward trends in state tobacco tax revenues

Cumulative percent change in inflation-adjusted state tobacco taxes

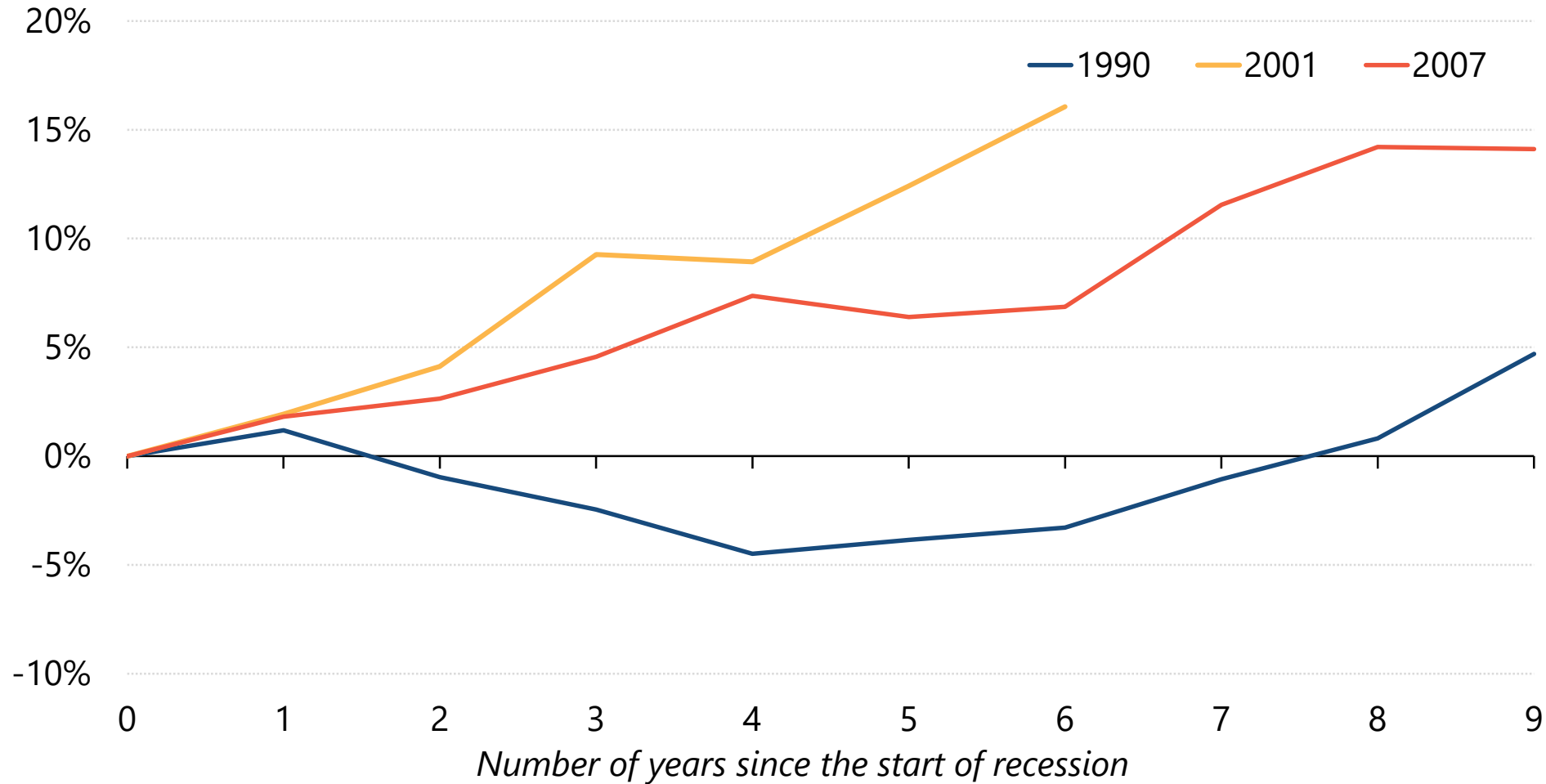


Alcohol taxation

- Alcohol tax has a long history dating back to the 18th century when Alexander Hamilton, the first secretary of the Treasury, proposed the whisky tax.
- 33 states regulate the alcohol industry through license systems, and 17 states have a monopoly system of regulation. These systems have very different implications for tax revenue.
- License states allow private enterprises to buy and sell alcohol at the states' discretion and generally collect liquor-related revenue through excise taxes and license fees.
- Monopoly states usually control the sale of distilled spirits and, in a few cases, they also control wine. The monopoly states generally obtain revenue from markup on sales of liquor in state-run stores, but also may impose liquor taxes.

Steady growth in alcohol revenues since 2008

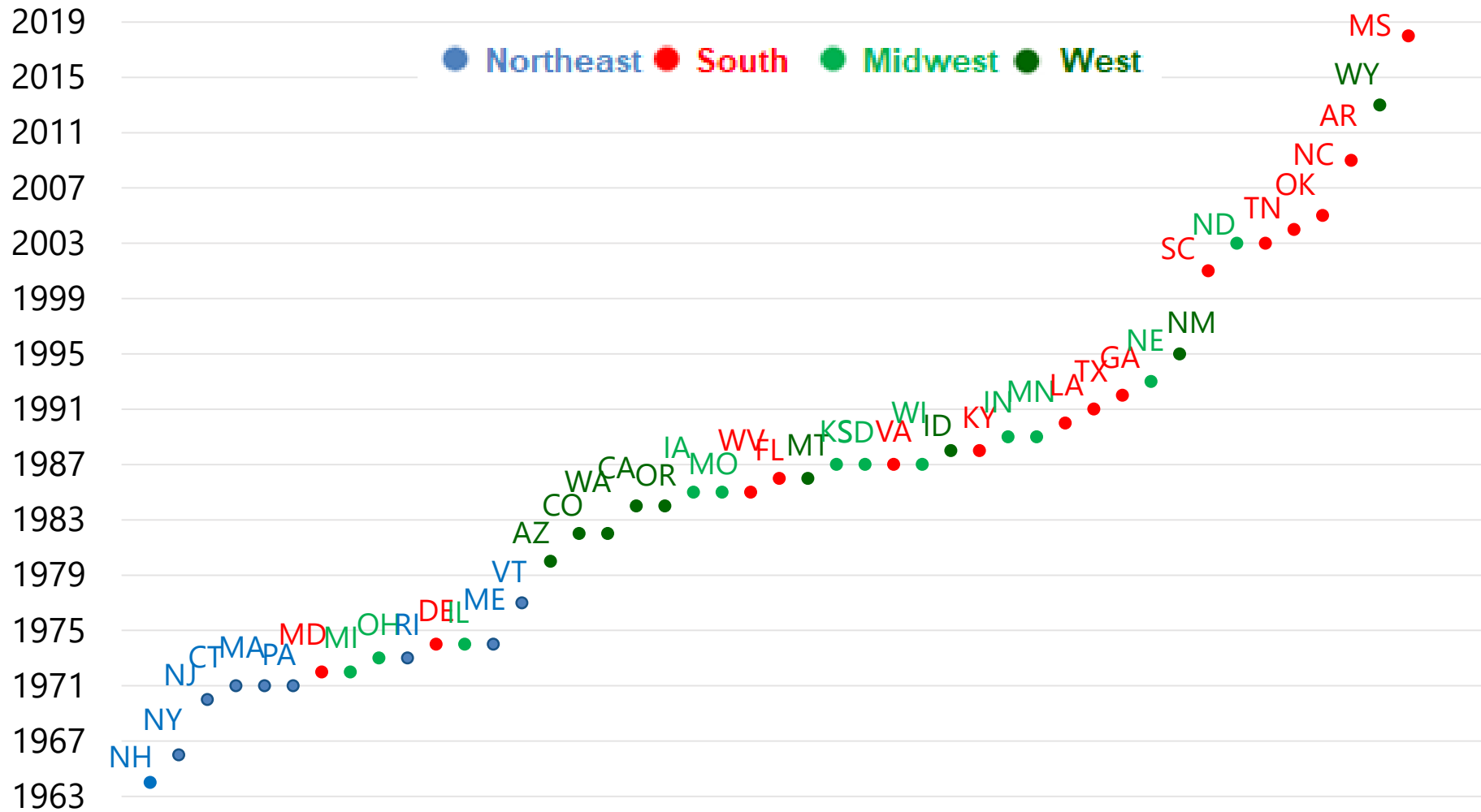
Cumulative percent change in inflation-adjusted alcohol taxes and liquor store revenues



Why do states legalize and expand gambling?

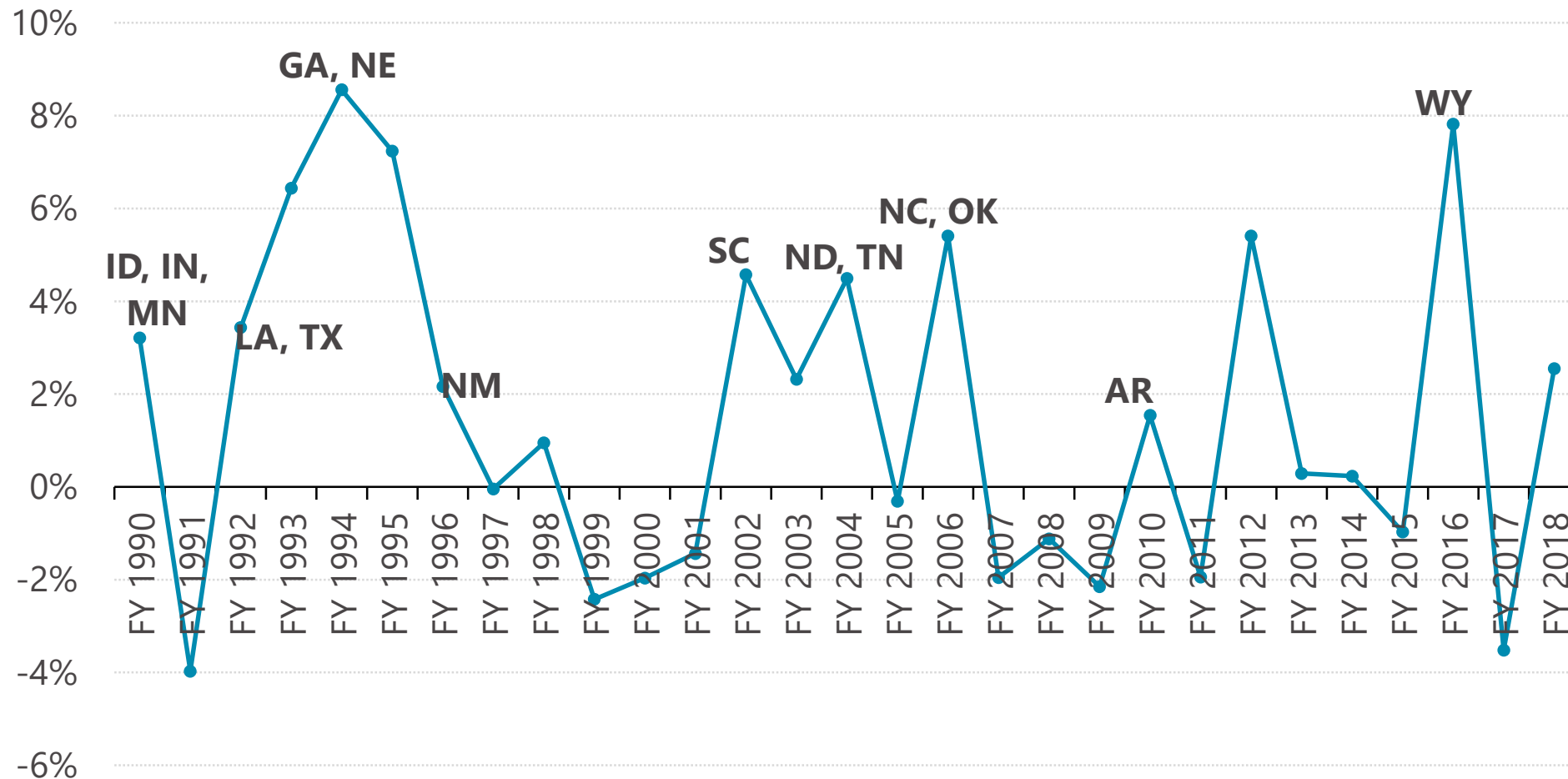
- Raise revenue in response to poor state fiscal conditions
- Stimulate economic development
- Counteract interstate competition for gambling revenue
- Attract tourism & keep gambling residents & tax dollars in-state
- Alignment of political interests in support of gambling

Lottery timeline

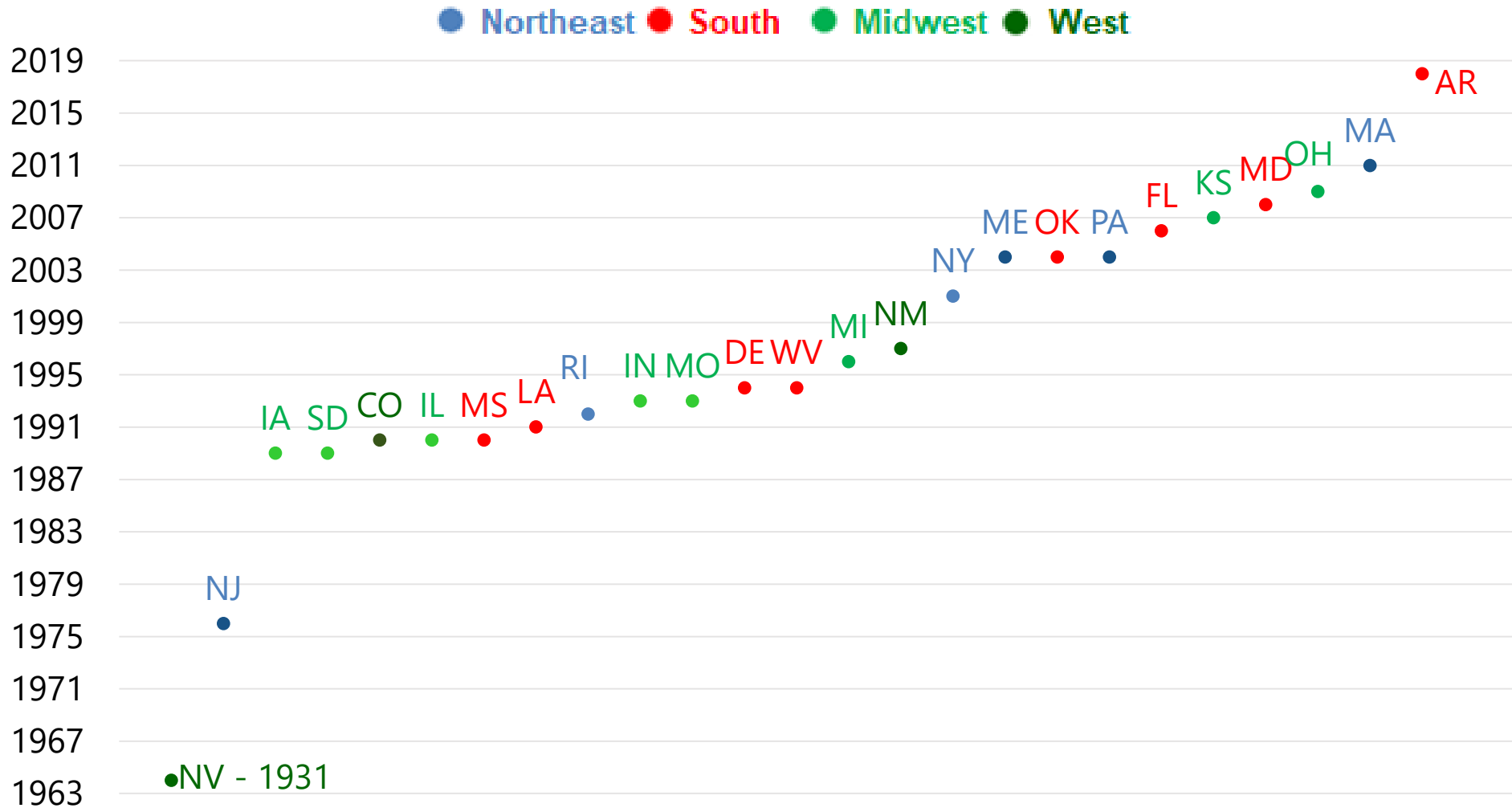


Growth in lottery revenues is often driven by expansion

Year-over-year real percent change, FYs 1990-2018

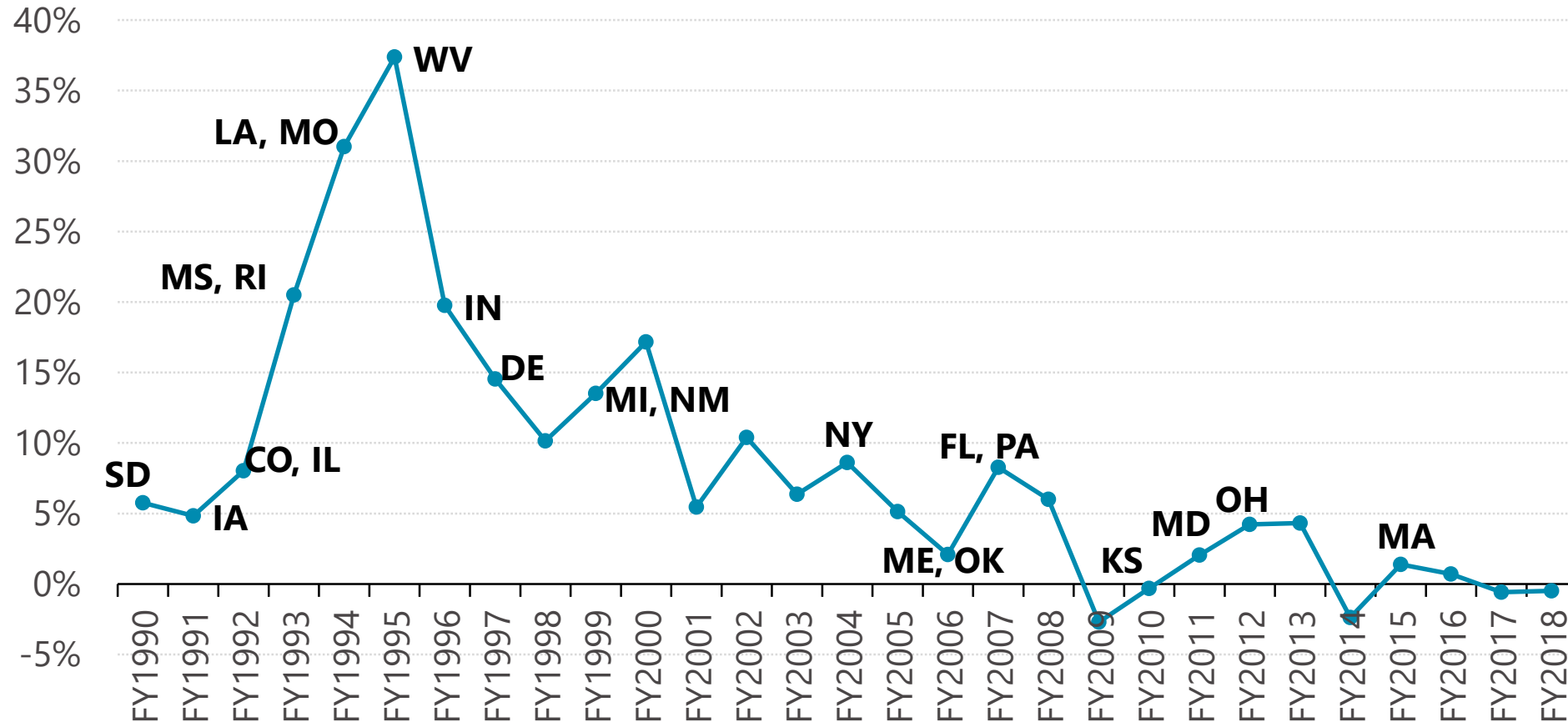


Casinos / racino timeline



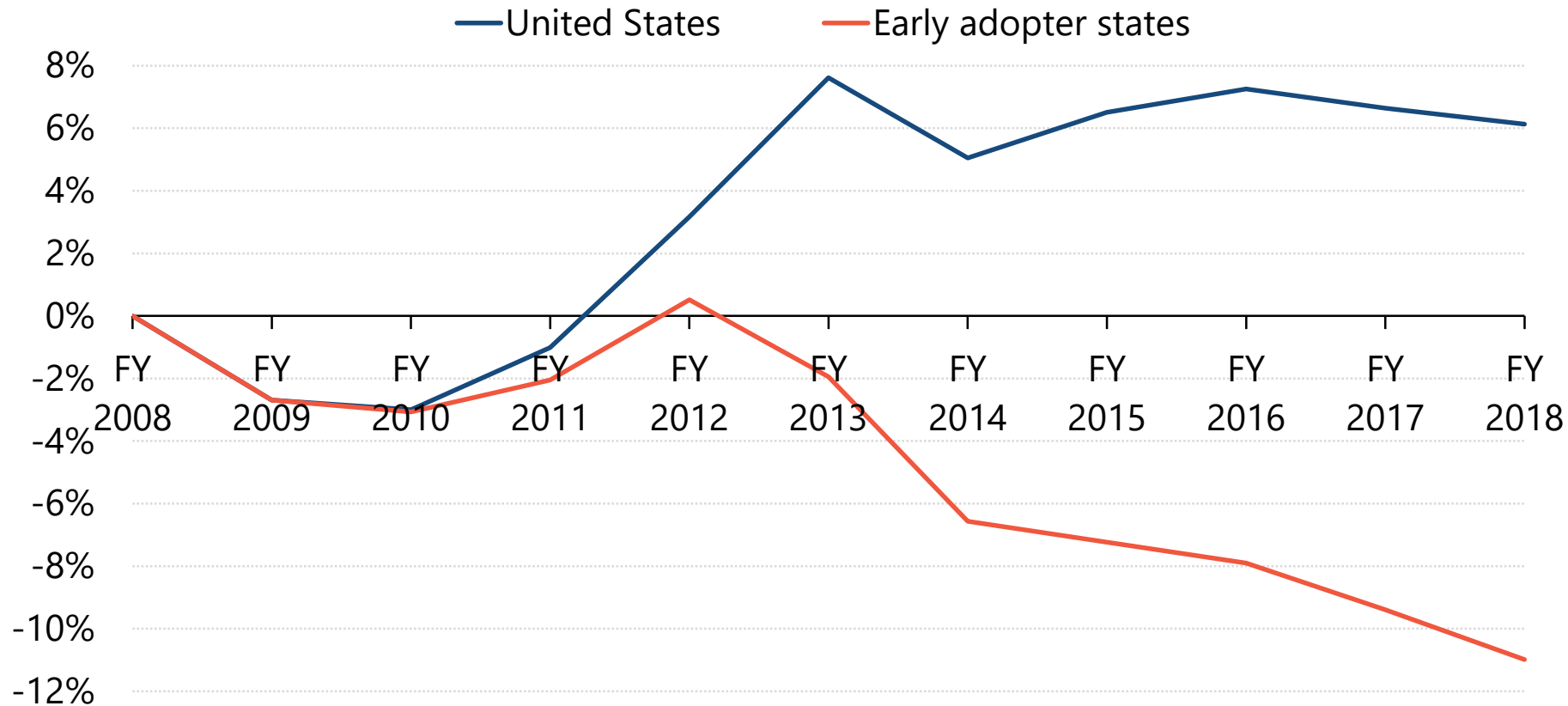
Not much growth in casino/racino revenues despite expansion

Year-over-year real percent change, FYs 1990-2018



Steep declines in casino/racino tax and fee revenues in early adopter states

Cumulative percent change in inflation-adjusted casino/racino tax& fee revenues



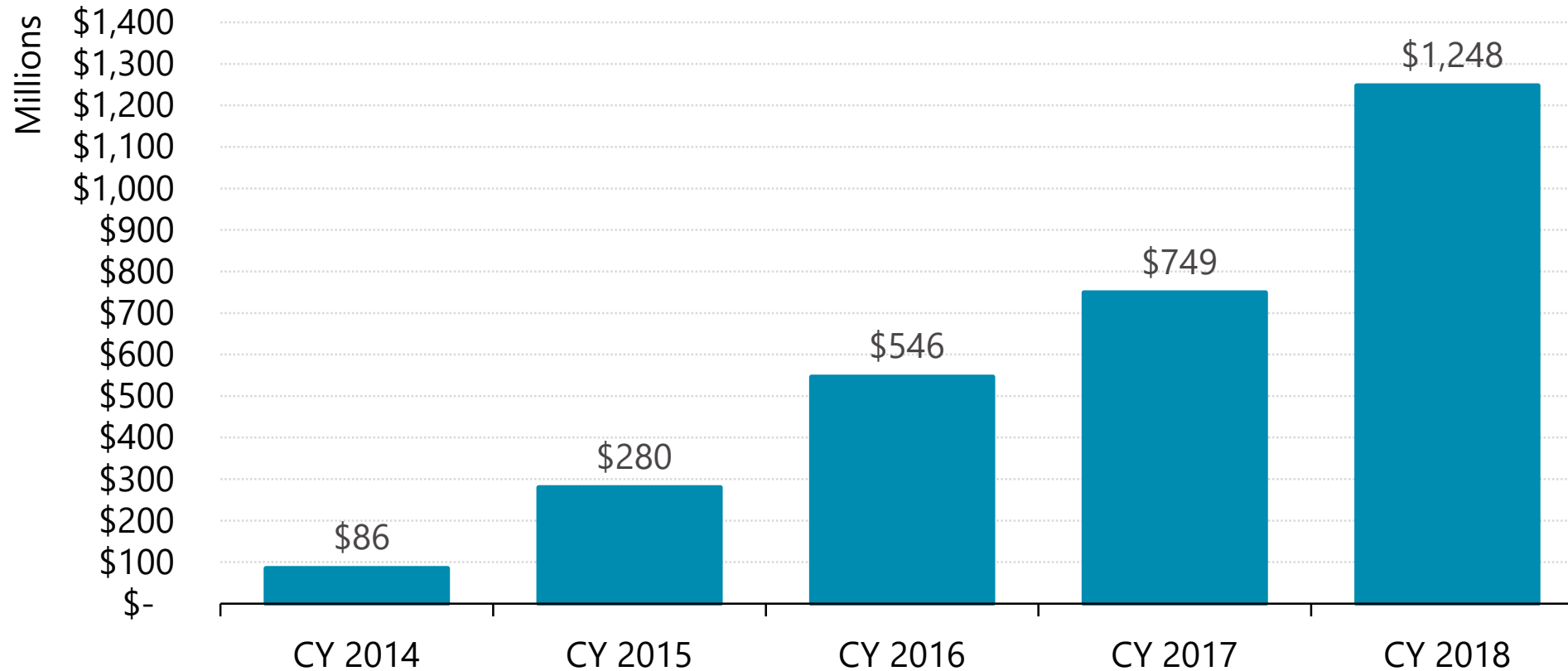
Notes: Four states - Kansas, Maryland, Massachusetts, and Ohio - are identified as late adopter states since they all started casino/racino operations after FY 2008.

Lessons from gambling revenues: Short-term relief, long-term disappointment

- Gambling is **NOT** recession-proof
- Gambling expansion brings in more revenue, until a saturation point is reached
- Some new revenue represents a shift, rather than net growth
- Future growth in gambling revenue will not keep pace with tax revenue, or spending
 - If gambling revenue is intended to support part of the overall budget, gaps may emerge in future years
- Gambling is a slow-growing revenue source & not a solution in the never-ending quest to balance the budget

States raised nearly \$3 billion in marijuana tax revenues since inception

Marijuana state tax revenues, inception through end of CY 2018



Notes: Local government tax revenues and license/application fees are excluded.

Recap: Marijuana tax rates and potential tax revenues

- Marijuana taxation is complicated and is evolving as states are gaining more experience and going through the steep learning curve.
- Marijuana in most states is taxed in an *ad valorem* manner, which normally has “automatic” growth potential, as prices rise.
- States should forecast marijuana tax revenues with caution, particularly as more and more states are legalizing marijuana.
- The spread of marijuana legalization means the tourism demand for marijuana will decline while in-state consumption would likely grow.
- The spread of marijuana legalization would likely lead to a substantial drop in wholesale prices, but would also mean higher rates of tax evasion, particularly if states end up with large discrepancies in marijuana tax rates

How taxes on sports betting works

- **Handle:** Amount of money wagered on sports.
 - Nevada's handle in 2018 was \$5 billion
- **Gaming revenue:** Money the sportsbook collects from wagers after paying out successful bets (but before it pays expenses and taxes).
 - Nevada's gaming revenue in 2018 was \$301 million
- **Hold:** Gaming revenue divided by the handle.
 - Nevada's hold in 2018 was 6.01%.
- **Tax revenue:** Nevada had a 6.75% tax on gaming revenue (all states tax gaming revenue).
 - Nevada's tax revenue from sports betting in 2018 was \$20 million (or 0.4% of all wagers).

What states offer and tax sports betting

TABLE 1
Sports Gambling Tax Rates

State	Tax rate
Arkansas	13% (first \$150 million) 20% (above \$150 million)
Delaware	43.75%
District of Columbia	10% on private operators DC Lottery collects revenue minus expenses
Indiana	9.5%
Iowa	6.75%
Mississippi	12%
Montana	Montana Lottery collects revenue minus expenses
Nevada	6.75%
New Jersey	9.75% in-person bet 14.25% online bet
Pennsylvania	36%
Rhode Island	51%
Tennessee	20%
West Virginia	10%

Source: State websites and legislation.

Revenue from sports betting: Estimates (and political promises) vs. reality

Sports Betting Tax Revenue Millions of dollars

State	Months of reported collections	Tax revenue collected	Annual projection
Delaware	10	\$6.0	\$5
Mississippi	8	\$3.1	\$5–10
Nevada	12	\$20.3	NA
New Jersey	10	\$20.0	\$12–17
Pennsylvania	5	\$4.5	\$5
Rhode Island	5	\$0.7	\$23.5
West Virginia	6	\$0.9	\$5

Sources: State gaming and lottery reports and the University of Nevada Las Vegas Center for Gaming Research. See appendix A for each state's regulatory agency. Representatives from Delaware and Rhode Island provided additional information.

Thank you!

Lucy Dadayan

LDadayan@urban.org

@lucydadayan

Richard Auxier

RAuxier@urban.org

@richardcauxier

URBAN INSTITUTE

Tax Policy Center

State and Local Finance Initiative