

Department of Legislative Services  
Maryland General Assembly  
2016 Session

FISCAL AND POLICY NOTE  
First Reader

House Bill 861 (Delegate Healey, *et al.*)  
Economic Matters and Ways and Means

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Electronic Smoking Devices - Regulation and Taxation

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This bill alters the definition of “cigarette” to include an electronic smoking device (ESD) and applies existing laws relating to cigarette sales, use, possession, distribution, and taxation to ESDs.

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Fiscal Summary

**State Effect:** General fund revenues increase, potentially significantly, beginning in FY 2017 due to the bill’s application of existing cigarette laws to ESDs, as discussed below; special fund revenues may increase minimally due to application of existing penalties. General fund revenues may also increase beginning in FY 2017 due to the imposition of the tobacco tax on ESDs, as discussed below. General fund expenditures for the Department of Health and Mental Hygiene (DHMH) increase by as much as \$25,000 in FY 2017 for the development of outreach materials related to the bill’s Clean Indoor Air Act (CIAA) provisions. Enforcement can be handled with existing resources.

**Local Effect:** Revenues decrease minimally due to the repeal of civil penalties for the distribution of ESDs to minors, which are currently remitted to the county in which the violation occurred. Enforcement can be handled with existing resources.

**Small Business Effect:** Potential meaningful.

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Analysis

**Bill Summary/Current Law:** Under existing law, “cigarette” means any size or shaped roll for smoking that is made of tobacco or tobacco mixed with another ingredient and is wrapped in paper or in any other material except tobacco.

*Cigarette Licenses:* Under Title 16 of the Business Regulation Article, a person must have a license to act as a manufacturer, retailer, storage warehouse, subwholesaler, vending machine operator, or wholesaler of cigarettes in the State. Additionally, a person must have a county license to sell cigarettes at retail in a county.

The Comptroller issues cigarette retailer licenses through the local clerks of the court. To obtain a license to sell cigarettes at retail, a person must (1) obtain a county license; (2) file an application with the clerk; and (3) pay the clerk a fee of \$30. A county license costs an additional \$25 in all counties except Cecil County, where the cost is \$50. Licenses expire on the first April 30 after the effective date, but they are renewable for an additional year. To renew a cigarette retailer license, licensees must pay the aforementioned application fees.

The bill alters the definition of “cigarette” under this law to include any ESD that can be used to deliver nicotine or other substances to an individual inhaling from the device.

*Cigarette Sales Below Cost Act:* Under the Commercial Law Article, a retailer or wholesaler with intent to injure a competitor or to destroy or substantially lessen competition may not make a retail sale of cigarettes or a wholesale sale of cigarettes at less than the cost to the retailer or the cost to the wholesaler. A retailer may not purchase cigarettes from a wholesaler at a cost that directly or indirectly is less than the cost to the wholesaler by any means.

The bill alters the definition of “cigarette” under this law to include any ESD that can be used to deliver nicotine or other substances to an individual inhaling from the device.

*Sales of Unpackaged Cigarettes:* Under the Commercial Law Article, a retailer or vending machine operator may not purchase from a tobacco product manufacturer or sell, resell, distribute, dispense, or give away to any person an unpackaged cigarette. A wholesaler may also not sell, resell, distribute, dispense, or give away to any person an unpackaged cigarette. A person who violates these provisions is guilty of a misdemeanor and on conviction is subject to a fine of up to \$500 and/or imprisonment for up to three months.

“Unpackaged cigarette” means any cigarette not contained in a sealed package of 20 or more cigarettes.

The bill alters the definition of “cigarette” under this law to include any ESD that can be used to deliver nicotine or other substances to an individual inhaling from the device.

*Tobacco and Minors:* Under the Criminal Law Article, a person may not purchase for or sell a tobacco product to a minor and may not distribute tobacco paraphernalia to a minor.

A person licensed to commercially distribute tobacco products may not distribute a tobacco product, tobacco paraphernalia, or a coupon redeemable for a tobacco product to a minor. A person who violates this law is guilty of a misdemeanor and is subject to a fine of up to \$300 for the first violation, up to \$1,000 for the second violation occurring within two years of the first violation, and up to \$3,000 for subsequent violations occurring within two years of the preceding violation. It is a defense against prosecution if the defendant examined the purchaser's valid identification (issued by an employer, government unit, or institution of higher education) that identified the purchaser as at least age 18.

A minor may not use or possess a tobacco product or cigarette rolling paper or obtain or attempt to obtain a tobacco product or cigarette rolling paper by identification that is false or identifies an individual other than the minor. A minor who violates this law is subject to specified provisions of the Courts and Judicial Proceedings Article and may be issued a citation by law enforcement.

The bill alters the terms "tobacco product" and "tobacco paraphernalia" to include nicotine products and paraphernalia and alters the definitions to include ESDs that can be used to deliver nicotine or other substances to an individual inhaling from the device.

*Smoking in Hospitals, Nursing Homes, Health Clinics, and Physicians' Offices:* Under the Health-General Article, every director of a nursing home, health clinic, or physician's office must have a plan that adequately protects the health of nonsmoking patients by regulating the smoking of tobacco products on the premises. The bill includes the use of ESDs in this requirement.

An individual may not smoke in any area of a hospital, except under specified circumstances. The bill includes the use of an ESD in this prohibition and in the specified exceptions.

*Smoking on Public Elevators:* Under the Health-General Article, the proprietor of a building with a public elevator must post a sign prohibiting the smoking of tobacco products in the elevator. A person may not smoke tobacco products in an elevator. A person who violates these provisions is subject to a civil penalty of up to \$25. The bill includes the use of ESDs in the signage requirement and related prohibition.

*Distribution of ESDs to Minors:* Pursuant to Chapter 425 of 2015, under the Health-General Article, a person may not sell, distribute, or offer for sale to a minor an electronic device, a component for an electronic device, or a product used to refill or resupply an electronic device that can be used to deliver nicotine to the individual inhaling from the device, including an electronic cigarette, cigar, cigarillo, or pipe. This prohibition does not apply to a nicotine device that has been approved by the U.S. Food and Drug Administration (FDA) as a tobacco cessation product and that is being marketed and sold

solely for this purpose. A person who violates this law is subject to a civil penalty of \$300 for a first violation and \$500 for any violation that occurs within 24 months after a previous violation. It is a defense against prosecution if the defendant examined the purchaser's valid identification (issued by an employer, government unit, or institution of higher education) that identified the purchaser as at least age 18. The District Court must remit any penalties collected to the county in which the violation occurred.

The bill repeals this law.

*Clean Indoor Air Act:* Under the CIAA, except as otherwise specified, a person may not smoke in (1) an indoor area open to the public; (2) an indoor place in which meetings are open to the public; (3) a government-owned or government-operated means of mass transportation; (4) an indoor place of employment; (5) a private home used by a licensed child care provider; or (6) a private vehicle used for public transportation of children or as part of health care or day care transportation. The prohibition includes bars, clubs, restaurants, pubs, taverns, retail establishments, theaters, concert halls, athletic facilities, financial service institutions, government buildings, educational institutions, museums, and libraries. DHMH was required to adopt regulations that prohibit environmental tobacco smoke in indoor areas open to the public. A person who violates the DHMH regulations is subject to a written reprimand for a first violation, a civil penalty of \$100 for a second violation, \$500 for a third violation, and \$1,000 for each subsequent violation, unless otherwise waived by DHMH. (Statute requires that the civil penalty for third and subsequent violations be at least \$250.) "Smoking" means the burning of a lighted cigarette, cigar, pipe, or any other matter or substance that contains tobacco.

The bill includes the use of an ESD in the CIAA and alters the definition of "environmental tobacco smoke" to include the smoke or vapor emitted from an ESD or exhaled by the user.

*Smoking in Indoor Place of Employment:* Under the Labor and Employment Article, a person may not smoke in an indoor place of employment. A person who violates this prohibition is subject to a written reprimand for a first violation, a civil penalty of \$100 for a second violation, and a civil penalty of at least \$250 for each subsequent violation. These penalties are paid into the Cigarette Restitution Fund.

The bill includes the use of an ESD in this requirement.

*Smoking on Buses:* The owner and operator of an intrastate motor bus carrier must prohibit smoking tobacco products while the bus is in service. A person may not smoke tobacco products on a motor bus carrier. A person who violates these requirements is subject to a civil penalty of up to \$25. The bill includes the use of an ESD in this requirement.

*Tobacco Tax:* Under State tax law, there is a rebuttable presumption that any cigarette or other tobacco product is subject to the State tobacco tax. The tobacco tax rate for cigarettes is (1) \$1.00 for each package of 10 or fewer cigarettes; (2) \$2.00 for each package of at least 11 and not more than 20 cigarettes; (3) 10 cents for each cigarette in a package of more than 20 cigarettes; and (4) 10 cents for each cigarette in a package of free sample cigarettes. Cigarette tax revenues accrue to the general fund. In fiscal 2016, cigarette tax revenues are projected to total \$358.6 million. The tobacco tax does not apply to ESDs.

The bill renames the “tobacco tax” to be the “tobacco and electronic smoking device tax”; applies the tobacco tax for cigarettes to ESDs; and applies the current tax requirements, procedures, and penalties for cigarette wholesalers and manufacturers to wholesalers and manufacturers of ESDs.

**Background:** Electronic cigarettes (sometimes referred to as “e-cigarettes”) are battery-operated devices that typically contain nicotine cartridges and other chemicals imitating flavors such as chocolate, mint, or strawberry. When a user draws on an electronic cigarette, a light-emitting diode causes the tip to glow, and the inhaled nicotine vapor is exhaled in a cloud that resembles cigarette smoke but dissipates more quickly and does not have a lingering odor.

E-cigarette use has been on the rise since first introduced in the United States in the mid-2000s. According to the U.S. Centers for Disease Control and Prevention, between 2010 and 2013, e-cigarette use more than doubled among U.S. adults, with about 20 million individuals trying the products in 2013. Additionally, *The Wall Street Journal* (citing a Wells Fargo industry analyst) reports that the e-cigarette market grew to about \$2.5 billion in 2014.

FDA initially attempted to regulate e-cigarettes as drug/device combination products under the federal Food, Drug, and Cosmetic Act. However, a 2010 federal appellate court held that FDA may not regulate e-cigarettes as drug/device combination products unless manufacturers specifically market the products as tobacco cessation aids. The court did hold, however, that FDA could regulate e-cigarettes as “tobacco products” under the Family Smoking Prevention and Tobacco Control Act of 2009 (TCA). FDA chose not to appeal the ruling and instead moved forward with regulations under its TCA authority. In April 2014, FDA issued its Proposed Rule to deem e-cigarettes as “tobacco products” subject to its regulatory authority. Among other regulations, FDA proposes to require a minimum age of 18 to purchase e-cigarettes (including any components or parts that contain nicotine). The public comment period for the Proposed Rule closed in August 2014, with thousands of comments submitted. In October 2015, FDA forwarded the Final Rule to the Office of Management and Budget for final review. As of February 2016, review is still pending.

**State Revenues:** General fund revenues increase, potentially significantly, due to several factors: (1) the bill's prohibition of the sale of individual ESDs; (2) application of existing cigarette licensing requirements to the sale of ESDs; (3) application of the existing tobacco tax for cigarettes to ESDs; and (4) application of existing criminal and civil penalties for the distribution or use of cigarettes to ESDs.

The bill adds ESDs to the definition of "cigarette" in existing law that prohibits the sale of unpackaged cigarettes; therefore, the bill prohibits the sale of individual ESDs. The sale of unpackaged cigarettes is a misdemeanor subject to a fine of up to \$500 and/or imprisonment for up to three months. The Comptroller advises that ESDs are typically sold individually. Thus, general fund revenues increase, potentially significantly, as retailers and wholesalers of ESDs are subject to criminal fines for the sale of individual ESDs.

General fund revenues also increase due to the bill's ESD licensing provisions. The bill adds ESDs to the definition of "cigarette" in Title 16 of the Business Regulation Article; therefore, manufacturers, retailers, storage warehouses, subwholesalers, vending machine operators, or wholesalers of ESDs must have licenses to sell ESDs. Retailers may also need a license to sell ESDs at the county level. This analysis assumes that existing cigarette business licenses encompass the sale of ESDs, and that a separate ESD license is not required. Thus, only those manufacturers, retailers, storage warehouses, subwholesalers, vending machine operators, or wholesalers that uniquely sell ESDs, and that do not already have cigarette business licenses, are required to obtain a license under the bill. DHMH estimates that at least 1,500 retailers in the State sell ESDs, although it is unclear how many of these retailers also have cigarette licenses. The number of manufacturers, storage warehouses, subwholesalers, vending machine operators, and wholesalers of ESDs in the State is also unclear.

The bill imposes the tobacco tax on ESDs. Cigarettes are currently taxed at a rate of \$2.00 per pack (standard size of between 11 and 20 cigarettes) and taxed at a rate of \$1.00 per pack with 10 or fewer cigarettes. However, as noted previously, current law prohibits the sale of unpackaged cigarettes – defined as any cigarette not contained in a sealed package of 20 or more cigarettes – and the bill includes ESDs in this prohibition. ESDs and vapor products are typically sold individually or in packs of fewer than 20.

Based on the assumption that a tax of \$1.00 for each package of 10 or fewer cigarettes will be imposed on ESDs, the Comptroller's Office estimates that revenues may increase by about \$150,000 annually beginning in fiscal 2017. The Department of Legislative Services advises that the actual revenue impact from the bill may be significantly different based on how the tobacco tax is applied to ESDs.

Four states (Minnesota, Kansas, Louisiana, and North Carolina) and the District of Columbia currently or soon will impose a tax on vapor products and/or electronic cigarettes. Two of these taxes are based on the value of the products, and three are imposed based on the milliliters of nicotine liquid or consumable material in the product (at a rate ranging from 5 to 20 cents per milliliter). Annual revenues from imposing taxes on these products are projected to total \$6.1 million in Minnesota (95% wholesale value tax), \$2.0 million in Kansas (\$0.20 per milliliter), and \$5.2 million in North Carolina (\$0.05 per milliliter).

Finally, general and special fund revenues also increase minimally due to the bill's application of criminal penalties to the distribution of ESDs to minors and civil penalties for the use of ESDs where their use is prohibited.

**State Expenditures:** The Department of Labor, Licensing, and Regulation and DHMH advise that regulations relating to the use of ESDs in indoor areas of employment and in areas covered under the CIAA can be handled with existing resources, respectively. However, DHMH advises that it must conduct outreach and issue advertising materials for the State's businesses affected by the changes to the CIAA, and that related costs are approximately \$25,000 in the first year and minimal thereafter.

Although sale of unpackaged ESDs is a misdemeanor, subject to maximum penalties of a \$500 fine and/or three months imprisonment, this analysis assumes that only fines would be imposed.

**Local Fiscal Effect:** Revenues decrease minimally due to the repeal of civil penalties for the distribution of ESDs to minors, which are currently remitted to the county in which the violation occurred. Additionally, the Maryland Association for County Health Officers advises that, while the bill has an operational impact for local health departments, enforcement can be handled with existing resources.

Montgomery County recently imposed its own excise tax on ESDs, effective August 2015. The county tax applies to any dealer of electronic cigarette products, including components and parts. The tax rate is 30% of the wholesale price. The county estimates \$325,000 in revenue in fiscal 2016 and \$338,300 in fiscal 2017.

Although sale of unpackaged ESDs is a misdemeanor, subject to maximum penalties of a \$500 fine and/or three months imprisonment, this analysis assumes that only fines would be imposed.

**Small Business Effect:** Manufacturers, retailers, storage warehouses, subwholesalers, vending machine operators, or wholesalers that uniquely sell ESDs, and that do not already

have cigarette business licenses, are likely required to obtain a license under the bill. Additionally, these entities are also subject to collecting tobacco tax on ESD products.

**Additional Comments:** The bill does not create an exception for nicotine products approved by FDA as tobacco cessation aids. This exception is included in § 24-305 of the Health-General Article, which establishes civil penalties for the distribution of ESDs to minors (the bill repeals this law). Additionally, the bill adds a definition for “ESD” to several provisions of existing law; however, the bill does not include components or parts of ESDs, such as liquid nicotine, in this definition. Components or parts may be considered “nicotine products” or “nicotine paraphernalia” under several other provisions in the bill, although the bill does not specifically define these terms either.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Maryland Association of County Health Officers; Montgomery County; Comptroller’s Office; Judiciary (Administrative Office of the Courts); Department of Health and Mental Hygiene; Department of Labor, Licensing, and Regulation; Department of State Police; U.S. Centers for Disease Control and Prevention; U.S. Food and Drug Administration; *Wall Street Journal*; Department of Legislative Services

**Fiscal Note History:** First Reader - March 1, 2016  
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