



ChangeLab Solutions
Law & policy innovation for the common good.



**HEALTHY FOOD
AMERICA**

Moving Science to Action



BEST PRACTICES IN DESIGNING LOCAL TAXES ON SUGARY DRINKS

ChangeLab Solutions and Healthy Food America

March 2016



ACKNOWLEDGMENTS

Best Practices in Designing Local Taxes on Sugary Drinks was written by Ian McLaughlin, staff attorney of ChangeLab Solutions, and Jim Krieger, MD, MPH, executive director of Healthy Food America, with additional contributions by Susan Mottet, JD, and was edited by David Goldberg, MS. The document benefitted immeasurably from input and discussion among these noted experts in the arena of sugary drinks taxes:

- Julie Ralston Aoki, JD, Staff Attorney, Public Health Law Center
- Jill Birnbaum, JD, Vice President, Office of State Advocacy and Health Initiative, American Heart Association
- Doug Blanke, JD, Director, Public Health Law Center
- Kelly Brownell, PhD, Dean, Sanford School of Public Policy, Duke University
- Frank Chaloupka, PhD, Distinguished Prof. and Director, Health Policy Center, University of Illinois at Chicago
- Joshua R. Daniels, JD, Campaign Co-Chair, Yes on Measure D (Berkeley, CA's sugary drinks tax)
- Roberta R. Friedman, ScM, Policy Director, UConn Rudd Center for Food Policy and Obesity
- Harold Goldstein, DrPH, Executive Director, California Center for Public Health Advocacy
- Deborah Hornor, Mission Advancement Director, American Heart Association
- Michael F. Jacobson, PhD, President, Center for Science in the Public Interest
- Laurie Whitsel, Director of Policy Research, American Heart Association

ChangeLab Solutions is a nonprofit organization that provides legal information on matters relating to public health. The legal information in this document does not constitute legal advice or legal representation. For legal advice, readers should consult a lawyer in their state. More at www.changelabsolutions.org

INTRODUCTION

Action for Healthy Food, Healthy Food America and ChangeLab Solutions collaborated to produce this analysis to identify best practices for designing taxes on sugary drinks as a strategy to improve public health. Our intent is to help communities develop tax legislation that will be both effective and workable for their constituencies. While this analysis focuses primarily on local taxes, much of the discussion is relevant for the development of state taxes.

A critical first step when considering a local tax is to review state law to determine what kinds of taxes are authorized for local governments in your state. Whereas states have broad authority to impose almost any type of tax, local governments can only impose taxes that have been specifically authorized by the state legislature or state constitution. Some states grant relatively broad authority for some local taxes (such as business license taxes, which are allowed in every municipality in California), whereas other states require specific state enabling legislation for each local tax. Therefore, it is essential that any local jurisdiction considering a tax consult with a local municipal tax expert to ascertain the available tax options.

When crafting a tax law, there are numerous policy considerations that will affect the scope and breadth of the tax, and also the disposition of the proceeds. This document discusses these critical policy considerations, including the effect of adopting different provisions; legal, administrative, and political considerations; and other factors.

These policy considerations were reviewed and discussed by a panel of public health, legal, and advocacy professionals with expertise in various aspects of sugary drink taxes. When possible, we sought consensus recommendations from the panel, although consensus was not always attained. The input from the panel of experts is woven throughout the discussion in this document, and areas where there was consensus are noted.

It is important to note that this is not a political strategy document, and that “best practices” are so labeled from the perspective of public health policy. Nonetheless, we make note of some relevant political and administrative considerations.

WHAT TYPE OF TAX TO EMPLOY?

The specific type of tax a local government should pursue will depend almost entirely on what has been authorized in its state. Assuming there is authority to impose a tax, there is a fundamental decision whether to pursue an *excise* tax or a *sales* tax. An excise tax is imposed on businesses for the privilege of conducting commercial activity such as distributing or selling sugary drinks. A sales tax is imposed on consumers, calculated as a percentage of the retail sales price, and collected by retailers at the time of sale.

The consensus in the literature on sugary drink taxes is that an excise tax is preferred as it is more likely to achieve the desired result of reduced consumption.¹ Excise taxes can result in an increase in the shelf price of the taxed item if businesses decide to pass the tax through to consumers in the retail shelf price of the product.

It may be possible in some states to require that the tax be passed through to the consumer, but this approach raises questions of how it can be practically enforced, and more importantly, whether it is legal. Answering these questions requires an analysis of state law by legal counsel. For example, it is possible that a court would interpret an excise tax with a pass-through provision to operate functionally as a sales tax; if local sales taxes are preempted in your state, the court could invalidate the tax.

Sales taxes, which are charged to consumers as a percentage of the sales price of taxable items, have a number of drawbacks and are not a strong strategy for reducing consumption and conveying a message about the product's health risks. First, a sales tax is always imposed on consumers and does not result in a higher shelf price for the taxed goods. In addition, in some states there is a cap on the total sales tax amount and many jurisdictions are at that cap, so additional sales taxes would not be feasible. Sales tax caps may also limit the size of the tax, thus eliminating the possibility of imposing a tax large enough to meaningfully change consumption.

Despite these disadvantages, in communities where a local excise tax is not feasible (due to pre-emption or other reasons), a sales tax may be the only viable option. If that is the case, in theory a sales tax could be set high enough to reduce sugary drink consumption (i.e., at least 20 percent of the price of an item) and coupled with a requirement that the shelf price reflect the after-tax price, or that the retailer post signs on the shelves to alert consumers that the beverage will be taxed at that higher rate at the register. It should be noted that these features are rarely, if ever, included in sales taxes.

One advantage of sales taxes is that most states have administrative mechanisms already in place for the collection of sales taxes, which could ease administration of a local sales tax. For an excise tax, the government will likely need to create new procedures and mechanisms to collect the tax.

Finally, because sales taxes are fairly common, it may be politically easier to impose or increase a sales tax than to impose an excise tax.

BEST PRACTICE RECOMMENDATION:

An excise tax imposed on businesses selling sugary drinks is the best type of sugary drink tax and is preferable to a sales tax. If an excise tax is not feasible, a sales tax is preferable to no tax if the tax rate is sufficient to raise the price by 20 percent, and if a meaningful amount of the proceeds is dedicated to health initiatives such as chronic disease prevention. However, we recognize that there is no one-size-fits-all approach. Advocates should craft the tax in the context of local circumstances and preferences.

DEFINING BEVERAGES SUBJECT TO THE TAX

A key early step in writing the tax legislation is defining the "sugar-sweetened beverages" subject to the tax, consistent with the evidence of the effects of the beverages on metabolism and health. The baseline definition that has commonly been used as a starting point is all nonalcoholic beverages with any added caloric sweetener, and necessary exemptions are carved out from there. Medically necessary beverages and infant formula are typically exempt from all tax proposals.

A tax law typically is permitted to include exemptions, even when they may seem somewhat arbitrary, so long as it includes specific findings to support the exemption. However, even when exemptions are legal, the perception that the list of taxed products is arbitrary can present political challenges.

From a public health policy perspective, our expert panel advocates for a graduated tax based on the amount of added sugars contained in the container or serving (e.g. 2 cents per teaspoon). Using this approach makes it less important to completely exempt low-sugar beverages, as those beverages would be taxed at a lower rate than high-sugar beverages. It also provides an incentive for sugary drink producers to offer lower-sugar products. However, this approach may not be legally feasible, depending on the state's tax laws. Moreover, it also is likely to be more difficult to administer, which is an important consideration. If the tax is imposed on fruit drinks and flavored milks – which may have both naturally occurring and added sugars – it will be very difficult for a tax department to determine how much sugar is subject to the tax. (That job could be made easier if and when added sugars are included on the Nutrition Facts Panel.)² If 100 percent fruit juices and flavored milks are exempt, all of the taxed beverages will contain added sugars and in many, nearly all of the "total sugar" on the label will be added sugars, so this approach would be feasible even if the Nutrition Facts Panel is not amended to include "added sugars."



Taxing each ounce of product – rather than each unit of added sugar – is an all-or-nothing approach that makes some of the exemptions in the definition more important. (See the "tax base" discussion below.) Some volume-based proposals have set a sugar *threshold* and would only impose the tax on beverages with added sugar content that exceeds that amount. Setting a threshold in a volume-based tax could provide an incentive for the industry to produce lower-sugar beverages, because beverages below the threshold would not be taxed at all. Where to set the threshold is a health policy question in its own right. An expert panel convened in 2013 by the Robert Wood Johnson Foundation to establish recommendations for healthier beverages suggests that for adults and adolescents, beverages should contain no more than 40 calories per container.³ Since one gram of sugar contains 4 calories, the threshold under this recommendation would be no more than 10 grams, or approximately 2.5 teaspoons, of sugar per container.

Flavored milks, 100 percent fruit juices, and low calorie/sugar beverages (including zero calorie beverages with non-nutritive sweeteners) often have been exempted. Research regarding the metabolic and health effects of flavored milks and 100 percent fruit juices is evolving. While many experts believe that their health effects are not significantly different from other sugary drinks, the current evidence is mixed, and recommendations and guidelines from expert groups and professional associations vary. It is therefore up to each jurisdiction to make its own judgment of the current evidence and its own determination whether to include these types of beverages.

There is also consensus among those who have run tax campaigns that it is important to “keep it simple.” To some members of our expert panel, this means that beverages that are widely perceived as “healthy,” such as milk and juice, should be exempt.

Finally, alcoholic beverages, which are subject to existing excise taxes in comprehensive regulatory regimes in most states, are typically exempt from sugary drink tax proposals.

Syrups and Powders

The second definitional issue is whether, and how, to tax powders and syrups used to make sugary drinks. There is consensus to impose the tax on syrups used in soda fountains to make sugary drinks. Be aware, however, that this means that restaurants with self-serve fountain soda would have to decide whether and how to charge different prices for sugary and sugar-free beverages.

There is no consensus whether to tax syrups and powders used by a business to make other sugary drinks, such as Italian soda or flavored coffee drink. Although the expert panel generally agreed that it makes sense from a public health perspective to tax them, it may be difficult to ascertain the quantity of drinks made from these types of syrups and powders absent a specific formula or manufacturer’s instructions. Also, as with juices and milks, the public may not perceive these types of drinks in the same way as soda. Because there is no consensus on this specific issue, consultation with tax policy design experts is recommended.

Panel members advised against imposing the tax on syrups and powders that are intended for use within the home, such as Tang powder. From a public health perspective it makes sense to include these types of syrups and powders, but doing so may prompt more political resistance to the tax.

BEST PRACTICE RECOMMENDATION:

At a minimum, a strong tax should include caloric sodas, sports drinks, fruit drinks, energy drinks, sweetened teas and coffees, as well as syrups and powders used by businesses to make such beverages. If pursuing a volume-based tax, a jurisdiction needs to decide whether to exempt beverages below a minimum sugar content. Regardless of type of tax, a jurisdiction needs to consider whether to include 100 percent juices and flavored milks.

DEFINING THE TAX BASE

The tax base is the measure upon which the tax liability (the amount to be paid) is calculated.

Volume: Tax per ounce

Most recent tax legislation has proposed to levy the tax on each ounce of beverage sold, regardless of amount of sugar. While simple to calculate, this approach taxes beverages with very high amounts of sugar at the same rate as low-sugar beverages (at least those above a threshold sugar content, if one is included.)

Sugar content: Tax per gram or teaspoon of [added] sugar

An alternative is to base the tax on the amount of sugar by levying the tax on each gram (or teaspoon) of added sugar. The expert panel generally agreed that this approach makes more sense from a public health policy perspective. It is important to understand state law prior to pursuing this approach, as it may not be legally feasible for local governments in some jurisdictions.

A tax based on sugar content is slightly more difficult to administer than a per-ounce tax but from a public health standpoint is more rational – the more sugar a beverage contains, the higher the tax for that beverage. It also may contribute to public awareness that sugar is an underlying health concern, and it may provide an incentive for industry to produce and market lower-sugar products. A tax based on sugar content may be useful in raising the issue of sugar and health more broadly, but also could make it more difficult to make the case for taxing sugary drinks and not other products with sugar. As the general public understands the amount of sugar in a teaspoon more readily than in a gram, basing the tax rate on sugar content measured by teaspoons, rather than grams, is preferable.

As discussed above (in the section “Defining Beverages Subject to the Tax”), a tax based on amount of sugar becomes more complicated when a beverage contains both added sugars and naturally occurring sugars, as in flavored milk, which contains lactose naturally. In that case officials could simply ask marketers to provide the amount of added sugars their products contain, and in the event of noncompliance either estimate the taxable content or tax the full amount of sugar. However, this is only a concern if flavored milk products and fruit drinks are included, and could be obviated should the FDA require added sugars to be noted on the Nutrition Facts Panel.

BEST PRACTICE RECOMMENDATION:

Although a per-ounce tax on volume is easy to understand and administer, there is consensus that a tax based on the amount of sugar in a beverage is more rational from a public health standpoint and therefore preferable. However, a jurisdiction considering this approach should note that a tax based on sugar content is slightly more difficult to administer than a volume-based tax, and local jurisdictions must analyze the legal feasibility of this approach under state law. Other political considerations – such as whether lawmakers or voters understand or support one tax base more than another – may also apply to this decision. See Tables 1 A and B for a comparison of methods for defining the tax base using 1 and 2 cents.

TAX RATE

Discussions about the proper tax rate typically focus on two issues: the amount of revenue to be raised, and whether and to what degree the rate is sufficient to reduce consumption.

By using the tax base, tax rate, and sales data, the potential revenue is relatively simple to calculate, though this information may not be readily available. One should also take into consideration that a well-designed sugary drink tax will likely suppress consumption and will thereby reduce revenue from the tax over time. The Rudd Center for Food Policy and Obesity has developed an online tax calculator that can help calculate the amount of revenue that would be raised by a tax in your jurisdiction.⁴

The issue of what level of tax will produce a sufficient reduction in consumption is much more difficult to analyze. Most experts agree that the price of a sugary drink must increase by at least 20 percent to meaningfully affect consumption patterns and health outcomes.⁵ When taxing by volume, a tax rate of two cents per ounce will result in a roughly 20 percent increase in the purchase price, if all of the tax is passed on to consumers in the shelf price. In many jurisdictions, polling shows equal support for rates of one- and two-cents-per-ounce.



When the tax is based on sugar content, a half-cent per gram (or 2.5 cents per teaspoon) yields about a 20 percent tax rate, based on the price and sugar content of popular sugary drink products. The best way to get a sense of how a per-gram tax may affect prices is to visit local retailers and get a sampling of prices for popular drinks. By looking at their sugar content you can get a sense of how certain per-gram or per-teaspoon rates may affect price. In Table 1B, you can see that, though the two products are comparable in price, a tax on amount of sugar raises the price for a 20-oz. Coca-Cola more than for a 20-oz. Vitaminwater, which has half the sugar. Although Red Bull and Coke have the same sugar content and Red Bull has twice the sugar of Vitaminwater, a 20 oz. Red Bull has the smallest percent price increase because the drink is significantly more expensive than Coke and Vitaminwater.

Note that most of the literature and modeling that discusses a potential reduction in consumption focuses on the potential effect of a specific percent price increase for the beverages subject to the tax. The actual increase in price produced by a given tax rate depends on the proportion of the tax that is passed through and the base price of the drink. Regardless of what type of tax is imposed, it is not yet clear how much the sales price might increase because of uncertainty in the exact proportion of pass-through.⁶ Economists suggest that the larger the jurisdiction, the more likely the full amount of tax will be passed on to the consumer.

As noted above, the tax law could conceivably mandate that the tax be “passed through” to businesses further down the distribution chain and ultimately to consumers. Even with mandatory pass-through language, the beverage industry retains control over the base costs and wholesale prices of the beverages, and could lower those to blunt the effects of the tax. Therefore, absent adoption of an actual minimum price law (which sets a statutory minimum price for retail sales of sugary drinks), a jurisdiction setting a tax rate must acknowledge this uncertainty.

There is also consensus that the tax rate should be automatically adjusted for inflation.

Table 1: Comparison of Methods for Defining the Tax Base Using 1 and 2 Cents

The tables below are included for illustration purposes only. Prices and preferences for different types of beverages vary across the US and will impact revenue generation and the percent by which prices increase. Price data were collected in January 2016 from a Safeway grocery store in Seattle, WA and may not represent prices across the US.

A.

Tax on Volume (ounces of beverage)		100% pass through*		100% pass through	
Product Size & Type	Price	1 cent per oz. tax price increase		2 cent per oz. tax price increase	
Coca-Cola 12 oz 39g sugar	\$ 1.17	\$ 0.12	10%	\$ 0.24	21%
Coca-Cola 2L/72oz 234g sugar	\$ 1.99	\$ 0.72	36%	\$ 1.44	72%
Mountain Dew 20 oz 77g sugar	\$ 1.89	\$ 0.20	11%	\$ 0.40	21%
Coca-Cola 20 oz 65g sugar	\$ 1.89	\$ 0.20	11%	\$ 0.40	21%
Red Bull 20 oz 65g sugar	\$ 4.29	\$ 0.20	5%	\$ 0.40	9%
VitaminWater 20 oz 32g sugar	\$ 1.39	\$ 0.20	14%	\$ 0.40	29%

B.

Tax on Amount of Sugar (grams)		100% pass through*		100% pass through	
Product Size & Type	Price	1 cent per teaspoon tax price increase		2 cent per teaspoon tax price increase	
Coca-Cola 12 oz 39g / 9 tsp sugar	\$ 1.17	\$ 0.09	8%	\$ 0.18	15%
Coca-Cola 2L/72oz 234g / 56 tsp sugar	\$ 1.99	\$ 0.56	28%	\$ 1.12	56%
Mountain Dew 20 oz 77g / 18 tsp sugar	\$ 1.89	\$ 0.18	10%	\$ 0.36	19%
Coca-Cola 20 oz 65g / 16 tsp sugar	\$ 1.89	\$ 0.16	8%	\$ 0.32	17%
Red Bull 20 oz 65g / 16 tsp sugar	\$ 4.29	\$ 0.16	4%	\$ 0.32	7%
VitaminWater 20 oz 32g / 8 tsp sugar	\$ 1.39	\$ 0.08	6%	\$ 0.16	12%

* In Berkeley, the sugary drink tax was on average passed through at 69%. If the tax is not passed through at 100%, a higher tax rate may be necessary to raise the price of products sufficiently to have an impact on consumption. For example, at 69% pass through, a two-cent-per-ounce tax on a 20 oz. Coke would only increase the price by 15%, somewhat less than desired.

BEST PRACTICE RECOMMENDATION:

While there is no ideal, uniform “best” rate, a tax that equals 20 percent of the price of the beverage is the appropriate starting point.

WHAT BUSINESSES ARE REQUIRED TO PAY THE TAX?

Assuming an excise tax is proposed, another decision is whether to impose the tax on wholesalers/distributors or on retailers. (Sales taxes are paid by consumers.) There are both policy and legal considerations in deciding this issue and input from local legal counsel is advised.

Applying the tax to wholesalers/distributors is potentially simpler to administer because there are fewer (generally larger) taxpayers. These larger businesses are better equipped to compute and pay the tax they owe. From a political standpoint, it may be easier to explain the tax as being “on the industry” rather than on local mom-and-pop businesses. However, there are several potential issues that arise with a tax on wholesalers/distributors. One potential disadvantage is that it may be difficult to identify all the wholesalers and distributors, particularly common carriers such as a trucking company with no affiliation with the soda industry.⁷ At the same time, some distribution occurs within a single company, such as store brand sodas transferred from a company-owned warehouse to a retail outlet within a large chain. The taxable event should be defined broadly enough to capture these intracompany transfers. Finally, some retailers travel to neighboring cities or counties to purchase their stock and therefore would not be a defined wholesaler or distributor in those instances. In such cases, the retailer could be made liable for the tax, to ensure that all eligible beverages are taxed.

For local jurisdictions, imposing the tax on retail businesses rather than distributors forecloses any legal argument that the payors are not subject to the city or county levies. Most retail businesses are also already required to obtain a general business license and they can therefore be more readily identified. (Many wholesalers/distributors also obtain business licenses, but not all of them.) However, applying a tax to retailers could be politically more difficult as it is a tax on local, often small businesses, and may also be more difficult to collect because there are more taxpayers (i.e., more retailers than distributors). Some retailers may also find it difficult to implement and remit the tax. Further, if levied at the retail level, it is more difficult to ensure that the shelf price reflects the tax.

BEST PRACTICE RECOMMENDATION:

There is consensus that wherever possible, the tax should be imposed on wholesalers/distributors. These businesses must be carefully defined to ensure that only those with a presence in the jurisdiction are taxed, and that the tax is on distribution rather than transportation. Moreover, the tax ordinance should include language to capture products that are distributed internally, or that are purchased by retailers from outside the jurisdiction.

EXEMPTION FOR SMALL BUSINESSES

In California it is not uncommon to exempt very small businesses (below a certain level of annual gross sales, typically \$100,000) from business license taxes. While supporters may find it politically advantageous to include such an exemption, the impact on the efficacy of the sugary drinks tax will be a local political and policy calculation.

EARMARKING TAX PROCEEDS

Another key policy decision – with legal considerations as well – is whether to earmark the revenue, and for what purposes. One approach has been to dedicate the proceeds in the law to support activities and programs aimed at improving population health. Various proposals have directed revenue toward chronic disease/obesity prevention, public health funding in general, and increased access to individual health insurance (e.g. Medicaid). Earmarking can also direct tax proceeds to the communities that disproportionately bear the burden of conditions such as diabetes and obesity that are associated with overconsumption of sugary beverages. Our experts agree that a meaningful amount of the tax revenue should support prevention of chronic disease and/or obesity. However, political considerations in the context of a specific tax initiative may require negotiations and compromises on the dedication target(s) or even whether revenues should be dedicated at all (versus contributing to the General Fund).

Dedication is the most certain mechanism to ensure that health initiatives are funded, but may limit flexibility for addressing changing priorities over time. Dedication may also pose legal and political problems in certain jurisdictions. An alternative strategy is to create a panel of experts to provide input on the process of allocating proceeds. If the tax proceeds are not earmarked, such a panel can make recommendations to the legislative body about how to spend the funds. Even if the tax proceeds are earmarked, a panel of experts can provide recommendations about how funds are used and disbursed, and serve as a point of accountability to assure that the entities that receive funds are using them as intended.

While there is consensus that a significant portion, if not all, of the tax proceeds should be directed to vulnerable populations, there is no consensus on the specific entities or programs that should receive the proceeds. This is a decision best made in the specific context of a jurisdiction designing the tax.

Note: In California there are different and more onerous procedural requirements for imposing taxes with the proceeds earmarked. This may be the case in other states.

BEST PRACTICE RECOMMENDATION:

There is consensus that tax proceeds should be earmarked for public health policies and programs that address the health conditions caused by sugary drinks and directed to communities that disproportionately suffer from sugar-related chronic disease, but no consensus about the exact type of programs and whether the tax is not worth pursuing without earmarking. We recommend dedication or including alternative mechanisms to direct all or at least a meaningful amount of the revenues to health initiatives. However, we recognize that there is no one-size-fits-all approach. Advocates should craft the tax in the context of local circumstances and preferences.



FOOTNOTES

1. The term “excise tax” encompasses many different types of taxes – gross receipts tax, business license tax, business and occupations tax, business privilege tax, and fees (e.g. the language used in California: business license fee, health impact fee) – to name a few. Although lacking a precise and universal definition, a common element of most excise taxes is that they are usually imposed on businesses for the privilege of operating the business or for the privilege of selling a specific product.

2. Note that at the time of this publication, the FDA has already begun a rulemaking process to include “added sugars” on the Nutrition Facts Panel.

<http://www.fda.gov/Food/GuidanceRegulation/GuidanceDocumentsRegulatoryInformation/LabelingNutrition/ucm385663.htm>

3. See “Recommendations for Healthier Beverages,” available at:

<http://childhoodobesity2015.com/docs/uploads/WS1.1-Fox.Handout.SS2013%20OrderSummary.pdf>

4. Available at: <http://uconnruddcenter.org/revenue-calculator-for-sugar-sweetened-beverage-taxes>

5. Long MW, Gortmaker SL, Ward ZJ, et al. Cost Effectiveness of a Sugar-Sweetened Beverage Excise Tax in the U.S. *Am J Prev Med*. 2015 Jul; 49(1):112-23

6. Falbe J, Rojas N, Grummon AH, Madsen KA. Higher Retail Prices of Sugar-Sweetened Beverages 3 Months After Implementation of an Excise Tax in Berkeley, California. *Am J Public Health*. 2015 Oct 7;105(11):2194-201.

7. Also, in some states, such as California, local jurisdictions cannot impose taxes on transportation businesses, so the tax proposal must be structured so as not to impose the tax on *transportation*, but rather on *distribution*.