

Department of Legislative Services
 Maryland General Assembly
 2020 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 3 (Senator McCray)
 Budget and Taxation

Electronic Smoking Devices, Other Tobacco Products, and Cigarettes - Taxation and Regulation

This bill (1) increases the tobacco tax rate from \$2.00 to \$4.00 per pack of cigarettes; (2) generally increases the other tobacco products (OTP) tax rate from 30% to 86% of the wholesale price; (3) imposes an electronic smoking device (ESD) tax equal to 86% of the wholesale price; (4) requires the Governor to include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program; (5) removes the prohibition from local governments imposing a tax on OTP and cigarettes; and (6) alters the definitions of electronic smoking devices and OTP. **The bill takes effect July 1, 2020.**

Fiscal Summary

State Effect: Net general fund revenues increase by \$62.9 million in FY 2021 due to additional cigarette, ESD, and OTP tax revenues, minus the loss of sales tax revenues. General fund expenditures increase by \$0.3 million in FY 2021 due to administrative costs at the Comptroller’s Office. Future year estimates reflect projected tax revenues, mandated general fund expenditures, and ongoing administrative costs. **This bill increases a mandated appropriation beginning in FY 2022.**

(\$ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	\$62.9	\$56.8	\$54.0	\$51.2	\$48.6
GF Expenditure	\$0.3	\$11.2	\$11.3	\$11.3	\$11.3
Net Effect	\$62.6	\$45.6	\$42.7	\$40.0	\$37.4

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local health departments in all counties may receive additional funding beginning in FY 2022 due to the increased funding for the Tobacco Use Prevention and Cessation Program. Local government revenues in Baltimore City, Baltimore County, and Montgomery County could increase by \$21.3 million in FY 2021 and by \$17.9 million in FY 2025 due to a net increase in tobacco tax and vaping tax revenues.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The bill increases the tobacco tax rate from \$2.00 to \$4.00 per pack of cigarettes and increases the OTP tax rate from 30% (currently 15% for premium cigars and 70% for all other cigars) to 86% of the wholesale price.

The bill imposes a tax equal to 86% of the wholesale price of electronic smoking devices (ESD). These devices are commonly known as e-cigarettes or vaping products. An ESD does not include a battery or battery charger when sold separately.

Subject to specified exceptions, a person may not possess or attempt to sell ESD on which the tax has not been paid. A violation is a misdemeanor punishable by a fine of up to \$500 and/or imprisonment for up to 30 days. The bill also establishes (1) the requirements for filing ESD tax returns, related record keeping, remitting the tax due, and posting a security bond with the Comptroller and (2) exemptions to when the tax must be paid.

The bill also imposes a one-time floor tax on cigarettes, OTP, and ESD in fiscal 2021.

Under current law, local governments may not impose a tax on OTP or cigarettes. The bill removes this prohibition.

OTP means a product that is intended for human consumption or likely to be consumed, whether smoked, heated, chewed, absorbed, dissolved, inhaled, or ingested in any manner that is made of, derived from, or contains tobacco or nicotine. OTP includes cigars, premium cigars, pipe tobacco, chewing tobacco, snuff, snus, filters, rolling papers, pipes, and hookahs. OTP excludes cigarettes, ESDs, or a drug, device, or combination product authorized for sale by the United States Food and Drug Administration (FDA) under the federal Food, Drug, and Cosmetic Act.

Beginning in fiscal 2022, the Governor must include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program.

Current Law:

Tobacco Product Taxes

Cigarettes are taxed at a rate of \$2.00 per pack. Generally, the tax rate for OTP is 30% of the wholesale price, which is the price for which a wholesaler buys OTP, exclusive of any discount, trade allowance, rebate, or other reduction. The tax rate for cigars is 70% of the wholesale price of the cigars. The tax rate for premium cigars is 15% of the wholesale price of the premium cigars. OTP is defined as any cigar or roll for smoking, other than a cigarette, made in whole or in part of tobacco or any other tobacco or product made

primarily from tobacco, other than a cigarette, that is intended by smoking or chewing or as a snuff.

Cigarette and OTP tax revenues accrue to the general fund. In fiscal 2021, cigarette tax revenues are projected to total \$299.0 million, and OTP tax revenues are projected to total \$42.6 million. In addition, the State sales tax rate of 6% is imposed on the final retail price of cigarettes and OTP.

Recent State and federal legislation generally raises the minimum age, from 18 to 21, for an individual to purchase or be sold tobacco products.

Electronic Smoking Devices

ESD and their components are subject to the State sales and use tax but are not subject to a State excise tax. Montgomery County imposes a 30% tax on the wholesale value of vaping products. Montgomery County estimates that the tax generated \$1.3 million in fiscal 2019 and projects that revenues will total \$1.9 million in fiscal 2020.

Chapter 396 of 2019 renamed “electronic nicotine delivery system” to be “electronic smoking device” and defined “electronic smoking device” as a device that can be used to deliver aerosolized or vaporized nicotine to an individual inhaling from the device. ESD includes (1) an electronic cigarette, an electronic cigar, an electronic cigarillo, an electronic pipe, an electronic hookah, a vape pen and vaping liquid and (2) any component, part, or accessory of such a device regardless of whether or not it is sold separately, including any substance intended to be aerosolized or vaporized during use of the device. ESD excludes a drug, device, or combination product authorized for sale by FDA under the Food, Drug, and Cosmetic Act.

Local Government Taxing Authority and Tobacco Products

Local governments may only impose taxes if the State confers this power on them. Local governments may not impose a tax on OTP or cigarettes. Subject to specified exceptions, local governments may not impose a retail sales or use tax on products for sale. While still subject to these restrictions, Baltimore City, Baltimore County, and Montgomery County generally have greater authority to impose local taxes.

Tobacco Use Prevention and Cessation Program

The Tobacco Use Prevention and Cessation Program aims to reduce the use of tobacco products and to reduce the burden of tobacco-related morbidity and mortality in the State. The Governor’s proposed fiscal 2021 budget includes \$10.0 million in funding for the program.

Tobacco Product Licensing

The Business Regulation Article governs the licensing of cigarette, OTP, and ESD manufacturers, wholesalers, retailers, storage warehouses, and vending machine and operators. The Comptroller issues manufacturer, wholesaler, and storage warehouse licenses. However, effective June 1, 2020, this responsibility is transferred to the Alcohol and Tobacco Commission (ATC) established under Chapter 12 of 2019, as discussed in further detail below. The clerks of the circuit courts issue retail licenses.

With limited exception, a person may not act, attempt to act, or offer to act as a (1) cigarette manufacturer, retailer, storage warehouse, subwholesaler, vending machine operator, or wholesaler; (2) OTP manufacturer, retailer, storage warehouse, or wholesaler or tobacconist; or (3) ESD manufacturer, retailer, wholesaler distributor, or wholesaler importer or vape shop vendor without an appropriate license. A violation is a misdemeanor punishable by a fine of up to \$1,000 and/or imprisonment for up to 30 days. Each day that a violation continues is a separate offense.

The Comptroller's Office is generally responsible for monitoring and enforcement activity related to tobacco and other business licenses. The Field Enforcement Division within the Comptroller's Office enforces State revenue and licensing laws pertaining to alcohol, tobacco, trader's, and transient vendor's licenses, the sales and use tax, and motor fuel, among others.

Chapter 12 of 2019, which takes effect June 1, 2020, establishes the Alcohol and Tobacco Commission (ATC) and transfers duties of the Field Enforcement Division pertaining to alcohol and tobacco enforcement to ATC. The Comptroller's Office, however, retains duties related to enforcement of alcohol and tobacco taxes.

Background:

Tobacco Taxes

Maryland's cigarette tax of \$2.00 per pack is currently 17th highest in the nation and the proposed excise tax of \$4.00 would be the 5th highest. In calendar 2020, a total of 21 states and the District of Columbia will impose an e-cigarette tax. The tax imposed is typically either a percentage of wholesale value or per milliliter of vapor product. Nationally, e-cigarette taxes range from 8% to 95% of wholesale value and from \$0.05 to \$0.40 per milliliter of vapor product. With the exception of Virginia, all of Maryland's neighboring jurisdictions impose a tax on e-cigarettes. **Exhibit 1** shows the tobacco product tax rates imposed in Maryland's neighboring jurisdictions.

Exhibit 1
Tobacco Product Tax Rates in Nearby Jurisdictions
As of January 14, 2020

<u>State</u>	<u>Cigarette</u>	<u>OTP¹</u>	<u>E-Cigarettes</u>
Delaware	\$2.10	30%	\$0.05/mL of vapor product
District of Columbia	4.50	91%	91% of wholesale value
Maryland	2.00	30%	
Pennsylvania	2.60	55 ¢ /oz.	40% of wholesale value
Virginia	0.30 ²	10%	
West Virginia	1.20	12%	\$0.075/mL of vapor product

¹ Tax is generally applied on the manufacturer or wholesale price. Most states have exemptions and/or variable tax rates depending on type of OTP.

² Local governments may impose an additional tax - currently ranges from \$0.60 to \$1.15 per pack.

Source: Campaign for Tobacco-Free Kids

Restrictions on E-Cigarette Products

On January 2, 2020, the FDA announced a policy to ban some, but not all, flavored e-cigarettes. According to the FDA, the policy is intended to limit the rise in the use of e-cigarettes by teens — who overwhelmingly prefer flavors — while balancing the potential benefits to adults who already smoke flavored products other than tobacco and menthol.

The policy prohibits the production, distribution, and sale of all flavored cartridge-based e-cigarettes, with the exception of menthol and tobacco flavors, after February 1, 2020. After that date, a manufacturer must show that an unauthorized flavored cartridge is “appropriate for the protection of public health” and receive FDA approval.

The regulation applies to cartridges, or disposable pods, that are enclosed units that hold vaping liquid that when heated in an e-cigarette is aerosolized into a breathable vapor. The policy does not apply to tank-style vapes, which are larger and run on refillable e-liquids that are customizable at vape shops.

State Revenues: The bill (1) increases the cigarette and OTP tax rates; (2) imposes an ESD tax; (3) requires the Governor to include at least \$21.0 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2022; and (4) removes the prohibition on local governments from imposing a tax on cigarettes or OTP.

As a result, the net effect on State finances will be a general fund increase of \$62.6 million in fiscal 2021, as shown in **Exhibit 2**.

Exhibit 2
Fiscal Impact of Legislation
Fiscal 2021-2025
(\$ in Millions)

	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
General Fund Revenues					
Cigarette tax ¹	\$44.7	\$40.0	\$37.1	\$34.4	\$31.8
OTP tax ¹	14.0	13.4	13.4	13.4	13.4
ESD tax ¹	19.9	19.1	19.1	19.1	19.1
Sales tax	(15.6)	(15.6)	(15.7)	(15.7)	(15.7)
Total Revenues	\$62.9	\$56.8	\$54.0	\$51.2	\$48.6
General Fund Expenditures					
Tobacco cessation	\$0	\$11.0	\$11.0	\$11.0	\$11.0
Comptroller	0.3	0.2	0.3	0.3	0.3
Total Expenditures	\$0.3	\$11.2	\$11.3	\$11.3	\$11.3
Net General Fund Impact	\$62.6	\$45.6	\$42.7	\$39.9	\$37.3

¹ Includes impact of one-time floor tax in fiscal 2021.

Tobacco Tax Revenues

The estimated increases in OTP and tobacco tax revenues are based on past cigarette tax increases in Maryland and an examination of the additional OTP revenues generated through recent tax increases in other states, adjusted for Maryland. Based on these experiences, the estimates assume a significant reduction in the taxable consumption of cigarettes and OTPs following the tax increases. The estimate also assumes that the three local jurisdictions with greater taxing authority – Baltimore City, Baltimore County, and Montgomery County – will impose a cigarette tax of \$1.00 and a 10% OTP tax beginning in fiscal 2021, leading to a further reduction in taxable sales within these three local jurisdictions and statewide.

Under the bill, local governments are not required to impose taxes on these products nor does it specify a rate to be imposed. To the extent these local jurisdictions do not impose taxes or impose a rate other than those assumed here, revenue increases will be different than estimated. For example, in the absence of a local cigarette tax, it is estimated that increasing the State cigarette tax to \$4.00 per pack would increase State general fund revenues by \$89.6 million in fiscal 2021 and by \$69.7 million in fiscal 2025.

The estimated revenue increase resulting from imposing an ESD tax is based on similar taxes collected in other states and in Montgomery County, adjusted for Maryland. DLS advises that there is considerable uncertainty about the impact the recent FDA restrictions on the sale of certain flavored vaping products will have on consumption and therefore the taxes imposed.

Tobacco Use Prevention and Cessation Program

The Maryland Department of Health (MDH) advises that the increased funding in fiscal 2022 will be expended on contracts for statewide tobacco prevention (\$4.5 million), health communication activities (\$1.1 million), and evaluation activities (\$1.0 million). In addition, MDH anticipates hiring additional staff (\$480,000) and providing \$3.9 million to local health departments for tobacco prevention and control activities.

Comptroller's Office

The Comptroller's Office advises that establishing a tax on ESD products will necessitate the hiring of two additional revenue examiners and two revenue field auditors. As a result, general fund expenditures will increase by \$275,600 in fiscal 2021, as shown in Exhibit 2. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect full salaries with annual increases and employee turnover as well as ongoing operating expenses.

Penalty Provisions

The bill's penalty provisions are not expected to materially impact State finances.

Local Fiscal Effect: Local health departments in all counties may receive additional funding beginning in fiscal 2022 due to the increased funding for the Tobacco Use Prevention and Cessation Program. Under the assumptions above, net local government revenues in Baltimore City, Baltimore County, and Montgomery County may increase by \$21.3 million in fiscal 2021 and by \$17.9 million in fiscal 2025 due to the imposition of OTP and cigarette taxes. This net increase also accounts for a decrease in the vaping product tax revenues collected in Montgomery County due to a decrease in the taxable consumption of these products resulting from the imposition of a statewide tax.

The bill's penalty provisions are not expected to materially impact local finances.

Small Business Impact: Small OTP, cigarette, and ESD businesses or small businesses that sell these products will be negatively impacted by the proposed tax and regulatory changes. The actual impact depends on the extent to which the tax increases decrease sales of these products and the extent to which the tax increases are passed on to customers. In addition, businesses who are located in counties in which local taxes are imposed may also be negatively impacted to the extent that nearby counties do not impose a tax.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Campaign for Tobacco-Free Kids; Comptroller's Office; Maryland Department of Health; Montgomery County; *The Tax Burden on Tobacco* - Orzakowski and Walker; Department of Legislative Services

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