State Vaping Taxes: Collections Not as High as Envisioned

E-cigarette and vape devices have continued to gain popularity in recent years, largely due to health concerns around traditional cigarettes, smoking cessation initiatives, and rising youth consumption. U.S. product sales for e-cigarettes are estimated at $7.4 billion annually.[1] Capitalizing on this trend, many states and local governments have implemented taxes on these tobacco alternatives. Despite high expectations, the total tax revenue from these products remains small relative to tobacco taxes—and even smaller as a percentage of budget. This KBRA report provides an overview of the e-cigarette/vape market, examines different forms of taxation by state, and assesses the limitations of these taxes in bolstering state budgets, as well as the possibility for future federal regulation.

Key Takeaways

- While the number of states that have implemented e-cigarette and vape device taxes has grown, these tax revenues represent only a small fraction of the traditional cigarette market size, and vaping tax collections still contribute a negligible percentage of current governmental revenues for U.S. states.
- Taxation methods vary among states and localities due to the uniqueness of vaping and tobacco alternative products.
- While a vapor excise tax regime could provide additional sources of revenue for states and localities, there are concerns surrounding states relying on these revenues as long-term solutions to close their budget gaps.
- Increased federal regulations on vapor products, as well as the implementation of a federal excise tax, are probable in the years to come, which could potentially curb usage and associated tax revenue collections at the state level.

Vapor Tax Collections Negligible

KBRA has observed that as e-cigarette and vape use continues to grow in popularity, states are increasingly finding ways to capture these previously untapped revenues. In 2022, Indiana joined the growing list of states where a tax on e-cigarette/vapor products has been implemented, levying 15% of the gross income received by retailers. Additionally, California added a retail tax of 12.5% in addition to raising its tax to 61.74% on wholesale transactions.

According to the National Association of Attorneys General (NAAG), state and local governments across the country collected $6.7 billion in tobacco Master Settlement Agreement payments in 2021, along with $12.14 billion in tax revenue from traditional cigarettes (i.e., excluding cigars, snuff, etc.). As such, e-cigarette and vape tax collections will likely represent a comparatively modest percentage of governmental revenues for the foreseeable future. Supporting this notion, a 2019 state tax actions survey from the National Conference of State Legislatures found revenue estimates for each new state vaping tax ranged from just $1 million to $10 million annually. However, the reporting of disaggregated data is notably challenging due to many governments combining vape and tobacco excise tax collections into one budgetary line item. Ultimately, while states such as California and Oregon are reporting collections exceeding projections, e-cigarette taxes accounted for a negligible portion of governmental revenues on a nominal basis.

While these taxes have succeeded in generating a new revenue source for some states, KBRA believes substantial revenue windfalls are unlikely in the short term. Further, increasing regulatory and taxing interest at the federal level could present headwinds for future consumption and longer-term associated revenue growth.

Market Size

Research shows that growth in e-cigarette usage is substantial. The Centers for Disease Control and Prevention (CDC) reports that approximately 4.5% of U.S. adults (10.9 million) were e-cigarette users in 2019, and of these adults, 39.5% were former traditional cigarette smokers and 36.9% used both.

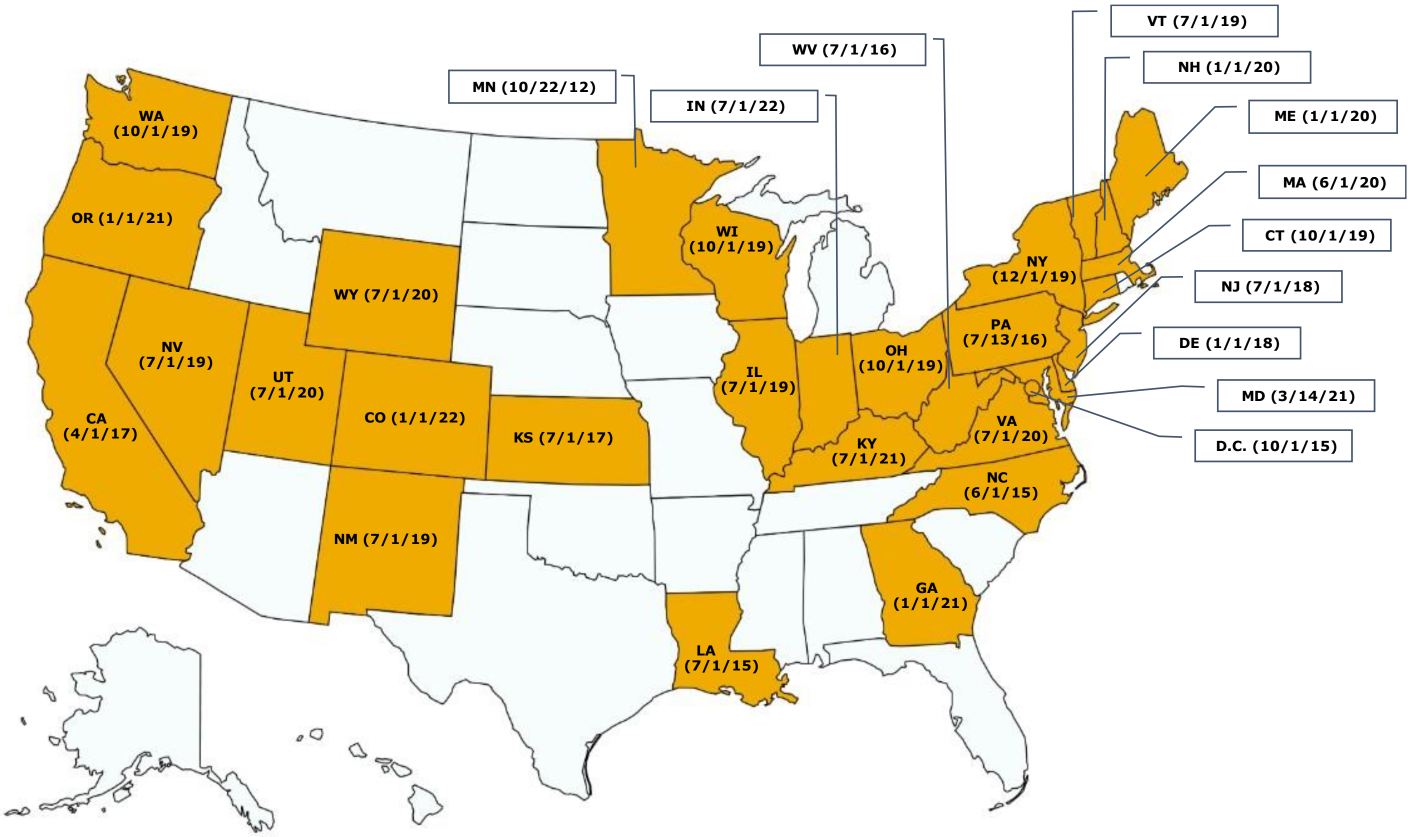
Although the U.S. vapor products market—which was estimated at approximately $7.4 billion in 2021—is projected to grow rapidly in the coming years, this is still a fraction of the $215.7 billion traditional cigarette market. That said, market size for traditional cigarettes has been shrinking at an average decline of 3.8% since 2007 according to NAAG, while the U.S. vapor products market is projected to expand at a compound annual growth rate (CAGR) of 27.3% over 2021-28.[2]

[1] International Journal of Environmental Research and Public Health, July 2022: The Reshaping of the E-Cigarette Retail Environment: Its Evolution and Public Health Concerns.
[2] Ibid.

States Increasingly Adopting Vapor Taxes

Unlike traditional cigarettes, there is currently no federal excise tax on vapor products, even though this product has been available to U.S. consumers since 2007, when they were largely unregulated and untaxed. In this policy vacuum, some states and localities enacted vapor excise taxes at varying rates, relying on unique policy rationales that classified vapor products as tobacco products. Currently, 30 states and Washington, D.C. have enacted vapor excise taxes (see Figure 1). Additionally, some localities have enacted their own vapor taxes in the absence of a state tax. For example, Alaska Governor Mike Dunleavy vetoed a proposed statewide tax on e-cigarettes in September 2022, but four of Alaska's municipalities have enacted their own vapor taxes. KBRA expects the overall trend of state and local governments adopting their own vapor tax regimes to continue.

Figure 1: States With Vaping Taxes



Source: CDC

State Vapor Taxes Compared

Taxation methods vary among states and localities due to the uniqueness of vaping and tobacco alternative products. For instance, a state or locality can elect to tax a percentage of the wholesale price, per unit or milliliter of e-liquid, or a combination of both based on the type of vapor product in terms of open versus closed devices (the former contains refillable cartridges, while the latter's are disposable). In Washington State, for example, there are separate tax rates for the two device types, while Connecticut has a combined taxing method (see Figure 2).

Opting to tax per unit or milliliter introduces the same pitfalls as alcohol and tobacco taxes, where tax collections could stagnate or decline even if prices rise, absent an inflation adjustment mechanism. A further complication is that taxes per milliliter of e-liquid may not effectively capture variances in concentration of nicotine in the product, which can vary significantly in this nascent industry.

As an illustrative example, a typical cigarette costs $12.85/pack in New York City, while an equivalent amount of one Juul pod costs approximately $4.50,[3] excluding the cost of a vaping instrument (which come in various forms and could range from $5 to over $100 as an initial cost). Even after factoring in a vapor excise tax (20% of retail price), the cost of the e-cigarette would only amount to approximately $5.40/day—significantly below that of a pack of traditional cigarettes.

[3] According to Juul, one pod of 0.7 ml contains approximately 20 cigarettes' worth of nicotine, roughly equal to the amount of nicotine in a pack of cigarettes.

Figure 2: Cigarette vs. Vapor Excise Taxes by State		
State	**Cigarette Excise Tax ($ per Pack)**	**Vapor Excise Tax[1]**
California	2.87	61.74% WP + 12% sales price
Colorado	1.94	35% MSRP
Connecticut	4.35	10% WP; closed: 40¢/ml
Delaware	2.10	5¢/ml
DC	4.50	79% WP
Georgia	0.37	7% WP; closed: 5¢/ml
Illinois	2.98	15% WP
Indiana	1.00	15% gross retail income; closed: 15% WP
Kansas	1.29	5¢/ml
Kentucky	1.10	15% WP; closed: $1.50/cartridge
Louisiana	1.08	5¢/ml
Maine	2.00	43% WP
Maryland	3.75	≤5ml: 60% retail price; others: 12% retail price
Massachusetts	3.51	75% WP
Minnesota	3.04	95% WP
Nevada	1.80	30% WP
New Hampshire	1.78	8% WP; closed: 30¢/ml
New Jersey	2.70	Liquid nicotine: 10¢/ml; Container e-liquid: 10% of retail price
New Mexico	2.00	12.5% MSRP; closed: 50¢ per cartridge
New York	4.35	20% of retail price
North Carolina	0.45	5¢/ml
Ohio	1.60	10¢/ml
Oregon	3.33	65% WP
Pennsylvania	2.60	40% WP
Utah	1.70	56% MSRP
Vermont	3.08	92% WP
Virginia	0.60	6.6¢/ml
Washington	3.03	≤5ml: 27¢/ml; ≥5ml: 9¢/ml
West Virginia	1.20	7.5¢/ml
Wisconsin	2.52	5¢/ml
Wyoming	0.60	15% WP

[1] WP – Wholesale Price; MSRP – Manufacturer's Suggested Retail Price.
Sources: State Legislatures, CDC

Limits on Vapor Excise Taxes

While a vapor excise tax regime could provide additional sources of revenue for states and localities, there are concerns surrounding states relying on these revenues as long-term solutions to close their budget gaps. The current absence of a uniform federal excise tax, coupled with the Food and Drug Administration's (FDA) federal authority to regulate vaping products, leaves the market exposed to future volatility. According to the Pew Research Center, uncertainties such as long-term consumption trends and shifts to the black market are potential drawbacks.[4] Further, if implemented taxes discourage vaping consumption, it will ultimately reduce the size of tax collections. The American Heart Association supports a vapor excise tax at a high enough rate to discourage consumption among the youth population, while retaining or increasing differentials with combustible products through higher taxes on those products.

[4] July 2018: Are Sin Taxes Healthy for State Budgets?

Federal Intervention Expected

Electronic nicotine delivery systems (ENDS) products went largely unregulated until 2016, when the FDA gained regulatory authority under the "deeming rule," which allows the agency to deem other tobacco products not included under its regulatory authority to be subject to the Federal Food, Drug and Cosmetic Act (FFDCA). Following this action, a court decision later required ENDS manufacturers to submit product applications for FDA review, resulting in an estimated 6.7 million applications submitted for consideration—effectively limiting the influx of new products into the market.

In 2019, the FFDCA raised the federal minimum age for sale of tobacco products to 21 years; the legislation applied to all retail establishments, and it included e-cigarette products.

Additional regulation came with the expanded Prevent All Cigarette Trafficking (PACT) Act, enacted March 2021, which further extended the federal regulations on traditional tobacco products, such as prohibiting transport through the U.S. postal system, to e-cigarettes. The regulation also required any business or person that sells, ships, or transfers ENDS for profit in interstate commerce to:

- Register with the Bureau of Alcohol, Tobacco, Firearms, and Explosives
- Register with any states where they ship vapes and similar products
- Verify the age of purchasers upon delivery
- Comply with state, local, or tribal excise tax and reporting requirements

Essentially, the amended PACT Act required e-cigarettes and vaping products to be treated more like traditional tobacco cigarettes. In KBRA's opinion, this effectively laid the groundwork for the implementation of a federal excise tax, as was the case of the first draft of President Joe Biden's Build Back Better Act of 2021, which included a new tax on nicotine purchased by manufacturers for use in vaping products. Although the implementation was struck from the final version of the Inflation Reduction Act of 2022, the proposal demonstrates the possibility of the implementation of a federal tax in coming years.

Conclusion

While many states have successfully tapped a new revenue stream, e-cigarette taxes continue to account for a negligible portion of governmental revenues. KBRA will continue to track the progress of vapor tax implementation across the country as states seek to benefit from the rapidly increasing popularity and sales of the previously unregulated market. However, given the popularity of e-cigarettes and vape products among teens and young adults, we anticipate increased federal regulation in the coming years, which could potentially curb usage and further limit associated tax revenue collections at the state level.

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