A Weight-Based Tax on Moist Smokeless Tobacco (MST)

Michigan

April 2009

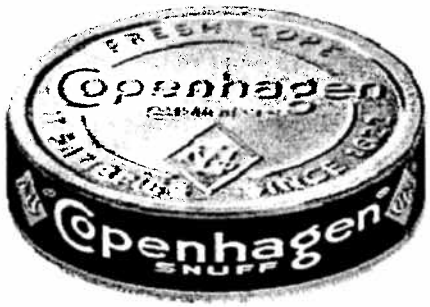
Altria Client Services Inc. (ALCS) Supports a Weight-Based Method of Taxation for MST

This legislation will:

- **Tax MST consistently with other consumer products.**
- **Align Michigan's tax methodology with that of the federal government and 16 other states.**
- **Establish tax equity for MST products.**
- **Generate additional state MST tax revenues.**
- **Create a stable and predictable stream of MST tax revenue for the state.**
- **Reduce complexity and administrative burden on the state, wholesalers and retailers.**

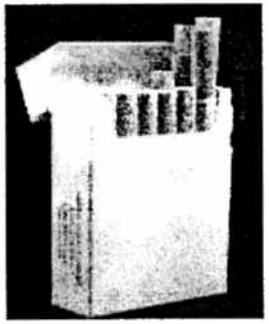
A Weight-Based Tax is Consistent with State Excise Taxes on Other Products

MST



Ad Valorem Tax
% of Wholesale Price

Cigarettes



Per Pack

Gasoline

Premium

Regular

Per Gallon

Beer

Per Barrel

An ad valorem tax method on consumer products is unusual. Unlike a sales tax, which is applied to the price of the product, an excise tax is a consumption tax. Its intent is to tax all like products uniformly. Product categories such as cigarettes, beer, wine and gasoline are taxed based upon unit, weight or volume. When taxing under a weight-based system, a state does not consider price points -- the weight of the product determines the excise tax liability.

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Information provided by Altria Client Services Inc. on behalf of
Philip Morris USA Inc. and US Smokeless Tobacco Company

A Weight-Based Tax Methodology Establishes Tax Equity for MST Products

An ad valorem system of taxation results in large variations in excise taxes:

- **The current ad valorem excise tax rate in Michigan is 32%.**
- **MST products of equal tobacco weight are priced differently throughout the smokeless tobacco category leading to large differences in taxes paid per unit.**
- **The current system, in effect, creates a tax break for lower-priced brands, resulting in an unfair advantage.**

A weight-based method of taxation does not favor one brand over another.

	Premium	Discount
Current Tax/1.2 oz. can	**$2.39 * 32% = $0.76**	**$0.98 * 32% = $0.31**
Weight-Based Tax/1.2 oz. can	**$0.80/oz. * 1.2 oz. = $0.96**	**$0.80/oz. * 1.2 oz. = $0.96**

Source: Copenhagen was used as the premium brand and Longhorn was used as the discount brand. Effective March 29, 2009, the price of Copenhagen will be $2.39. As of March 11, 2009, the wholesale price of Longhorn was $0.98.

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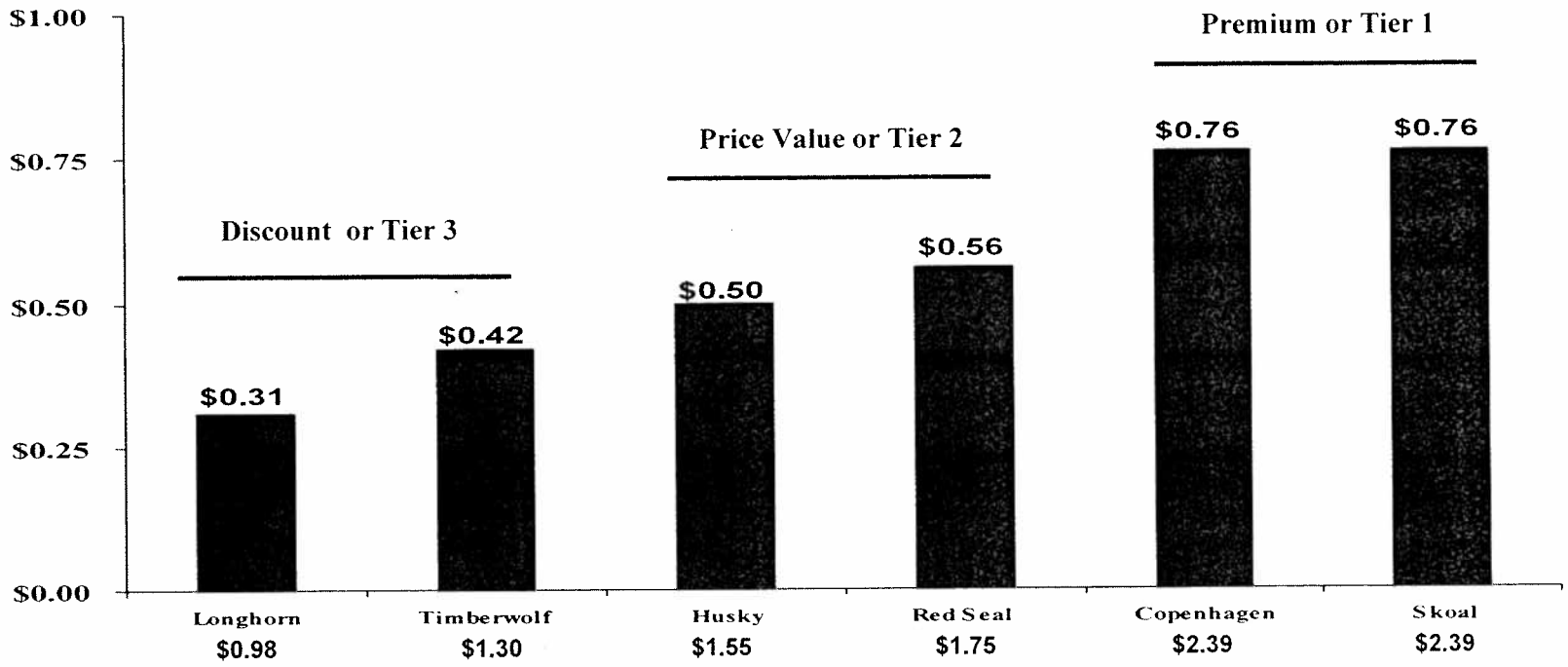
Effect of an Ad Valorem System

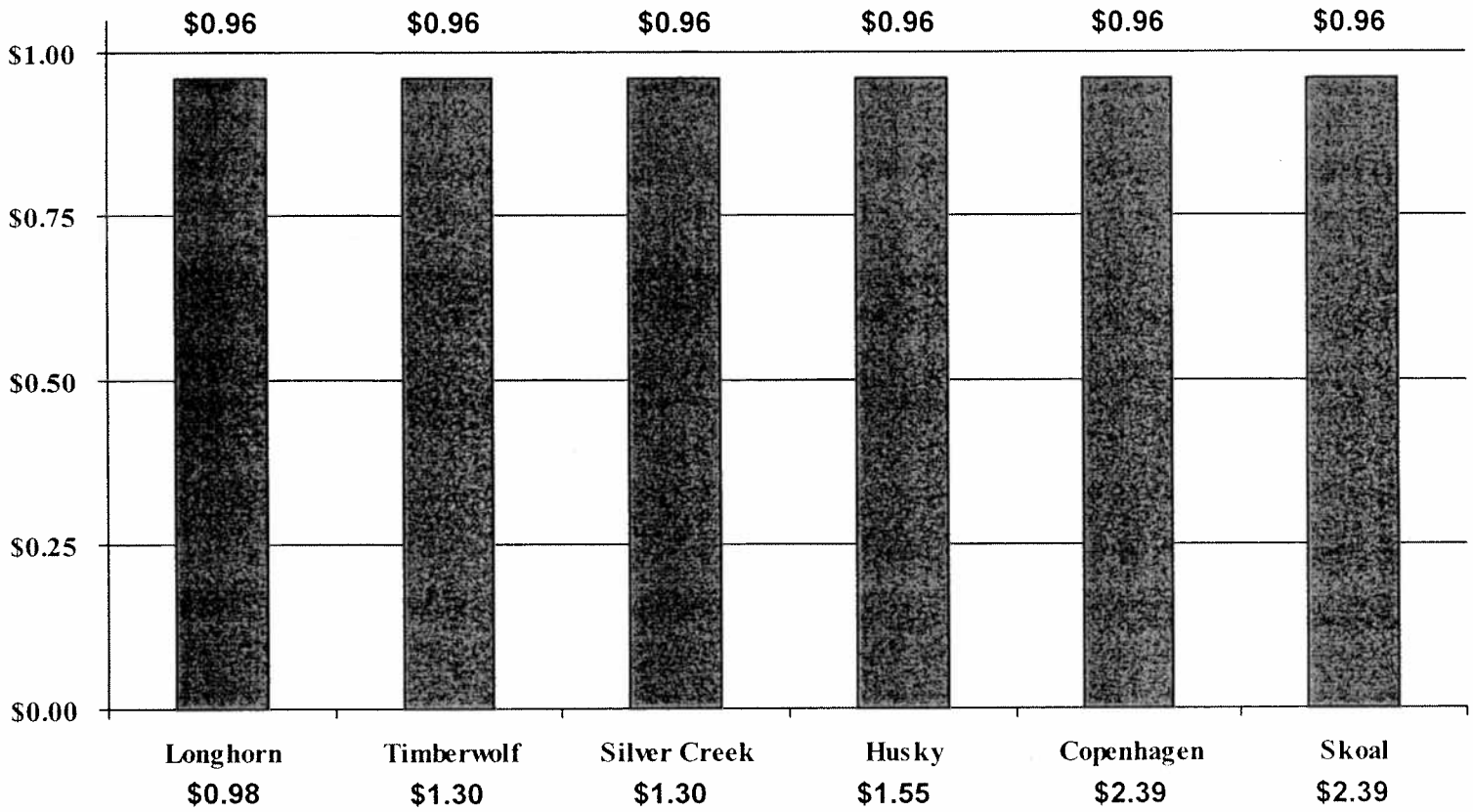
Equivalent products carry different tax burdens…



Source: Longhorn and Timberwolf pricing as of February 1, 2009 based on USSTC RAD SVT sales database; these prices are estimates and may vary. As of March 8, 2009 the price of Husky is $1.55. Effective March 29, 2009 the price of Red Seal is $1.75 and the price of Copenhagen and Skoal is $2.39.

Under a Weight-Based System

Equivalent products carry the same tax burden…



Source: Longhorn, Silver Creek and Timberwolf pricing as of February 1, 2009 based on USSTC RAD SVT sales database; these prices are estimates and may vary. As of March 8, 2009 the price of Husky is $1.55. Effective March 29, 2009 the price of Copenhagen and Skoal is $2.39.

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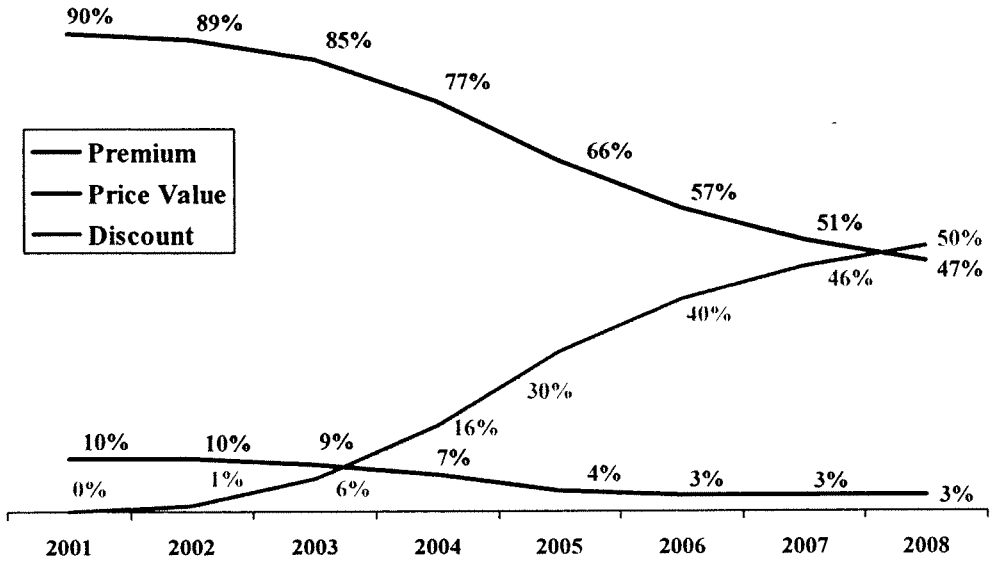
Under an Ad Valorem Methodology, Down Trading Means Less Revenue for the State

In 2008 Tier 3 share of market continued to grow. The state receives as much as $0.45 less revenue per can every time an adult consumer down-trades from a Tier 1 MST product to a Tier 3 product under the current ad valorem system.

Michigan left an estimated $8 million on the table in 2008 due to down-trading.



Note: $8 million MST excise tax revenue gain based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a rate of $0.80 per oz.

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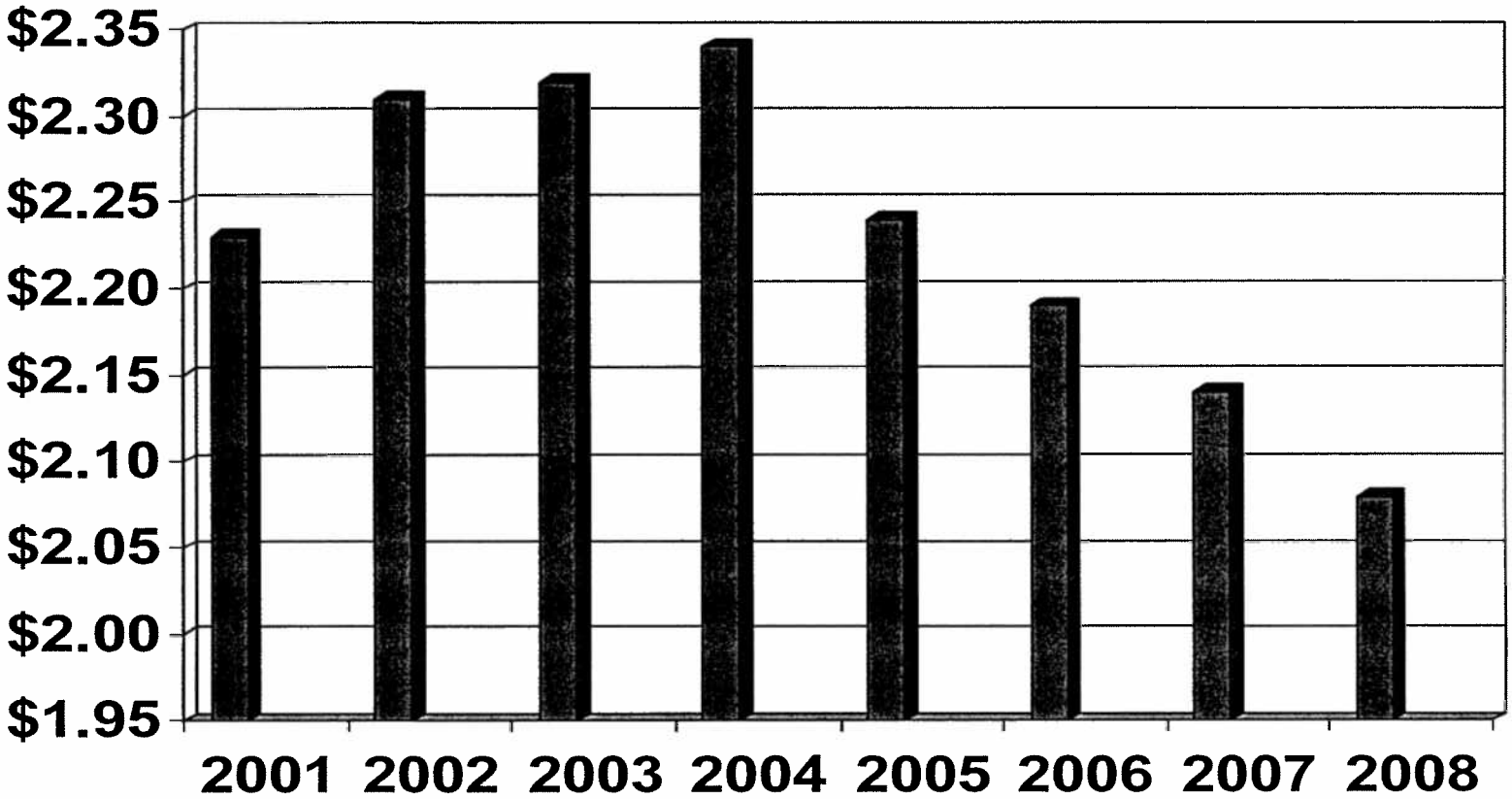
MST National Average Wholesale Price 2001- 2008



Source: Based on USSTC RAD SVT sales database as of October 31, 2008.

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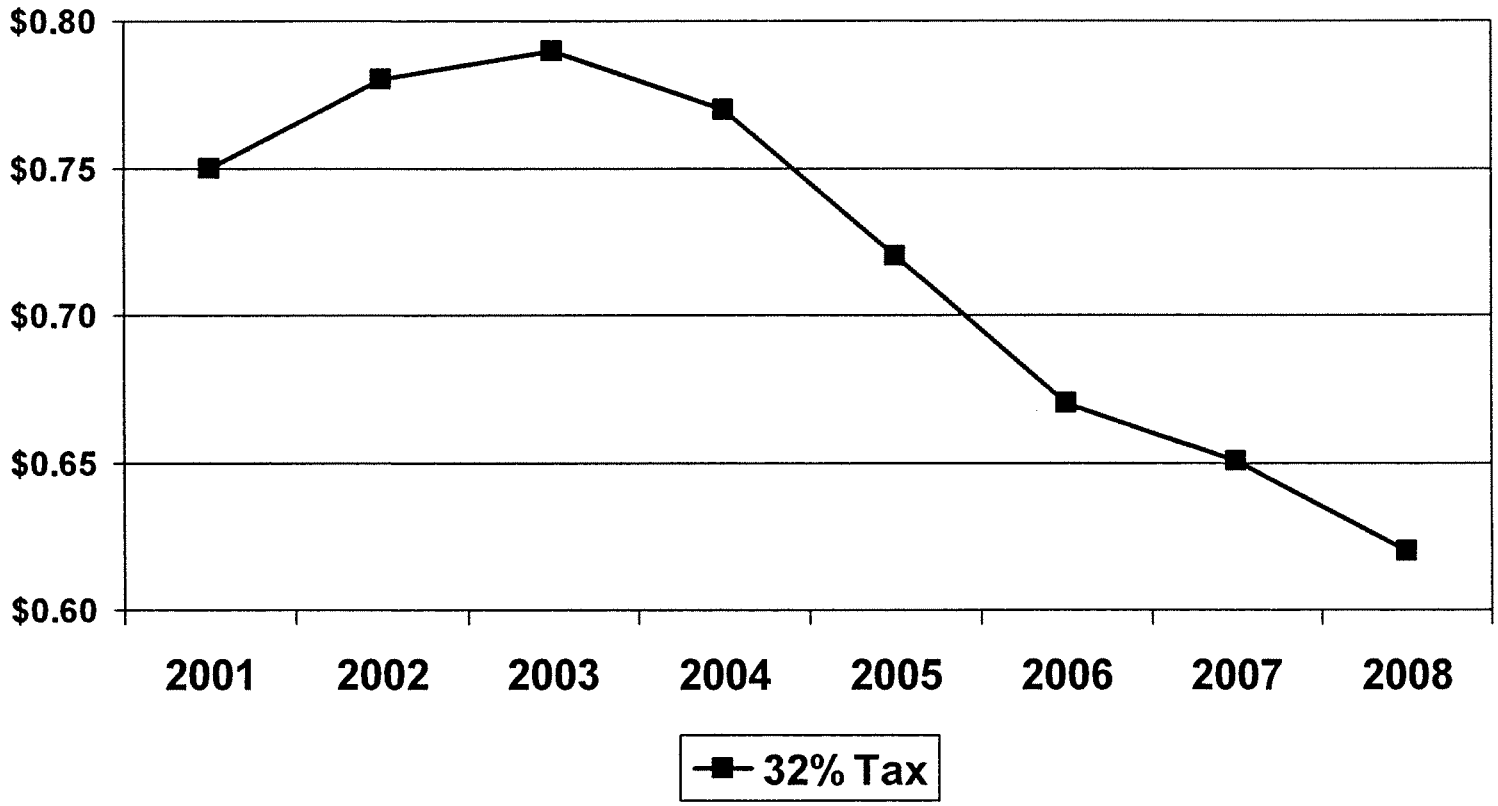
Michigan Weighted Average Tax Per MST Can 2001-2008



Source: USSTC RAD SVT sales database.

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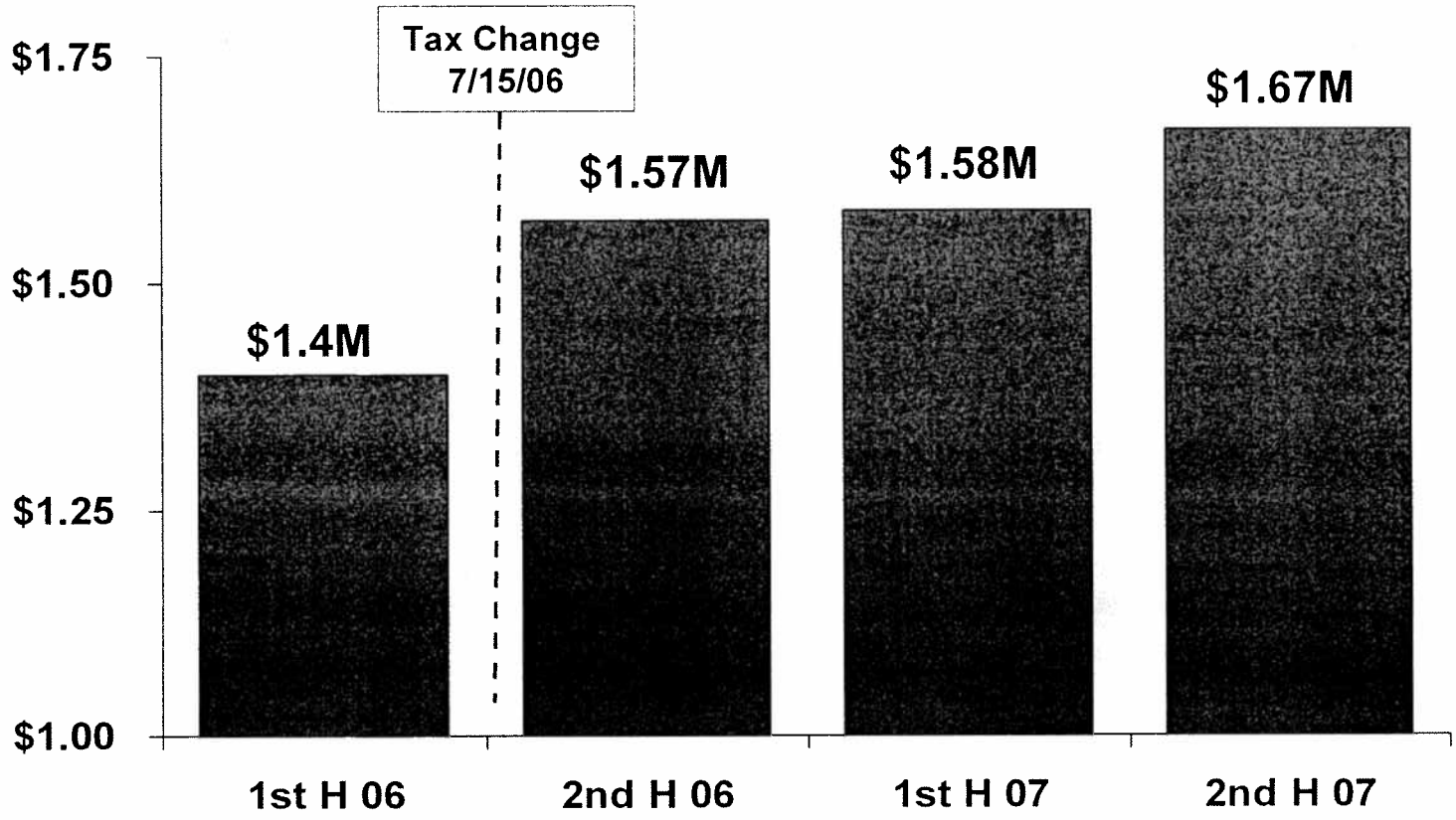
New Jersey Weight-Based Conversion Case Study

In July 2006, New Jersey converted its MST tax from a 30% ad valorem rate to a 75¢/oz. weight-based Rate.

In the 18 months following the conversion, revenues increased by 19%.



Source: Based on USSTC RAD SVT System

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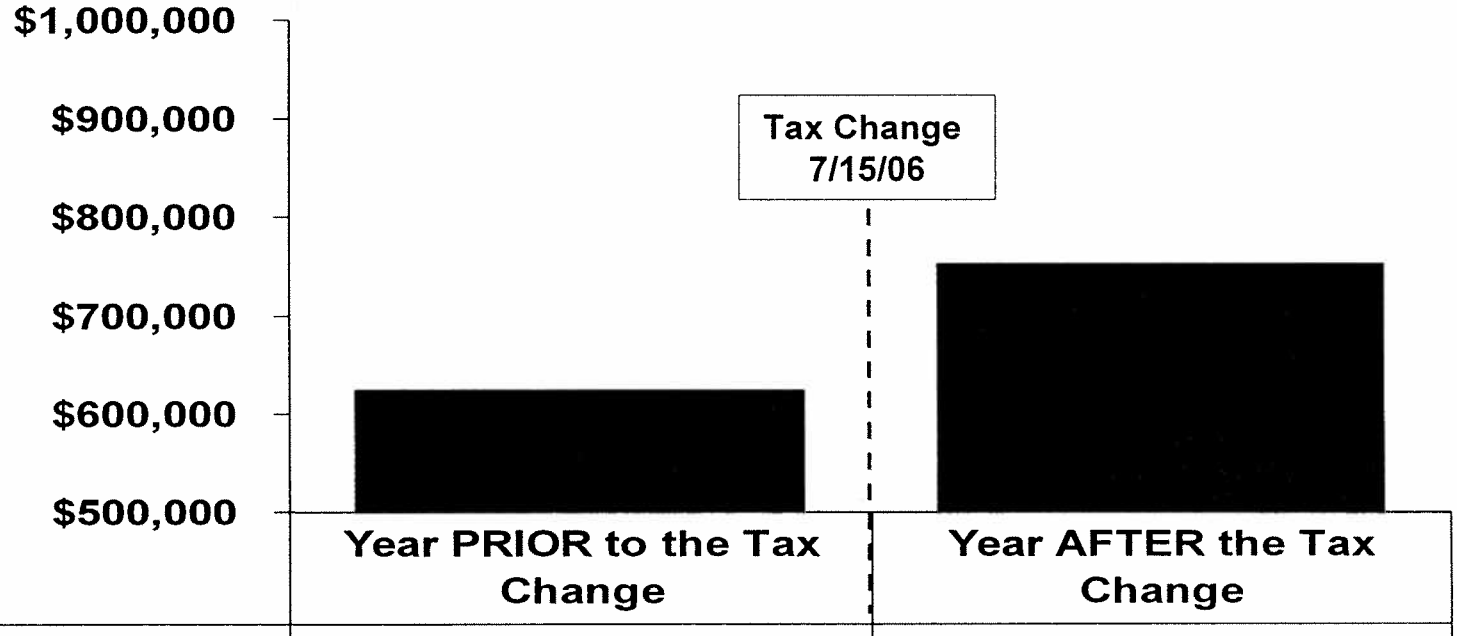
Rhode Island Weight-Based Conversion Case Study

In July 2006, Rhode Island converted its MST tax from a 40% ad valorem rate to a $1.00/oz. weight-based rate.

One year following the conversion revenues were up 20.5%.



	Year PRIOR to the Tax Change	Year AFTER the Tax Change
■ EST RI MST Tax Collections	$624,870	$752,856

Source: RAD SVT compares time period 52 weeks prior to 7/1/06 and 52 weeks after 7/1/06

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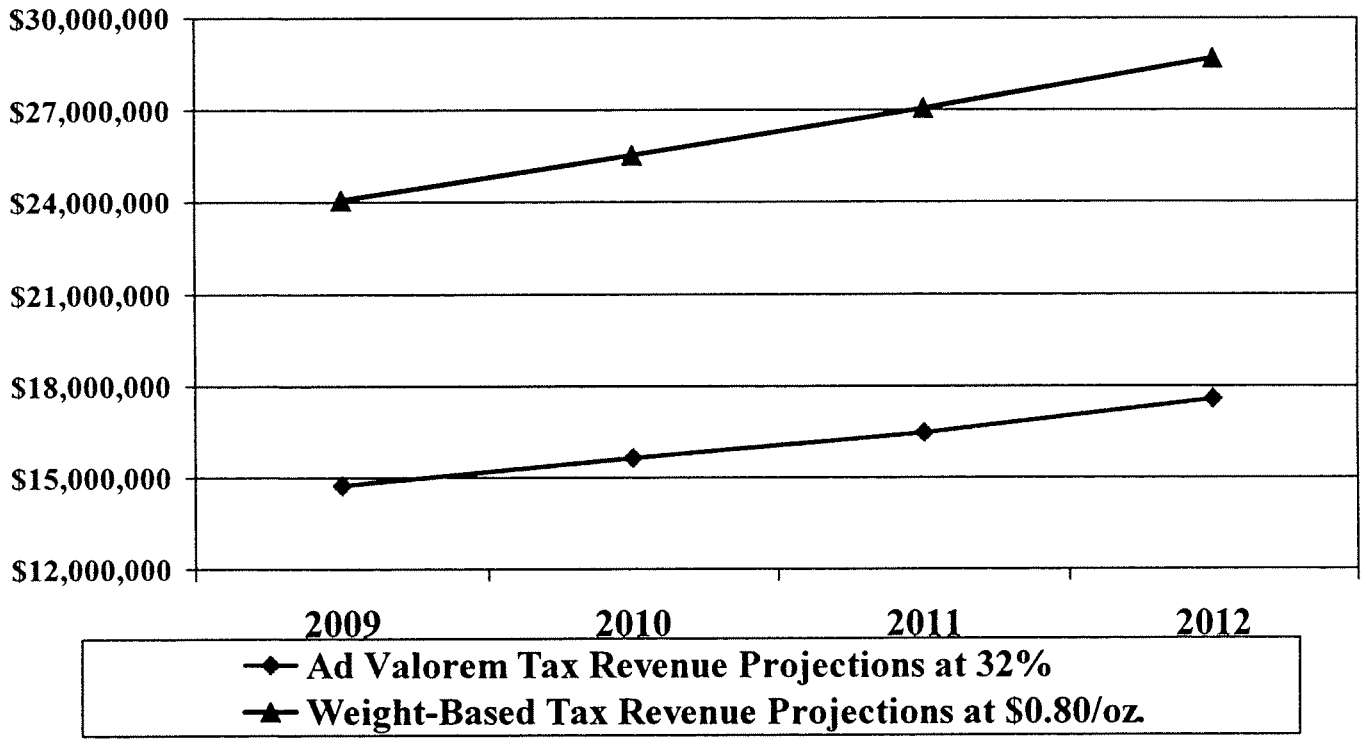
Future MST Tax Revenue Projections

Revenues are projected to increase under a weight-based method of taxation.



Note: Based on estimated sales from USSTC RAD database and share trends in 2008. The revenue model was run on a rate of $0.80/oz.

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