

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

MEASURE

2020 BR NUMBER 108

HOUSE BILL NUMBER 351

TITLE AN ACT relating to revenue measures and declaring an emergency.

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 | | \$58.8 million | \$51.6 million | \$51.6 million |
| EXPENDITURES | | | | |
| NET EFFECT | | \$58.8 million | \$51.6 million | \$51.6 million |

() indicates a decrease/negative

PURPOSE OF MEASURE: HB 351 provides the General Fund revenue measures related to the Governor’s proposed executive branch budget. The Governor’s proposal increases various tobacco taxes, imposes a tax on vapor products, and increases the minimum tax due for the limited liability entity tax.

The key provisions in HB 351 are:

- Defines an electronic cigarette as any device, whether manufactured, distributed, marketed, or sold as an e-cigarette, e-cigar, e-pipe, or similar product and every variation thereof, regardless of shape or size, that contains a heating element, battery, electronic circuit, power source, or other electronic, chemical, or mechanical means used to produce vapor from nicotine or any other substance, the use of which simulates smoking;
- Defines vapor product as any liquid solution that is intended to be used with or in an electronic cigarette and includes that term within the definition of tobacco products;
- Increases the cigarette surtax by \$0.10 per pack of cigarettes;
- Increases the excise tax rate on snuff from \$0.19 to \$0.38 per each one and one-half ounces;
- Increases the excise tax rates on chewing tobacco to \$0.38 per single unit, \$0.80 per half-pound unit, and \$1.30 per each pound unit. The current rates are \$0.19 per single unit, \$0.40 per half-pound unit, and \$0.65 per each pound unit;
- Imposes an excise tax on vapor products at a rate of \$0.10 per fluid milliliter;

- Increases the excise tax rate on tobacco products other than snuff, chewing tobacco, and vapor products to 30 percent of the wholesale price. The current rate is 15 percent of the wholesale price;
- Removes statutory language which provides a 25% or 50% tax reduction for cigarettes or tobacco products if designated as a modified risk tobacco product by the federal government;
- Removes the statutory language which states that smokeless tobacco poses less risk than other forms of tobacco products;
- Imposes a floor stock tax on cigarettes and tobacco products based on inventory as of 11:59 p.m. on June 30, 2020. The floor stock tax is equal to the difference between the new and old tax rates. The floor stock tax may be paid in 3 monthly installments beginning on August 10, 2020; and
- Increases the minimum tax due for the limited liability entity tax to \$225. Currently, the minimum tax is \$175.

The changes related to the tobacco taxes take effect at 11:59 p.m. on June 30, 2020. The change to the limited liability entity tax applies to taxable years beginning on or after January 1, 2020.

The Governor’s recommended budget, HB 352 as introduced, relies on revenues potentially generated by the Governor’s tax proposal, HB 351 as introduced, and by HB 137.

FISCAL EXPLANATION: The chart below details the fiscal impacts by category related to General Fund receipts.

| Estimated Fiscal Impact | FY 2021 | FY 2022 |
|--|-----------------------|-----------------------|
| Increase in Cigarette Surtax Collections | \$22.6 million | \$21.7 million |
| Increase in Tobacco Excise Tax | \$22.3 million | \$24.3 million |
| Change in Sales Tax | \$0.7 million | (\$2.6 million) |
| Floor Stocks Tax | \$5.0 million | 0 |
| Limited Liability Entity Tax | \$8.2 million | \$8.2 million |
| Increase in General Fund | \$58.8 million | \$51.6 million |

The estimated increase in General Fund receipts in FY 2021 include the floor stock tax, 12 months of receipts for the cigarette surtax, 11 months of receipts for the excise tax on other tobacco products, and 11 months of receipts for the sales tax. The floor stocks tax was estimated based on one month of sales multiplied by the difference in the tax rates. FY 2022 General Fund estimated tax receipts include 12 months of receipts for all tobacco products but do not include the floor stocks tax since this tax is imposed on inventory as of June 30, 2020. The tax increases imposed by this bill will likely cause the price of tobacco products to rise, which should lead to higher sales tax receipts in FY 2021.

The cigarette surtax estimate for FY 2022 includes a 4 percent decrease in cigarette pack sales because sales typically decline from one year to the next. This will lead to a reduction in excise and sales tax receipts attributable to cigarette sales. In FY 2022, the sales tax loss from lower cigarette pack sales is larger than the increase in the sales tax due to the tax increase on other tobacco products. The net effect is lower sales tax receipts in FY 2022.

In developing the fiscal impact estimates of the proposed bill, staff utilized current cigarette tax receipts to calculate pack sales in Kentucky and then adjusted pack sales due to price increases and cross-border effects. The higher cigarette tax rate was then applied to the estimated cigarette pack sales to calculate

cigarette tax receipts under the provisions of HB 351. Estimated receipts were compared to current receipts to arrive at the increase in General Fund receipts.

Current tax receipts for snuff and chewing tobacco were used to calculate the unit sales of each of these products in Kentucky. The proposed tax rates in HB 351 were applied to these unit sales to calculate estimated tax receipts. Estimated receipts were compared to current receipts to arrive at the increase in General Fund receipts. The estimated General Fund receipts from other tobacco products besides snuff and chewing tobacco were determined based on the relative change in the tobacco excise tax rate for these products.

Increased sales tax receipts from snuff, chewing, and other tobacco products were calculated based on the estimated increase in the dollar value of sales of these products and the current sales tax rate (6%). The floor stocks tax for snuff, chewing tobacco, and other tobacco products was estimated to be one-month of sales at the higher tax rate.

The fiscal impact of taxing vapor products based on fluid content was developed using prevalence data (i.e., Estimated Kentucky adults who use e-cigarettes) from the US Centers for Disease Control and Prevention's (CDC) Behavioral Risk Factor Surveillance Survey and from state tax data. Tax data was collected from three states that tax vapor products based on fluid content (KS, NC, and WV). The tax data from Kansas and West Virginia were not used in the analysis because the tax paid per estimated vapor product user was higher (56 percent) than the tax collected per vapor product user in North Carolina.

Four other states (DE, LA, OH, WI) tax vapor products based on fluid content, but data from these states were either not current, or were limited because the tax had only recently been implemented. Due to these limitations, these states were not used in staff's analysis of the fiscal impact of taxing vapor products in Kentucky.

The CDC prevalence data for Kentucky indicated 2.4 percent of the adult population (79,000 persons) used vapor products daily. The data from North Carolina suggested that vapor product users paid \$32.23 in taxes based on a tax rate of \$0.05 per milliliter. Vapor taxes collected per user were then adjusted based on Kentucky's proposed tax rate and then multiplied by the number of estimated Kentucky vapor product users to determine the fiscal impact of taxing vapor products at \$0.10 per milliliter.

Kentucky tax data attributable to tobacco product sales in the state allowed staff to develop fiscal impact estimates of tax changes based on Kentucky specific data for cigarettes and all other tobacco products. However, Kentucky data were not available to estimate the fiscal impact of taxing vapor products. For this reason, there are certain 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 appear to have dampened the growth in vapor product sales. Also, based on the limited data collected by staff, the tax collected per vapor product user may vary widely from one state to another. Press releases from other states that impose a tax on vapor products suggest that receipts rise slowly and compliance issues can arise. 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.

It is estimated that approximately 164,000 taxpayers currently pay the minimum tax due for the limited liability entity tax. A \$50 increase for each of these taxpayers results in an annual impact of \$8.2 million.

Full implementation of the bill will occur during the second year of the biennium. It is estimated that tobacco tax receipts will continue to decline in future fiscal years.

DATA SOURCE(S): LRC staff

PREPARER: Jennifer Hays NOTE NUMBER: 98 REVIEW: JAB DATE: 1/30/2020