April 24, 2019

Written Testimony of

Max Behlke, Director
State Public Policy, JUUL Labs

Before the House Committee on Revenue
Oregon State Legislature

Chair Nathanson and Distinguished Members of the House Committee on Revenue,

Good morning. My name is Max Behlke and I am the Director of State Public Policy at JUUL Labs and I appreciate the opportunity to testify before you today. Prior to my current role, I served as the Director of Budgets and Revenue, and as the Director of the State and Local Taxation Task Force at the National Conference of State Legislatures (NCSL).

I am here today to provide my insights and general observations that apply to the bills before this committee pertaining to the taxation of vapor products.

JUUL's corporate mission is simple: the elimination of combustible cigarettes.

Smoking is the number one cause of preventable death in the U.S. and the world. In the two short years that JUUL Labs has been around, it has already profoundly changed the tobacco industry as the year-over-year decline in cigarette use has accelerated to a historic high. In fact, for the 4-week period ending in late March, year-over-year declines for cigarette pack volumes worsened, falling to 8.8 percent, according to U.S. syndicated market data from Nielsen. This was the second consecutive month featuring year-over-year cigarette pack volume declines of 8 percent or more.[1]

JUUL can attribute its success and healthy market share within the vaping industry to the fact that individuals trying to quit smoking combustible cigarettes find it is easier to switch to JUUL (it is how I quit smoking after nearly a dozen attempts) compared to traditional nicotine replacement therapies (NRTs), such as the patch or gum, which, historically, have low rates of efficacy. Therefore, it is important to develop an e-liquid tax structure that will be easy to administer, enforce, and that will not stifle the growth of this still nascent industry.

The government should not disincentivize smokers from switching to vapor products by levying exorbitant excise taxes and increasing their cost. Vapor products provide an alternative to adult smokers interested in switching away from combustible cigarettes. Reducing the number of people who smoke cigarettes is a shared public policy goal that can also reduce strains on public healthcare budgets. While still a small part of the overall tobacco product category, vapor products hold the potential to be a viable alternative for adult smokers and could lead to the end of smoking combustible cigarettes, which continue to take the lives of nearly 500,000 Americans each year.

Tax Administration Challenges of Vapor Products

When states first began levying retail sales taxes in the 1930s, they were unsure about their ability to administer the tax and limit evasion. Tax enforcement was difficult as there was no audit trail to inventory purchases for administrators to track.[2] Since then, states have worked to improve enforcement to provide tax administrators with tools to ensure compliance. Today, retailers are typically required (depending on the state) to report monthly to the tax agency the total amount of taxable sales and then remit the appropriate sales tax. These reports provide tax administrators the ability to track the chain of custody of the product to the retail store and can therefore flag suspicious or illegal activity, such as sales of counterfeit products. Thus, states should be mindful of their ability to administer and enforce any vapor tax that they choose to impose.

[1] https://newsroom.juul.com/2019/04/03/cigarette-sales-in-the-u-s-continue-historic-decline-into-the-first-quarter-of-2019/
[2] https://www.brookings.edu/wp-content/uploads/2018/04/Mikesell-Kioko1.pdf

The administrative challenges regarding the taxation of vapor products stem from the nascent nature of an industry that offers products that are not uniform across the product category. Unlike traditional tobacco products, which are generally homogenous across product class, vapor products can vary drastically depending on the e-liquid solution and delivery device. Moreover, wide disparities in state tax rates can incentivize smuggling from lower tax jurisdictions, as high tax rates can fuel a black market.[3] Therefore, states should carefully craft their tax frameworks and develop robust enforcement regimes in order to limit opportunities for tax evasion and to ensure better regulation of vapor products.

Tax Avoidance and Tax Evasion

Tax avoidance and tax evasion can make tobacco products more affordable, accessible, and widely available, especially for youth. This activity undermines the health impact of higher tobacco taxes and other tobacco control efforts. New York state, for instance, has the highest cigarette tax in the country and also has the highest rate of cigarette smuggling. Approximately 56%[4] of cigarettes sold in New York are smuggled.

Given the structure of the excise tax system and enforcement process, taxpayers are faced with opportunities to reduce their tax payments and any changes in the tax system will induce different behavioral responses. For example, an increase in taxes on vapor products may create an incentive to engage in tax avoidance and tax evasion. As highlighted in a July 2018 report from the Pew Charitable Trusts:

> State regulations [on vapor products] have already had significant effects on suppliers. In Pennsylvania, for example, more than 100 [vape] shops have closed since a tax—40 percent of wholesale value—went into effect in October 2016. Wide disparities in state tax rates probably incentivize smuggling and tax evasion; high tax rates could fuel a black market. A shortage of data is the major obstacle to reliable forecasting, which makes it challenging for policymakers to base long-term budgeting decisions on this revenue stream.[5]

To reduce the opportunity for tax evasion and to maximize tax collections, any tax on vapor products should be administered at the retail point-of-sale and the tax amount should be clearly displayed on the customer's receipt and reported as a separate product category by the retailer. Moreover, states should require retailers to submit detailed tax reports regarding the sale of vapor products. Detailed reports will provide state officials more information to ensure tax compliance and to deter counterfeit/illegal sales.

Lessons from Marijuana Taxation

States should also consider the best practices developed for the taxation of marijuana when developing their tax structures for vapor products. Like vapor products, marijuana products are not homogenous across the product category. In addition to the marijuana plant, consumers can buy marijuana infused foods, marijuana liquids, etc. Therefore, states are developing marijuana tax structures that ensure that one type of product does not receive more favorable tax treatment.

States should also look to find the optimal vapor tax rate that will create a reliable revenue stream and that, at the same time, minimizes sales on the black market. As the marijuana industry has shown, if prices are similar, consumers will likely shift to the regulated market because the selection, quality, and product safety is generally much higher at a licensed retail provider. Moreover, any imposed vapor tax should be simple to enforce. Oregon, one of the first states to legalize recreational marijuana, replaced its initial tax on marijuana growers with a 17 percent retail excise tax over concerns that the tax would be too complicated to enforce.

[3] https://taxfoundation.org/cigarette-tax-cigarette-smuggling-2015/
[4] https://www.mackinac.org/smokes#map
[5] https://www.pewtrusts.org/ar/research-and-analysis/reports/2018/07/19/are-sin-taxes-healthy-for-state-budgets

A Simple and Equitable Structure

A tax levied at the final point of sale is the most workable tax structure for vapor products, as has been true for taxes on many other types of products. This tax type is relatively straightforward to administer, is transparent for consumers, and is equitable between different types of vapor products.

Vapor product taxes that are 1) imposed at the retail level and are 2) separate and distinct on a customer's receipt, provide transparency and instant accountability for the retailers who sell these products. Taxes imposed at retail provide more data points for the state to enforce their tax and commerce laws because documentation would be provided on the sales receipt, the wholesalers invoice, and the manufacturers invoice. In other words, the state would be able to follow a product upstream.

A wholesale tax, on the other hand, is more easily avoided and some of the less professional members of the industry might be tempted to bypass a wholesaler altogether by, for example, purchasing over the internet cheap knock-offs or imports. Similarly, if the tax were to be imposed at wholesale on the nicotine content in e-liquid, then the e-liquid tax is once again easily avoided by bad actors within the industry intent on tax evasion by simply buying tax-free raw materials and mixing them in their shop. In both examples, the taxes envisioned in the bills before you today would not be collected.

For the aforementioned reasons, it is within the state's interest to impose any e-liquid tax at retail at point-of-sale based on the value of vaping liquid sold. A value-based tax at retail:

- Does not discriminate between disposable and reusable products.
- Does not discriminate against open-tank vaping systems.
- Does not encourage vapor sellers or consumers to avoid tax by separating e-liquid components and combining them at time of use.
- Is easily verifiable by sellers, buyers and taxing authorities.

In closing, I would like to say that I am proud of my past work with NCSL in promoting tax policies that are good for both the states and the industries they regulate. I am equally proud to now represent JUUL, considering that it personally helped me in my battle to quit smoking.

No other company within the e-cigarette industry is more committed to responsible use of its products, which are made for Adult Smokers. We require all consumers, regardless of their state of residency, to be +21 years of age to purchase vaping products from our website, Juul.com, which is the only legal outlet to purchase JUUL products over the internet. We also have the industry's most robust age-gating mechanisms in place on our website and I encourage the members of the committee to attempt to purchase products on our website without proper identification (Good Luck!). That may seem like an odd thing to brag about, but I think its emblematic of the company's commitment to fighting underage use while also completing its mission: **Improve the lives of the world's 1 billion smokers by eliminating cigarettes.**

Thank you. I would be happy to answer any questions.

Estimating Revenue from Various Vapor Tax Frameworks

Some states are considering imposing taxes on vapor products for various purposes, including to raise revenue. Revenue projections in the states rely on assumptions regarding future growth in vapor product sales and effective tax collection and enforcement on those sales and are therefore subject to a degree of uncertainty. Additionally, high tax rates encourage smuggling and illegal sales. Moreover, the lack of established historical data and the recent growth in the vapor product sector has led many traditional smokers to switch to tobacco substitutes, adding even more uncertainty for revenue estimation.

States have struggled to estimate revenue receipts from vapor taxes for various reasons, including:

(1) lack of historical information,
(2) the rapid growth in the category, and
(3) inefficient tax administration and tax enforcement, which can lead to tax avoidance.

This analysis estimates revenue from three different tax structures:

(1) an excise tax applied to the retail sales price,
(2) a volume tax on vaping liquid, and
(3) a wholesale tax applied to the manufacture price.

Oregon Example

This analysis estimated 2018 tax revenue for the different tax types in Illinois to demonstrate the revenue variability between the different taxes. Detailed explanations for each tax are found in the subsequent sections.

- **$2.3 million –** 2% Retail Excise Tax
- **$0.58 million –** 10% Wholesale Taxation
- **$2.87 million –** Volume Taxation ($0.10/ml)

Retail Excise Tax

Summary

Wholesale taxes are applied to the price of the product sold by a manufacturer to a retailer or a distributer. Conversely, excise taxes based on the retail price are applied to the price at which the retailer sells the product and are essentially sales taxes. Given that an excise tax on retail sales can be determined by multiplying the tax rate to the aggregate sales of the entire vapor category, this analysis divides the estimated nationwide sales of vapor products in 2018 by the population of each state and then multiplied the volume of sales in the state by the excise tax value.

Methodology

- Wells Fargo analyst Bonnie Herzog projects $9 billion in e-cigarette sales in the United States in 2019.[6]
- Therefore, in order to calculate revenue of an individual state: (1) determine the state's share of the United States population as a percentage; (2) multiply the population percentage against the total volume of U.S. vapor sales to estimate the state's share of vapor sales; and then (3) multiply the state sales against the expected rate.
- Given that sales in the vapor category are expected to grow in 2019, a corresponding increase in revenue collections from a retail excise tax are expected to grow at a similar rate.

[6] https://www.journalnow.com/business/juul-ends-with-percent-market-share/article_6f50f427-19ec-50be-8b0c-d3df18d08759.html

Volume Taxation (on milliliters of vaping liquid)

Summary

A volume tax on vaping liquid is a tax that applies a tax on a specified volume of vaping liquid. Each state that has enacted a volume tax on vaping liquid has enacted a tax in the range of $0.05/ml - $0.10/ml.

Methodology

In 2018, the New Jersey Office of Legislative Services[7] estimated that the state's 10 cents per milliliter tax on liquids intended for use as tobacco substitutes would generate $6.1 million in FY20. Applying the fiscal estimates of New Jersey, which relied on the data of previous states that have enacted a similar tax, this analysis estimates revenue for other states should they enact a tax of $0.1 ml on e-liquid.

The fiscal note in New Jersey took into account that the state has a minimum age of purchase of 21. While more states are considering making this change and it is likely that an increasing share of the U.S. population will live in T21 jurisdictions, some states will continue to have a lower minimum age of purchase, and this is a conservative estimate.

- 2018 N.J. population[8]: 8.9 million people
- N.J. tax rate: $0.10
- Estimated N.J. tax revenue: $6.1 million

Therefore, 8.9 million people = $6.1 million in tax revenue, or $685,393 in tax revenue for every 1 million people at a $0.10/ml tax rate.

Wholesale Taxation

Summary

A wholesale tax on vaping liquid is applied to the price the product is sold by a manufacturer to a retailer or a distributer. Wholesale taxes are more difficult to administer and are easier to avoid than consumption taxes, which are paid at the point-of-sale. These factors also increase the difficultly in estimating revenue collections.

In FY17, the Minnesota Department of Revenue estimated[9] that the state's 95% wholesale tax generated $7.4 million.

Methodology

Revenue projections rely on assumptions regarding future growth in e-cigarette sales and prevalence of e-cigarette use and are therefore subject to a degree of uncertainty. Additionally, high tax rates encourage smuggling and illegal sales. These factors also increase the difficultly in estimating revenue collections.

As Minnesota is not a T21 jurisdiction, states that have raised, or plan to raise, the age of tobacco sales to 21 could, depending on the growth of the vapor category, realize less revenue than this projection.

- 2018 Minn. population[10]: 5.6 million people
- Minn. tax rate: 95%
- FY17 vapor tax collections: $7.4 million

Therefore, we can assume that a 100% wholesale tax would generate $7.79 million: ($7.4 million / 95% rate)

Therefore, 5.6 million people = $7.79 million in tax revenue at 100% wholesale tax rate, or $1,391,071 in tax revenue for every 1 million people at a 100% wholesale tax rate.

---

[7] *https://www.njleg.state.nj.us/2018/Bills/A4500/4132_E1.HTM*
[8] *All data for population calculations references "2018 National and State Population Estimates." U.S. Census Bureau. December 2018. https://www.census.gov/newsroom/press-kits/2018/pop-estimates-national-state.html*
[9] https://www.revenue.state.mn.us/research_stats/revenue_analyses/2017_2018/hf4385_1.pdf
[10] *All data for population calculations references "2018 National and State Population Estimates." U.S. Census Bureau. December 2018. https://www.census.gov/newsroom/press-kits/2018/pop-estimates-national-state.html*