TAXATION OF ELECTRONIC SMOKING DEVICES - BACKGROUND MEMORANDUM

Section 1 of Senate Bill No. 2355 (2019) (appendix) directs the Legislative Management to study the feasibility and desirability of applying an alternative or additional tax on liquid nicotine and electronic smoking devices. The study must include consideration of the current method of taxation applied to these products, the methods of taxation applied in other states, and the fiscal impact of applying an alternative or additional method of taxation.

As introduced, Senate Bill No. 2355 would have changed the tax applied to all cigarette and tobacco products to a value-based method of taxation by imposing a tax of 28 percent on the wholesale cost of those products. The change would have increased the tax on a pack of cigarettes from 44 cents per pack to an equivalent tax of $1.12 per pack. The bill also would have expanded the definition of a tobacco product to include electronic smoking devices and liquid nicotine. It was estimated the bill provisions would result in a $68.7 million increase in state general fund revenues in the 2019-21 biennium. The bill was amended in the Senate to remove the substantive provisions and to provide for this study.

BACKGROUND

Electronic smoking devices have been available to consumers in the United States for more than a decade. The devices generally consist of a battery, an atomizer, a sensor that detects inhalation, and a cartridge containing a liquid solution (e-liquid) that may or may not contain nicotine. The devices have been marketed as a safer alternative to traditional cigarettes that cause users to inhale smoke and tar.

FEDERAL REGULATION

In 2009, Congress passed the Family Smoking Prevention and Tobacco Control Act, which gave the United States Food and Drug Administration (FDA) the authority to regulate the manufacturing, distribution, and marketing of tobacco products. This authority was expanded by rule in 2016 under the FDA's authority to "deem" certain products as tobacco products. The final deeming rule, which became effective on August 8, 2016, allows the FDA to regulate electronic nicotine delivery systems, which include e-cigarettes, vapes, e-liquids, e-cigars, e-pipes, and e-hookahs. The rule subjects the products to the same rules applied to other tobacco products, including the prohibition on sales to individuals under the age of 18, sales in vending machines located outside of adult-only areas, and free sample distributions. The rule also subjects all newly regulated tobacco products, including electronic nicotine delivery systems, to FDA marketing authorization requirements unless the products were commercially marketed before February 16, 2007.

The FDA staggered the deadlines by which manufactures are required to submit premarket review applications based on the type of application submitted. The staggered application timelines included a 12-month deadline for substantial equivalence exemption applications, used in instances in which only minor changes were made to a tobacco additive; an 18-month deadline for substantial equivalence applications, used in instances in which a manufacturer claims the product is nearly identical to a product that received grandfather status; and a 24-month deadline for premarket tobacco product applications for new products. Applications for new products must show the new product would be appropriate for the protection of public health, taking into consideration the risks and benefits to users and nonusers of tobacco products. Manufacturers can continue to market their products during the application period and for 12 months after the application period, unless the FDA issues a ruling on an application before the end of that time period.

In August 2017, the FDA extended the application deadlines for manufacturers submitting applications for review of electronic nicotine delivery system products to August 8, 2022. Following various additional changes to the application deadlines, multiple public health groups filed a lawsuit against the FDA which culminated in an order from the United States District Court in Maryland requiring the FDA to set a deadline of May 11, 2020, for manufacturers to submit premarket tobacco applications for any electronic nicotine delivery systems on the market as of August 8, 2016. Premarket tobacco applications submitted to the FDA must contain information detailing any investigations or reports that illustrate the health risks of the product submitted for review and whether the product poses less of a risk compared to other products; a statement of the components, ingredients, additives, and properties of the product; a description of the methods used in manufacturing, processing, and packaging the product; samples of the product and any necessary components of the product; and samples of proposed warning labels for the product.

The most recent federal action relating to e-cigarettes occurred on September 11, 2019, when President Donald Trump announced the FDA would takes steps to remove flavored e-cigarettes from the market. The announcement targeted the rapid increase in the underage use of e-cigarettes which, according to statistics cited by the FDA, were used by 3.62 million middle and high school students in 2018. The announcement also came after weeks of widely publicized reports of lung injuries and deaths seemingly linked to vaping. Figures released by the Centers for Disease Control and Prevention (CDC) indicated, as of September 17, 2019, 530 cases of lung injuries in individuals who reported using e-cigarettes or vaping products were reported to the CDC by 38 states. The CDC also reported seven confirmed deaths of individuals in the states of California, Illinois, Indiana, Kansas, Minnesota, and Oregon. The CDC is working actively with the FDA and state and local health departments to investigate further the causes behind the recent outbreak of illnesses but has yet to identify any specific product or substance that is linked to all cases.

STATE REGULATION

Legislation had been enacted in various states to regulate e-cigarettes, partially as a result of delays in regulating the products at the federal level. According to data published by the Public Health Law Center at Mitchell Hamline School of Law, as of June 15, 2019, 29 states have enacted e-cigarette product packaging laws, 26 states have enacted licensing requirement laws for e-cigarette retailers, and 20 states have enacted laws raising the minimum age at which e-cigarettes legally may be purchased to either age 19 or 21. North Dakota has enacted laws that prohibit the sale or distribution of electronic smoking devices or e-liquid to individuals under the age of 18, require nicotine liquid containers be child-resistant, and prohibit the operation of e-cigarettes in public places, places of employment, and within 20 feet of entrances, exits, windows, air intakes, and ventilation systems.

States and cities also have taken recent action to ban various e-cigarette products following reports of lung injury and death seemingly linked to vaping. In June 2019, San Francisco Mayor London Breed signed an ordinance, effective January 2020, suspending the sale of all e-cigarettes that had yet to undergo a premarket review by the FDA. The ordinance expanded upon the existing ban on flavored e-cigarettes, which had been in place since 2017. On September 4, 2019, Michigan Governor Gretchen Whitmer ordered the Michigan Department of Health and Human Services to issue emergency rules banning the sale of flavored nicotine vaping products in Michigan. On September 15, 2019, New York Governor Andrew Cuomo announced an emergency executive action to ban the sale of flavored e-cigarettes in New York State.

TAXATION OF ELECTRONIC SMOKING DEVICES

Nineteen states and the District of Columbia have taken administrative action or passed legislation imposing tax on electronic smoking devices or e-liquid. Minnesota was the first state to impose a tax in 2012, and the most recently imposed tax will become effective in Maine on January 2, 2020.

Taxes on electronic smoking devices or e-liquid generally take the form of a specific unit-based tax or a value-based tax. Unit-based taxes are a specific tax based on volume. These taxes generally take the form of a cents per milliliter tax on e-liquid. The tax in Kansas is an example of a unit-based tax and is imposed at a rate of five cents per milliliter of e-liquid. Value-based taxes are imposed at a specified percentage of the cost or price of a product and may be imposed at the wholesale or retail level. The tax in Pennsylvania is an example of a value-based tax and is imposed at a rate of 40 percent of the wholesale cost of electronic cigarette products. Each method of taxation poses its own set of benefits and detriments, which should be weighed by lawmakers if a tax is considered.

In addition to the method of taxation, consideration also must be given to the point at which the tax would be imposed. Unlike traditional tobacco products, electronic smoking devices do not always flow from a manufacturer to a distributor or retailer. Care must be taken to determine the point at which the tax will be imposed based on the manner in which products reach consumers. The types of products also must be evaluated to determine if a tax will be imposed on all electronic cigarette products, including e-liquid; on e-liquid alone; or only on e-liquid that contains nicotine.

Various policy arguments have been raised regarding the rate of tax imposed on electronic smoking devices and e-liquid. Proponents of lower taxes generally argue a higher tax burden might drive consumers back to purchasing traditional cigarettes, which might cause more detrimental health consequences. Proponents of higher taxes generally argue a lower tax burden might make electronic smoking devices more accessible, potentially attracting consumers who previously were not smokers. An alternative method of analysis removes policy arguments from consideration entirely, taking the view that taxation should not be applied as a means to influence consumer behaviors. This approach simply takes into consideration the need for revenue and the amount of tax required to generate the needed revenue.

The following table provides a summary of the method and rate of tax applied in each state or territory in which a tax on electronic smoking devices or e-liquid is imposed.

State/Territory	Tax Rate
California	59.27 percent of the wholesale cost of electronic cigarette products
Connecticut[1]	40 cents per milliliter of nicotine-containing e-liquid contained within an electronic cigarette product that is prefilled and not intended to be refillable or 10 percent of the wholesale sales price of any other electronic cigarette product
Delaware	5 cents per milliliter of e-liquid that contains nicotine
District of Columbia[2]	91 percent of the wholesale cost of electronic cigarette products
Illinois	15 percent of the wholesale price of electronic cigarette products
Kansas	5 cents per milliliter of e-liquid
Louisiana	5 cents per milliliter of e-liquid that contains nicotine
Maine[3]	43 percent of the wholesale sales price of electronic cigarette products
Minnesota	95 percent of the wholesale cost of any product containing or derived from tobacco
Nevada[4]	30 percent of the wholesale price of electronic cigarette products
New Jersey[5]	10 cents per milliliter of nicotine-containing e-liquid contained within an electronic cigarette product that is prefilled and not intended to be refillable or 10 percent of the retail sales price of any other nicotine-containing e-liquid
New Mexico	50 cents per single-use, pre-filled, disposable e-liquid cartridge containing 5 milliliters or less of e-liquid and 12.5 percent of the wholesale cost of all other containers of e-liquid
New York	20 percent of the retail sales price of electronic cigarette products
North Carolina	5 cents per milliliter of e-liquid that contains nicotine
Ohio[1]	10 cents per milliliter of e-liquid that contains nicotine
Pennsylvania	40 percent of the wholesale cost of electronic cigarette products
Vermont	92 percent of the wholesale cost of electronic cigarette products
Washington[1]	9 cents per milliliter of e-liquid in accessible containers larger than 5 milliliters or 27 cents per milliliter of e-liquid in all other containers
West Virginia	7.5 cents per milliliter of e-liquid
Wisconsin[1]	5 cents per milliliter of e-liquid

[1]The tax in Connecticut, Ohio, Washington, and Wisconsin becomes effective on October 1, 2019.

[2]The tax in the District of Columbia decreases from 96 to 91 percent of the wholesale cost on October 1, 2019.

[3]The tax in Maine becomes effective on January 2, 2020.

[4]The tax in Nevada becomes effective on January 1, 2020.

[5]The 10 percent tax in New Jersey becomes effective on November 1, 2019.

PREVIOUS INTERIM STUDIES AND PROPOSED LEGISLATION

A study regarding the regulation and taxation of electronic smoking devices or e-liquid has not been undertaken by a Legislative Management interim committee. A study of the health risks of vapor products in relation to traditional cigarettes was proposed in House Concurrent Resolution No. 3033 (2013), but the resolution failed to pass. However, the 66th Legislative Assembly was successful in passing Senate Concurrent Resolution No. 4007 (2019) urging Congress and the FDA to end the marketing and advertising of e-cigarettes to youth.

Only a small number of bills relating to the taxation of vapor products have been proposed over the past 10 years. Senate Bill No. 2322 (2015) would have expanded the definition of "other tobacco products" for purposes of taxation to any product or device that contains nicotine and would have imposed a tax at a rate of 50 percent of the wholesale purchase price of the products. House Bill No. 1421 (2015) would have modified the definition of "other tobacco products" for purposes of taxation to mean any product not separately defined which is made up or composed of tobacco in whole or in part and would have imposed a tax at a rate of 43.5 percent of the wholesale purchase price of the products. Senate Bill No. 2328 (2017) would have imposed licensing requirements on businesses engaged in selling vapor products. House Bill No. 1495 (2019) would have imposed a tax of 10 cents per milliliter on sales of liquid nicotine.

POSSIBLE STUDY APPROACH

In reviewing the taxation of electronic smoking devices, the committee may find it helpful to receive:

1. Information regarding the amount of revenue generated by the tobacco taxes imposed under North Dakota Century Code Chapter 57-36 and the amount of revenue that could be generated through the imposition of a tax on electronic smoking devices;
2. Information regarding the various types of tax that could be applied to electronic smoking devices;

3. Testimony from retailers and manufacturers of electronic smoking devices; and
4. Testimony from representative of the State Department of Health and other smoking cessation groups.

ATTACH:1