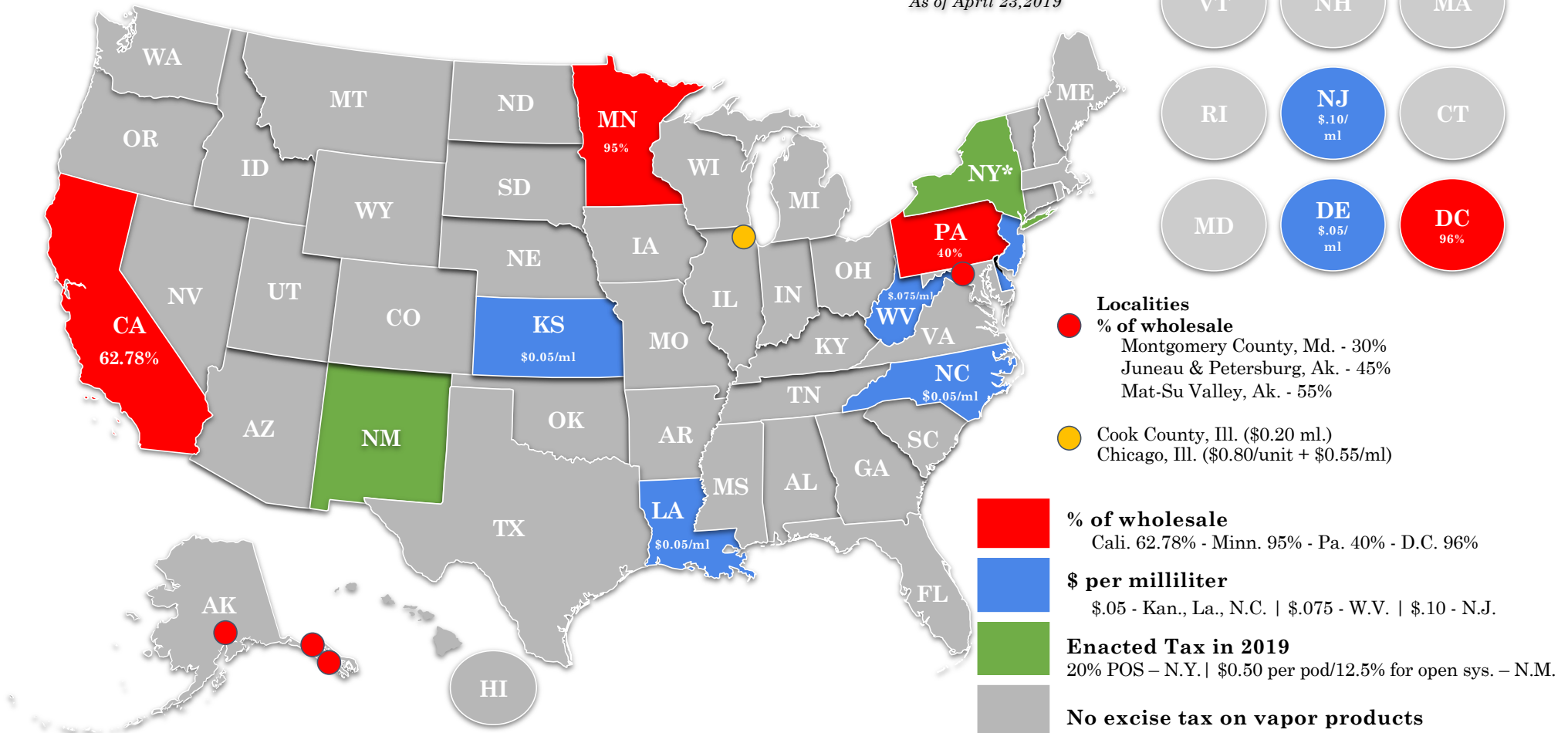


High Taxes on Vapor Products Disincentivize the Use of Tobacco Alternatives

- Tax administration should be effective in the sense of ensuring high compliance by taxpayers, and efficient in the sense that administrative costs are low relative to revenue collected.
- Good tax administration requires strong technical capacity by the administrative agency, but also a well-designed tax.
- Vapor products provide an alternative to adult smokers interested in switching away from combustible cigarettes. Reducing the number of people who smoke cigarettes is a shared public policy goal that can also reduce strains on public healthcare budgets.
- The government should not disincentivize smokers from switching to vapor products by levying exorbitant excise taxes and increasing their cost.
- High tax rates encourage smuggling and illegal sales.
- Specific excise taxes are levied in order to address a negative externality; vapor products, however, while still a small part of the overall tobacco product category, hold the potential to be a viable alternative for adult smokers and are intended to reduce the social friction caused by smoking cigarettes.

Enacted Taxes on Vapor Products

As of April 23, 2019



Estimating Revenue from Various Vapor Tax Frameworks

- Some states are considering imposing taxes on vapor products for various purposes, including to raise revenue.
- Revenue projections in the states rely on assumptions regarding future growth in vapor product sales and effective tax collection and enforcement on those sales and are therefore subject to a degree of uncertainty.
- The lack of established historical data and the recent growth in the vapor product sector has led many traditional smokers to switch to tobacco substitutes, adding even more uncertainty for revenue estimation.
- E-liquid can be readily manufactured by an individual, thus, a tax could be easily avoided. So compliance checks of retailers and vape shops are vital for tax enforcement.

Estimating Revenue from Various Vapor Tax Frameworks

Using tax collection data from the states of Minnesota and North Carolina, this analysis estimates revenue from three different tax structures:

- an excise tax applied to the retail sales price,
- a volume tax on vaping liquid, and
- a wholesale tax applied to the manufacture price.

Oregon Example

This analysis estimated 2018 tax revenue for the different tax types in Oregon to demonstrate the revenue variability between the different taxes. Detailed explanations for each tax are found in my written testimony

- **\$2.3 million** – 2% Retail Excise Tax
- **\$0.58 million** – 10% Wholesale Taxation
- **\$2.87 million** – Volume Taxation (\$0.10/ml)

A Simple and Equitable Structure

- A tax levied at the final point of sale is the most workable tax structure for vapor products, as has been true for taxes on many other types of products. This tax type is relatively straightforward to administer, is transparent for consumers, and is equitable between different types of vapor products.
- Vapor product taxes that are 1) imposed at the retail level and are 2) separate and distinct on a customer's receipt, provide transparency and instant accountability for the retailers who sell these products.
- Taxes imposed at retail provide more data points for the state to enforce their tax and commerce laws because documentation would be provided on the sales receipt, the wholesalers invoice, and the manufacturers invoice. In other words, the state would be able to follow a product upstream.
- A wholesale tax, on the other hand, is more easily avoided. Less professional members of the industry might be tempted to bypass a wholesaler altogether by purchasing counterfeits over the internet.

A Simple and Equitable Structure

For the aforementioned reasons, it is within the state's interest to impose any e-liquid tax at retail at point-of-sale based on the value of vaping liquid sold.

A value-based tax at retail:

- Does not discriminate between disposable and reusable products.
- Does not discriminate against open/closed vaping systems.
- Does not encourage vapor sellers or consumers to avoid tax by separating e-liquid components and combining them at time of use.
- Is easily verifiable by sellers, buyers and taxing authorities.

Lessons from Marijuana Taxation

- States should also consider the best practices developed for the taxation of marijuana when developing their tax structures for vapor products.
- Like vapor products, marijuana products are not homogenous across the product category.
 - In addition to the marijuana plant, consumers can buy marijuana infused foods, marijuana liquids, etc. Therefore, states are developing marijuana tax structures that ensure that one type of product does not receive more favorable tax treatment.
- States should also look to find the optimal vapor tax rate that will create a reliable revenue stream and that, at the same time, minimizes sales on the black market.
 - As the marijuana industry has shown, if prices are similar, consumers will likely shift to the regulated market because the selection, quality, and product safety is generally much higher at a licensed retail provider.
- Any imposed vapor tax should be simple to enforce.
 - Oregon, one of the first states to legalize recreational marijuana, replaced its initial tax on marijuana growers with a 17 percent retail excise tax over concerns that the tax would be too complicated to enforce.

Lessons from Marijuana Taxation

In a May 2018 report, the New York City Comptroller found that:

Both Washington and Colorado began allowing adult-use marijuana sales in 2014. Washington originally imposed a 25% tax on grower sales to processors, a 25% tax on processor sales to retailers, and a 25% tax on retail sales to customers, but has since moved to a single 37% excise tax on gross retail receipts. **This change simplified enforcement,** eliminated double taxation on non-integrated producers, and allowed sellers to deduct taxes paid on their federal income taxes.

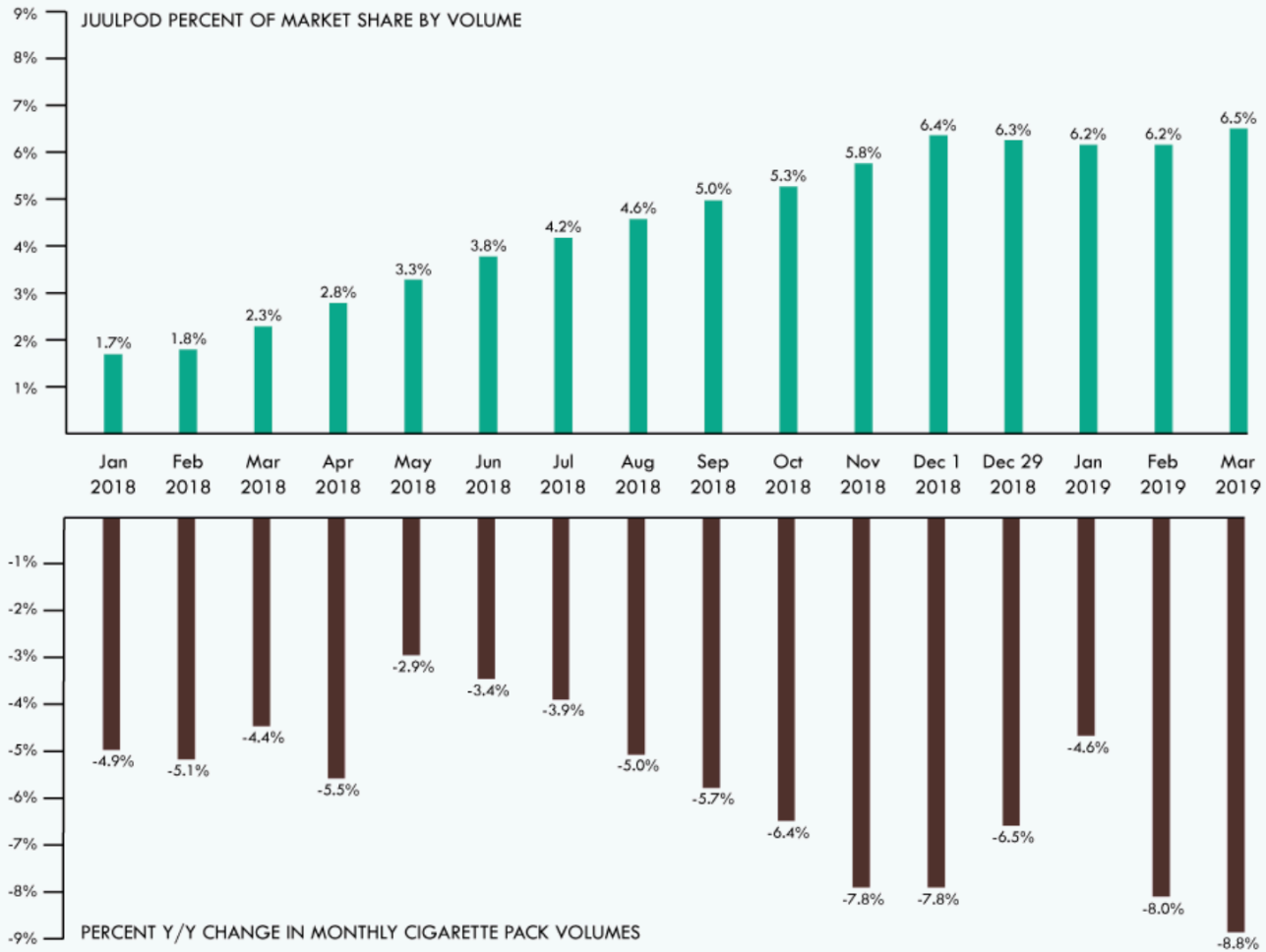
In Oct. 2018, the [Vermont Governor's Marijuana Advisory Commission](#) found that:

Retail sales of marijuana should be subject to a new 20% excise tax and the existing 6% sales tax.

Creating an ad valorem tax structure where tax is imposed on retail sales would be the simplest option to allow for a quick and streamlined rollout by the Department of Taxes.

Imposing an ad valorem tax at the retail level has been shown by other states to generate reliable levels of revenue.

CIGARETTE SALES CONTINUE HISTORIC DECLINE IN THE U.S.



Volume Market Share = Cigarette Packs + JUULpods

Source: Nielsen

Tax Avoidance, Tax Evasion, and Smuggling

- Tax avoidance and tax evasion can make tobacco products more affordable, accessible, and widely available, especially for youth. This activity undermines the health impact of higher tobacco taxes and other tobacco control efforts.
- New York state, for instance, has the highest cigarette tax in the country and also has the highest rate of cigarette smuggling. Approximately 56% of cigarettes sold in New York are smuggled.
- Given the structure of the excise tax system and enforcement process, taxpayers are faced with opportunities to reduce their tax payments and any changes in the tax system will induce different behavioral responses.
- For example, an increase in taxes on vapor products may create an incentive to engage in tax avoidance and tax evasion. As highlighted in a July 2018 report from the Pew Charitable Trusts:
 - State regulations [on vapor products] have already had significant effects on suppliers. In Pennsylvania, for example, more than 100 [vape] shops have closed since a tax—40 percent of wholesale value—went into effect in October 2016. Wide disparities in state tax rates probably incentivize smuggling and tax evasion; high tax rates could fuel a black market. A shortage of data is the major obstacle to reliable forecasting, which makes it challenging for policymakers to base long-term budgeting decisions on this revenue stream.

More Than 30 Companies Are Selling Counterfeit Juuls

A federal court granted Juul Labs a temporary restraining order and froze the PayPal accounts of the companies selling the fakes.



Leticia Miranda

BuzzFeed News Reporter

Posted on September 11, 2018, at 3:57 p.m. ET

BUSINESS

A tale of two Juul pods: China's counterfeits pose a threat to US

By John Crudele

April 10, 2019 | 9:29pm



A real (left) Mango flavored JUUL cartridge and a fake one

U.S. Customs officers seize more than 1,000 fake Juul pods in Philly

The counterfeit merchandise was on its way to Newark, Delaware



BY **ADAM HERMANN**
PhillyVoice Staff



CONTRIBUTED IMAGE/U.S. CUSTOMS & BORDER PATROL

Tax Avoidance, Tax Evasion, and Smuggling

- To reduce the opportunity for tax evasion and to maximize tax collections, any tax on vapor products should be administered at the retail point-of-sale and the tax amount should be clearly displayed on the customer's receipt and reported as a separate product category by the retailer.
- States should require retailers to submit detailed tax reports regarding the sale of vapor products. Detailed reports will provide state officials more information to ensure tax compliance and to deter counterfeit/illegal sales.

Louisiana Department of Health Report

- In January 2018, the Louisiana Department of Health issued a report entitled: Health Impacts and Taxation of Electronic Cigarettes
- States who currently tax e-cigarettes were sent a Request for Information by the Louisiana Department of Revenue regarding the challenges they have incurred from taxation and regulation of e-cigarette products.

Louisiana Department of Health Report

Minnesota

“E-cigarette products are currently taxed at the tobacco excise tax rate of the 95% of the wholesale cost. In many circumstances this tax assessment is made only on the nicotine solution itself, rather than on the sale of the final consumable product. **Meanwhile e-cigarette products that are in a consumable form when brought into Minnesota are taxed at the same 95% rate but on a much higher value. This results in a significant tax discrepancy for two very similar products:** artificially low tobacco taxes on e-cigarette products when the final (often flavored) solution is mixed in Minnesota, as is most often the case for vapor shops; high tobacco taxes for similar products that are shipped into Minnesota in their final consumable form.”

Pennsylvania

”Pennsylvania’s Bureau of Trust Fund Taxes adds: **‘Out of state companies are a problem for both the enforcement and administrating aspect. Enforcement does not have the means to visit out-of-state companies, especially those across the country, and therefore reporting and taxation do not happen.** A high call volume of complaints was received about the high tax rate and the type of products taxed. This also made businesses refuse to collect and remit tax [sic]. In addition, complaints were received from small and large companies stating that they do not have the system capabilities to produce all of the required reporting information that was requested in the law.”

Louisiana Department of Health Report

Louisiana Office of Alcohol and Tobacco Control

”There are several challenges posed by the regulation and taxation of electronic cigarettes and ecigarette products. Currently, vapor and e-cigarette products are not entirely distributed through licensed wholesalers as other tobacco products are. There is no tax stamp purchased in advance and required to be affixed to the product itself. Thus, it is more challenging to monitor the distribution and tax collection efforts.

Additionally, there are safety and legal questions and issues involved as it relates to adulterated products. Many of the products sold can contain additives which are added at the retail level with no supervision or control. Finally, any attempt to apply the existing tobacco distribution model to these new products will be met by some resistance from wholesalers. Wholesale operations in most cases are automated and designed to sort and ship product packaged in standard established sizes. Without standardizing packaging, wholesalers would have to manually handle the product or invest in new or adapted automated processes and both options could be expensive.”

Louisiana Department of Revenue

“LDR encountered some challenges in taxing e-cigarette products. The challenges included lack of staff, educating the staff and potential taxpayers, no requirement for vapor retail dealers or vape shops to register with LDR, no requirement for vapor retail dealers or vape shops to provide a bond, and inability to identify vape shops.”