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Impose Tobacco Products Tax on Vapor Products
(General Fund Taxes -- Excise Taxes and Other Taxes)

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CURRENT LAW

Wisconsin levies an excise tax on cigarettes and levies separate excise taxes on other tobacco products. The definition of a cigarette and the definition of a tobacco product for taxation purposes include only products that contain tobacco, and do not specifically include vapor products. Therefore, vapor product sales are not subject to any of these excise taxes because they do not contain tobacco. However, retail sales of vapor products are subject to state and local sales and use taxes (as are cigarettes and other tobacco products).

GOVERNOR

Impose the tobacco products tax on vapor products at the rate of 71 percent of the manufacturer's list price to distributors and impose an inventory (floor) tax on vapor products held in inventory for sale or resale.

Definition of a Vapor Product. A vapor product subject to the tobacco products tax would be defined as any noncombustible product that employs a heating element, power source, electronic circuit, or other electronic, chemical, or mechanical means that can be used to produce vapor from a solution or other substance, regardless of the product's shape or size or whether the product contains nicotine. A vapor product would include an electronic cigarette, electronic cigar, electronic cigarillo, electronic pipe, or similar product or device, and would include any cartridge or other container of a solution or other substance that is intended to be used with such a device, regardless of whether the solution or other substance contains nicotine. In addition, vapor products would be added to the definition of tobacco products under current law. A vapor product would not include certain products regulated as a drug or device under federal law. The Department of

Revenue (DOR) indicates the intent of this provision is to exempt products approved for smoking cessation by the federal Food and Drug Administration (FDA) from the definition of taxable vapor products.

Inventory Tax Imposed. The bill would levy an inventory tax at a rate equal to 71 percent of the manufacturer's list price on vapor products that are held in inventory by distributors or retailers for sale or resale. Any person liable for this tax would be required to determine the number of vapor products in their possession on the first day of the third month following publication of the bill and would have to file a return and pay the applicable taxes no later than 30 days thereafter.

Definition of Manufacturer's List Price. Current law does not specifically define manufacturer's list price for purposes of the tobacco products tax. The administration indicates an explicit statutory definition is needed to clarify DOR's longstanding treatment of the total price subject to the tobacco products tax. The bill would define manufacturer's list price as the total price of tobacco products charged by the manufacturer or other seller to an unrelated distributor. The total price would include all charges by the manufacturer or other seller that are necessary to complete the sale, and could not be reduced by any cost or expense incurred by the manufacturer or other seller such as fees, delivery, freight, transportation, packaging, handling, marketing, federal excise taxes, and import fees or duties, regardless of whether such cost or expense is separately stated on an invoice. The total price also could not be reduced by the value or cost of discounts or free promotional or sample products. A manufacturer or other seller would be considered related to a distributor if the two parties have significant common purposes and substantial common membership or, either directly or indirectly, have substantial common direction or control.

The provision would take effect on the first day of the third month beginning after publication of the bill. The administration estimates levying the tobacco products tax on vapor products would increase state tax revenues by $14,900,000 in 2019-20 and $19,800,000 in 2020-21 and annually thereafter. The Governor's recommendations did not include any revenues associated with the imposition of the inventory tax.

DISCUSSION POINTS

1. Vapor products began to be commercialized in the U.S. in the mid-2000s. The products apply a heating element to a liquid solution to produce an aerosol that is then inhaled. The solution intended to be used with vapor products contains varying levels of nicotine, and some solutions contain no nicotine.

2. In addition, vapor products are sold in various types. For example, some vapor products are disposable and are intended for single use, while others are purchased for continuous use. A distinction is also made between open and closed systems. In an open system, the device and solution are sold separately, whereas in a closed system, the device and solution are sold together. There are a variety of commonly known products that would meet the definition of vapor products under the bill, such as e-cigarettes (including JUUL and similar devices), vape pens, and liquid tank systems.

3. Many experts point to the wide availability of flavored vapor products as a cause of the growing popularity of these products among adolescents. In an effort to address this concern, the FDA proposed policies in March, 2019, that would require retailers and online sellers to strengthen their age-verification requirements when selling fruit-flavored vapor products to consumers. However, those in favor of a diverse selection of flavors argue that they are an important component for adult smokers who want to stop smoking conventional (combustible) tobacco products. They contend that the availability of several unique flavors allows current smokers to draw a clear distinction between combustible tobacco products and vapor products, and industry retailers often recommend that those looking to use vapor products as a cessation tool start by using flavored solutions.

Rationale for the Taxation of Vapor Products

4. The use of vapor products by young people has increased substantially in recent years. The FDA reports that, between 2017 and 2018, the use of vapor products increased by 48% for middle school students and by 78% for high school students. Proponents argue that an excise tax on vapor products would discourage their use among young people, and curb the growing trend of adolescent exposure to these products. Supporters of a tax on vapor products are especially concerned that their increasing popularity among young people will negate longstanding public health efforts to discourage people from smoking. The FDA has reported that nearly 90% of people who become routine smokers of conventional tobacco products begin smoking before the age of 18. Therefore, the agency states that preventing adolescent initiation to vapor products is vital to curbing overall smoking rates.

5. The FDA has also expressed concern that the rise of vapor product usage among young adults could increase the number of such people who eventually smoke conventional cigarettes and other tobacco products. Some researchers have cautioned that because the use of vapor products simulates the action of smoking, more young people could become accustomed to this behavior, and could also gravitate towards smoking conventional tobacco products. A 2018 literature review conducted by the National Center for Biotechnology Information (NCBI) found substantial evidence that the use of vapor products by young people increases the risk that these individuals will use combustible tobacco products.

6. Health experts have cautioned that the increased use of vapor products by adolescents is especially dangerous because the nicotine in such products can be detrimental to brain development. Specifically, they report that nicotine can negatively affect susceptibility to peer pressure, and can hamper the brain's ability to control mood, impulse, and attention. Researchers also report that nicotine is an addictive substance, and that nicotine addiction can be most difficult to overcome for those who begin using the drug at an earlier age. Health officials are further concerned because many of the health effects of these products, including the liquids used in such products, are still largely unknown.

Rationale Against the Taxation of Vapor Products

7. Opponents of taxes on vapor products argue that the products can be an effective cessation tool for habitual smokers who desire to quit smoking conventional cigarettes. They posit that a tax on vapor products could discourage their use by making them more expensive, thereby

lowering their efficacy as a means of cessation. Moreover, to the extent that adult smokers use vapor products as an alternative to conventional tobacco products, they argue that the continued use of vapor products could create significant health care cost savings by reducing the incidence of smoking-related illnesses.

8. Studies suggest that vapor products are less harmful to health than conventional cigarettes. The research points to the fact that many of the harmful chemicals linked to smoking-related disease are not present in vapor products, and that using vapor products is considerably less harmful to health than inhaling smoke from cigarettes or cigars. NCBI found considerable evidence that smokers would experience a reduction in short-term adverse health outcomes in several organ systems if they fully substituted vapor products for combustible tobacco products. In addition, the Surgeon General reports that the aerosols in e-cigarettes typically contain fewer toxicants than conventional cigarettes, and the FDA has recognized the potential of certain vapor products to offer a viable alternative to combustible cigarettes that is less damaging to health.

Methods of Taxation

9. States that impose an excise tax on vapor products either tax them at a rate based on the wholesale price, or based on the volume of solution being sold for use with the vapor product device. For example, Minnesota taxes vapor products at the rate of 95% of the wholesale sales price, while Louisiana imposes a tax of five cents per milliliter of consumable nicotine liquid solution. The Attachment shows the taxes that exist on vapor products in 10 states and the District of Columbia as of May, 2019, as reported by the Campaign for Tobacco-Free Kids.

10. Proponents of a tax based on wholesale price argue that such a tax is more resistant to inflationary pressure and can generate more revenue than a volume-based tax. Supporters argue that, because it creates a larger tax burden that is to be borne by the consumer, a tax based on wholesale price is better suited than a volume-based tax to achieve the goal of reducing the use of vapor products. In addition, they assert that a volume-based tax is not well positioned to adapt to an industry that is quickly evolving, whereas a wholesale tax that includes taxing the vapor products themselves ensures that the tax can withstand changes in the vapor products market. Moreover, those in favor of a price-based tax state that such a tax would be easier to administer than a volume-based tax. They argue that a volume-based tax would entail extensive recordkeeping requirements to document the total volume of solution purchased or sold, whereas the administration of a price-based tax could be accomplished by examining the general receipts of a business.

11. Others counter that the more sensible approach is a tax based on the volume of solution to be used with the device. They contend that such a tax avoids taxing the device itself, which they state would be akin to taxing a pipe along with the tobacco smoked in the pipe. Additionally, supporters of a volume-based tax are wary of the price increases to the consumer that a relatively higher wholesale-based tax could create, which could push adults looking for alternatives to conventional tobacco products away from potentially helpful vapor products. The Committee could consider taxing vapor products based on the volume of the solution that is intended to be used with such products (Alternative 2). Like the Governor's proposal, the tax would be imposed on the first sale of solution used in vapor products into the state.

12. Many owners of stores selling vapor products have asserted that the tax being recommended by the Governor would be prohibitively expensive and would put them out of business. They argue that the tax would make their products relatively more expensive for consumers, which would cause more of these consumers to circumvent the tax by purchasing less expensive vapor products online. They note that such online sales may be more difficult to regulate. In addition, many have expressed specific concern with the nature of the floor tax being proposed under the bill, which they contend would be too costly for them to absorb and remain profitable.

13. In addition, representatives of the vapor products industry maintain that a tax based on wholesale price as proposed by the Governor would lead to the closure of several vapor products retail stores. As an example, they state that several retail stores closed following implementation of the vapor products tax in Pennsylvania (which levies a 40 percent tax on the wholesale price). The Pennsylvania Department of Revenue states that it does not have information regarding how many vapor product retailers closed as a result of the imposition of the tax, but the Department reports that the associated tax revenues have continued to show year-over-year growth.

Administrative Provisions

14. DOR states that retailers may have difficulty properly executing the inventory tax under the bill. Specifically, the Department expressed concern that vapor products retailers may not be able to access the manufacturer's list price on which the floor tax would otherwise be calculated. To more easily administer the floor tax, the administration has requested an amendment to specify that the tax would be applied at a rate of 71 percent of the purchase price, defined as the total amount a person paid, in money or other consideration, to a manufacturer, distributor, or other person to obtain the vapor product.

15. According to the administration, an amendment is needed to specify that vapor products retailers not currently in possession of a tobacco products retailer license would need to obtain such a license from their municipality prior to the effective date of the inventory tax. Under current law, all retailers selling tobacco products are required to apply for, and receive, such a license. Because vapor products would be added to the definition of tobacco products under the bill, this would trigger the same license requirement for vapor products retailers. The amendment would provide that vapor products retailers that currently do not possess a tobacco products retailer license must apply for such a license on the day after publication of the bill. DOR indicates the intent of this amendment is to enable the Department to investigate inventory at retail locations prior to the imposition of the inventory tax, to ensure that retailers do not preemptively remove product or otherwise underreport their inventory levels upon imposition of the tax.

16. In general, because vapor products would be included in the definition of tobacco products under the bill, the associated regulations governing tobacco products would also apply to vapor products, including the requirement to obtain a tobacco products distributor permit by certain retailers. DOR indicates that some vapor products retailers purchase certain products directly from manufacturers, and thus act as distributors. Such retailers would need to obtain a tobacco products distributor permit and remit the associated tobacco products taxes to DOR on those purchases made directly from manufacturers. This would align vapor products retailers with current practice for retailers of certain other tobacco products, such as premium cigars, who purchase such products

directly from manufacturers and are required to hold both tobacco products retailer licenses and tobacco products distributor permits as a result.

17. Based partly on data from other states that currently levy a vapor products tax based on the wholesale price, the administration's fiscal estimate for the provision appears reasonable. However, as noted above, the administration's estimate did not include any revenues associated with the imposition of the floor tax. Based on revenue data following the imposition of previous floor taxes, it is estimated that the floor tax on vapor products under the bill would generate additional excise tax revenues of approximately $1.7 million on a one-time basis. Therefore, total excise tax collections resulting from these provisions are estimated at $16.6 million in 2019-20 and $19.8 million in 2020-21.

18. However, DOR has indicated that enforcement of the floor tax would constitute a significant administrative burden to enforce. The Department estimates that the costs associated with administration of the floor tax would be approximately $230,000 on a one-time basis, comprised of $165,000 for computer programming costs, and $65,000 for general administration and enforcement of the tax. If the Committee chose to impose the floor tax included in the Governor's recommendations, the Committee could consider providing additional funding of $230,000 GPR to DOR for the associated administrative costs (Alternative 3).

19. The Committee could also consider whether to impose the floor tax (Alternative 4). Under this alternative, if the floor tax were not implemented, it is assumed that some retailers and distributors would make additional purchases of vapor products in the near term that would otherwise have been subject to the new tax rate before that rate takes effect. In this scenario, the increased excise tax revenues under the bill are estimated to be reduced by approximately $1.2 million on a one-time basis.

20. If the Committee chose not to adopt the Governor's request, the Committee could decide to retain the provision in the bill that explicitly defines manufacturer's list price for purposes of the tobacco products tax (Alternative 5). As described above, DOR has indicated that such an explicit, statutory definition is necessary to codify the Department's longstanding practical treatment of the manufacturer's list price for tobacco products tax purposes.

ALTERNATIVES

1. Adopt the Governor's request, and specify that the inventory tax would be applied at a rate of 71 percent of the purchase price paid by the retailer to obtain vapor products. In addition, specify that any vapor products retailers not currently in possession of a tobacco products retailer license would need to apply for the license on the day after publication of the bill. Estimate increased excise tax collections of $16,600,000 in 2019-20 and $19,800,000 in 2020-21.

ALT 1	**Change to**	
	Base	**Bill**
GPR-Tax	$36,400,000	$1,700,000

2. Instead of imposing a tax on vapor products based on the wholesale price, impose a tax on the solution used with vapor products at the rate of:

a. Five cents per milliliter of solution. Estimate increased excise tax revenues relative to current law of $2,500,000 in 2019-20 and $3,000,000 in 2020-21. Imposition of the floor tax accounts for $400,000 of the fiscal effect in 2019-20.

ALT 2a	**Change to Base**	**Change to Bill**
GPR-Tax	$5,500,000	- $29,200,000

b. 10 cents per milliliter of solution. Estimate increased excise tax revenues relative to current law of $4,700,000 in 2019-20 and $5,600,000 in 2020-21. Imposition of the floor tax accounts for $800,000 of the fiscal effect in 2019-20.

ALT 2b	**Change to Base**	**Change to Bill**
GPR-Tax	$10,300,000	- $24,400,000

c. 20 cents per milliliter of solution. Estimate increased excise tax revenues relative to current law of $8,200,000 in 2019-20 and $9,900,000 in 2020-21. Imposition of the floor tax accounts for $1,400,000 of the fiscal effect in 2019-20.

ALT 2c	**Change to Base**	**Change to Bill**
GPR-Tax	$18,100,000	- $16,600,000

d. 40 cents per milliliter of solution. Estimate increased excise tax revenues relative to current law of $11,900,000 in 2019-20 and $14,300,000 in 2020-21. Imposition of the floor tax accounts for $2,000,000 of the fiscal effect in 2019-20.

ALT 2d	**Change to Base**	**Change to Bill**
GPR-Tax	$26,200,000	- $8,500,000

3. Adopt Alternative 1. In addition, provide funding of $230,000 GPR in 2019-20 ($165,000 to the administrative services and space rental -- integrated tax system technology appropriation and $65,000 to the collection of taxes -- general program operations appropriation) to fund the administrative costs associated with implementation of the floor tax. Estimate increased excise tax revenues of $16,600,000 in 2019-20 and $19,800,000 in 2020-21.

ALT 3	Change to	
	Base	Bill
GPR	$230,000	$230,000
GPR-Tax	$36,400,000	$1,700,000

4. Adopt Alternative 1, but delete the provision that would require the imposition of an inventory tax on vapor products. Estimate increased excise tax revenues of $13,700,000 in 2019-20 and $19,800,000 in 2020-21.

ALT 4	Change to	
	Base	Bill
GPR-Tax	$33,500,000	- $1,200,000

5. Take no action on the Governor's request, but retain the provision to codify DOR's definition of "manufacturer's list price" for purposes of the tobacco products tax. Estimate reduced excise tax collections under the bill of $14,900,000 in 2019-20 and $19,800,000 in 2020-21.

ALT 5	Change to	
	Base	Bill
GPR-Tax	$0	- $34,700,000

6. Take no action. Estimate reduced excise tax collections under the bill of $14,900,000 in 2019-20 and $19,800,000 in 2020-21.

ALT 6	Change to	
	Base	Bill
GPR-Tax	$0	- $34,700,000

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Attachment

ATTACHMENT

Vapor Products Taxes in Other States

State	Tax Rate
California	62.78% of wholesale price
District of Columbia	96% of wholesale price
Delaware	5 cents per milliliter
Kansas	5 cents per milliliter
Louisiana	5 cents per milliliter
Minnesota	95% of wholesale price
New Jersey	10 cents per milliliter
North Carolina	5 cents per milliliter
Pennsylvania	40% of wholesale price
Washington*	9 or 27 cents per milliliter
West Virginia	7.5 cents per milliliter

* The vapor products tax in Washington will become effective on October 1, 2019.

Source: Campaign for Tobacco-Free Kids