

**COMMONWEALTH OF KENTUCKY FISCAL NOTE STATEMENT
LEGISLATIVE RESEARCH COMMISSION
2020 REGULAR SESSION**

MEASURE

2020 BR NUMBER 32

HOUSE BILL NUMBER 32HCS1

TITLE AN ACT relating to the taxation of tobacco products.

SPONSOR Representative Steven Rudy

FISCAL SUMMARY

STATE FISCAL IMPACT: YES NO UNCERTAIN

OTHER FISCAL STATEMENT(S) THAT MAY APPLY: ACTUARIAL ANALYSIS
 LOCAL MANDATE CORRECTIONS IMPACT HEALTH BENEFIT MANDATE

APPROPRIATION UNIT(S) IMPACTED: _____

FUND(S) IMPACTED: GENERAL ROAD FEDERAL RESTRICTED _____

FISCAL ESTIMATES	2019-2020	2020-2021	2021-2022	ANNUAL IMPACT AT FULL IMPLEMENTATION
REVENUES		\$22,600,000	\$27,300,000	
EXPENDITURES				
NET EFFECT		\$22,600,000	\$27,300,000	

() indicates a decrease/negative

PURPOSE OF MEASURE: Under current statutes, the snuff and chewing tobacco excise tax is applied on a unit basis and all other tobacco products (excluding cigarettes) are taxed at 15% of the wholesale price. Vapor products are subject to the sales and use tax under current statutes, but are not included in the definition of tobacco products; therefore, vapor products are not currently subject to the tobacco products excise tax.

HB 32 HCS1 increases the current excise tax on snuff, chewing tobacco and other tobacco products and adds vapor products (e-cigarettes and similar products) to the definition of tobacco products. By including vapor products in the tobacco products definition, these products would be subject to the tobacco excise tax. Under the provisions of the proposed substitute, the excise tax rate on snuff and chewing tobacco will increase by 100%, and the tax rate on all other tobacco products (excluding cigarettes) will increase from 15% to 25% of the wholesale price.

Under the proposed substitute, the change in the tobacco excise tax rates is effective as of August 1, 2020. Key provisions of the proposed substitute are listed below.

- Defines vapor products and includes these products in the definition of tobacco products;
- Changes the excise tax rate on snuff from \$0.19 to \$0.38 per each one and one-half ounces;

- Changes the excise tax rate on chewing tobacco from \$0.19 to \$0.38 per single unit, from \$0.40 to \$0.80 per half-pound unit, and from \$0.65 to \$1.30 per pound unit;
- Changes the excise tax rate on tobacco products—other than snuff and chewing tobacco—from 15% to 25% of the wholesale price;
- Imposes an excise tax on vapor products at a rate of 25% of the wholesale price;
- Imposes a floor stock tax on tobacco products based on inventory as of July 31, 2020. The floor stocks tax is equal to the difference between the new and old tobacco excise tax rates and is applied to all tobacco products including vapor products. The floor stocks tax will be paid in 3 monthly installments beginning on August 10, 2020;

FISCAL EXPLANATION: Expanding the tobacco excise tax base to include vapor products and increasing current tobacco tax rates will increase General Fund (GF) tax receipts attributable to tobacco product sales. HB 32 HCS1 is estimated to increase GF receipts by \$22.6 million in FY 2021 and \$27.3 million in FY 2022.

HB 32 PHS 1: Estimated Fiscal Impact	FY 2021	FY 2022
Increase in Tobacco Excise Tax	\$18.9 million	\$25.8 million
Increase in Sales Tax	\$1.1 million	\$1.5 million
Floor Stocks Tax	\$2.6 million	
Increase in General Fund	\$22.6 million	\$27.3 million

GF receipts in FY 2021 include floor stocks tax receipts and 10 months of tax receipts at the higher tobacco excise tax rates. FY 2022 GF tax receipts include 12 months of tax receipts at the higher tobacco excise tax rates, but do not include floor stocks tax receipts since this tax is imposed only on inventory as of July 31, 2020. The overall impact of these two effects in FY 2022 is estimated to result in a \$4.7 million dollar increase in the GF when compared to the GF increase in FY 2021.

The increased tax rate on snuff and chewing tobacco will result in a higher tax on each unit sold. Increasing the excise tax rate on other tobacco products from 15% to 25% of the wholesale price will result in a higher tax on each unit sold. Applying the 25% excise tax to vapor products will increase GF tax receipts since these products are not currently subject to the tobacco excise tax. It is estimated that imposing a 25% tobacco excise tax and increasing the current tobacco tax rates will cause the price of these tobacco products to increase, which will lead to higher sales tax receipts.

In developing the fiscal impact estimates, staff utilized current tobacco tax collections for snuff and chewing tobacco to calculate the unit sales of these two products in Kentucky. Estimated unit sales were then used to estimate the additional GF receipts due to the tax increase on snuff and chewing tobacco. Increased GF receipts from other tobacco products were determined based on the relative change (66.7%) in the tobacco excise tax rate for these products. Increased sales tax collections from snuff, chewing tobacco, and other tobacco products, were calculated based on the estimated increase in total sales of these products. The floor stocks tax was estimated to be one-month of sales at the higher tax rate.

Currently, seven states tax vapor products on an ad valorem basis (i.e., percentage of the wholesale price). Four of these states (MA, ME, NV, VT) imposed a vapor products tax within the past year and only one year of data was available for two states, (CA and MN). Given the limited availability of data for these six states, they were not used to estimate Kentucky tax receipts from vapor product sales.

The estimated GF impact from applying the tobacco excise tax to vapor products was developed using prevalence data (i.e., estimated Kentucky adults who use e-cigarettes) from the U.S. Centers for Disease Control and Prevention’s Behavioral Risk Factor Surveillance Survey, data on US E-Cigarette sales (i.e.,

Neilsen Scanner data and Wells Fargo Securities) and state tax data from Pennsylvania. These data were used to estimate the number of e-cigarette users, total e-cigarette sales, vapor tax collections per user, and total tax receipts on vapor products in Kentucky.

Kentucky tax receipts attributable to tobacco product sales allowed staff to develop fiscal impact estimates of tax changes based on Kentucky specific data for snuff, chewing tobacco, and other tobacco products, but not for vapor products. For this reason, there are limitations to this fiscal impact estimate.

The vapor product market has evolved rapidly over the past ten years. New products have been introduced, prices have fallen, and competition has increased. Since their introduction, vapor product sales have grown, but recent health and regulatory issues have dampened the growth in vapor product sales. Also, based on the limited data available, the tax collected per vapor product user varies widely from one state to another, and these tax receipts do not capture all vapor product sales. Data and information from states that impose a vapor products tax suggest that tax receipts rise slowly, and compliance issues can arise during the early implementation months. For these reasons, the estimated tax receipts from imposing a vapor products tax in Kentucky is difficult to determine due to uncertainty regarding the size of the vapor products market in the future.

DATA SOURCE(S): A&R Staff, LRC Office of Economic Analysis, US Centers for Disease Control and Prevention, Wall Street Tobacco Industry Update: 2019, U.S. Bureau of the Census, Kentucky State Data Center, Commonwealth of Kentucky Quarterly Economic and Revenue Report FY 2019 Annual Edition,

PREPARER: Katy Jenkins NOTE NUMBER: 149 REVIEW: JAB DATE: 2/17/2020