

HOUSE BILL REPORT

HB 1873

As Reported by House Committee On:

Finance
Appropriations

Title: An act relating to the taxation of vapor products as tobacco products.

Brief Description: Concerning the taxation of vapor products as tobacco products.

Sponsors: Representatives Pollet, Harris, Cody, Robinson, Tarleton, Frame, Bergquist, Ryu, Kilduff, Macri, Stonier, Dolan, Orwall, Doglio, Senn, Stanford, Appleton, Callan, Wylie, Peterson, Valdez, Walen, Leavitt, Kloba and Lovick.

Brief History:

Committee Activity:

Finance: 2/26/19, 3/14/19 [DPS];
Appropriations: 4/22/19 [DP2S(w/o sub FIN)].

Brief Summary of Second Substitute Bill

- Imposes a 37 percent tax on vapor products, levied on the consumer at the point of sale.
- Creates the Essential Public Health Services Account.
- Authorizes the Governor to enter into vapor products taxation compacts with federally recognized Indian tribes, and establishes requirements for such compacts.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Tarleton, Chair; Walen, Vice Chair; Chapman, Frame, Macri, Orwall and Wylie.

Minority Report: Do not pass. Signed by 5 members: Representatives Orcutt, Ranking Minority Member; Young, Assistant Ranking Minority Member; Springer, Stokesbary and Vick.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Staff: Rachelle Harris (786-7137).

Background:

Tobacco Products Regulation and Tax.

"Tobacco products" are defined as products that include tobacco prepared to be suitable for chewing or smoking, or for both chewing and smoking, as well as any other product that contains tobacco, and is intended for human consumption or placement in the oral or nasal cavity. This includes cigars, stogies, pipe or other smoking tobacco, snuff, fine-cut and other chewing tobaccos, etc. The term does not include cigarettes or vapor products.

The Other Tobacco Products (OTP) tax is due from a distributor for the sale, use, consumption, handling, and distribution of items defined as "tobacco products," including cigars, pipe tobacco, chewing tobacco, and other forms of tobacco, but excluding cigarettes. The OTP tax is due when the product is brought into or manufactured in Washington for sale in the state. The OTP tax is distinct from the cigarette tax. The OTP tax rate is imposed on the taxable sales price of most tobacco products at a rate of 95 percent. For cigars, the tax is capped at 65 cents per cigar. Dipping tobacco is taxed based on the net weight listed by the manufacturer at the rate of \$2.526 per single unit of 1.2 ounces or less, and at a proportionate rate for larger single units. All OTP tax revenue is deposited in the State General Fund. Tobacco product distributors and retailers are subject to various regulatory requirements. Distributors must maintain records of their tobacco product transactions.

Tobacco product distributors and retailers must obtain a license from the Liquor and Cannabis Board (LCB). The distributor license fee is \$650, and the retailer license fee is \$93, annually. The LCB has the authority to revoke or suspend the license of a retailer or distributor for noncompliance with the OTP tax regulations. The LCB may seize tobacco products from: (1) an unlicensed distributor or retailer; or (2) a distributor or retailer selling tobacco products while their license is suspended or revoked. Shipment and transportation of tobacco products (other than cigars) ordered or purchased by mail, or through the internet, to anyone other than a licensed wholesaler or retailer is prohibited.

Vapor Products.

"Vapor products" are defined in state law to include any noncombustible product that may contain nicotine that employs a heating element or other electronic, chemical, or other means that can be used to produce vapor or aerosol from a solution or other substance. This is inclusive of electronic cigarettes, electronic pipes, and any vapor cartridge or other container that is intended to be used with or in an electronic cigarette or other similar device. The definition does not include cigarettes or other tobacco products.

In 2016 the Legislature established retailer, distributor, and delivery sale licenses administered by the LCB to regulate the sale and distribution of vapor products. Possession of one or more license types is required in order to engage in the sale, distribution, or delivery of vapor products. Vapor products are required to be labeled with various health and safety warnings. It is illegal for a person under the age of 18 to purchase or possess vapor products, and retailers must display signage clearly identifying that the sale of vapor products to persons under age 18 is prohibited.

The use of vapor products is prohibited in various places including inside child care facilities, schools, within 500 feet of schools, school buses, and elevators. The LCB has various enforcement powers related to the sale and distribution of vapor products, including the ability to enter and inspect businesses where vapor products are sold, to suspend or revoke a retailer, distributor, or delivery sale license, and to impose monetary penalties for license violations.

Vapor products are subject to normal sales and use taxes, but are not subject to any additional state taxes.

Tribal Compacting.

The Governor is authorized by statute to enter into compacts and agreements with the Indian tribes of the state regarding matters of mutual interest or concern. Among these contracts are those regarding the sale and taxation of cigarettes. In general, cigarettes sold on Indian lands during a contract term are subject to a tribal cigarette tax equal to the total combined rate of state cigarette and state and local sales and use taxes. Cigarettes sold on Indian land are exempt from state cigarette taxes, and from state sales and use taxes.

Summary of Substitute Bill:

Vapor Products Tax.

The sale, use, consumption, handling, possession, or distribution of vapor products subject to a tax of 60 percent of the taxable sales price. "Vapor products" are defined as any noncombustible product containing a solution or other consumable substance, regardless of whether it contains nicotine, which employs a mechanical heating element, battery, or electronic circuit that can be used to produce vapor from the solution or other substance. For purposes of taxation, vapor products do not include tobacco cessation products, component ingredients in vapor products, or marijuana or tobacco products. The distributor is responsible for the payment of the tax, but the tax may be imposed on the consumer if it was not previously collected. The tax may be collected only once during the commercial distribution and retail sales process.

The tax applies to preexisting inventories of vapor products. Retailers and distributors must report the tax due on preexisting inventories of vapor products on or before October 31, 2019, and are responsible for payment of the tax by January 31, 2020. A penalty equal to the greater of \$250 or 10 percent of the tax due is applied if the preexisting inventory tax is not paid. Bundled transactions that include a vapor product are subject to the tax on the entire selling price of the transaction.

The Department of Revenue (DOR) is responsible for administration of the tax and all agency administrative provisions apply with respect to collection and administration of the tax. The DOR and LCB have various enforcement powers, including inspection of records and premises of distributors and retailers, and seizure of illegally held vapor products. Distributors and retailers of vapor products must keep records, including itemized invoices, of vapor products sold in the state.

Essential Public Health Services Account.

The Essential Public Health Services Account (Account) is created in the State Treasury. For the 2019-21 biennium, the Account will be funded with 75 percent of the proceeds from the vapor products tax. Beginning with the 2021-23 biennium, 60 percent of the proceeds from the vapor products tax will be deposited into the Account.

The Department of Health must use the funds in the Account for four purposes: (1) 33 percent to fund foundational health services; (2) 33 percent to fund tobacco, vapor product, and nicotine control and prevention, and other substance use prevention and education programs; (3) at least 10 percent to support increased access and training of public health professionals at public health programs at institutions of higher education in Washington; and (4) no more than 12.5 percent may be provided to the LCB to enforce vapor products regulations.

Tribal Compacting for Vapor Products.

The Governor is granted the authority to enter into vapor products tax contracts with federally recognized Indian tribes located within the geographic boundaries of the state of Washington. Contracts must require that the tribal vapor products tax rate be 100 percent of the combined sum of the state vapor products tax and state and local sales and use taxes. Contracts with the Puyallup Tribe may set the tribal tax rate at 90 percent of the state vapor products tax. Any vapor products tax agreement with the Puyallup Tribe may also require the tribe to remit to the state 30 percent of all vapor products tax revenue it collects. The tribal vapor products tax is in lieu of all state and local taxes that would otherwise be applicable to sales of vapor products.

The Governor may delegate the power to negotiate vapor product tax contracts to the DOR. The DOR must consult with the LCB during any such negotiations.

Substitute Bill Compared to Original Bill:

The substitute bill establishes the vapor products tax in a new chapter of the RCW, rather than tax them as an Other Tobacco Product. The taxation rate is 60 percent instead of 95 percent. Provisions related to taxation of preexisting inventories, bundled transactions, tribal compacting, and enforcement and record keeping are added in the substitute. Distributions from the Account are modified.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect October 1, 2019.

Staff Summary of Public Testimony:

(In support) The health impacts of electronic cigarettes and vapor products are huge. Claims of use of electronic cigarettes as a smoking cessation device are not true. People are more

likely to smoke cigarettes if they vape. Juul has seen skyrocketing sales, and uses nicotine salts which give the user more nicotine and give it to the user faster and smoother than other vaping devices. This is a real problem for our youth. Many youth thought that when buying a Juul product that it did not have nicotine. This is false. The cost of electronic cigarettes is a fraction of the cost of the same pack of traditional cigarettes. Every other nicotine product is taxed at the 95 percent "other tobacco products" rate. This bill aims for parity surrounding payment of the tobacco products tax. There is a clear correlation between increasing the cost of cigarettes and decreasing the incidence of smoking. This will save lives through the prevention of addiction and smoking. Most claims about cessation of smoking using vaping products are overblown. The money from the bill will go into education, prevention, and foundational health services. Significant increases in the tax code on tobacco products are the most effective ways to reduce the incidence of kids smoking. Vapor products have not yet been approved by the Food and Drug Administration as cessation products. Underage possession of vapor products is subject to a civil infraction. About 20 percent of high school students use e-cigarettes, which is an alarming increase in youth use. These products contain highly addictive nicotine.

(Opposed) This bill will put many small businesses out of business. It will allow only large tobacco and other companies with distribution power to sell vapor products. Online sales are already much cheaper. Vaping is safer than smoking, there are many studies that have shown this. The New England Journal of Medicine says that electronic cigarettes are two times more effective for smoking cessation than traditional approaches. There are ways to keep these out of the hands of kids without harming other consumers. The tax penalizes people for making the correct health care decision. This tax will result in more people returning to the use of cigarettes. It will reduce jobs in the state. This will make vapor industry products out of reach to consumers. Vapor stores are vigilant about preventing underage sales. Vaping has saved lives through the prevention of smoking. Vaping also generates strong community. A real penalty should be provided for underage possession. That would be a better deterrent. There are varying levels of nicotine in different products. Providing vapor products is a public service to help people get off of cigarettes and move towards better health. Many vape shops do not carry Juuls, there are much better ways to quit smoking. Kids are getting cigarettes from convenience stores and gas stations, not from vapor shops. If you really want to stop kids from smoking, then empower the vapor shops that prevent youth access. Raising the cost will not keep vapor products out of the hands of children, they will simply find them elsewhere. Electronic cigarettes are a valid form of harm reduction.

Persons Testifying: (In support) Representative Pollet, prime sponsor; Representative Harris; Mary McHale, American Cancer Society Cancer Action Network; Kathy Lofy, State Health Officer; Annie Tegen, American Lung Association, Campaign for Tobacco-Free Kids; and Jaime Bodden, Washington Association of Local Public Health Officials.

(Opposed) Joshua Baba, Gakaxy Vapor; James Hoy, Northwest Fog; Guy Bentley, Consumer Freedom at Reason Foundation; Anthony Covert; Matt Waggoner, Fatboy Vapors; Tyler Dennison; Johnathan Zilar, Cloud 509; Margot Ross; Matthew Page; Aaron Crisp; Anthony McMullen, MAXX Vape; Steven Berry; Kim Thompson, Pink Lung Brigade; Matthew Zukowski; and Joshua Ross.

Persons Signed In To Testify But Not Testifying: Amy Brackenbury, Public Health Roundtable; Connor Crisp; Mark Johnson, Washington Retail; Eric Miller; Ruvin Munden, Ruze Vapor Industries Corporation; Ann Simons, JUUL Labs; John Jensen, Artisan Clouds; and Allan Kettle.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: Do pass. Signed by 18 members: Representatives Ormsby, Chair; Bergquist, 2nd Vice Chair; Robinson, 1st Vice Chair; Cody, Dolan, Fitzgibbon, Hansen, Hudgins, Jinkins, Macri, Pettigrew, Pollet, Ryu, Senn, Stanford, Sullivan, Tarleton and Tharinger.

Minority Report: Do not pass. Signed by 14 members: Representatives Stokesbary, Ranking Minority Member; MacEwen, Assistant Ranking Minority Member; Rude, Assistant Ranking Minority Member; Caldier, Chandler, Dye, Hoff, Kraft, Mosbrucker, Schmick, Steele, Sutherland, Volz and Ybarra.

Minority Report: Without recommendation. Signed by 1 member: Representative Springer.

Staff: Linda Merelle (786-7092).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Finance:

The Appropriations Committee recommended the following:

- the imposition of a 37 percent excise tax on vapor products, levied on the consumer at the point of sale, rather than a 60 percent tax at the time of distribution;
- a revision in the distribution of the revenue from the vapor tax, resulting in: (a) 75 percent directed to the Essential Public Health Services Account; and (b) 5 percent of that amount transferred to the Andy Hill Cancer Research Endowment Fund, beginning in the 2021–2023 biennium and continuing through fiscal year (FY) 2025;
- an appropriation of \$613,000 from the State General Fund in FY 2020 to the Liquor and Cannabis Board for enforcement purposes; and
- the removal of obsolete provisions, including the tax on pre-existing inventories, various definitions, and other enforcement and administrative provisions.

Appropriation: The sum of \$613,000, or as much thereof as may be necessary, is appropriated for the fiscal year ending June 30, 2020, from the State General Fund to the Liquor and Cannabis Board for enforcement of the provisions of this act, to prevent the sales of vapor products to minors, and for control of marketing and product safety.

Fiscal Note: Available.

Effective Date of Second Substitute Bill: The bill takes effect on October 1, 2019.

Staff Summary of Public Testimony:

(In support) The taxing rate under this bill parallels the taxing rate of cannabis. The tax increase proposed under this bill, along with other legislation that raised the legal age of access to vaping products to 21 years, will result in a substantial reduction in youth access. The dedicated revenue for cessation programs is vital.

Electronic cigarette (e-cigarette) use is skyrocketing among youth. Individuals in the age range of 18 to 24 years represent one-fourth of adults who use e-cigarettes. Most e-cigarettes contain nicotine, which is addictive and can harm the developing brain. Youth are more responsive to price changes than adults are, and the increase in price will immediately help reduce youth use. The taxation of vaping products will also reduce the dual use of cigarettes and vaping devices in adults.

There is a clear correlation between higher costs and smoking cessation. The tax rate is high enough to discourage youth from vaping. The Legislature should increase the rate even more. A tax on sale price helps simplify enforcement.

The allocation model of the revenue should be revised. Communicable disease outbreaks are skyrocketing, and a strong public health system and funding are necessary to address this.

(Opposed) If there is a tax, people will go to Oregon instead. These taxes will disproportionately affect the lower-wage customer and create a barrier to adult access. The instances of lung cancer in persons with lower incomes is very high. Vaping is an alternative to traditional cigarettes and has been embraced as a valued method of cessation. Smoking cessation can rid people of respiratory illnesses related to smoking. Vaping is much less harmful than a cigarette. This tax will create a roadblock to access to these products.

Everyone wants to keep vapor products out of the hands of young people. Raising the legal age to 21 years is a powerful tool, and that bill has already passed. That measure should be given a chance to work before implementing this bill. Under the tax proposed in this bill, youth would be forced back to cigarettes instead of vaping. This tax will not solve youth nicotine problems.

The 37 percent retail tax is the equivalent of 95 percent wholesale tax. Consumers will simply travel across the borders, to the north and to the south, and it will destroy many small businesses. This tax will cut into the book of business for small convenience stores. In states that have implemented a tax like this, many businesses have been driven out. The revenue will not materialize, and the businesses will be destroyed. One approach is a bifurcated tax for different vaping products.

The items covered by the bill are very broad. This tax is completely unreasonable. If vaping products are no longer available, counterfeit products will fill the space. The tax will also push customers to online, unregulated sources. There is no way to compete with the Internet. Even though the bill addresses online sales, the enforcement will not be effective because there is no framework for enforcement. Working with local businesses is easier than trying to create an enforcement structure. The state can create a partnership with the vaping companies, but the companies have not been given that opportunity.

Persons Testifying: (In support) Kathy Lofy, Washington State Department of Health; Amy Brackenbury, Public Health Round Table; Jaime Bodden, Washington Association of Local Public Officials; Chris Thompson, Washington State Liquor and Cannabis Board; Kate White Tudor, American Cancer Society Cancer Action Network; and Thomas Bates, Fred Hutchinson Cancer Research Center.

(Opposed) Ann Simons, Juul Labs; Joshua Baba, Galaxy Vapor; Clint Pettee, River Reserve E-Liquid; Justin Rawlinson, Justin Smith, and Elizabeth Miller, Erupted Vapor; Zachariah Vasilas; Jenell Ham; Mark Johnson, Washington Retail Association; Jack Crutchfield and Kim Thompson, Pink Lung Brigade; James Hoy, Northwest Fog; Allan Kettle; Julie Anderson, E-Cig n' Vape; Aaron Crisp, Crisp Vapes LLC; Derreld Carmin; Travis Bain; and Ralph Kunkle.

Persons Signed In To Testify But Not Testifying: None.