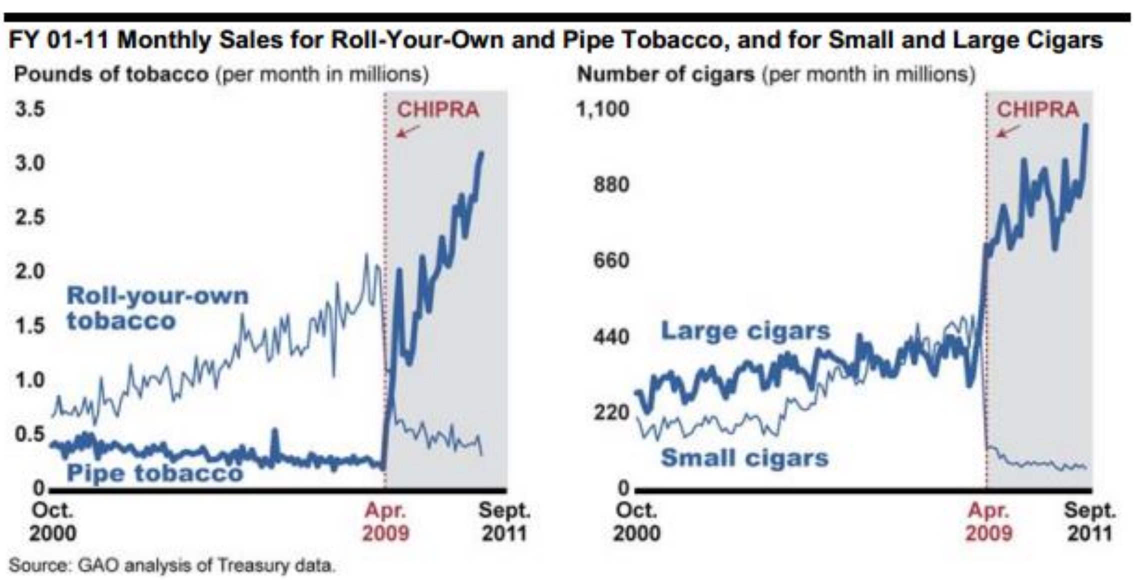
April 23, 2012

TAX ROLL-YOUR-OWN, CONSUMERS JUST SWITCH TO PIPE TOBACCO

By Scott Drenard
The Tax Foundation – Tax Policy Blog
April 20, 2012

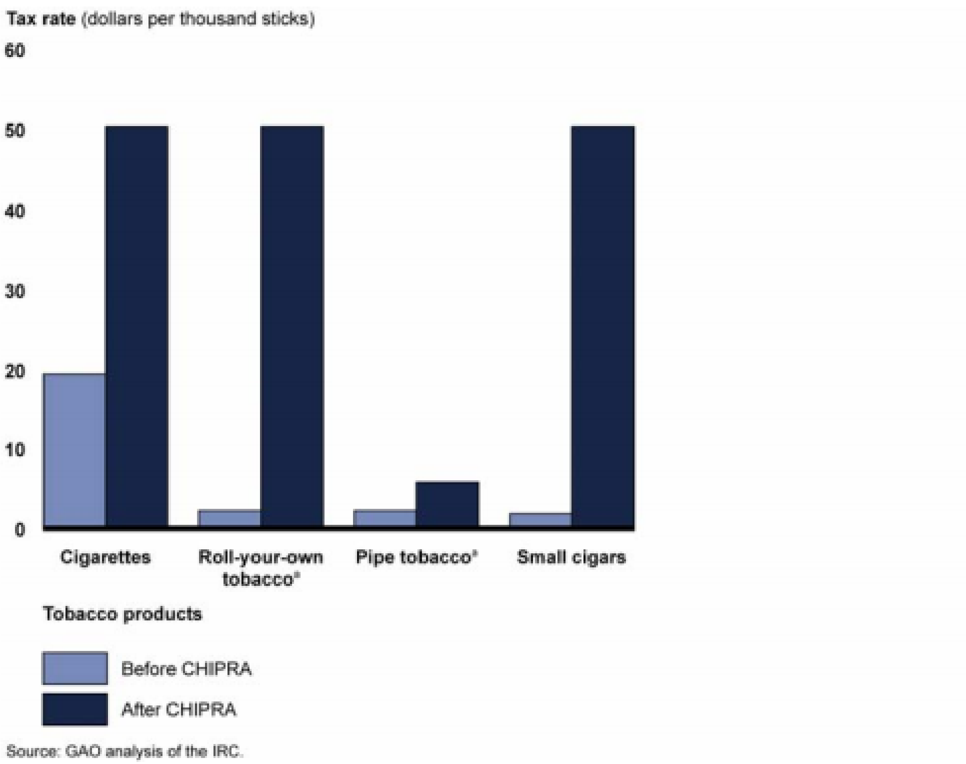
The GAO recently released a report on tobacco taxes in which they determine that the disparities between the excise tax rates of roll-your-own tobacco and pipe tobacco has led to a substantial market shift from the former to the latter. Additionally, the differential treatment of large cigars and small cigars has led to a spike in the sale of large cigars.

Below is a graph from the report, showing the changes in the sales of roll-your-own tobacco vis a vis pipe tobacco, as well as the change in large cigars vs. small cigars as a result of the passage of CHIPRA in 2009).



This change was driven by the fact that CHIPRA substantially raised rates on cigarettes, roll-your-own tobacco, and small tobacco, but did not raise taxes on pipe tobacco to equivalent rates. Below are the tax rate changes from CHIPRA (large cigars are not taxed per stick, but are taxed by price, so are not included in this graph):

Figure 3: Changes in Federal Excise Tax Rates as a Result of CHIPRA—for Cigarettes, Roll-Your-Own Tobacco, Pipe Tobacco, and Small Cigars



[a]The roll-your-own tobacco and pipe tobacco cigarette stick equivalent is based on the weight of 0.0325 ounces of tobacco per cigarette stick using the Master Settlement Agreement conversion rate.

The biggest reason for these consumption shifts is that the definitions of roll-your-own tobacco and pipe tobacco are virtually indistinguishable; they mostly concern how the product is packaged and how it is "likely to be smoked." In many cases, roll-your-own makers took exactly the same tobacco product and just changed the label to read "pipe tobacco."

The main take away from this report is that taxes substantially affect consumer and industry behavior. People naturally respond to price changes to avoid taxes. If you tax cigarettes heavily, consumers move to roll-your-own tobacco. When you tax roll-your-own tobacco, consumers move to pipe tobacco. Further, if you tax any product at a prohibitive rate, people will turn to the black market.

More on tobacco taxes here.

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GAO SUGGESTS EQUALIZING TOBACCO TAX RATES

Convenience Store Decisions Magazine
April 21, 2012

A new report finds shift in using pipe versus roll-your-own tobacco and large cigars versus small cigars to avoid hefty taxes.

This week, the federal Government Accounting Office (GAO) issued a report titled “Large Disparities in Rates for Smoking Products Trigger Significant Market Shifts to Avoid Higher Taxes.”

The document shows the impact of the different federal tax rates on various tobacco products as a result of the federal cigarette and tobacco tax increases which went into effect on April 1, 2009, the National Association of Tobacco Outlets (NATO) reported.

The report further found that market shifts are causing revenue losses for the federal government and recommended that Congress should consider equalizing tax rates on roll-your-own and pipe tobacco.

Market Shifts

Below is a chart that shows the federal excise tax rates on tobacco products before and after the April 1, 2009 tax increase:

Product	**Federal Tax Rates Through March 31, 2009**	**Federal Tax Rates on April 1, 2009**
Cigarettes	39¢ per pack	$1.0066 per pack (Rounded to $1.01/pack)
Large Cigars	20.719% of manufacturer’s price; cap of 4.875¢/cigar	52.75% of manufacturer’s price; cap of 40.26 cents per cigar
Little Cigars	4¢ per pack	$1.0066 per pack (Rounded to $1.01/pack)
Pipe Tobacco	$1.0969 per pound	$2.8311 per pound
Chewing Tobacco	19.5¢ per pound	50.33¢ per pound
Snuff	58.5¢ per pound	$1.51 per pound
Roll Your Own; Cigar Wrappers	$1.0969 per pound	$24.78 per pound
Cigarette Paper	1.22¢ per 50 papers	3.15¢ per 50 papers
Cigarette Tubes	2.44¢ per 50 tubes	6.30¢ per 50 tubes

The GAO noted monthly sales of pipe tobacco increased from about 240,000 pounds in January 2009 to more than three million pounds in September 2011. Monthly sales of roll-your-own tobacco, meanwhile, decreased from approximately two million pounds to 315,000 pounds in the same time frame.

Similarly, large cigar sales rose from 411 million cigars to more than one billion cigars, while small cigar sales declined from about 430 million cigars to 60 million cigars.

The report showed that given these market shifts in pipe versus roll-your-own tobacco and large cigars versus small cigars, the federal government experienced revenue losses of between $615 million and $1.1 billion in tobacco taxes.

The GAO report recommended that Congress "should consider equalizing tax rates on roll-your-own and pipe tobacco and, in consultation with Treasury [the U.S. Treasury Department], consider options for reducing tax avoidance due to tax differentials between small and large cigars."

Originally published here: http://www.csdecisions.com/2012/04/20/gao-suggests-equalizing-tobacco-tax-rates/

HIGHER TAXES DRIVING PEOPLE TO SMOKE PIPES, CIGARS?

By Shauna Wright
WJBC 1230-AM (Bloomington, IL)
April 21, 2012

Three years ago, a federal act meant to help reduce the number of people who smoke greatly increased the tax rates for cigarettes, roll-your-own tobacco, and small cigars, counting on the fact that making smoking more expensive would prompt people to quit.

And while it may have caused some to do so, the move had an unintended effect: sales of pipe tobacco and large cigars, which aren't taxed quite as harshly, have boomed.

The Children's Health Insurance Program Reauthorization Act (CHIPRA) of 2009 resulted in a more than 2,000 percent bump in the federal tax on roll-your-own tobacco and small cigars, while the tax on large cigars and pipe tobacco only went up about 150 percent.

As a result, the Government Accountability Office report states, "Monthly sales of pipe tobacco increased from approximately 240,000 pounds in January 2009 to over three million pounds in September 2011 [and] large cigar sales increased from 411 million to over one billion cigars."

The GAO noted some manufacturers of roll-your-own tobacco products have simply re-branded their products as pipe tobacco while making few changes in the products themselves. And the makers of small cigars now just make them bigger to avoid the extra taxes.

The bottom line? The GAO estimates that the new tax structure has resulted in somewhere between $615 million and $1.1 billion less in taxes, writing in its report, “Congress … should consider equalizing tax rates on roll-your-own and pipe tobacco.”

Originally published here: http://wjbc.com/cigarette-taxes-pipes-cigars-dollars-and-sense/

MAMMOTH BILL MAKES IRS PLAY BORDER CONTROL

By Kelly Phillips Erb
Forbes.com
April 23, 2012

And here I thought, in an election year, that nothing would get done. In the blink of an eye, the Senate has managed to pass a bill that does practically everything. The bill, which has the descriptive title, “Moving Ahead for Progress in the 21st Century Act” or “MAP-21” is called, in shorthand, the “Highway Bill.” It’s about 1,865 pages long. The official summary alone is 2,650 words: by the time it was engrossed in the Senate, the bill was 317,182 words long – or about four times longer than the first Harry Potter book.

Of course, it’s not all about highways. We know how Congress loves to gunk up bills… So, welcome MAP-21. It’s a two year, $100 billion bill, chock full of provisions which touch on highways and mandatory black boxes for everyone, Gulf Coast Restoration, Buy America provisions, a National Driver Register (!), Sport Fish Restoration and Recreational Boating Safety, Aircraft noise abatement, Internal Revenue Service levies and Thrift Savings Plan Accounts – take a breath, there’s more – Roll-your-own cigarette machines, Clarification of tax basis of life insurance contracts, Amtrak on time performance and the Paperless Hazard Communications Pilot Program.

There’s more but that should give you the flavor of the bill. And by flavor of the bill, I mean that it’s so large and bloated that I’m pretty sure that nobody in Congress actually read it. And yet, it still passed the Senate with a 74-22 vote.

The bill was introduced by Sen. Barbara Boxer (D-CA). There were three co-sponsors: Sen. Max Baucus (D-MT); Sen. James Inhofe (R-OK) and Sen. David Vitter (R-LA). Sen. Orrin Hatch (R-UT) reportedly tried to kill it but was, sadly, not successful.

There’s so much wrong about the bill that it’s hard to pick out just one thing that deserves recognition. But not impossible. Because the one thing is horribly, horribly offensive. It’s buried near the end, at Section 40304, and is meant to amend the Tax Code to add (yes, add) the following:

SEC. 7345. REVOCATION OR DENIAL OF PASSPORT IN CASE OF CERTAIN TAX DELINQUENCIES.

> (a) In General- If the Secretary receives certification by the Commissioner of Internal Revenue that any individual has a seriously delinquent tax debt in an amount in excess of $50,000, the Secretary shall transmit such certification to the Secretary of State for action with respect to denial, revocation, or limitation of a passport pursuant to section 4 of the Act entitled ‘An Act to

regulate the issue and validity of passports, and for other purposes', approved July 3, 1926 (22 U.S.C. 211a et seq.), commonly known as the 'Passport Act of 1926'.

(b) Seriously Delinquent Tax Debt- For purposes of this section, the term 'seriously delinquent tax debt' means an outstanding debt under this title for which a notice of lien has been filed in public records pursuant to section 6323 or a notice of levy has been filed pursuant to section 6331, except that such term does not include–

'(1) a debt that is being paid in a timely manner pursuant to an agreement under section 6159 or 7122, and

'(2) a debt with respect to which collection is suspended because a collection due process hearing under section 6330, or relief under subsection (b), (c), or (f) of section 6015, is requested or pending.

There are a few more paragraphs but you get the idea. It's the authority to deny U.S. citizens a passport if there's a tax debt.

Let me clarify a few things for you. Liens are filed when the IRS believes that a debt might not be collectible. It doesn't, however, mean that the debt is confirmed or accurate. A lien can exist when a collections matter is pending, when a matter is challenged in Tax Court or – as is the case with at least one of my clients – the debt was admittedly not correct but the IRS does not believe that it has a responsibility to remove the lien (enter the attorneys). And while a lien is generally reserved for matters that are more than $25,000 (the new, kindler, gentler IRS has, in theory, extended this amount to $50,000), the IRS may – and has and does – impose a lien for smaller amounts.

Similarly, a Notice of Levy can be filed when a matter is still being contested. And a Notice of Levy can be issued for very small amounts. We've seen them issued for double digits.

Please don't think that a lien or a levy is always an indication of a taxpayer shirking their responsibility to pay. Just Congress thinks that.

And yes, there's supposed to be an out for those matters with extenuating circumstances (see subparagraph 2 above) but – how do I say this nicely? – I don't trust the IRS to do this and to timely communicate with the Department of State.

Oh, I didn't get to that part yet. The IRS notifies the Department of State as to those taxpayers which qualify under these rules. And the Department of State then gets to use their discretion to "limit a previously issued passport or passport card only for return travel to the United States" – there are other mandatory directions regarding new passport denials and the like.

Since there's no actual authority to share taxpayer information (remember how worried Congress was about doing that?), the bill would authorize the IRS to share taxpayer identity information with the Department of State "to the extent necessary." Yeah. Cause there are no privacy concerns there, right?

Let me summarize the terms of the bill for you: if the IRS liens or levies you, the Department of State can choose to restrict your right to travel without a judicial hearing. To be clear, these aren't cases of U.S. citizens who have been found to have committed a crime or have even been proven to owe taxes. You don't get your day in court. You don't get to argue your case. You don't get to prove that there has been a mistake. In other words, it gives the IRS the authority to determine your future travel plans. No due process for you.

Ah, that pesky issue of due process. Generally, the taking or denial of a passport is a judicial matter tied to issues where there is a risk of a person trying to flee the country. Not so here.

But why worry about the Constitution and fairness when there are votes to be won? Because, let's be honest… That's what this is about. It's not about the fear that taxpayers are picking up and leaving the country under the cover of night to escape a tax debt even if that's what our officials in Congress (yes, that means you, Sen. Boxer) think. Contrary to what this bill implies, we aren't seeing long lines at the border of folks wanting to get out.

Here's your reality check: most people who are leaving the country aren't fleeing a tax debt with backpacks filled with diamonds – they're leaving on business. To work. To make more money. And maybe – just maybe – that means that they will settle their tax debts. Taking away their right to work surely won't do that.

The bottom line is that MAP-21 is a stupid, stupid bill. It's pigheaded and wrong. And it shows a complete disregard about the reasons for the tax gap. It's not the result of rich expats or expat-wannabes. It's much more complicated than that. But Congress doesn't want to hear it. They want a quick fix that makes for a soundbite during election season.

(*read with a deep voice*): Senator Boxer worked hard to keep our tax dollars from being stolen and diverted overseas.

Yeah.

That's not what's happening. And pretending that it is shows a complete lack of understanding of the problem. There's so much wrong with our tax system – from the flawed Tax Code to collections to administration. But you know what isn't going to make it better? Yet another layer of bureaucracy. Nobody loves bureaucracy more than Congress. And so far, that's been working out for us… how?

Fortunately, the House hasn't approved this version of the bill yet. It passed a separate bill related to the highway provisions. Let's hope they show more sense than their comrades compatriots in the Senate.

Originally published here: http://www.forbes.com/sites/kellyphillipserb/2012/04/23/mammoth-bill-makes-irs-play-border-control/

ENDORSEMENTS: YES ON PROP. 29, TOBACCO TAX INCREASE

Sacramento Bee Editorial (CA)
April 22, 2012

Despite its reputation as an unwelcoming place for smokers, California ranks 33nd among states in taxing tobacco. Smoking-related diseases cost us hundreds of millions of dollars yearly in health care and lost productivity. Thousands of young people get hooked on nicotine each year.

California can do better. To save lives, it must do better.

Passage of Proposition 29, on the ballot in June, would be a major breakthrough for public health. This initiative would add $1 to the per-pack tobacco tax in California, currently 87 cents.

There is no dispute that raising the price would result in significant declines in smoking. Health groups backing the tobacco tax hike estimate that it would cause 118,000 adults to quit smoking and prevent 228,000 young Californians from becoming addicts.

Increasing the tax would raise more than $700 million yearly, and under Proposition 29, nearly all of it would go to cancer research and smoking cessation.

While the revenues would decline over time as smoking rates dropped, the funding would nonetheless help scientists come up with better treatments for cancer patients, and possibly new ways to detect tumors in their most early stages.

Opponents of Prop. 29 – largely the tobacco industry and groups that receive funding from cigarette companies – are trying to derail the initiative as the work of "a washed-up politician," former state Senate President Pro Tem Don Perata. It's true that Perata, a survivor of prostate cancer, helped launched the initiative and has raised money for it. But Prop. 29 is supported by the American Cancer Society, the American Lung Association, the American Heart Association and other reputable groups and individuals that can't be smeared by the "taint" of serving in public office.

Opponents also claim that the initiative represents another dangerous exercise in "ballot box budgeting," in which voters – instead of lawmakers – make decisions on expenditure of revenues. They are right, but it's a disingenuous claim. If Prop. 29 required all of the proposed tax increase to flow into the general fund, the tobacco industry would still oppose it – as it has opposed dozens of proposed tobacco taxes over several decades.

In general, The Bee opposes initiatives that seek to use the ballot box to lock in budgetary decisions. But we have made exceptions. In 1988, the editorial board supported Proposition 99, which placed a 25-cent-per-pack tax on cigarettes to support tobacco education and prevention efforts. Over the years, that measure has been hugely successful in reducing smoking rates and saving lives.

More recently, we've also supported a few other revenue initiatives that were legitimate and had been blocked repeatedly by special interests.

Prop. 29 falls into that category. Since 1998, when voters approved Proposition 10 – which raised the tobacco tax by 50 cents to support early childhood development programs – the tobacco industry has blocked 15 attempts to further raise the cigarette tax through the Legislature or the ballot box.

Prop. 29 is hardly perfect. The initiative would create a new state agency to dispense cancer research funds. It would be overseen by a nine-member board that would include university chancellors and cancer center directors who would have a stake in how the money is dispensed.

Critics rightly worry that this model could end up repeating the mistakes of the quasi-public California Institute for Regenerative Medicine, which voters approved in 2004. Undoubtedly, it will take constant vigilance to prevent a "Son of Stem Cell," with big money decisions being made with little transparency and a sizable potential for conflicts. There are also real worries, despite the wording of Prop. 29, that too much of the money raised by the tobacco tax could flow to researchers in other states.

Even so, the potential benefits of raising the tobacco tax outweigh the uncertainties posed by Prop. 29 governance. And that's the bottom line. To discourage smoking and save lives, California must again raise the tobacco tax. It must again overcome the specious arguments and hired guns of the tobacco barons.

It won't be easy – the tobacco industry could end up outspending supporters of the initiative by a 15-to-1 margin. But the cigarette companies and their minions have no credibility. All they have is a dangerous product to sell.

The Bee's past stands:

"The tobacco industry, in the guise of Californians Against Unfair Tax Increases, is betting that $15 million in TV ads will create enough confusion to beat a cigarette tax initiative that voters had once heavily favored. There's a fair chance that it will win its bet." -- Oct. 28, 1988

Originally published here: http://www.sacbee.com/2012/04/22/v-print/4430800/endorsements-yes-on-prop-29-tobacco.html

PROP. 29 FUNDS RESEARCH FOR CANCER, BUT IT'S STILL A TAX HIKE

By Debra J. Saunders
San Francisco Chronicle
April 22, 2012

The American Cancer Society, American Heart Association and American Lung Association wrote Proposition 29, the measure on the June 5 ballot to increase California's cigarette tax by $1 to $1.87 per pack. Lung Association President Jane Warner likes to emphasize the demarcation at play: She's with the good guys, while the bad guys, Big Tobacco, will spend buckets more money trying to fight the measure than her groups will spend trying to pass it.

It's the virtuous underdogs versus the nefarious moneybags. Good versus evil.

There's one unmistakable plus that comes with raising the tobacco tax: As Warner explained, "If you raise the cost of cigarettes, smoking goes down, especially among children."

The unmistakable downside: Prop. 29, which would raise an expected $735 million annually, represents the kind of me-first lawmaking that helped dig state government's $9.2 billion budget hole.

I cannot help but look at Prop. 29 and wonder: If raising state cigarette taxes should reduce smoking all by itself, why not put the new money in the state's cash-starved general fund? When Sacramento has to implement further cuts or new taxes to fill a gaping hole, why did Prop. 29's authors insist on raising money to bankroll their preferred programs - mostly cancer research and antismoking campaigns, for which Washington and Sacramento already pay.

Prop. 29 is "ballot-box budgeting." People and organizations with money write ballot measures that appeal to voters because they dedicate tax dollars to popular programs. It's like asking a child: "Which would you rather eat first: broccoli or ice cream?"

Of course, voters feel good when they vote to protect mental health services or after-school programs. They are not so happy when lawmakers have to slash spending because they don't have much flexibility on the budget. Because lawmakers have limited say on how $40 billion in special funds are spent, they must make most spending cuts in the $93 billion general fund.

Robert Stern, former president of the Center for Governmental Studies, agrees that Prop. 29 represents ballot-box budgeting but "a different type of ballot-box budgeting." It is unlike the 2004 ballot measure that authorized $3 billion in bonds to fund stem cell research, for which the general fund pays interest. Prop. 29 at least pays for itself.

Also, as American Cancer Society Vice President Jim Knox argued, "There is an obvious nexus to the product that's being taxed" and how the money is spent.

True, but it's still a tax increase to bankroll shiny new programs, while Sacramento faces cutting existing programs.

Mike Genest, state director of finance under Gov. Arnold Schwarzenegger and now a consultant, has seen how these special funds can "get out of control." Prop. 71 spawned the California Institute for Regenerative Medicine, which paid former California Democratic Party Chairman Art Torres a $225,000 salary and investment banker Jonathan Thomas $400,000 to serve as chairman - for a four-day workweek. These special funds invite a certain arrogance, Genest noted, that can lead to "another black mark on government."

At a Chronicle editorial board meeting last week, I asked Genest and fellow Prop. 29 opponent David Kline of the California Taxpayers Association if they would support a $1 per pack cigarette tax if the money went to the general fund.

Kline didn't think he would. CalTax doesn't go for "targeted taxes," he said, especially one designed to bring in less money over time, assuming the antismoking programs work.

Also, CalTax understands that smokers will have to pick up the tab, and that has ramifications on California's overall economy.

Genest said that he doesn't like Prop. 29's steep rise in cigarette taxes. But among the many things that Sacramento lawmakers may have to do to balance the books, he said, a higher tobacco tax "could fit in the mix."

The Prop. 29 folks told The Chronicle that Californians would not approve a tobacco-tax increase that puts the money into the general fund, because voters don't trust the Legislature.

So Prop. 29's authors had to give the money to their cause. And they're the good guys.

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EDITORIAL: RAISING CIGARETTE TAXES $1 MAKES SENSE FOR ILLINOIS

Chicago Sun-Times Editorial (IL)
April 23, 2012

The very first cigarette tax in the nation was imposed in 1921 in Iowa. It was 2 cents a pack.

Cigarette taxes have gone up a bunch since then. Massachusetts now has the highest rate — $2.51 a pack — and supporters of a health-care bill there hope to boost it an additional $1.25 this spring.

Illinois' tax is 98 cents a pack, 32nd highest among the states. Gov. Pat Quinn wants to raise that by $1 a pack to generate about $3 38 million a year for Medicaid. The new revenue would be matched dollar for dollar by the federal government.

Nobody likes tax increases. But this is one that makes sense, and the Legislature should approve it.

Arguments against cigarette taxes fill the air like cigarette smoke in an elevator. Critics say it's a nanny tax, an example of government using its power to tax to steer citizens in a desired direction.

They say it hurts small retailers. When an Illinois smoker drives to Missouri to buy smokes, where the tax is 17 cents a pack, Illinois businesses lose not only that cigarette sale, but also the sale on gasoline, liquor, groceries and whatever else the smoker buys.

The number can be significant. When Cook County doubled its cigarette tax to $2 in 2006, cigarette sales at one Riverside gasoline station plummeted from 110,000 packs a month to just 17,000.

The Illinois Retail Merchants Association says the state already is battling a problem of unregulated counterfeit cigarettes on which no taxes are paid. And the association predicts that after an initial revenue bump, the tax increase would generate less and less net revenue.

Republican legislative leaders oppose any tax increases. "A cigarette tax, even if that's one that's not offensive to many people, is a revenue solution to a spending problem," Senate GOP Leader Christine Radogno said Friday. "And that's a philosophical difference between our parties."

The critics overlook more important facts.

First, a tax on cigarettes will deter smoking. The American Cancer Society estimates the tax increase would stop 72,700 children in Illinois from becoming smokers and encourage 53,400 adults to quit. That's no small accomplishment, given how terrible smoking is for our health.

Second, smoking-related health-care costs drive up Medi-caid spending, a fact Gov. Quinn emphasized when he met with the Sun-Times editorial board Friday. Smoking is estimated to cost the state $4.10 billion a year in health-care costs — and $1.5 billion of that tab is picked up by Medicaid.

“This is a very big public health measure,” Quinn said, “and anyone who is involved in public health is all for this.”

Third, trying to balance the state’s Medicaid budget with cuts alone means walking away from federal dollars. No other tax offers that huge federal match.

Fourth, Quinn already is proposing 58 stunningly deep Medicaid cuts. Further cuts would be devastating.

Fifth, the last three Republican governors of Illinois backed cigarette tax increases five times.

Radogno and the House Republican leader, Tom Cross, have voted for a cigarette tax increase, too.

It’s time they do so again, and bring their party with them.

Are we, or are we not, a just and compassionate society?

Originally published here: http://www.suntimes.com/opinions/12026025-474/editorial-raising-cigarette-tax-1-makes-sense-for-illinois.html?print=true

NEW TOBACCO STUDY RAISES CIGARETTE PRICE HIKE POSSIBILITY

Convenience Store News
April 20, 2012

This time of year typically sees an uptick in gas prices, but this year, cigarettes prices may be the ones doing the climbing.

The Wells Fargo Securities 1Q12 U.S. Tobacco Retailer Survey found that more than 70 percent of the company's tobacco industry retailer and wholesale trade contacts expect to see a price increase in May or June. Wells Fargo Securities anticipates The Altria Group's Philip Morris USA division to lead the 5-cent to 7-cent bump, according to Bonnie Herzog, managing director of Beverage, Tobacco & Consumer Research.

Even with the expected increase, she added that the company continues to believe the industry has pricing power. "Furthermore, we feel the price increase will help offset some pressure on margins stemming from the 'Battle of the Brands' in the second tier," she explained.

Breaking the survey down to individual brands, Wells Fargo Securities found that Marlboro volume seems to be stabilizing driven by increased promotions and innovation. Specifically, more than 45 percent of those responding to the survey reported a low-to-mid-single digit volume increase in Marlboro during the first quarter. A similar number of respondents noted an uptick in promotional support for the brand as well.

Herzog added that Marlboro Special Blends and the December 2011 launch of Marlboro Black are likely driving the volume activity.

"We continue to see signs that PM USA is achieving a better balance between leveraging Marlboro for profitable growth and maintaining strong brand equity," she said. "Therefore, we believe PM USA will be successful in preserving margins with a combination of share gains, cost-savings initiatives and new, innovative products."

Marlboro is not alone in its increased promotional activity. Pall Mall is also stepping up promos, but volume growth appears to be slowing down, according to Wells Fargo Securities. And with increased promotional activity among all second tier brands, it continues to be under attack.

"Given that Pall Mall is [Reynolds American Inc.'s] largest cigarette brand, we believe it has the most to lose as this 'Battle of the Brands' among the second tier continues to heat up. Thirty-five percent of our contacts indicated Pall Mall volume decreased mid-to-high single digits during [the first quarter]," Herzog explained. "Therefore, to defend its turf, RJR would need to continue to increase its promos on Pall Mall which could put pressure on its margins in the near term."

The tobacco survey also found that Newport Menthol continues its strong growth trajectory with the majority of the respondents indicating mid-to-low double digit volume growth in the first quarter. The vast majority also indicated flat promos. However, Herzog noted that Lorillard Inc. will need to promote Newport Red more than originally anticipated in order to grow that brand.

The survey also pointed to smokeless tobacco products as bright spot in the tobacco category. With the help of increased promotions, smokeless volume trends continue to rise with more than 80 percent of respondents reporting mid-to-low double digit volume growth. Furthermore, Herzog noted that several of Wells Fargo Securities contact pointed to Grizzly as a factor in that growth.

Altria is also seeing growth in its smokeless category, primarily driven by the mid-tier Copenhagen and Skoal line extensions, she added, which had some retail contacts raising their eyebrows. "While we do share our trade contacts' concerns about dilution of brand equity from these lower-priced line extensions, we believe [Altria] is leveraging these brands to stabilize share, offering a price point that is compelling to the consumer. Volume growth and cost savings initiatives should more than offset margin pressure as [Altria] executes its total tobacco strategy," Herzog explained.

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