



DEPARTMENT OF AUDITS AND ACCOUNTS

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February 18, 2020

Honorable Brett Harrell
Chairman, House Ways and Means
133 State Capitol
Atlanta, Georgia 30334

SUBJECT: Revised Fiscal Note
House Bill 864 (LC 43 1493)

Dear Chairman Harrell:

This fiscal note replaces the LC 43 1493 fiscal note dated February 12, 2020. Based on information from the Office of the Legislative Counsel, this revised fiscal note removes smoking cessation products from the definition of alternative nicotine products subject to the bill's tax.

The bill would establish excise taxes of seven percent on the sale of vapor devices and consumable vapor products. It would also require that each place of business selling these products to obtain an annual license from the Department of Revenue. The license would require a \$250 initial registration fee and a \$10 renewal for each place of business. The bill also applies the existing excise tax on loose and smokeless tobacco—ten percent of wholesale price—to alternative nicotine products. The bill has no effective date but is assumed July 1, 2020 for the purpose of the analysis.

Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would result in a revenue gain of \$9.6 million to \$14.5 million in FY 2021 (**Table 1**). The revenue increase is \$6.9 million to \$12.9 million in FY 2022, with the amounts increasing in subsequent years. The higher first year revenue is due to the issuance of initial licenses, which are expected to generate approximately \$3.4 million. In subsequent years, renewal license revenue is estimated at less than \$300,000 annually. Details of the analysis are included in the appendix.

Table 1. Projected Revenue Gains under LC 14 4393

(\$ millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
High Case	\$14.5	\$12.9	\$14.6	\$16.6	\$18.9
Low Case	\$9.6	\$6.9	\$7.4	\$7.9	\$8.4

Impact on State Expenditures

The bill would require an estimated \$199,468 in one-time costs and approximately \$1.1 million annually for the Department of Revenue (DOR). As shown in **Table 2**, the one-time costs are associated with new vehicles and equipment for new staff, while the annual costs are associated with new staff. DOR would use existing information technology resources to modify the Integrated Tax System and Georgia Tax Center; however, it noted that the changes would require approximately eight months and 5,000 hours. This would require a re-direction of staff from current planned activities.

Table 2. Department of Revenue Estimated Costs Under LC 43 1493

	One-Time Costs	Annual Costs
Alcohol and Tobacco Division		
Staff (7 Criminal Investigators; 9 Auditors/Examiners)		\$900,912
GETS IT Charges		\$32,000
Staff Equipment	\$81,068	
Vehicles (procurement and operating costs)	<u>\$118,400</u>	<u>29,250</u>
<i>ATD Subtotal</i>	<i>\$199,468</i>	<i>\$962,162</i>
Legal Affairs and Tax Policy		
Staff (Hearing Officer)		\$157,803
<i>LATP Subtotal</i>		<i>\$157,803</i>
Grand Total	\$199,468	\$1,119,965

The additional staff needed to implement the bill’s provisions are discussed below.

- The Alcohol and Tobacco Division anticipates the need for an additional seven criminal investigators and nine auditors/examiners. DOR expects approximately 13,000 tobacco license holders to obtain the new license created by this bill. It also expects a significant number of the currently unregulated “vape shops” to obtain the license.
- The DOR Hearing Office anticipates additional citation hearings and excise tax hearings as a result of the bill. An additional hearing officer would be necessary given the additional cases.

Sincerely,



Greg S. Griffin
State Auditor



Kelly Farr, Director
Office of Planning and Budget

Analysis by the Fiscal Research Center

Tax on Alternative Nicotine Products:

In Section 1 of the subject bill, ‘alternative nicotine product’ is defined as any product intended for human consumption that contains nicotine, but does not contain tobacco, is not a ‘consumable vapor product.’ These products include, but are not limited to, nicotine gel, pouches, gum, dissolvable nicotine strips, sticks, lozenges, or pellets. However, the definition also excludes any product regulated as a drug or device by the United States Food and Drug Administration (FDA) under Chapter V of the Federal Food, Drug, and Cosmetic Act.

Legislative council interprets this definition of alternative nicotine product to exclude most, if not all, of the over-the-counter nicotine-replacement or smoking-cessation products currently on the market, with the exception of a non-tobacco-derived nicotine pouches currently marketed under the brand name “Zyn,” which is apparently regulated as a tobacco product and not a drug.

The bill imposes tax on alternative nicotine products by including them under the definition of ‘loose or smokeless tobacco,’ thus subjecting these products to the 10 percent excise tax on the wholesale price of loose or smokeless tobacco. The estimates assume that, among existing nicotine-replacement products on the market, only Zyn would initially be taxable under the bill. Limited data available on the sales of Zyn in the U.S. in the first half of 2019 suggest annual retail sales of about \$131 million. Assuming a Georgia share of 3.2 percent (the state’s share of U.S. population) and a markup of 47 percent (average for tobacco products other than cigarettes), this implies annual sales in the state at wholesale of about \$2.9 million and excise tax revenue of about \$0.3 million. Applying a growth rate of 5 percent per annum, roughly the midpoint between recent growth rates for smokeless tobacco and nicotine-replacement products according to the Foundation for a Smoke-Free World, this would grow to about \$0.4 million in FY 2025. Amounts in Table 1 reflect these nominal revenues from alternative nicotine products.

Tax on Consumable Vapor Products:

Section 2 of the bill creates a new excise tax on consumable vapor products at a rate of 7 percent of the retail sale price of such products sold in Georgia.

The FDA defines the group of products that deliver nicotine through the vaporization of nicotine solution as Electronic Nicotine Delivery systems (ENDS). These products are sold in three broad forms: disposable e-cigarettes, rechargeable e-cigarettes, and vaporizers. According to Forbes and Statista, U.S. retail sales of ENDS was approximately \$2.35 billion dollars in 2016.

The sale of e-cigarettes and other vapor products grew as fast as 21 percent annually when first widely available, though according to Neilson Market Research, this growth has slowed in recent years. Mordor Intelligence forecasts the e-cigarette market in the U.S. to grow by 11.5 percent annually between 2019 and 2024.

- A 2018 study by the Centers for Disease Control (CDC) estimates that Georgia represented about 3.46 percent of the retail sales of ENDS in 2016. The estimates assume that between three and four percent of the \$2.35 billion U.S. retail sales of consumable vapor products in 2016 occurred in Georgia.

- Based on the prevailing market research, it is assumed that sales in consumable vapor products growth in Georgia will be between 7 and 14 percent annually between 2016 and 2024.
- Federal regulators recently increased the minimum age to purchase ENDS products from 18 to 21, materially reducing the number of people eligible to purchase these products. Existing market size estimates are based on 18 to 20-year-olds being able to purchase these products, thus the estimates are reduced to account this reduction in the pool of legal-age consumers. Survey data on e-cigarette use from the CDC suggest that 18 to 20-year-olds account for about 14.8 percent of the population using e-cigarettes.

Table 2. High and Low Projected Revenue Gains from Consumable Vapor Products

(\$ millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Consumable Vapor Product Retail Sales					
High growth estimate	\$154.2	\$175.7	\$200.4	\$228.4	\$260.4
Low growth estimate	\$84.2	\$90.1	\$96.4	\$103.2	\$110.4
Revenue from Consumable Vapor Product Sales					
High growth estimate	\$10.8	\$12.3	\$14.0	\$16.0	\$18.2
Low growth estimate	\$5.9	\$6.3	\$6.8	\$7.2	\$7.7

Consumable Vapor Product Dealer License Fees:

In Section 4, the subject bill establishes a licensing fee structure for manufacturers, wholesalers, and retailers of consumables vapor products. Each place of business would be required to obtain a license, paying an initial registration fee of \$250 dollars and an annual license fee of \$10.

- According to data from the Georgia Department of Revenue (DOR), there are 12,786 individual business locations in the state with tobacco licenses as of April 2018. It is assumed for the estimates that virtually all tobacco retail licensees (98.4 percent of the total) will also become consumable vapor product retail licensees as typical outlets (e.g. grocery and convenience stores) already sell these products. The numbers of manufacturing and wholesale licensees are also assumed to be similar.
- DOR data indicate that roughly 3.8 percent of the total tobacco licensees were in the initial year of their licenses. The estimates assume the same share of initial licensees for the consumable vapor products per year after the first year under the proposed law; during FY 2021, all licensees would be in their first year.
- DOR data indicate that tobacco license fees grew by 1.95 percent annually between 2015 and 2018. The estimates assume that consumable vapor product licensees and annual fees have grown at that rate since 2018 and will continue to do so through FY 2025.

Table 3. Projected License Holders and Revenues

	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
License holders (<i>thousands</i>)	13.5	13.8	14.1	14.4	14.6
License Revenues (\$ <i>millions</i>)	\$3.39	\$0.26	\$0.27	\$0.27	\$0.28