



## DEPARTMENT OF AUDITS AND ACCOUNTS

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February 21, 2020

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

SUBJECT: Fiscal Note  
House Bill 864 (LC 43 1560S)

Dear Chairman Harrell:

The bill would establish multiple nicotine product excise taxes and changes the taxation of other products under the existing tobacco excise tax. It applies new excise taxes on consumable vapor products delivered through open and closed systems and a ten percent excise tax on the wholesale cost price of alternative nicotine products. It reduces the excise tax rate on Modified Risk Tobacco Products (MRTPs) by thirty percent of the otherwise applicable tax and changes the definition of cigarettes to include heat-not-burn tobacco products. Finally, the bill requires that each place of business selling these products obtain an annual license from the Department of Revenue. Each license would require a \$250 initial registration fee and a \$10 renewal fee. 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 \$7.3 million to \$10.4 million in FY 2021 (**Table 1**). The revenue increase is \$4.4 million to \$8.3 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 1560S**

<i>(\$ millions)</i>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>
High Case	\$10.4	\$8.3	\$9.4	\$10.6	\$12.1
Low Case	\$7.3	\$4.4	\$4.7	\$5.0	\$5.3

**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 1560**

	<b>One-Time Costs</b>	<b>Annual Costs</b>
<b>Alcohol and Tobacco Division</b>		
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>
<b>Legal Affairs and Tax Policy</b>		
Staff (Hearing Officer)		\$157,803
<i>LATP Subtotal</i>		<i>\$157,803</i>
<b>Grand Total</b>	<b>\$199,468</b>	<b>\$1,119,965</b>

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,

/s/ Greg S. Griffin  
 Greg S. Griffin  
 State Auditor

/s/ Kelly Farr  
 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 41 percent (the 2018 average for tobacco products other than cigarettes, according to the National Association of Convenience Stores), this implies annual sales in the state at wholesale of about \$2.97 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.**

### **Heat-Not-Burn Tobacco Products**

Section 1 of the bill also changes the definition of cigarettes for the purpose of taxation to include any stick for smoking when the stick is heated in a device without combustion. This change defines heated tobacco products, sometimes called heat-not-burn tobacco sticks as cigarettes for purposes of the tobacco excise tax. According to the Department of Revenue (DOR), these products are subject to tax under current DOR regulation and this change simply codifies this fact. Thus, this provision of the bill has no state revenue impact.

### **Modified Risk Tobacco Products**

Section 2 of the bill reduces the excise tax rate otherwise imposed by 30 percent on any modified risk tobacco product (MRTP), which is an FDA legal designation for a tobacco product that poses a lower risk of tobacco-related disease compared to existing tobacco products such as cigarettes. To date, only one MRTP application, for a line of snus smokeless tobacco sold by Swedish Match North America Inc., has been approved by the FDA. Snus products are moist powder tobacco pouches that are currently taxable as a smokeless tobacco product under Georgia law. There is currently one pending MRTP application for a similar snus product, Camel Snus from R.J.

Reynolds, on which the comment period closed in May 2019 and which is assumed for this note to be approved and to qualify for the lower tax rate effective FY 2021.

Other pending MRTTP applications include one heat-not-burn product, one snuff product, and a line of very low nicotine cigarettes. Given the long (3+ year) approval process for the Swedish Match snus line, the dissimilarities of these products to snus, and the high degree of uncertainty about the market share potential of these products, it is not possible at this time to estimate likely revenue impacts from these products. Nevertheless, should they be approved as MRTTPs and should they gain significant market shares, particularly relative to standard cigarettes, the revenue impact could be significant.

Revenue effects of MRTTP status for the two major snus brands, approved or likely to soon be approved, are estimated as follows:

- DOR data indicate that loose and smokeless tobacco generated \$20.2 million in excise tax revenue in FY 2018, the latest breakdown available.
- The 2018 Federal Trade Commission Smokeless Tobacco report indicated that snus represented 3.55 percent of total U.S. loose and smokeless tobacco wholesale sales in 2018. The estimates assume this share of Georgia’s revenue from loose and smokeless tobacco was generated from snus.
- The 2018 Federal Trade Commission Smokeless Tobacco report also indicated that snus sales grew 13.4 percent annually between 2013 and 2017 and by 10.7 percent in 2018. The estimate assumes ten percent annual growth in snus sales between FY 2018 and FY 2025.
- According to its last quarterly SEC filing in 2017 before being acquired by British American Tobacco, R.J. Reynolds reported that Camel Snuff had a market share of “over 75 percent” of the U.S. snus market. Swedish Match reports its snus products having a U.S. market share of 9.9 percent in 2018. Together, these products are assumed to represent 85 percent of the U.S. snus market for purposes of this note.

**Table 2. Modified Risk Tobacco Products**

(\$ millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Snus Total GA Wholesale Sales	\$9.5	\$10.5	\$11.5	\$12.7	\$14.0
Effect of 30 Percent Rate Reduction	(\$0.2)	(\$0.3)	(\$0.3)	(\$0.4)	(\$0.4)

**Tax on Consumable Vapor Products**

Section 2 of the bill creates a new excise tax at a rate of 7 percent of the wholesale cost price of consumable vapor products and devices in an open system and a 5¢ per fluid milliliter for consumable vapor products in a closed system.

The Federal Drug Administration (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. Other key facts and assumptions in estimating revenue from this tax are as follows:

- 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.
- According to market researcher Euromonitor, 66 percent of 2017 vaping system retail sales were in the form of closed systems and 34 percent were open systems.
- Starting in FY 2016, North Carolina has collected a 5¢ per fluid milliliter tax on consumable vapor products. Based on 2016 retail sales of ENDS in North Carolina, one dollar in retail sales equates to approximately .95 milliliters of consumable vapor fluid. The estimates assume this conversion rate for the tax on consumable vapor products in closed systems.
- The estimates assume a 41 percent retail markup for consumable vapor products in open systems.
- Based on the prevailing market research, it is assumed that consumable vapor products sales 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 18-20 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 18-20 year-olds account for about 14.8 percent of the population using e-cigarettes.

**Table 3. High and Low Projected Revenue Gains from Consumable Vapor Products**

<i>(millions)</i>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>
<b>Consumable Vapor Products and Devices Retail Sales</b>					
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
<b>Consumable Vapor Product Closed System Milliliters</b>					
High growth estimate	88.2	100.5	114.6	130.6	148.9
Low growth estimate	48.2	51.5	55.2	59.0	63.1
<b>Wholesale Sales in Open Systems</b>					
High growth estimate	\$36.4	\$41.5	\$47.3	\$53.9	\$61.4
Low growth estimate	\$19.9	\$21.3	\$22.8	\$24.4	\$26.1
<b>Revenue from Consumable Vapor Product and Device Sales</b>					
High growth estimate	\$7.0	\$7.9	\$9.0	\$10.3	\$11.7
Low growth estimate	\$3.8	\$4.1	\$4.4	\$4.7	\$5.0

**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 4. Projected License Holders and Revenues**

	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>
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