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DRAFT II

SOFT DRINK TAXATION GUIDE AND HANDBOOK

May 31, 1984

I. INTRODUCTION

Soft drink excise taxes are a major, growing problem for the industry. This "how to" guide provides direction for handling the problem in a systematic and timely way.

The information found here will equip state associations with tools to fight any proposed tax on soft drinks. The soft drink industry has a sound, winning, case to present elected officials and the public. This guide identifies these arguments and shows how they fit into a comprehensive strategy to support the industry.

II. BACKGROUND

Ironically, the recent popularity of state soft drink excise taxes flies in the face of historical experience. Proponents dismiss past experience that excise taxes are inefficient revenue raisers. Since

1948, excise taxes have dropped from 38 percent to only 17 percent of all state revenues.

The experience with soft drink excise taxes is a clearly unprofitable one for a number of reasons:

- The burden of an excise tax places local firms at a competitive disadvantage with out-of-state firms. An excise tax causes sales to drop and tax revenue estimates to fall short.

- The excise tax is very regressive, taking the biggest bite out of the smallest pocketbooks.

The current push for soft drink excises makes little sense in the light of the general trend away from such taxes.

PRESSURE ON THE STATES. Much of the cry for state excise taxes on soft drinks stems from budgetary pressures induced by reductions in federal aid and the shift of numerous federal programs to the states. The massive federal deficit places enormous political pressure to cut state aid even further and to find new revenue sources.

It is unlikely that Congress will revert to its 1970's practice of sending billions of dollars each year to finance state and local governments. Economic pressures on both state and federal governments make the soft drink industry an inviting target for new revenues.

Since the early part of this century, the industry has faced threats of special levies applied solely to soft drinks. It has successfully prevented imposition of most excises, but the battles are becoming more frequent and increasingly more difficult to win.

FEDERAL EXPERIENCE. The federal government first imposed excise taxes on soft drinks during World War I as part of a larger effort to provide revenues for the war. Such taxes, modified after the war, were repealed in 1924. Similarly, a 1932 tax passed as part of a measure to meet rising budget deficits was repealed in 1934. During the war years of 1941, 1942 and 1943, Congress considered and subsequently rejected proposals to enact a soft drink excise tax.

STATE EXPERIENCES Over the years, many state legislatures considered soft drink taxes, and the overwhelming majority rejected them. Ohio, Kentucky and Pennsylvania enacted and later repealed soft drink excise taxes. Today, only North Carolina, South Carolina, West Virginia, Louisiana and Nevada levy excise taxes on soft drink products. (See Appendix A for specific provisions of these laws).

Other states, including Missouri, Tennessee, Virginia and Rhode Island, impose taxes on soft drink manufacturers which are not considered "excise" taxes. Missouri's tax is an inspection fee, and Tennessee taxes gross receipts of the manufacturer. "Litter taxes" in Tennessee, Virginia and Rhode Island fund a variety of anti-litter programs.

III. HOW AN EXCISE TAX PROPOSAL EMERGES

The soft drink industry has never objected to paying its fair share of taxes to finance government services. It seeks no special favors or exemptions, requesting only the same treatment and consideration given all businesses operating in the state. __ states currently levy a broad-based sales tax on food and groceries, and the industry expects no special treatment apart from that given other food products.

Most excise tax proposals emerge for purely financial reasons. Facing the prospect of budget deficits, state governments turn to numerous revenue options to fill the gap. Excise taxes on soft drinks appear more and more in state tax increase proposals.

Insert Table 1: Taxes Paid by Kentucky Soft Drink Industry

EARLY WARNING SIGNALS. A red warning light should flash if projected tax receipts are insufficient to balance the state budget in the coming fiscal year. Since states are prohibited constitutionally from incurring deficits, even a slight downturn in the national or regional economy forces elected officials to explore new revenue options.

The shift in spending responsibilities from federal to state governments is reflected in excises. Older, industrial states use excise-generated funds to finance economic development programs. Many states, especially in the South, greatly expanded their financial commitment to public eduction. A West Virginia excise tax, for example, is earmarked to support the state university medical school.

Changes in the state tax code, by either the state or federal government, impact state revenue needs. A state referendum restricting the ability to raise taxes can affect local taxing authorities as well. Cities, counties and school districts find themselves unable to raise sufficient revenues to provide basic services such as police, fire and education. The state usually compensates for these lost revenues thorough increased funding for its local government units. Proposition 13, for example, forced California to assume the entire cost of local welfare payments and a much higher level of state aid to school districts.

Any referendum restricting broad-based tax increases or the taxing power of local governments increases pressure for excise taxes of all kinds.

Aside from government budgetary concerns, there is an argument that excise taxes be used to extract payment from those who impose a cost on society. For example, a tax on soft drinks in California was proposed to raise funds for a dental screening program for elementary students. In Virginia, Tennessee and Rhode Island, this reasoning has been applied in litter control taxes on soft drinks.

HOW THE PROCESS WORKS. "The tax bill that is easiest to beat is the tax bill that isn't introduced."

A common mistake of industries concerned with state tax matters is failure to respond to early warning signals in the budgetary process. This process does not begin when the legislature convenes; many decisions are made months in advance.

It is useful to consider the budgetary process in two stages:

- o Stage I involves the initial deliberations leading to the usual January submission of the state budget by the governor.
- o Stage II involves the actual legislative consideration of the proposed tax package.

Stage I (October-January). The three-month period preceding the January submission of the state budget, during the initial deliberations in the governor's office, is the best time to beat a tax increase. The key official involved is the governor's chief political/financial advisor (an executive staff member or the agency head responsible for financial matters.)

Although the governor's key legislative allies often participate in the initial deliberations, the legislature usually plays a reactive role after the budget is submitted.

Stage II (January - Adoption of a State Budget). After January, the effort shifts from the governor's office to committee hearings and the floor of the state legislature. The legislature will either pass the governor's tax package, ignore the governor's tax hike request, or develop its own tax increase package.

Central players here are revenue committee chairmen in both the House and Senate, key committee members and committee staff, as well as the governor's chief financial advisor.

IV. FACING THE PROBLEM

The consistently proven way to turn back soft drink excise tax proposals is to be thoroughly versed in the issues and to know the facts related to the industry. There are valid arguments against such a tax on every issue that is raised. It is important to develop and tailor these arguments for the special circumstances of each state tax proposal and to deliver them effectively to elected officials and the general public on a timely basis.

The most popular arguments for and against a soft drink excise tax are listed below. (Details on these issues are found in Appendix B).

<u>Soft Drink Excise Tax Issues.</u>

Funding Worthwhile Projects

The Fairness Issue

A Sales Depressant

Health and Nutrition Concerns

Litter Tax

Fair Share

All employees of the soft drink industry should be knowledgable on these issues as they can be effective spokesmen in the community.

COALITION BUILDING. In politics, it is said, there are no friends, only temporary allies. Knowing this and knowing how to build coalitions are the bases of legislative success. Coalition building involves:

- o targeting arguments to diverse groups influential in tax and revenue deliberations;
- o knowing which arguments will persuade them to your side;
- o determining when those groups can be helpful to your case and when you will be competing against them.

The external groups that will influence the final shape of the tax proposal must be identified. These include:

Traditional Business Coalition

Industries Affected (Directly or indirectly) by Soft Drink Excises

Members of State Associations

Vendors

Retailers

Convenience Stores

Restaurants and Hotels

Suppliers

Groups Concerned with Tax "Fairness"

Labor Unions

Organizations Representing Lower Income Groups

It is vital to know when a coalition member is useful and what you have in common. For example, the competitive disadvantage of local distributors is of no interest to a person living on a fixed income. Nor would a restaurant supplier care much about tax regressivity.

Traditional Business Coalition. This group -- including Chambers of Commerce, Associations of Manufacturers and other broad-based industry groups -- is a useful coalition for the soft drink industry when uncertainty exists about whether <u>any</u> tax increase is necessary.

Once a tax increase is inevitable, these groups tend to oppose broad-based and business taxes and usually support excise taxes. They are more willing to let a single industry bear the brunt than for the entire business community to be taxed.

In some states, coalitions of business groups most affected by excise taxes have been formed. In addition to soft drinks, these include distilled spirits, beer, gasoline, tobacco, candy, amusements, cosmetics, restaurants and hotels.

Once the need for a tax increase is established, a coalition of these industry groups can be very influential in supporting a broad-based tax increase instead of a collection of more harmful excises. The overriding concern of these groups, however, is to avoid excise taxes on their own industry's products and services.

<u>Industries Affected by Soft Drink Excises.</u> The most useful and dependable coalition contains all business groups financially affected by a soft drink excise tax. The state soft drink association should take the lead in organizing the political and legislative clout of vendors, suppliers, retailers, truckers and others with strong financial interest in defeating the excise.

<u>Groups Concerned with Tax Fairness.</u> In many states, there are coalitions supporting tax policies based on criteria of "fairness" -- generally opposing excise and sales taxes and supporting broad-based taxes on income and wealth. They are usually funded by organized labor (especially teachers and other government employee unions), and include senior citizens, minorities and citizen activist organizations.

Cooperation with this "fair tax" coalition lends vocal support against excise taxes. In most cases, these liberal/labor groups influence a different set of legislators than the ones normally influenced by the industry.

<u>Communication</u>. To keep any coalition intact and effective, you must communicate and make a real team effort. Keep your allies abreast of your activities and informed of how they can help.

** Insert Table 2 -- Summary of Coalition Building Process**

<u>PACKAGING YOUR ARGUMENTS.</u> To defend successfully aginst a soft drink excise tax, the debate must be conducted on strictly economic grounds. Supporters' attempts to inject health issues or earmark receipts for popular spending programs must <u>not</u> be allowed to dominate the debate. Although the industry can offer satisfactory <u>technical</u> rebuttal, these emotional arguments place the industry on the wrong side of the issue.

The excise tax must be isolated and considered on its own merits as a revenue raiser. A concise, factual presentation of the economic arguments should be made. (Appendix C contains a list of these arguments).

It is very useful to produce an economic impact study -- a basic document presenting these arguments. The entire study can be used with certain audiences while specific elements can be targeted to groups motivated by more narrow appeals. (See Appendix C, "How to Produce and Use an Economic Impact Study.")

V. MEETING THE THREAT

Proposals to finance state government operations through soft drink excises can be defeated with a sophisticated, multi-faceted set of strategies. While continuing and even augmenting its traditional approach in opposing excise taxes, the industry must seek additional allies and use new techniques to influence the new breed of legislators elected in recent years.

The political debate on taxes has shifted from control of a handful of powerful legislative leaders to a more open forum, the general public. In a number of states, major tax questions have been placed on the ballot in election referenda, much like California's

Proposition 13. In other states, legislator's actions have been severely restricted by limits on available tax options. Public opinion is a critical battleground for tax issues of all kinds.

POLITICAL STRATEGY The best way to assure a favorable legislative outcome is to elect individuals sympathetic to the industry's concerns. The following pre-election and post-election activities are the first steps.

Insert Table 3 - Pre-election and Post-election Activities

LEGISLATIVE STRATEGY. The executive branch, as well as the legislature, helps decide the fate of a soft drink excise. Success with either group will stop passage of the tax. Since many important decisions are made concerning the need for a tax increase and the specific elements of a tax package in the weeks preceding the start of a legislative session, the following steps should be taken at the first indication of tax increase consideration by either the governor or key legislators.

Insert Table 4 - Legislative Activities

PUBLIC RELATIONS STRATEGY. The state association should be prepared at all times to take its case to the public. Although this tactic is not always necessary, public officials must recognize it as a viable threat.

Insert Table 5 - Public Relations Activities

VI. SUMMARY

Soft drink excises are a growing threat to the industry. For 75 years, state governments have tried to pass such taxes, although only five succeeded. To continue defeating these excises, the national, state, and local soft drink associations must proceed in a systematic fashion.

- Coalitions must be expanded to gain access to more legislators.
- Arguments must be developed, packaged and targeted to the most receptive audiences.
- Politicians must be held accountable for their voting records. Modern communications techniques must be employed to impact public opinion and, ultimately, influence legislation.

In recent years, soft drink excise tax initiatives have been defeated in West Virginia, Oregon, New Hampshire, Utah and Kentucky.

- In West Virginia, a very poor state, the industry mobilized the minority/labor/poor coalition to defeat a tax using the regressivity argument.
- Oregon earmarked soft drink excise revenues for a jobs programs, but the "competitive disadvantage" argument persuaded legislators against the bill.
- In New Hampshire, where there is no sales or income tax, soft drinks were one of many

excise targets. By responsibly supporting a broad-based business tax, the soft drink industry saw the excise bill defeated in committee.

- In a six-day phone and letter campaign suppporting a broad-based tax increase, the soft drink industry in Kentucky killed a proposed soft drink excise measure.

While it is comforting to be "right" on an issue, it is much more important to be effective in communicating that message to decision makers.

TABLE 1

TAXES PAID BY THE KENTUCKY SOFT DRINK INDUSTRY

Amusement Machine License
Carrier Permits and Certificates
Corporation Income Tax
Corporation License Tax
Corporation Organization Tax
Hazardous Waste Management Assessment
Highway Use Taxes
Weight-Distance Tax
Motor Carriers Tax
Insurance Premium Surcharge
Insurance Premium Tax
Other Agency Licenses
Gasoline Tax
Liquefied Petroleum Tax
Special Fuel Tax
Vehicle Operator Tax
Vehicle Registration
Vehicle Usage Tax
Property Taxes
Retirement Plan Tax
Sales & Use Tax
Unemployment Insurance Tax
Worker's Compensation Insurance Tax

TABLE 2

SUMMARY OF THE COALITION BUILDING PROCESS

A. Traditional business coalition supports issues of general business concern. It includes Chambers of Commerce, industry associations and dominant corporations in the state.

B. The business coalition questions the need for any tax increase and is especially effective in questioning the accuracy of revenue forecasts made by the governor.

C. Once the need for a tax increase is determined, the traditional business coalition disintegrates and it's every man for himself.

D. Industries financially affected by soft drink excises are reliable throughout the process. State soft drink associations should capture the leadership of this coalition.

E. Liberal/labor groups oppose excise taxes and influence different legislators. Whenever possible, the industry should work with these groups.

TABLE 3

PRE-ELECTION AND POST-ELECTION ACTIVITIES

Pre-election Activities

- Establish a political action committee. The advantages of financial support to a legislator's political campaign will provide access.

- Produce a concise economic impact study which lays out the arguments against a soft drink excise tax.

- Organize political education meetings on the tax issue for all bottlers and their employees. Demonstrate how arguments against the excises can be used to gain support of candidates for political office prior to election day.

- Arrange meetings between each candidate for the legislature and bottlers from the same district to seek a formal commitment against the soft drink excise tax. Where appropriate, bottlers should include local union leaders in these meetings, especially in those districts where organized labor support is politically useful.

Post-election Activities

- Meet with legislators shortly after the election to remind them of their campaign position against the excise tax.

- For those legislators who did not make a commitment during the pre-election period, make another attempt to convince them on the issue. Where appropriate, bottlers should involve representatives of other business or labor groups that the legislator views as having played an important role in his/her election.

- Arrange plant tours for legislators.

TABLE 4

LEGISLATIVE ACTIVITIES

- Notify NSDA immediately upon hearing any preliminary speculation about a tax increase -- even if a soft drink excise tax has not been mentioned.

- Determine political pressure points by making a list of the key decision makers in the governor's office, the legislative leadership, and the key staff and members of the tax writing committees of both the House and Senate.

- Establish or work with the three different coalitions that will oppose the soft drink excise tax for widely varying reasons:

  - the traditional broad-based business coalitions that oppose any type of tax increase;
  - the coalition of all elements of the soft drink industry to support some alternative tax increase in order to avoid the soft drink excise; and

  - o liberal/labor groups to make the regressivity argument.

- o Contact legislators and key staff.

- o Encourage all association members and coalition allies to write personal letters to each committee member and the legislator who represents their district.

- o Arrange to testify before legislative committees (See Appendix D for an example of testimony given in New Hampshire.)

- o Set up a broad-based delegation to visit each legislator involved in consideration of the proposed tax. The composition of this delegation can be altered to reflect the political sensitivities of each legislator.

- o Set up a tracking system listing every contact between industry supporters and legislators. Report the legislators' reactions to each personal contact made.

TABLE 5

PUBLIC RELATIONS ACTIVITIES

- Contact NSDA for recommendations on developing a public relations strategy for a specific situation.

- Consider a consumer awareness campaign for promoting the industry position. Components of such a campaign could include the following elements:

  - Paid advertising, including television, radio, print and billboards. (See example in Appendix D.)
  - Media placement activities, including coverage on local news broadcasts, newspaper articles and editorials, and appearances by spokespersons on TV and radio talk shows.
  - Direct mail campaign activities. (See Appendix D.)
  - Production of special brochures, petitions and posters on the excise tax issue for use with selected audiences. (See Appendix D.)

- Special events, such as rallies or demonstrations.

dollar tax on each gallon of syrup. Even though this tax has placed North Carolina bottlers on an unfavorable competitive footing with bottlers in neighboring states, all attempts to repeal the excise tax have been unsuccessful.

South Carolina. In effect since 1925, this tax is levied at the rate of one cent per 12 ounce container. Syrups are taxed at 95 cents per gallon. Initially passed as temporary legislation, it continues in force today.

West Virginia. Since 1951, West Virginia has levied a soft drink tax of one cent on each 16 ounces or fraction thereof and 80 cents on each gallon of syrup. Proposed to finance the construction and operation of a medical school for the state university, this tax is not a likely target for repeal.

States That Have Repealed Excise Taxes

Ohio. Ohio has twice repealed an excise tax on soft drinks, once in 1934 and once in 1982. In 1933, the state legislature imposed a tax of 1 cents per bottle on soft drinks. When the tax failed to produce the desired results, it was suspended. In 1982, the state enacted a new excise tax on distribution of soft drinks. The soft drink industry filed suit on the grounds of discrimination and won.

Kentucky. A tax on soft drinks of one cent for each five cents of retail selling price and 76 cents per gallon of syrup was levied in Kentucky. In the nine months the tax was in force, sales volume dropped 21 percent and sales losses were incurred by machinery equipment and other supply manufacturers allied to the soft drink industry.

Public reaction to the 20 percent levy was quick and unfavorable, and the measure was repealed by unanimous vote of both houses of the legislature. Within 60 days, soft drink sales jumped 33 percent and within a few months 15 new plants were opened and equipment and machinery purchases increased.

APPENDIX B

SOFT DRINK EXCISE TAX ISSUES

1. Funding Worthwhile Projects.

The soft drink tax is an inviting target when seen as a vehicle for providing funds for a politically popular spending initiative. States have proposed to use soft drink tax revenues to finance a veterans' home, raise teachers salaries and other similar purposes. It is difficult to argue against the need for these items and doing so moves the debate away from the merits of the tax as a suitable and "fair" revenue raiser.

The real question is not whether these projects are worthwhile, but whether one segment of the business community or one set of consumers should be singled out to finance them.

QUESTION: The teachers in this state are some of the lowest paid in the nation. How can the soft drink industry object to a small tax to finance a teacher pay raise?

ANSWER: We do not object to a raise or a broad-based tax to finance the raise. We object to being singled out along with our consumers and put at a disadvantage with out-of-state competitors to finance a program that is for the commmon good of all citizens.

2. The Fairness Issue.

The most powerful argument against a soft drink excise tax concerns its regressivity. Simply stated, it takes the biggest bite out of the smallest pocketbooks.

A tax on soft drinks will be paid primarily by parents with children at home and particularly by those with large families. According to market research conducted by Dr. Pepper for the State of Nevada, the percentage of soft drink consumption, broken down by age groups, is as follows:

AGE GROUP	% OF TOTAL CONSUMPTION BY VOLUME
Under 6	3.0%
6 - 12	7.8%
13 - 19	20.0%
20 - 29	24.0%
30 - 39	18.8%
40 - 49	10.8%
50 - 59	9.2%
60 and Over	6.3%

Main Point: 70% of soft drink taxes are paid by individuals between the ages of 20 and 39.

3. <u>A Sales Depressant</u>

QUESTION: If the taxpayer can accept a proposed tax on soft drinks, how can the collector of the tax object?

ANSWER: Very simply, the excise is a sales depressant that hurts the bottler and, eventually, the economy of the state. Soft drink taxes have damaged sales in the few areas where they have been levied. Other effects have been unemployment, loss of business to supplying firms and general discouragement of industrial development.

Insert Chart -- Factory Closings

4. <u>Health and Nutrition Concerns</u>.

QUESTION: What about the drink itself? Shouldn't a product that contains significant amounts of sugar be subjected to a tax levy which can generate some revenues to cover its cost to our society?

ANSWER: In truth, soft drinks contain sugar levels comparable to those of various natural fruit juices. Due to their liquid form, soft drinks

pass quickly through the mouth, limiting contact with the teeth and cavity-producing agents.

Further, the sugar in soft drinks is quickly absorbed into the body, providing almost immediate energy.

Tremendous growth in diet soft

drinks has become an important component in the efforts of millions of Americans to maintain health and body weight. According to many physicians and nutritionists, obesity is the single most serious health problem for Americans.

5. <u>Fair Share</u>

QUESTION: The state and federal budgets are in a bind. Why won't the soft drink industry do its part by accepting an excise tax?

ANSWER: The federal government is running a huge deficit. Every time the economy slows down, states experience even more severe fiscal difficulties because they are not allowed to run budget deficits.

The soft drink industry will pay its fair share to alleviate any fiscal crisis and will support an across-the-board tax increase when necessary.

"No business and no individual has any right to expect that it can escape taxation, but every business and every individual has every right to expect that it will not be singled out for special or punitive taxation."

APPENDIX C

HOW TO PRODUCE AND USE AN ECONOMIC IMPACT STUDY

THE ECONOMIC ISSUES. Although all of the following arguments may not be applicable in every circumstance, each must be carefully scrutinized for its usefullness with potential coalition partners.

- o Does the state really need the revenues? Judge the reliability of the governor's revenue forecast and the political reality of the proposed budget spending items. If general consensus exists that the budget figures are essentially accurate, drop this argument and move to specific consideration of the soft drink excise tax.

- o The soft drink tax is discriminatory and will hurt small business in the state. Business is lost to producers in bordering states. After South Carolina adopted an excise tax, the market share for out-of-state bottlers rose from 10 percent to 22 percent.

- The soft drink tax is regressive as it is primarily by younger heads of larger households. Research conducted by Dr. Pepper showed that nearly 70 percent of total soft drink sales taxes are paid by individuals between the ages of 20 and 39.

  The excise tax is usually a flat one cent per container, not based on income or the ability to pay. The effective tax rate for any soft drink excise is much higher for low and moderate income families, especially those with a large number of children.

- The soft drink tax is an undependable revenue source. The reduction of in-state sales has two effects:

  Reduced volume in sales directly reduces excise tax revenues below what was originally expected.

  As profits of in-state businesses are reduced, tax collections from these businesses, their owners and employees, also drop.

  In order to determine whether a soft drink excise will raise money for the state, public officials must consider reductions in personal income taxes, sales taxes, and property taxes (when a company goes out of business).

- If a state needs additional tax revenues, an alternative revenue-raising package should be proposed. The specific elements in such a package will vary from state to state, but the basic principle should be a broad-based tax increase based on a person's ability to pay.

  This alternative gets the industry off the defensive if funds are earmarked for some popular purpose. In addition, it attracts liberal/labor coalition partners who would support the industry on "tax fairness" grounds, but who are dependent on the increased tax revenues.

HOW TO PRODUCE AN ECONOMIC IMPACT STUDY

- Contact NSDA for guidance on producing a study tailored to the specific tax problem.
- The study should be no more than 15 to 20 pages in length.
- Identify an economist in the state who can produce the specific data that make the economic case against the excise tax.

HOW TO USE AN ECONOMIC IMPACT STUDY

- Use the study as an organizing tool for setting up a coalition to oppose the excise tax. It will be especially useful with allied business groups.
- Distribute the study to key public officials in both the executive and legislative branches of government.
- At the appropriate time, release the study to the media, with special emphasis to editorial boards of key newspapers.
- Make the economist available for meetings, media appearances, briefings and public

testimony.

- Since certain sections of the study will be more persuasive with different target groups, package and target the arguments accordingly.

APPENDIX D

SAMPLE MATERIALS

**Insert: New Hampshire Testimony

Kentucky Ad

West Virginia Direct Mail Piece

Utah and West Virginia Brochures