

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1565

Bill Subtitle: TO PROVIDE FUNDING FOR A NATIONAL CANCER INSTITUTE-DESIGNATED CANCER CENTER IN THE STATE THROUGH CHANGES IN THE LAWS RELATING TO THE SALE AND TAXATION OF TOBACCO PRODUCTS, CIGARETTE PAPER, AND E-CIGARETTES.

Basic Change :

Sponsors: Representatives A. Davis and M. Gray; Senators J. Dismang and Irvin

This proposal would provide funding for a National Cancer Institute-Designated Cancer Center in the State through increases in the taxation of cigarette papers and the levy of a new special excise tax on E-Liquids used in E-Cigarettes. The bill also amends provisions within the Unfair Cigarette Sales Act and the Arkansas Tobacco Products Tax Act. This bill amends the age at which a person may purchase tobacco products, cigarette paper, alternative nicotine products, and e-cigarettes. Increased tax receipts from cigarette papers and e-Liquids will be deposited to the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund.

This bill directs the General Revenue produced by the marijuana special privilege tax under section 17(c) of the Arkansas Medical Marijuana Amendment of 2016 to the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund.

This bill specifies a minor may not purchase or possess cigarettes, tobacco products, vapor products, alternative nicotine products, or e-liquid products. Any minor found to be in possession of any of these products is subject to the products being confiscated by a certified law enforcement officer or school official and the products are subject to immediate destruction. A minor is defined as a person under twenty-one (21) years of age. Minor does not include a person who is under twenty-one (21) of age if the person presents a military identification card establishing that he or she is a member of the United States Armed Forces or has attained the age of nineteen (19) as of December 31, 2019. This bill amends various Arkansas Tobacco Control Board statutes to change the language defining a "minor" as specified in the bill.

Additional Cigarette Paper Tax --- The bill levies an additional tax of fifty cents (50¢) per package of approximately thirty-two (32) sheets of cigarette paper sold in the state. The tax will be in addition to the current cigarette paper of twenty-five cents (25¢) per package. The revenue from the additional levy is designated as special revenue and is to be credited to the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund.

E-Liquid Excise Tax --- The bill creates the E-Liquid Excise Tax Act which levies an excise tax on e-liquid sold in this state. The tax would be levied at the rate of ten cents (10¢) per one milliliter (1mL) of e-liquid sold. The tax will apply to the inventory and stocks of e-liquid held by a wholesaler or retailer on the effective date of the act. The tax would be administered in the same manner as taxes on tobacco products with the revenue collected being special revenue for deposit to the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund. The tax is to be separately stated on each invoice from the manufacturer or wholesaler as the "E-Liquid Excise Tax." The Director of the Department of Finance and Administration and the Arkansas Tobacco Control Board will adopt rules to implement and to allow for the enforcement of the E-Liquid Excise Tax.

Increased Cost to the Retailer on Cigarette Prices --- The bill amends the Unfair Cigarette Sales Act by changing the definition of the "cost to the retailer" of cigarettes by raising the cost of doing business from seven and one-half percent (7.5%) to nine and five tenths percent (9.5%) of the basic cost of

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cigarettes to the retailer. The increase will result in an increased sales price by the retailer when selling cigarettes to consumers. Retailers may provide proof to the Tobacco Control Board of a lesser or higher cost of doing business and request a variance from the presumed cost of doing business that will be changed to nine and five tenths percent (9.5%) by the bill.

County and Municipal Preemption Tobacco Regulation --- The bill provides for the preemption of the enactment and enforcement of any county, municipal or other local regulation of the manufacture, sale, storage, or distribution of tobacco products that is more restrictive than the state provisions or rules. Any county, municipal, or other local regulation that exists as of the effective date of this act is not preempted.

Reduced Cigarette Taxes on Modified Risk Products --- The bill provides for a fifty percent (50%) reduced Arkansas tax rate for any product for which a modified risk tobacco product order has been issued by the United States Secretary of Health and Human Services under 21 U.S.C. § 387k(g)(1) and a twenty-five percent (25%) reduced tax rate for any product for which a modified risk tobacco product order has been issued under 21 U.S.C. § 387k(g)(2).

The act would be effective on the on the first day of the second calendar month following the effective date of the act (September 1, 2019).

Revenue Impact :

\$2.5 Million Annual Gain in Cigarette Paper Tax Revenue --- Special Revenue for University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund.

\$1.5 Million Annual Gain in E-Liquid Excise Tax --- Levied at ten cents per milliliter. Special Revenue for the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund.

\$1.15 Million Annual Gain in State Sales Tax --- Increased retail cigarette prices resulting from increased cost of doing business by the retailer from seven and one-half percent (7.5%) to nine and one-half percent (9.5%) of the basic cost of cigarettes to the retailer. Increased average price per cigarette pack = \$.12 applicable to 148,000,000 packs annually. Total 6.5% State Sales Tax -- \$1.15 Million; General Revenue only -- \$775,000. \$380,000 Annual gain in city and county sales tax revenues.

Loss of Cigarette, Tobacco Products and Sales Taxes Resulting from Reduced Consumption --

FY2020

\$(4,817,738) Total Loss - Cigarette and Tobacco Products Taxes

\$(1,138,424) Total Loss State Sales Tax on Cigarette and Tobacco Products

- . \$(5,291,736) --- General Revenue
- . \$(16,588) --- Aging/Adult Services Fund - Meals on Wheels Program
- . \$(2,765) --- AR Prostate Cancer Foundation
- . \$(67,745) --- Breast Cancer Control Fund
- . \$(19,010) --- Breast Cancer Research Fund

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- . \$(8,294) --- UAMS Center Fund
- . \$(25,957) --- Meals on Wheels
- . \$(148,499) --- Educational Adequacy (7/8% tax)
- . \$(84,856) --- Property Tax Relief Trust Fund
- . \$(21,214) --- Conservation Tax
- . \$(84,856) --- Highway Fund
- . \$(125,080) --- State Central Services
- . \$(59,561) --- Constitutional Officers
- . \$(379,482) --- Local City and County Sales Tax

FY2021

\$(5,150,145) Total Loss -- Cigarette and Tobacco Products Taxes

\$(1,324,028) Total Loss -- State Sales Tax on Cigarette and Tobacco Products

- . \$(5,611,198) --- General Revenue
- . \$(17,805) --- Aging/Adult Services Fund - Meals on Wheels Program
- . \$(2,967) --- AR Prostate Cancer Foundation
- . \$(72,713) --- Breast Cancer Control Fund
- . \$(20,404) --- Breast Cancer Research Fund
- . \$(8,902) --- UAMS Center Fund
- . \$(27,180) --- Meals on Wheels
- . \$(107,988) --- Educational Excellence Trust Fund
- . \$(9,546) --- Educational Adequacy (GR transfer)
- . \$(172,709) --- Educational Adequacy (7/8% tax)
- . \$(98,691) --- Property Tax Relief Trust Fund
- . \$(24,673) --- Conservation Tax
- . \$(98,691) --- Highway Fund
- . \$(135,958) --- State Central Services
- . \$(64,741) --- Constitutional Officers
- . \$(441,351) --- Local City and County Sales Tax

FY2022

\$(7,573,459) Total Loss -- Cigarette and Tobacco Products Taxes

\$(1,925,157) Total Loss -- State Sales Tax on Cigarette and Tobacco Products

- . \$(8,273,020) --- General Revenue
- . \$(26,290) --- Aging/Adult Services Fund - Meals on Wheels Program
- . \$(4,381) --- AR Prostate Cancer Foundation
- . \$(107,365) --- Breast Cancer Control Fund
- . \$(30,127) --- Breast Cancer Research Fund
- . \$(13,145) --- UAMS Center Fund
- . \$(39,139) --- Meals on Wheels
- . \$(125,594) --- Educational Excellence Trust Fund
- . \$(11,103) --- Educational Adequacy (GR transfer)
- . \$(251,122) --- Educational Adequacy (7/8% tax)
- . \$(143,498) --- Property Tax Relief Trust Fund

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- \$(35,875) --- Conservation Tax
- \$(143,498) --- Highway Fund
- \$(199,471) --- State Central Services
- \$(94,986) --- Constitutional Officers
- \$(641,732) --- Local City and County Sales Tax

Unknown Loss of State General Revenue from Sales of Modified Risk Tobacco Products --- Modified Risk Tobacco Products are currently not sold in the United States although sold in many foreign countries. Applications are pending before the United States Food and Drug Administration for certification of products to be declared a Modified Risk Tobacco Product for sale in the United States. If these products are granted Modified Risk status and are sold in Arkansas, the bill provides for a fifty percent (50%) reduction or a twenty-five percent (25%) reduction in the current Arkansas excise taxes levied on these tobacco products.

Taxpayer Impact :

Consumers purchasing cigarette papers, medical marijuana, e-cigarette products and cigarettes will pay additional taxes on their purchases. Tobacco and E-cigarette manufacturers, distributors, wholesalers, and retailers of these products will collect the additional taxes and report the additional taxes on their monthly tax reports. Taxpayers would modify and establish accounting records and systems to report taxes.

Resources Required :

If electronic filing of monthly tax reports and electronic tax payment is required in the same manner as current taxpayers reporting cigarette taxes, implementation of the new tax on e-cigarettes will not be required. If paper filing and payment is allowed, additional resources will be required for DFA for third party data entry costs and tax return imaging services. Additional personnel resources would be needed for tax return error correction, tax return processing and taxpayer support.

Time Required :

If electronic filing and remittance is required, adequate time is provided for implementation. If paper returns are allowed, a minimum of six months for implementation will be required for development of tax forms and processing procedures.

Procedural Changes :

Modifications to the DFA tax return database as well as its electronic filing system will be necessary to account for the increase in the tax rate for Medical Marijuana and cigarette papers. New development will be required for the new tax on E-cigarettes.

Other Comments :

It may be recommended that the bill be amended to provide that the E-Cigarette tax will be due from

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retailers that also manufacture their own products. -- Tobacco excise taxes are levied at the wholesale level. The definition of a wholesaler specifically defines wholesaler to mean a person other than a manufacturer or a person owned or operated by a manufacturer. The definition of a manufacturer specifically includes a person that mixes, compounds, repackages, or resizes e-liquids or vapor products. There are many retailers for e-cigarettes and vapor products that also meet the definition of a manufacturer as the result of their own manufacture of products to be sold in their retail stores.

It may also be recommended that the bill be amended to provide for taxation of products manufactured by retailers and to provide the monetary value upon which the tax is to be levied and calculated by retailers.

This proposal requires the privilege tax on e-cigarettes to be imposed, reported, remitted and administered in the same manner and at the same time as taxes on tobacco products under the Arkansas Tobacco Products Act. Cigarette tax returns are due the 15th day of the month; the tax on cigarette paper is due on the 15th while all other tobacco products are due on the 20th day. It is recommended that a due date of the 20th day of the month be specified for the reporting of the new tax as levied by the bill.

Cigarette taxes require electronic filing of required tax returns. The proposal does not mandate electronic filing for e-cigarette products. It is recommended that electronic filing of tax reports and tax remittances be required which would provide taxpayers a simpler method of reporting and reduce DFA administrative processes and procedures and reduce additional resource costs of DFA to implement the new tax type.

Legal Analysis :

This bill modifies and establishes taxation for a number of tobacco and marijuana products and creates additional funding for the University of Arkansas for Medical Sciences National Cancer Institute Designation Trust Fund ("Fund").

- First, it raises the retailer's presumed "cost of doing business" from 7.5% to 9.5%. This will raise the minimum cigarette price in the state and reflects an amount to be retained by the retailer.
- Raises the minimum age to purchase, use, or possess tobacco, vapor, alternative tobacco, or e-liquid products to twenty-one (21).
- Restricts local regulation of the manufacture, sale, storage, or distribution of tobacco products. Accordingly, local regulation that becomes effective after this bill cannot be more restrictive than the requirements of § 26-57-259.
- Reduces tobacco tax rates by 50% or 25% for certain "modified risk tobacco products".
- Levies an additional rate of tax on cigarette paper. § 26-57-801 already provides for a 25¢ tax per 32-sheet package. This bill will add an additional 50¢ per 32-sheet package tax. These revenues will be credited to the Fund as special revenues.
- Credits an amount to the Fund equal to the total amount of sales and privilege tax on the sale of medical marijuana deposited into General Revenue. This amount would be the excess revenues after special privilege and sales tax revenue are applied as required by Amendment 98, § 17 to the Arkansas Constitution.

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- Levies an excise tax on "e-liquid." "E-liquid" and "e-liquid product" are already defined by § 26-57-203(13) as "a liquid product, which may or may not contain nicotine, that is vaporized and inhaled when using a vapor product, and that may or may not include without limitation propylene glycol, vegetable glycerin, nicotine from any source, and flavorings." This bill creates an excise tax of 10¢ per milliliter of e-liquid sold to wholesalers. The tax is to be remitted in the same manner as the Arkansas Tobacco Products Tax Act of 1977, § 26-57-201, et seq. Revenues from this excise tax will be credited to the Fund as special revenues.
- There is a potential issue in § 26-57-1607. This section provides that the excise tax is applicable to inventory and stocks of both wholesalers and retailers after the effective date of the chapter. However, this seems to contradict § 26-57-1604, which says imposition of the tax is on the wholesale level. Clarification is needed to know whether § 26-57-1607 imposes a duty to remit tax on retailers with current inventory of e-liquid. Additionally, an audit by the Department of Finance and Administration of the wholesalers and retailers would be required to determine what inventory existed as of the effective date of the bill.
- The final portion of the bill mandates the promulgation of rules by the Department of Finance and Administration, the Director of Arkansas Tobacco Control, and the Arkansas Control Board on an accelerated timeline. The rules are to be finalized sufficiently in advance for approval by the Legislative Council before a September 1, 2019 deadline.

The raising of the retailer's cost of doing business margin and the rule promulgation mandate will go into effect 91 days after adjournment sine die. The remaining portions will go into effect on the first day of the second calendar month following the effective date of the act.

This rules deadline presents a substantial issue for the promulgating agencies. Most of the provisions of the bill that require rule promulgation will not be effective until after the rules deadline. The remaining provision would go into effect shortly before the rule promulgation deadline. It is unclear whether the agencies would have authority to promulgate and publish notice for rules that are required by a statute which is not yet effective. Moreover, the accelerated timeline to promulgate rules would create a significant administrative burden on the promulgating agencies requiring promulgation efforts to begin in earnest before adjournment of the General Assembly. To meet the required deadline of September 1, the Rules would need to be approved by ALC in August requiring submission for the agenda in July, assuming that ALC even chooses to meet in August. To submit the Rules and comments in July will require that they be approved for publication and public comment by the beginning of June at the latest to have the 30 days of publication and time to collate any public comments received. To have the rules prepared would likely require that drafters begin work in March or April at the latest.