Taxing E-Cigarettes: the Next (Complicated) Frontier

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PRESENTERS

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Webinar Goals:

- Rationale: Why tax e-cigarettes
- Which products should be taxed
- Developing and enforcing policies
- Example: Minnesota’s e-cigarette tax
- Legislative Landscape - other states
- Challenges/Lessons Learned
- Q & A
Tobacco Control Legal Consortium

Attorneys supporting tobacco control policy change.
What We Do:

1. Legal research, analysis, and interpretation
2. Policy development
3. Litigation support
4. Education and training
The Family Smoking Prevention and Tobacco Control Act

FDA cannot:

– Prohibit the use of tobacco products
– Prohibit the sale of an entire class of tobacco product
– Prohibit the sale of tobacco products in a specific category of retail outlets
– Require a prescription for tobacco products
– Levy taxes on tobacco products
– Raise the minimum purchase age of tobacco products
Baseline Questions

1. Why tax?
2. Which products should be taxed?
3. Where should tax be levied?
4. What is the appropriate level of taxation?
5. How is the tax enforced?
Why tax e-cigarettes?

- General love of taxes?
- Discourage initiation/use?
- Revenue generation?
- Combination?
Which products?

• Which products should be subject to the tax?
• E-juice – all or only nicotine?
Which products?

- Which products should be subject to the tax?
  - Device
  - Components/parts
Product definitions

- Clear definition of what is being taxed is essential
- Define as “tobacco products”
What is the appropriate level of taxation?

- Tax them as tobacco products
- Create differential between e-cigarettes and all tobacco products or just combustible
- Leave subject to retail sales tax
How should tax be structured?

Options

• Ad valorem - % of price
• Product specific
  • Per milliliter of e-juice
  • Per milligram of nicotine
• Where collected?
  • Wholesaler?
  • Retailer?
Key definitions

• Existing framework

• “Manufacturer means any person who manufactures and sells cigarettes or tobacco products.”
  • Who does this include?
  • Who should it include?
Plan for enforcement?

Key areas

- Effective licensing
- Burden of proof
- Laboratory for testing
- Internet sales
Current E-Cigarette Tax Landscape
Taxation of E-Cigarettes in Minnesota:
Overview

1. ClearWay Minnesota
2. Tobacco Taxes in Minnesota
3. E-Cigarette Tax: How it Happened
4. Challenges
• 1998
• Nonprofit
• $202 million
• 25 years
• Reduce harm of tobacco
Our Programs

- Cessation
- Priority Populations
- Mass Media
- Public Policy
- Research
- Partnerships
2015 State of Tobacco Control

A
Smoke-Free Air

B
Cigarette Tax

B
Cessation Coverage

F
Tobacco Prevention
Tobacco Taxes in Minnesota
May 2013

Governor Dayton Signs Tobacco Tax Increase
Raised the Excise Tax on Cigarettes

$1.60

Annual adjustment (indexing)
$1.23 \rightarrow $2.83

28th \rightarrow 7th
Closed the “Little Cigar” Loophole

Changed definition of cigarette to include so-called little cigars
Increased the Tax on Tobacco Products from 70% to 95% of Wholesale Price
Created a Minimum Tax on Moist Snuff:
95% of Wholesale Price OR $2.90 per Container (cigarette tax)...
...whichever is greater
New Tax on “Premium Cigars”
95% of Wholesale Price OR
$3.50 per Cigar...
...whichever is less
Increased the Fee on Cigarette Manufactured by Non-Settling Companies from 35 cents to 50 cents per pack
One-Time Floor Stock Tax
Cigarettes = $3.43 per pack (Excise tax = $2.90 + Fee in lieu of sales tax = 52.6 cents)

Little Cigars = Cigarettes for tax purposes

OTPs (including e-cigs) = 95% of wholesale price

Moist Snuff = 95% of wholesale price or $2.90 per container whichever is greater

Premium Cigars = 95% of wholesale price or $3.50 per cigar whichever is less

Annual indexing on cigarettes

Non-settlement Manufactures Fee = 50 cents
E-Cigarette Tax: How it Happened
New Products
The Tobacco Modernization and Compliance Act of 2010
“The Tic Tac Tobacco Act”

Senate File 3055 / House File 3467

Sen. Dibble
Rep. Davnie
Policy Goal:

• Update definitions to capture new products that were evading tobacco tax laws, the unfair cigarette sales act, promotional distribution, and youth access laws.
Political Goal:

• Spotlight on the evolving tobacco industry
• Talk about cheap prices
• Show new products
• Build toward a tobacco tax increase
• Build relationships with new lawmakers
OLD DEFINITION

Subd. 19. Tobacco products. "Tobacco products" means cigars; little cigars; cheroots; stogies; periques; granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco; snuff; snuff flour; cavendish; plug and twist tobacco; fine-cut and other chewing tobacco; shorts; refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or smoking in a pipe or otherwise, or both for chewing and smoking; but does not include cigarettes as defined in this section.

Minn. Stat. § 297F.01, subd. 19 (1997)
NEW DEFINITION

Subd. 19. Tobacco products. "Tobacco products" means any products containing, made, or derived from tobacco that is intended for human consumption, whether chewed, smoked, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means, or any component, part, or accessory of a tobacco product, including, but not limited to, cigars; little cigars; cheroots; stogies; periques; granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco; snuff; snuff flour; cavendish; plug and twist tobacco; fine-cut and other chewing tobacco; shorts; refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or smoking in a pipe or otherwise, or both for chewing and smoking; but does not include cigarettes as defined in this section. Tobacco products excludes any tobacco product that has been approved by the United States Food and Drug Administration for sale as a tobacco cessation product, as a tobacco dependence product, or for other medical purposes, and is being marketed and sold solely for such an approved purpose.

Success: Policy Win

New Cartridges!
- New cartridges include the atomizer
- One-piece design for maximum vapor
- Get stronger, full flavor every time
- No more missing puffs
- As close to a cigarette as you get

Made in the U.S.A.
Department of Revenue

Revenue Notice # 12-10: Tobacco Products Tax – Taxability – E-Cigarettes

Introduction
An electronic cigarette, or e-cigarette, is an electrical device that simulates the act of cigarette tobacco smoking by producing an inhaled vapor bearing the physical sensation, appearance, and often the flavor, of inhaled tobacco smoke. The e-cigarettes do not meet the definition of a cigarette set forth in Minnesota Statutes, section 297F.01, subdivision 3, but they do meet the definition of a tobacco product set forth in Minnesota Statutes, section 297F.01, subdivision 19, which provides in part as follows:

“‘Tobacco products” means any product containing, made, or derived from tobacco that is intended for human consumption, whether chewed, smoked, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means, or any component, part, or accessory of a tobacco product…’

The key phrases in the statute that establish the taxability of an e-cigarette are (1) “any product containing, made, or derived from tobacco…” (2) “…whether … smoked, …or inhaled…” and (3) “…any component, …or accessory of a tobacco product…”

Department Position
The department’s position is that the e-cigarettes are subject to the tobacco products tax. The cartridge containing nicotine is a component of the e-cigarette. The cartridge contains nicotine which is ordinarily derived from tobacco and is used by a person by smoking them or inhaling. The department assumes that all nicotine is derived from tobacco and the taxpayer will bear the burden of proving otherwise. If it can be documented that the nicotine has been derived from sources other than tobacco, it would not be taxable as a tobacco product.

Further, the department’s position is that if a wholesaler sells the cartridge separately and can isolate the cost of the product, the tax will be imposed only on the nicotine based cartridges or liquid nicotine in a bottle. Otherwise, the sales price of a whole kit or content of an e-cigarette package will be taxed. The tax is due and is determined on whatever format the product is brought into the state.

Publication Date: OCT 22 2012

SUSAN VON MOSCH, Assistant Commissioner for Tax Policy
E-cigarettes

An electronic cigarette or e-cigarette is a device that simulates smoking tobacco. In Minnesota, e-cigarettes and e-juice which contain nicotine derived from tobacco meet the definition of a tobacco product found in (Minnesota Statutes, section 297F.01, subdivision 19).

E-cigarettes are Taxable

E-cigarettes and e-juice are considered tobacco products and are subject to the Tobacco Tax, which is currently 95% of the wholesale cost of any product containing or derived from tobacco. For example, the Tobacco Tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax would only be on the nicotine cartridge value. Similarly, a disposable e-cigarette may have the tax calculated on its nicotine cartridge value if the cartridge is replaceable.

Printable handout: E-cigarettes are Taxable in Minnesota

<table>
<thead>
<tr>
<th>Item</th>
<th>Taxable or Not Taxable?</th>
</tr>
</thead>
<tbody>
<tr>
<td>One time use e-cigarette</td>
<td>Taxable</td>
</tr>
<tr>
<td>Reusable/refillable device &amp; components</td>
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</tr>
<tr>
<td>Cartridges/e-juice containing nicotine</td>
<td>Taxable</td>
</tr>
<tr>
<td>Cartridges/e-juice with 0% nicotine</td>
<td>Not Taxable</td>
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E-cigarettes in Minnesota

<table>
<thead>
<tr>
<th>I am a...</th>
<th>So I...</th>
<th>If I don't then...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributor</td>
<td>Pay Tobacco Tax on all e-cigarette purchases that contain nicotine derived from tobacco.</td>
<td>I will be assessed tax, penalty and interest on any unreported purchases. My license from the commissioner of revenue may be revoked. I may be criminally prosecuted.</td>
</tr>
<tr>
<td>Retailer</td>
<td>Purchase e-cigarettes from distributors licensed by the State of Minnesota. Collect and remit sales tax on e-cigarette sales.</td>
<td>My e-cigarette products could be seized as contraband or I could be assessed tax, penalty and interest. My license from the county or city government may be revoked. I may be criminally prosecuted.</td>
</tr>
<tr>
<td>Consumer</td>
<td>Pay Tobacco Consumer Use Tax on all e-cigarettes that are not purchased through a retailer located in Minnesota. This includes e-cigarettes purchased online.</td>
<td>I will be assessed tax, penalty and interest as information on my purchase becomes available to the commissioner of revenue. I may be criminally prosecuted.</td>
</tr>
<tr>
<td>County or city government</td>
<td>License retailers who sell e-cigarettes and e-juice.</td>
<td></td>
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E-cigarettes are Taxable in Minnesota

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Distributors who do not pay Tobacco Tax on these products are subject to penalties, interest, license revocation, and possible criminal charges.

Retailers are required to purchase tax paid product. If you do not comply you are subject to penalties, interest, license revocation, and possible criminal charges.

Consumers who purchase from someone who has not paid the tobacco tax must pay Tobacco Consumer Use Tax.

For more information, go to our website, www.revenue.state.mn.us and use keyword: e-cigarette
Challenges
Challenges

Explosion of nontraditional distribution channels
– What is the taxable transaction?
  Manufacture = Distributor = Retailer
Challenges

• Lack of action by FDA
• Compliance capacity
• Unable to specify how much tax revenue is generated from e-cigarettes
• What is the taxable unit?
• Claims of “non-tobacco” nicotine
2015 Department of Revenue Bill

HF 865 as introduced - 89th Legislature (2015 - 2016) Posted on 02/12/2015 02:34pm

KEY: stricken = removed, old language. underscored = added, new language.
Version List > Authors and Status

Jump to page/line # leg. 2.1

1.1 A bill for an act
1.2 relating to taxation; tobacco; providing penalties; appropriating money;
1.3 amending Minnesota Statutes 2014, sections 289A.63, subdivisions 1, 2;
1.4 297F.01, subdivision 14; 297F.03, subdivisions 5, 6; 297F.04, subdivisions 1, 2;
1.5 297F.13, subdivision 4, 297F.19, by adding a subdivision; 297F.20, by adding
1.6 subdivisions; 609.035, by adding a subdivision; proposing coding for new law
1.7 in Minnesota Statutes, chapter 297F.
1.8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

1.9 Section 1. **PURPOSE.**
1.10 This act is designed to bring fairness to tobacco tax administration and enforcement
1.11 and reduce smuggling of contraband tobacco products. By increasing enforcement efforts
1.12 and providing a unified system of collecting the taxes on cigarettes and other tobacco
1.13 products, this proposal will deter tax evasion, prevent the expansion of criminal activity in
1.14 Minnesota, and reduce youth access to unregulated tobacco products.
1.15 As required by Minnesota Laws 2013, chapter 143, article 5, section 27, the
1.16 Department of Revenue submitted a report to the legislature on February 19, 2014. The
1.17 report, conducted by an independent evaluator, included recommendations to improve
1.18 collection of cigarette and tobacco products taxes. The proposals in this act include many
1.19 of the recommendations in the report.

1.20 **EFFECTIVE DATE.** This section is effective the day following final enactment.

1.21 Sec. 2. Minnesota Statutes 2014, section 289A.63, subdivision 1, is amended to read:
1.22 Subdivision 1. **Penalties for knowing failure to file or pay; willful evasion.** (a) A
1.23 person required to file a return, report, or other document with the commissioner, who
1.24 knowingly, rather than accidentally, inadvertently, or negligently, fails to file it when
1.25 required, is guilty of a gross misdemeanor. A person required to file a return, report, or
1.26 other document who willfully attempts in any manner to evade or defeat a tax by failing
1.27 to file it when required, is guilty of a felony. Each violation of this paragraph is a single
1.28 course of conduct separate and independent from the conduct constituting a violation of
Thank you!
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North Carolina

- Adopted in 2014
- 5 cents per milliliter of “consumable product”
- Enforcement is unclear
Missouri
“Alternative nicotine products and vapor products shall only be sold to persons eighteen years of age or older, shall be subject to local and state sales tax, but shall not be otherwise taxed or regulated as tobacco products.”

Missouri Statutes, Section 407.926.1
New Jersey E-cigarettes Tax Plan Has Some Fuming

Governor Herbert wants to tax e-cigarette sales in Utah, bring in $10M

E-cigarette entrepreneurs say 49 percent tax proposed in Kasich’s budget would cripple growing industry
New Jersey
New Jersey (did not pass in 2014)

- 2014 Senate Bill
- 75% of wholesale price
- Parts and components included
- New York has similar bill pre-filed in 2015
Washington
Washington (budget proposal)

- Governor’s budget
- Defined as “vapor products”
- Would appear to tax e-juice, device and all components at 95%
New Mexico
New Mexico (proposed)

• 4 cents per milligram of nicotine contained in the “nicotine product”

• Enforcement?
Virginia
Virginia (proposed)

- 40 cents per milliliter of consumable product
- “Any county, city, or town that had the authority...to impose a tax upon the sale or use of cigarettes may by ordinance impose a tax on the sale or use of a vapor product. The tax shall be based upon the per milliliter content of consumable product in the vapor product at a rate and on such terms as determined by the governing body of the county, city, or town.”
Learning Lessons: E-Cigarette Taxes

1. Build a robust, state-specific evidence base in support

2. Consult an attorney early in the drafting process
   – Each state’s tax code is different; legislation must “fit”
   – Definitions are critical
   – Concise language

3. Develop a plan with enforcement folks
   – Robust enforcement options; well-planned implementation
   – Testing and verification of claims

4. Local taxing authority? → watch for preemption provisions
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THANK YOU!!