Soda taxes create controversy and tie up the courts

David M. Kall | Thursday, August 10, 2017

It was not long ago that we addressed the case in Philadelphia that is headed to the Pennsylvania Supreme Court over the city's Jan. 1, 2017 imposition of a 1.5 cents tax per fluid ounce on the distribution of certain sugar filled beverages. The plaintiffs lost in the trial and appellate courts, and promptly filed their petition for allowance of appeal in mid-July, hoping that the high court will agree that the beverage tax is unlawful for, among other things, duplicating Pennsylvania's sales and use taxes.

Philadelphia's soda tax debate

Sugar-sweetened beverage taxes have raised a fair amount of controversy. For instance, in a blog titled Soda Tax Experiment Failing in Philadelphia Amid Consumer Angst and Revenue Shortfalls, the Tax Foundation disapproves of the city's effort because, it is not generating the promised revenue, has hurt local employment, and harmed low-income taxpayers disproportionately. For these reasons, the Tax Foundation argues, "Philadelphia's experience serves as a cautionary tale for other areas weighing similar beverage taxes."

Philadelphia's mayor estimated that this "sin tax" would raise $91 million annually to pay for pensions, schools, and investments in community infrastructure and energy efficiency. The tax was only in effect for half of fiscal year 2017, which ended on June 30, 2017, so the revenue goal was half of that, about $46 million. The tax's purpose was unusual for a sin tax, which is usually designed to discourage unhealthful, costly behavior. In a PBS Newshour interview, Philadelphia's mayor referred to a reduction in soft drink

consumption as merely an "ancillary benefit."

Regardless of any health benefits, the Tax Foundation points out that for fiscal year 2017, Philadelphia collected just $39.4 million in new tax revenues, 15 percent below original expectations. In fact, revenues have missed their target of $7.7 million each month of this year, as follows:

	MONTHLY GOAL	ACTUAL COLLECTIONS	DIFFERENCE
January	$7,700,000	$5,931,239	-29.8%
February	$7,700,000	$6,180,869	-24.6%
March	$7,700,000	$7,042,953	-9.3%
April	$7,700,000	$6,521,859	-18.1%
May	$7,700,000	$6,870,000	-12.1%
June	$7,700,000	$6,920,000	-11.3%

Moreover, citing a February Bloomberg article, the Tax Foundation notes that from the beginning, sales had begun to decline, by nearly 50 percent, according to some distributors and retailers. This is one of the underlying problems with these kinds of revenue raising measures: the change in consumer behavior threatens the sustainability of the tax, calling reliability of the revenues into question.

Besides overestimated tax proceeds, another problem that the group observes is the negative impact of the tax on the beverage market:

> Since implementation, stories have emerged of harm to local manufacturing and convenience store workers and reductions in consumer choices…local branches of Coca-Cola report a workforce downsizing of 40 positions and PepsiCo reports laying off 80-100 workers as a result of decreased soda sales from the tax. PepsiCo further announced that it would be pulling all 12-pack and 2-liter products of its brands from Philadelphia grocery and convenience stores and other vendors.

Yet a third issue is the regressive nature of the beverage tax. The regressive nature of the tax is exacerbated because some consumers can travel outside of the city to avoid the tax; those who cannot are likely to be poorer.

Finally, the litigation that we have described is costly. Suggests the Tax Foundation, "[o]ther localities wishing to avoid these travails should seek funding for programs with broader-based, more predictable tax instruments."

Cook County litigation

Chicago is another jurisdiction in which litigation is playing out over a beverage tax. At the end of June, the Illinois Retail Merchants Association (IMRA) and several food retailers sued Cook County for its 1 cent per ounce tax. Unlike Philadelphia's, Chicago's tax is imposed on the *retail* sale of sugary beverages.

The plaintiffs' argue that the levy violates the Illinois Constitution's uniformity clause because it "creates classifications of sweetened beverages that are not based on any real or substantial differences." For example, they say that "ready-to-drink, pre-made sweetened beverages," such as bottled, sweetened ice tea, or bottled Frappuccinos, are taxable, whereas "on-demand, custom sweetened beverages," like sweetened ice tea mixed by a barista, or hand-made Frappuccinos, are not. Thus, "identical sweetened beverages…are classified as both taxable and non-taxable."

Moreover, the plaintiffs argue that even if the tax classifications are based on real and substantial differences, they "bear no reasonable relationship to the purpose" of the tax, which is to "promote public health and reduce obesity rates, because the health consequences of identical beverages in separate classifications are the same."

The complaint also contends that the tax is unconstitutionally vague, because it is "impossible to implement and apply in the circumstances it is intended to operate." This is so with respect to application of the law for sales under the SNAP program, or Federal Supplemental Nutrition Assistance Program, as well as its application to the "sale price," because what actually constitutes the sale price, for purposes of the law, is uncertain.

This litigation has moved fast so far. The lower court dismissed the case on July 28, 2017, just a month after it was filed. In the opinion, posted online by Bloomberg, the court disagreed with the plaintiffs' Uniformity Clause argument because Cook County has "set forth a real and substantial difference between the people taxed, who purchase ready-to-drink, pre-made sweetened beverages, and those not taxed, who purchase on-demand, custom sweetened beverages."

The court also concluded that there was a reasonable enough relationship between the purpose of the tax classification and its stated objectives: "perfect rationality is not required…a minimum standard of reasonableness is all that is required."

Finally, the court acknowledged that there could be instances of both over and under taxation, but determined that this is permissible: "[t]he fact that a statute might be susceptible of misapplication or varying interpretations does not necessarily make it unconstitutional."

On Aug. 1, 2017, the plaintiffs filed their notice of appeal, also posted on-line by Bloomberg, seeking a hearing to determine the case on its merits. Cook County warns that tax collections were to begin on Aug. 2, 2017.

David M. Kall
Team member bio