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## Memorandum

**Date:** February 11, 2025

**To:** Members of the North Dakota House Finance and Taxation Committee

**From:** Adam Hoffer, PhD, Director of Excise Taxation, Tax Foundation

**Subject:** North Dakota HB 1570 Regarding Excise Tax Increases on Tobacco Products

House Bill 1570 would increase excise taxes on tobacco products in North Dakota, including cigarettes, snuff, electronic nicotine delivery systems, and all alternative tobacco products.

HB 1570 specifically proposes to:

- Increase the excise tax on cigarettes from \$0.44 per pack to \$1.53 per pack
- Increase the tax on snuff from \$0.60 to \$1.96 per ounce
- Increase the tax on chewing tobacco from \$0.16 to \$0.52 per ounce
- Impose a tax on alternative tobacco products including electronic smoking devices at the rate of 56 percent of the wholesale purchase price

Some of the revenues from these tax increases would be directed to a new tobacco tax distribution behavioral health fund. Unfortunately, excise taxes, particularly those applied to a shrinking tax base, are a poor policy solution to fund unrelated programs or general revenues. Excise taxes constitute a volatile source of tax revenue; revenues from excise taxes tend to decrease over time while revenues needed for government services tend to grow.

A tax increase on cigarettes is likely to increase revenue in the short term. North Dakota's fiscal analysts estimate an increase of roughly \$50 million per year in the first two years. Tax Foundation calculations largely support this estimate. The additional revenue generated from the higher cigarette tax rate will decrease each year, however, as the number of smokers continues to fall. Higher tax rates are also likely to induce more smuggling and illicit trade.

These excise taxes would also be regressive, disproportionately impacting low-income North Dakotans.

Simply because a tax is regressive, however, doesn't mean it should not be levied. Most consumption taxes are regressive, but they still have a role in a broader system of tax and

transfers that is almost invariably highly progressive. Best practices for tax policy usually include a mix of both progressive and regressive taxes that provide a stable source of revenue but minimize market distortions and the tax burden on the poor.

While most excise taxes are regressive, taxes on tobacco are the most regressive excise tax the Tax Foundation has studied.<sup>1</sup> In North Dakota, households in the lowest quintile already face an effective tax rate that is six times greater than the effective tax rate of households in the top three income quintiles.

**Table 1. Effective Tax Rates on Cigarettes Across Income Groups in North Dakota**

| <b>Income Group</b> | <b>Effective Tax Rate</b> |
|---------------------|---------------------------|
| 0% to 20%           | 6.0%                      |
| 20% to 40%          | 2.0%                      |
| 40% to 60%          | 1.0%                      |
| 60% to 80%          | 1.0%                      |
| 80% to 100%         | 0.0%                      |

Source: Adam Hoffer, “Compare Tobacco Tax Data in Your State,” Tax Foundation, May 24, 2023, <https://taxfoundation.org/data/all/state/tobacco-tax-data-tool/>.

Higher tax rates on smokeless tobacco and alternative tobacco products also go against recommendations from both Tax Foundation and the US Food and Drug Administration. Products that allow users to consume nicotine via methods other than combustible cigarettes are substantially less harmful to consumers. To encourage users to switch from combustible cigarettes to less harmful products, Tax Foundation recommends a preferential tax rate for these products, reducing rates between 50 and 100 percent based on how much less harmful these products are and whether cigarette smokers are willing to switch.

Legislatures are charged with the difficult task of striking the right balance: they often simultaneously seek to discourage the take-up of products by non-smokers, encourage harm reduction with smokers switching to vapor products, and raise enough revenue to fund public programs. As you consider these matters, we are happy to be a resource and would be delighted to provide you with more research on this topic. Thank you for your time.

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<sup>1</sup> Adam Hoffer, “Global Excise Tax Application and Trends,” Tax Foundation, Apr. 7, 2023, <https://taxfoundation.org/research/all/global/global-excise-tax-policy-application-trends/#regressivity>.