

**COMMONWEALTH OF KENTUCKY STATE FISCAL NOTE STATEMENT  
LEGISLATIVE RESEARCH COMMISSION  
2015 REGULAR SESSION  
REVISED 2/26/15**

**MEASURE**

2015 BR NUMBER **1373**

**HOUSE** BILL NUMBER **438**

RESOLUTION NUMBER \_\_\_\_\_

AMENDMENT NUMBER \_\_\_\_\_

**SUBJECT/TITLE** **AN ACT relating to the taxation of electronic cigarettes.**

**SPONSOR** **Representative Larry Clark**

**NOTE SUMMARY**

FISCAL ANALYSIS:  IMPACT     NO IMPACT     INDETERMINABLE IMPACT

LEVEL(S) OF IMPACT:  STATE     LOCAL     FEDERAL

BUDGET UNIT(S) IMPACT: \_\_\_\_\_

FUND(S) IMPACT:  GENERAL     ROAD     FEDERAL     RESTRICTED AGENCY \_\_\_\_\_     OTHER

**FISCAL SUMMARY**

<b>FISCAL ESTIMATES</b>	<b>2014-2015</b>	<b>2015-2016</b>	<b>ANNUAL IMPACT AT FULL IMPLEMENTATION</b>
<b>REVENUES</b>		\$7,000,000	\$8,000,000
<b>EXPENDITURES</b>			
<b>NET EFFECT</b>		\$7,000,000	\$8,000,000

( ) indicates a decrease/negative

**MEASURE’S PURPOSE:** If enacted, this proposal will tax “electronic cigarettes” under Kentucky’s tobacco products tax at the rate of 15% of the wholesale price.

**PROVISIONS/MECHANICS:**

Amends KRS 138.130 to define “electronic cigarettes”, and amend the definition of “tobacco products” to include “electronic cigarette”, effective July 1, 2015.

**FISCAL EXPLANATION:**

Since e-cigarettes are not currently in the tax base and only two states currently tax these products, there is little primary or even state-level data, in which to develop an estimate of the likely fiscal impact of an ad valorem wholesale tax.

At the national level there is information on E-cigarette sales and the market share that has been captured by these new products. These two pieces of information were used to develop a fiscal impact estimate of the potential effect of taxing Kentucky E-Cigarette sales.

The most recent data from the third quarter of 2014 suggests that sales of E-Cigs are now on pace to reach \$2.5 billion, compared to estimated US E-Cig sales of \$1.7 billion in 2013. The most recent data on the conventional cigarette market suggests that US sales of this product are \$70 billion annually. These two pieces of data suggests that E-Cigs have captured about 3.6% of the US cigarette market.

Kentucky's share of the US population—adjusted for smoking prevalence—is 2.2%. With a US E-Cig market of \$2.5 billion, if Kentucky smokers have adopted E-Cigs at the same rate as the US, then Kentucky E-cig sales are estimated to be \$54.3 million. Based on this estimate of Kentucky E-Cig sales, it is estimated that a wholesale tax of 15% would generate \$7.6 million.

Another way to estimate the potential fiscal impact of taxing E-Cigs is to develop the estimate based on the market share that has been gained by these products and applying this percentage to the Kentucky market. FY 2014 excise tax data indicate that sales of cigarettes in Kentucky are equal to 386.6 million packs. Assuming a 3.6% market share would lead to E-Cig pack equivalent sales of 13.9 million. Based on an average range of prices for E-Cig cartridges and the related component sales, using a 3.6% market share would suggest a 15% wholesale tax would generate \$6.1M.

Overall, at its present level, the E-cigarette market could generate between \$6 to \$8 million in tax receipts based on a 15% wholesale tax. However, this amount will likely grow in future years as the market for E-Cig matures. The E-cigarette market is an emerging market—one that is changing in terms of the types of products offered, the variability of products offered, and the technology used to vape the liquid nicotine. Industry reports suggest that internet sales of e-cigarettes are growing in significance, even as these products become more prevalent in the retail distribution chain. Moreover, in the coming years, e-cig volume is likely to grow, before leveling off and maybe even declining in future years like conventional cigarettes. Retail markup on E-cigs is higher than regular cigarettes, thus helping distribution and product placement in retail outlets. The price of certain E-Cig components may grow as the category matures, but overall prices of e-cig should fall as technology and competition increase. A prominent Wells Fargo Securities tobacco analyst suggests that weekly spend on e-cigarettes is 30% less compared to traditional cigarettes; therefore, to attain an equivalent amount of tax revenue the tax rate on E-cigs would have to be higher than the rate placed on conventional cigarettes.

**DATA SOURCE(S):** \_\_\_\_\_

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