

# DEPARTMENT OF TAXATION

## 2016 Fiscal Impact Statement

1. **Patron** Paul E. Krizek

3. **Committee** House Finance

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

2. **Bill Number** HB 627

**House of Origin:**

  X   **Introduced**

      **Substitute**

      **Engrossed**

**Second House:**

      **In Committee**

      **Substitute**

      **Enrolled**

### 5. **Summary/Purpose:**

This bill would impose an excise tax on “vapor products” at the rate of 15 percent of the manufacturer’s sales price. “Vapor products” would be defined as any nonlighting, noncombustible product that employs a mechanical heating element, battery, or electronic circuit that can be used to produce aerosol from nicotine in a solution. Revenues from the tax would be dedicated to the Health Care Fund. The 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 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 15 percent of the manufacturer’s sales price.

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, Revenue Administration Services

306, Medicaid Program Services, Department of Medical Assistance Services

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

**7a. Expenditure Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Positions</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|-------------------------|--------------------|
| 2015-16                   | \$0                   | 0                       | GF                 |
| 2016-17                   | \$0                   | 0                       | GF                 |
| 2017-18                   | \$171,000             | 2                       | GF                 |
| 2018-19                   | \$165,000             | 2                       | GF                 |
| 2019-20                   | \$165,000             | 2                       | GF                 |
| 2020-21                   | \$165,000             | 2                       | GF                 |
| 2021-22                   | \$165,000             | 2                       | GF                 |

**7b. Revenue Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|--------------------|
| 2015-16                   | \$0                   | HCF                |
| 2016-17                   | \$3.8 Million         | HCF                |
| 2017-18                   | \$9.4 Million         | HCF                |
| 2018-19                   | \$9.6 Million         | HCF                |
| 2019-20                   | \$9.8 Million         | HCF                |
| 2020-21                   | \$10.1 Million        | HCF                |
| 2021-22                   | \$10.3 Million        | HCF                |

**8. Fiscal implications:**

Administrative Costs

The Department would incur administrative expenses of approximately \$171,000 in Fiscal Year 2018 and \$165,000 in Fiscal Year 2019 and each Fiscal Year thereafter for 2 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 Health Care Fund by an estimated \$3.8 million in Fiscal Year 2017, \$9.4 million in Fiscal Year 2018, \$9.6 million in Fiscal Year 2019, \$9.8 million in Fiscal Year 2020, \$10.1 million in Fiscal Year 2021, and \$10.3 million in Fiscal Year 2022. 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 2017, \$0.5 million in Fiscal Year 2018, \$0.5 million in Fiscal Year 2019, \$0.6 million in Fiscal Year 2020, \$0.6 million in Fiscal Year 2021, and \$0.6 million in Fiscal Year 2022. 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, 2014*, published by the Weldon Cooper Center for Public Service, 29 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 proposed state rate of 15 percent of the manufacturer's sales price effective January 1, 2017, the bill would increase local revenues by approximately \$1.8 million in Fiscal Year 2017, \$4.4 million in Fiscal Year 2018, \$4.5 million in Fiscal Year 2019, \$4.6 million in Fiscal Year 2020, \$4.7 million in Fiscal Year 2021, and \$4.8 million in Fiscal Year 2022.

**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.

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.

### 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

Legislation taxing electronic cigarettes has been enacted in Washington, D.C., Kansas, Louisiana, 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 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 is scheduled to impose an excise tax on vapor products at the rate of \$0.20 per milliliter effective July 1, 2016.

## 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, 2014*, published by the Weldon Cooper Center for Public Service, 29 cities and 52 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 15 percent of the manufacturer’s sales price. “Vapor products” would be defined as any nonlighting, noncombustible product that employs a mechanical heating element, battery, or electronic circuit regardless of shape or size that can be used to produce aerosol 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 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 15 percent of the manufacturer’s sales price.

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 85** and **House Bill 419** 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 830** would increase the Cigarette Tax rate from \$0.30 per pack to \$1.50 per pack of 20 cigarettes and would increase the tax on roll-your-own tobacco from 10% to 50% of the manufacturer's sales price. The bill would also increase the Tobacco Products Tax tobacco products other than moist snuff or loose leaf tobacco from 10% to 50% of the manufacturer's sales price and increase the Tobacco Products Tax on loose leaf tobacco.

**House Bill 1192** would authorize all counties to impose a local cigarette tax at a rate not to exceed 5 cents per pack or twice the amount levied under state law, whichever is greater. The bill also would require the revenue from such authorization to be dedicated to K-12 public school education.

**House Bill 1198** and **Senate Bill 155** would increase the rate that the Counties of Arlington and Fairfax are authorized to impose the local cigarette tax from the amount levied under state law or five cents per pack, whichever is greater, to double the amount levied under state law or five cents per pack, whichever is greater. The portion of the revenues derived from the imposition of the tax that is greater than 30 cents per pack would be required to be annually dedicated to elementary or secondary education.

cc : Secretary of Finance

Date: 1/21/2016 AM  
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