

DEPARTMENT OF TAXATION

2017 Fiscal Impact Statement

1. **Patron** Kaye Kory

3. **Committee** House Finance

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

2. **Bill Number** HB 2056

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would impose an excise tax on consumable vapor products at the rate of \$0.05 per fluid milliliter of consumable product and at the rate of 10 percent of the retail sales price of non-consumable vapor products and devices. "Vapor products" would include electronic cigarettes and similar products or devices that are nonlighting, noncombustible, and employ a mechanical heating element, battery, or electronic circuit that can be used to produce aerosol in a solution. "Consumable vapor products" would be defined as any liquid solution or other material that is depleted as a vapor product is used. Revenues from the tax would be dedicated to the Tobacco Settlement Fund. The tax would be administered in the same manner as the Tobacco Products Tax.

The bill would also authorize any county, city, or town that had the authority to impose a local cigarette tax prior to January 1, 1977, to impose a tax on the sale or use of vapor products at a rate based on the per fluid milliliter of consumable product and an excise tax based upon the manufacturer's sales price of 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 \$0.05 per fluid milliliter of consumable product and 10 percent of the retail dealer's sales price of non-consumable vapor products.

Under current law, all cities and towns with general taxing powers are 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, 2017.

6. **Budget amendment necessary:** Yes.

ITEM(S): Page 1, Revenue Estimates
275, Department of Taxation

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

7a. Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2016-17	\$	0	GF
2017-18	\$122,000	3	GF
2018-19	\$236,000	3	GF
2019-20	\$230,000	3	GF
2020-21	\$230,000	3	GF
2021-22	\$230,000	3	GF
2022-23	\$230,000	3	GF

7b. Revenue Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2016-17	\$0	TSF
2017-18	\$4.3 Million	TSF
2018-19	\$10.5 Million	TSF
2019-20	\$10.8 Million	TSF
2020-21	\$11.0 Million	TSF
2021-22	\$11.3 Million	TSF
2022-23	\$11.6 Million	TSF

8. Fiscal implications:

Administrative Costs

The Department would incur administrative costs of approximately \$122,000 in Fiscal Year 2018 and \$230,000 in Fiscal Year 2019 and each Fiscal Year thereafter. Such expenses include systems and forms changes in Fiscal Year 2018 and ongoing expenses for 3 auditors beginning in Fiscal Year 2018 to audit stores selling vapor products, but not currently selling traditional cigarettes.

Revenue Impact

This bill would increase the total revenues designated for the Tobacco Settlement Fund by an estimated \$4.3 million in Fiscal Year 2018, \$10.5 million in Fiscal Year 2019, \$10.8 million in Fiscal Year 2020, \$11.0 million in Fiscal Year 2021, \$11.3 million in Fiscal Year 2022, and \$11.6 million in Fiscal Year 2023. 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 by approximately \$0.2 million in Fiscal Year 2018, \$0.6 million in Fiscal Year 2019, \$0.6 million in Fiscal Year 2020, \$0.6 million

in Fiscal Year 2021, \$0.6 million in Fiscal Year 2022, and \$0.7 million in Fiscal Year 2023. However, the estimated revenue impact of the bill on the Retail Sales and Use Tax does not take into account the effect increasing the price would have on the number of vapor products sold. If the excise tax on vapor products results in substantially fewer vapor products being sold, the actual revenue gain could be significantly lower than the revenue estimate.

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, 2015*, published by the Weldon Cooper Center for Public Service, 30 cities, 2 counties, and 52 towns currently report imposing a cigarette tax. If every locality currently imposing a local cigarette tax imposed the vapor products tax at the equivalent of the proposed state rate effective January 1, 2017, the bill would increase local revenues by approximately \$1.9 million in Fiscal Year 2018, \$4.6 million in Fiscal Year 2019, \$4.7 million in Fiscal Year 2020, \$4.9 million in Fiscal Year 2021, \$5.0 million in Fiscal Year 2022, and \$5.1 million in Fiscal Year 2023.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Foundation for Healthy Youth
Tobacco Settlement 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.

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.

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 is imposed on all other tobacco products at the rate of 10 percent on the manufacturer's sales price.

Tobacco Settlement Fund

The Virginia Foundation for Healthy Youth determines the appropriate recipients and distributes moneys in the Tobacco Settlement Fund. A portion of the annual amount received by the Commonwealth from the Master Settlement Agreement is dedicated to the Tobacco Settlement Fund. The Tobacco Settlement Fund is required to be used for the purposes of discouraging, eliminating or preventing the use of tobacco products by minors, including but not limited to educational and awareness programs on the health effects of tobacco use on minors and laws restricting the distribution of tobacco products to minors. Moneys in the Fund may also be used for the purpose of reducing childhood obesity, including but not limited to educational and awareness programs, implementing evidence-based practices, and assisting schools and communities with related policies and programs.

Other States

Legislation taxing electronic cigarettes has been enacted in 8 states (California, Kansas, Louisiana, Minnesota, North Carolina, Pennsylvania, Washington, D.C., and West Virginia). 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 imposed an excise tax on vapor products at the rate of \$0.05 per fluid milliliter of consumable product effective June 1, 2015. Louisiana imposed an excise tax on vapor products at the rate of \$0.05 per milliliter effective August 1, 2015. Washington, D.C. imposed an excise tax on vapor products at the rate of 67 percent of the wholesale price effective October 1, 2015. Kansas imposed an excise tax on vapor products at the rate of \$0.20 per milliliter effective July 1, 2016. West Virginia imposed an excise tax on

vapor products at the rate of \$0.75 per milliliter effective July 1, 2016. Pennsylvania recently enacted an excise tax on electronic cigarettes and vapor products at the rate of 40 percent of the wholesale price effective October 1, 2016. California voted to include electronic cigarettes in the definition of “other tobacco products” and is scheduled to impose the tobacco products tax on electronic cigarettes effective April 1, 2017.

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*, 2015, published by the Weldon Cooper Center for Public Service, thirty cities and fifty-two 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 consumable vapor products at the rate of \$0.05 per fluid milliliter of consumable product and at the rate of 10 percent of the retail sales price of non-consumable vapor products and devices. “Vapor products” would include electronic cigarettes and similar products or devices that are nonlighting, noncombustible, and employ a mechanical heating element, battery, or electronic circuit that can be used to produce aerosol in a solution. “Consumable vapor products” would be defined as any liquid solution or other material that is depleted as a vapor product is used. Revenues from the tax would be dedicated to the Tobacco Settlement Fund. The tax would be administered in the same manner as the Tobacco Products Tax.

The bill would also authorize any county, city, or town that had the authority to impose a local cigarette tax prior to January 1, 1977, to impose a tax on the sale or use of vapor products at a rate based on the per fluid milliliter of consumable product and an excise tax based upon the manufacturer’s sales price of 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 \$0.05 per fluid milliliter of consumable product and 10 percent of the retail dealer’s sales price of non-consumable vapor products.

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, 2017.

Similar Legislation

House Bill 1913 and **Senate Bill 1390** would require possession of a newly created Department-issued exemption certificate to purchase for resale cigarettes bearing Virginia revenue stamps exempt from Retail Sales and Use Tax beginning January 1, 2018.

House Bill 1925 and **Senate Bill 1329** (similar) would authorize all counties to impose a local cigarette tax at a rate not to exceed 5 cents per pack or the amount levied under state law, whichever is greater.

House Bill 1950 would require localities that use stamps as evidence of payment of the local cigarette tax to provide a refund for any stamps that are returned to the locality.

cc : Secretary of Finance

Date: 1/22/2017 AM
DLAS File Name: HB2056F161