

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

MEASURE

2020 BR NUMBER 32

HOUSE BILL NUMBER 32 SCS1

TITLE AN ACT relating to the taxation of tobacco products.

SPONSOR Senator Christian McDaniel

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		\$9,400,000	\$15,900,000	\$15,900,000
EXPENDITURES				
NET EFFECT		\$9,400,000	\$15,900,000	\$15,900,000

() indicates a decrease/negative

PURPOSE OF MEASURE:

Under current statutes, vapor products are subject to the sales and use tax but are not included in the definition of tobacco products. Therefore, vapor products are not currently subject to the tobacco products excise tax.

The substitute would impose an additional tax on vapor product sales in Kentucky. Under the substitute, vapor products would be included in the definition of tobacco products and would be placed into two categories: open vaping systems and closed vaping systems. In this substitute, open vaping systems would be taxed at 15% of the wholesale price and closed vaping systems would be taxed at \$1.50 per cartridge. A floor stocks tax, which discourages increased purchases prior to the tax increase, is also included in the substitute. The effective date of the vapor products tax is August 1, 2020. Therefore, in FY 2021, the fiscal estimate in the table below reflects 10 months of tax receipts. The FY 2022 estimate in the table below reflects 12 months of tax receipts.

Vapor Products Taxation in the US

Twenty-one states currently tax vapor products, but the method of taxation varies from state to state. Ten states impose an ad valorem wholesale tax on all vapor products. Six states impose a wholesale tax on vapor products based on fluid content. Currently, five states (CT, NJ, NH, NM, and WA) tax vapor products by imposing a differential tax on open and closed vaping systems. Four of the five states (CT, NJ, NH, and NM) tax open vaping systems on an ad valorem basis as a percent of either the wholesale or retail price. Three of the five states (CT, NJ, and NH) tax closed vaping systems on a fluid (milliliter) basis. Washington state taxes open vaping systems at \$0.09 per milliliter and closed vaping systems at 27 cents per cartridge. New Mexico imposes a per cartridge tax on closed vaping systems. The substitute, if adopted, would impose a vapor products tax that is similar to the tax in NM, but would differ from the tax in 20 other states.

Four of the states with a bifurcated vapor tax (CT, NJ, NH, and WA) just recently imposed the tax. Given the limited availability of data (three or fewer months) for these four states, they were not used to estimate Kentucky tax receipts from vapor product sales. New Mexico imposed their vapor tax in July 2019. The vaping tax in NM is 12.5% for open systems and 50 cents per cartridge for closed systems. Staff obtained NM tax receipts on vapor products for July through December 2019. The monthly vapor product tax receipts from NM were highly variable, ranging from \$13,509 to \$253,205. After reviewing this information and corresponding with a NM tax official, staff did not use the NM tax receipts data to develop the fiscal impact of this measure.

FISCAL EXPLANATION:

Limitations and Estimation Method

Kentucky, or comparable states' tax receipts data, were not available to estimate the fiscal impact of imposing a tax on vapor products in Kentucky. For this reason, there are limitations to this fiscal impact estimate.

The vapor products 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. Based on the limited data available, the tax collected per vapor product user, even after controlling for different state tax rates, varies considerably from state to state, it is difficult to identify the market share of open versus closed systems, and national and state data do not capture all vapor product sales. Also, for the states staff were able to obtain tax receipts data from, the data indicated that vapor products tax receipts rise slowly, and compliance issues may arise during the early months of implementation. For these reasons, the estimated tax receipts from imposing a vapor products tax in Kentucky are difficult to determine due to uncertainty regarding the size of the vapor products market and the market share of open versus closed systems.

Fiscal Analysis

The estimated General Fund impact from imposing a vapor products tax was developed using prevalence data (i.e., estimated Kentucky adults who use e-cigarettes) from the US Centers for Disease Control and Prevention's Behavioral Risk Factor Surveillance Survey, data on US e-cigarette sales (i.e., Nielsen 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 by type of vapor products (open or closed) in Kentucky.

In the analysis, it was estimated that 30% of vapor sales in Kentucky would be attributable to open system products and 70% would be attributable to closed system products. The increased sales tax collections from vapor products were calculated based on the assumption the tax would be passed on to the retail consumer. The floor stocks tax was estimated to be one month of sales at the higher tax rate.

Table 1 contains the fiscal impact estimates if open vaping systems are taxed at 15% of the wholesale price and closed vaping systems are taxed at \$1.50 per cartridge. In FY 2021, the General Fund impact includes 10 months of tax receipts attributable to the vaping and sales tax, and the floor stocks tax. The FY 2022 General Fund impact includes 12 months of tax receipts but does not include the floor stocks tax. In FY 2021, the estimated General Fund impact is \$9.4 million. In FY 2022, the General Fund impact is estimated to be \$15.9 million. The estimated fiscal impact in FY 2022 is larger compared to FY 2021 due to two additional months of tax collections and higher collection rates in the second year following imposition of the tax.

Table 1
Vapor Products Fiscal Impact Estimate:
15% Open Systems and \$1.50 Per Cartridge Closed Systems

	FY 2021	FY 2022
Increase in Tobacco Excise Tax	\$8,160,000	\$15,000,000
Increase in Sales Tax	\$490,000	\$900,000
Floor Stocks Tax	\$750,000	
Change in General Fund	\$9,400,000	\$15,900,000

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, Pennsylvania Department of Revenue 2019 Annual Report.

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