

**DEPARTMENT OF TAXATION
2015 Fiscal Impact Statement**

1. **Patron** K. Rob Krupicka

2. **Bill Number** HB 1310

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Vapor Products; Imposition of Tax

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would impose an excise tax on “vapor products” at the rate of \$0.40 per fluid milliliter of consumable product. “Vapor products” would be defined as any noncombustible product that employs a mechanical heating element, battery, or electronic circuit regardless of shape or size that can be used to produce vapor from nicotine in a solution. The term includes any vapor cartridge or other container of nicotine in a solution or other form that is intended to be used with or in an electronic cigarette, electronic cigar, electronic cigarillo, electronic pipe, or similar product or device. The term does not include products regulated by the U.S. Food and Drug Administration under the Drugs and Devices chapter of the Federal Food, Drug, and Cosmetic Act. Revenues from the tax on vapor products would be dedicated to the Health Care Fund. The excise tax would be administered in the same manner as the Tobacco Products Tax.

The bill would also authorize any locality with the authority to impose a local cigarette tax to impose a tax on the sale or use of vapor products at a rate based upon the per milliliter content of consumable product in the vapor product. Fairfax County and Arlington County would be authorized to impose the local vapor products tax at a rate not to exceed the state excise tax rate of \$0.40 per milliliter of consumable product. The revenues would be required to be used to make grant payments or fund center-based kindergarten programs or preschool programs designed for child development and kindergarten preparation in the Commonwealth.

All cities and towns with general taxing powers are already currently authorized to impose a cigarette tax with no rate limitations. Only two counties, Arlington and Fairfax, are authorized to impose a local cigarette tax, which is limited to the amount of the state cigarette tax rate. The state cigarette tax rate is currently 30 cents per pack of 20 cigarettes.

The effective date of this bill is January 1, 2016.

6. Budget amendment necessary: Yes.

ITEM(S): Page 1, Revenue Estimates

301, Medicaid Program Services, Department of Medical Assistance Services

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **7a. Expenditure Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2014-15	\$0	0	GF
2015-16	\$0	0	GF
2016-17	\$171,000	2	GF
2017-18	\$165,000	2	GF
2018-19	\$165,000	2	GF
2019-20	\$165,000	2	GF
2020-21	\$165,000	2	GF

7b. **Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2014-15	\$0	HCF
2015-16	\$16.9 Million	HCF
2016-17	\$41.3 Million	HCF
2017-18	\$42.2 Million	HCF
2018-19	\$43.1 Million	HCF
2019-20	\$44.0 Million	HCF
2020-21	\$45.0 Million	HCF

8. **Fiscal implications:**

Administrative Costs

The Department would incur administrative expenses of approximately \$171,000 in Fiscal Year 2017 and \$165,000 in Fiscal Year 2018 and each Fiscal Year thereafter for 2 auditors beginning in Fiscal Year 2017 to cover stores selling vapor products, but not currently selling traditional cigarettes.

Revenue Impact

This bill would increase the total revenues designated for the Health Care Fund by an estimated \$16.9 million in Fiscal Year 2016, \$41.3 million in Fiscal Year 2017, \$42.2 million in Fiscal Year 2018, \$43.1 million in Fiscal Year 2019, \$44.0 million in Fiscal Year 2020, and \$45.0 million in Fiscal Year 2021. As vapor products and electronic cigarettes are a new market and little data is available, the revenue estimates do not take into account the effect increasing the price would have on the number of vapor products sold. Because fewer vapor products may be sold as the price increases, increasing the price of vapor products by imposing a tax on the product may result in a decrease in the number of vapor products sold. If the increase in tax results in substantially fewer vapor products being sold, the actual revenue gain could be significantly lower than the revenue estimate.

As the Retail Sales and Use Tax is imposed on vapor products, increasing the price of the vapor products by imposing an excise tax on the vapor products would result in an increase of Retail Sales and Use Tax revenues. The chart below shows the estimated revenue impact of the bill to on the Retail Sales and Use Tax without taking into account the effect increasing the price would have on the number of vapor products sold.

However, if the increase in tax results in substantially fewer vapor products being sold, the actual revenue gain could be significantly lower than the revenue estimate.

<i>State and Local Retail Sales and Use Tax Revenue Estimate</i> (Estimate does not take into account effect increasing the price would have on the number of vapor products sold) (\$ millions)						
Excise Tax rate \$0.40						
	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
<i>General Fund-Unrestricted</i>	\$0.4	\$0.9	\$0.9	\$0.9	\$1.0	\$1.0
<i>General Fund-Restricted</i>	\$0.2	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5
<i>Transportation Trust Fund</i>	\$0.1	\$0.2	\$0.2	\$0.2	\$0.2	\$0.2
<i>Local Option</i>	\$0.2	\$0.4	\$0.4	\$0.4	\$0.4	\$0.4
<i>Dealer Discount</i>	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<i>HMOF GF Transfer</i>	\$0.0	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
<i>HMOF</i>	\$0.0	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
<i>IPROCF</i>	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<i>Mass Transit Fund</i>	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<i>HRTPO and NVTA Fund</i>	\$0.1	\$0.2	\$0.2	\$0.2	\$0.2	\$0.2
Total	\$1.0	\$2.3	\$2.4	\$2.4	\$2.5	\$2.5

This bill also would allow the localities currently authorized to impose a local cigarette tax to impose a vapor products tax. This would result in an unknown gain in local revenues. According to *Virginia Local Tax Rates, 2013*, published by the Weldon Cooper Center for Public Service, 30 cities, 2 counties, and 53 towns currently report imposing a cigarette tax. If every locality currently imposing a local cigarette tax imposed the vapor products tax at the proposed state rate of \$0.40 per fluid milliliter, the bill would increase local revenues by approximately \$17 million annually.

9. Specific agency or political subdivisions affected:

- Department of Taxation
- Department of Medical Assistance Services
- Health Care Fund
- All localities

10. Technical amendment necessary: No.

11. Other comments:

Tobacco Products Tax

Prior to January 1, 2011, the tobacco products tax was imposed on tobacco products at the rate of 10% on the manufacturer’s sales price. Cigarettes are not subject to the tax on tobacco products.

Tobacco products include the following:

- Cigars -- any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco that is a cigarette).
- Smokeless tobacco --
 - Snuff -- any finely cut, ground, or powdered tobacco not intended to be smoked.
 - Chewing tobacco -- any leaf tobacco not intended to be smoked.
- Pipe tobacco -- any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe.

Effective January 1, 2011, the tobacco products tax is imposed on moist snuff at a rate of \$0.18 per ounce based on net weight. Moist snuff is defined as any tobacco product consisting of finely cut, ground, or powdered tobacco that is not intended to be smoked but shall not include any finely cut, ground or powdered tobacco that is intended to be placed in the nasal cavity.

Effective January 1, 2011, the tobacco products tax is imposed on loose leaf tobacco at rates of \$0.21 for each unit that is less than 4 ounces, \$0.40 for each unit that is at least 4 ounces but not more than 8 ounces, and \$0.70 for each unit more than 8 ounces but not more than 24 ounces. Units of loose leaf tobacco that exceed 24 ounces are subject to the Tobacco Products Tax at a rate of \$0.21 per unit plus \$0.21 for each 4 ounce increment that the unit exceeds 16 ounces. Loose leaf tobacco is defined as any leaf tobacco that is not intended to be smoked, but does not include moist snuff.

The tax continues to be imposed on all other tobacco products at the rate of 10% on the manufacturer's sales price.

Health Care Fund

Under current law, all revenues from the Cigarette Tax, the tax on roll-your-own tobacco and the Tobacco Products Tax are deposited into the Health Care Fund. The federal government matches state funds spent on Medicaid, based on a state's federal medical assistance percentage (FMAP) match rate. The FMAP determined for each state has a statutory minimum of 50 percent and maximum of 83 percent; although Medicaid expenditures for some selected services and supports are matched at a higher rate for all states.

Currently, Health Care Fund revenues are used solely for the provision of health care services including, but not limited to, Medicaid payments, disease diagnosis, prevention and control, and community health services.

Other States

While legislation taxing electronic cigarettes has been introduced in 20 states, legislation has only been enacted in Minnesota and North Carolina. In 2010, Minnesota amended the definition of "tobacco products" to include products containing, made, or derived from

tobacco that are intended for human consumption. The Minnesota Department of Revenue issued Revenue Notice 12-10 on October 22, 2012, stating the Department's position that the 2010 legislation subjected any electronic cigarette or cartridge containing nicotine to the tobacco products tax, unless the taxpayer can prove that the nicotine was not derived from tobacco. Minnesota currently imposes the Tobacco Products Tax at the rate of 95% of the wholesale sales price.

North Carolina enacted legislation in 2014 to impose an excise tax on "vapor products" at the rate of \$0.05 per fluid milliliter of consumable product. The tax is scheduled to take effect June 1, 2015.

Local Cigarette Tax

All cities and towns with general taxing powers are already currently authorized to impose a cigarette tax with no rate limitations. According to Virginia Local Tax Rates, 2013, published by the Weldon Cooper Center for Public Service, thirty cities and fifty-three towns currently report imposing a cigarette tax. Only two counties, Arlington and Fairfax, are authorized to impose a local cigarette tax, which is limited to the amount of the state cigarette tax rate, currently 30 cents per pack of 20 cigarettes. Both Arlington County and Fairfax County impose the local cigarette tax at the maximum allowed rate of 30 cents per pack of 20 cigarettes.

Proposal

This bill would impose an excise tax on "vapor products" at the rate of \$0.40 per fluid milliliter of consumable product. "Vapor products" would be defined as any noncombustible product that employs a mechanical heating element, battery, or electronic circuit regardless of shape or size that can be used to produce vapor from nicotine in a solution. The term includes any vapor cartridge or other container of nicotine in a solution or other form that is intended to be used with or in an electronic cigarette, electronic cigar, electronic cigarillo, electronic pipe, or similar product or device. The term does not include products regulated by the U.S. Food and Drug Administration under the Drugs and Devices chapter of the Federal Food, Drug, and Cosmetic Act. Revenues from the tax on vapor products would be dedicated to the Health Care Fund. The excise tax would be administered in the same manner as the Tobacco Products Tax.

The bill would also provide that a distributor that calculates and pays the tax in good faith reliance on the amount of consumable product listed by the manufacturer on its invoice shall not be liable for additional tax, interest or penalties, solely by reason of a subsequent determination that such information was incorrect.

The bill would also authorize any locality with the authority to impose a local cigarette tax to impose a tax on the sale or use of vapor products at a rate based upon the per milliliter content of consumable product in the vapor product. Fairfax County and Arlington County would be authorized to impose the local vapor products tax at a rate not to exceed the state excise tax rate of \$0.40 per milliliter of consumable product. The revenues would be required to be used to make grant payments or fund center-based kindergarten programs or preschool programs designed for child development and kindergarten preparation in the Commonwealth.

Localities imposing the tax on the sale or use of vapor products would be authorized to enact an ordinance providing for the administration and enforcement of the tax. The ordinance may provide for the registration of any distributor, wholesaler, vendor, retailer, or other person selling, storing, possessing, or transporting vapor products within the taxing jurisdiction. Such registration may be conditioned upon the filing of a bond with a surety company, which may not exceed one and one-half times the average monthly liability of such person. The ordinance may also (i) impose a penalty for the late payment of any vapor products tax not to exceed 10 percent per month, (ii) impose a penalty for fraud or evasion of such tax not to exceed 50 percent, and (iii) assess interest not to exceed three quarters of one percent per month, upon any vapor products tax found to be overdue and unpaid.

The bill would authorize any locality imposing a tax upon the sale or use of vapor products to delegate, by ordinance, its administrative and enforcement authority to an agency or authority. The agency or authority would be authorized to employ such staff and agents and promulgate such rules and regulations as are necessary to administer and enforce the tax.

The effective date of this bill is January 1, 2016.

Similar Legislation

Senate Bill 784 would authorize all counties, cities and towns to impose a local cigarette tax. Any county cigarette tax authorized by this bill would be limited to 5 cents per pack or the amount levied under state law, whichever is greater.

Senate Bill 1004 would impose an excise tax on “vapor products” at the rate of \$0.18 per fluid milliliter of consumable product. The bill would also authorize any locality with the authority to impose a local cigarette tax to impose an excise tax on vapor products at a rate based upon the per milliliter content of consumable product in the vapor product.

cc : Secretary of Finance

Date: 1/22/2015 AM
DLAS File Name: HB1310F161