SHOP TALK

Burning Questions for the Tobacco Product Industry as it Deals with Increased and Evolving Tax, Regulation, Registration and Licensing Issues

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The tobacco industry has always been complicated from a tax and regulatory standpoint, but recent and evolving changes in state and local taxes, regulations and licensing on traditional tobacco products and newer tobacco-related products have added a new layer to the complexity, and concerns, that those in the industry currently face. This article explores the intersection between the ever-changing taxation of these products, including the extension of Wayfair's economic nexus principles to tobacco excise taxes, and the growing regulatory, licensing and registrations concerns at the Federal, state and level for the manufacture, sale and delivery of tobacco-related products.

Old and New Tax Issues - Increased Taxes on Traditional and Newer Tobacco-Related Products, and Wayfair-Based Thresholds Add Costs and Concerns

There is a staggering amount of Federal and state excise tax compliance obligations and responsibilities for those involved in the manufacture, distribution and sale of tobacco-related products that must be complied with and constantly monitored. From a Federal excise tax ("FET") perspective, the first question is the specific type of tobacco product. While most think of cigarettes and cigars, the FET and related reporting requirements are also imposed on other tobacco products like chewing tobacco, snuff, pipe tobacco, roll-your-own tobacco, and related tobacco components such as cigarette papers and tubes. **1** In addition to the types of products, the FET structure is often further broken down by size and weight. **2** There is, however, still no FET imposed on many newer tobacco-related products, such as vaping products, often referred to as electronic nicotine delivery systems ("ENDS"), though several bills have been introduced by Congress in recent years to include all non-tobacco nicotine products. **3**

The FET is generally imposed on the manufacturer or importer of the tobacco product, and collected on the basis of a return filed based upon the time of removal from the manufacturer's facilities, or in the case of importers, upon release from the customs custody or bond. **4** Upon removal, tobacco products (and certain accessories) must be properly packaged and bear all marks, labels, and notices as required by relevant regulations. **5** Additionally, strict record retention and inventory and sales reports must also be complied with on an ongoing basis. **6**

In addition to the FET, there is also heavy state and local excise taxes imposed on any and all traditional tobacco products depending upon the jurisdiction ranging anywhere from less than $0.50 to $9.00 (per unit depending upon the type of product). **7** Also unlike the FET, state and local jurisdictions have been quick to jump on amending or enacting new statutes and ordinances to impose an excise tax on vaping products, either by adding a new definition and tax for "nicotine-containing products," "inhalant delivery systems," or like term, or by including it in the current definition of "other tobacco products" ("OTP"), and imposed through one of two main ways: (i) a wholesale tax on the product, (ii) a per milliliter retail tax on e-liquid in vaping systems, or sometimes a combination of the two. **8** These laws are becoming even more prevalent the past two years as jurisdictions continue to look for new revenue sources, particularly after the COVID-19 pandemic, as lawmakers typically view such taxes as low hanging fruit and politically acceptable.

For example, before 2019, approximately ten states imposed an excise tax on vaping products, with that number doubling in the first half of 2019, and that number currently reaching near thirty states. My home state of Kentucky, which has traditionally been more friendly to tobacco-products as a historical cash crop, has continued to increase excise tax rates on traditional tobacco products the past few years, and in 2020 also passed legislation

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to tax closed vaping systems at $1.50 per cartridge and 15% of the distributor price of open vaping systems (including all components and e-liquids), and encompasses both nicotine and non-nicotine (e.g., CBD vaping) products. **9**

However, that rate on vaping products is modest compared to many states, such as California which, effective July 1, 2020, imposes a 56.93% tax on the wholesale cost of all nicotine-containing products. **10** Oregon is another example that recently passed a measure to tax inhalant delivery systems at 65%

of the wholesale price, including hardware and components like e-liquid (yet exempts cannabis vaping products from the tax). **11** Another recent approach can be seen in Colorado which has an escalating tax on nicotine-containing products that begins at 30% of the manufacturer's list price beginning in 2021 and gradually increases to 62% in 2027 (with some lowering of rates possible for products given a "modified risk" designation by the FDA). **12** The list goes on and on with no limit in sight, including Massachusetts with a 75% wholesale tax on all vaping products, Vermont with a 92% wholesale tax on e-liquid, devices and other nicotine products, the District of Columbia's current tax of 91% of the wholesale cost of vaping product devices and nicotine-containing e-liquids (down from 96%), and Minnesota (the first state to tax e-cigarettes) currently at an astounding 95% of wholesale of most nicotine-containing products. **13**

Local cities and counties can impose just as high of rates on nicotine-containing products, often on the wholesale cost of the products. **14** However, some states, like Tennessee, have recognized that vapor products, among other non-traditional forms of tobacco-related products (e.g., nicotine pouches, hemp cigarettes, and other tobacco substitutes) are not subject to its OTP tax as currently written since they do not contain tobacco, but laws could soon change to one day include these other products. **15**

In addition to the above, one cannot forget that many states and local jurisdictions also impose a sales or use tax on the retail use or consumption of tobacco products which only adds to the already high taxation of these products. Also, like all things in SALT, the tobacco product industry cannot escape the grasp of the post-*Wayfair* world not only in terms of sales/use tax nexus and compliance concerns, but also for tobacco-related excise tax purposes as some states have incorporated the economic nexus rules of *Wayfair* for state-specific tobacco taxes - a trend which is sure to continue.

For example, Ohio imposes a separate tobacco product excise tax which can pull in, and impose the tax on, an out-of-state seller which is primarily responsible for remitting the tax when selling to Ohio consumers if the seller has "substantial nexus" in Ohio based on the $100,000 gross receipts or 200 transactions threshold in *Wayfair*, as well as presumed to have substantial nexus if certain physical presence activities are present. **16** If a seller does not meet these substantial nexus standards, then it is not responsible for the Ohio tobacco tax, and the consumer is instead liable for the tax. This determination is important because, as is the case for most excise-type taxes, personal liability for the tobacco tax can attach to the seller and its responsible employees.

Virginia also recently enacted legislation which extended its OTP tax to remote sellers starting January 1, 2021, and thus now will include among the "distributors" required to pay the tax "any non-Virginia company who ships tobacco products to wholesale or retail customers in Virginia and meets certain sales volume thresholds during the current or previous year," and like Ohio, will track to the *Wayfair* $100,000 receipts or 200 transaction thresholds. **17** Although not directly tied to economic nexus principles, South Dakota is the most recent state to extend its

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wholesale tobacco tax to remote sellers shipping products directly to consumers. **18**

This is likely only the start as such an extension of the economic nexus principles to tobacco product taxes, while currently still relatively unique, is sure to spread throughout the country through either legislation like Ohio and Virginia, regulations, or at least through internal or administrative policies and interpretations of these economic nexus principles by various state (and local) tax departments, like the Minnesota Department of Revenue did by releasing administrative guidance in late 2020 explaining its decision to extend the state tobacco excise tax to remote tobacco retailers pursuant to the economic nexus thresholds in *Wayfair.* **19**

Regulation Issues on the Sale and Delivery of Products - Can I Sell or Not, and How?

Although the focus is typically on the various tax implications of a business, one can also not forget the multitude of regulatory issues that go hand-in-hand with tax reporting, payment and compliance issues as many often are administered by the same government agencies.

One of the main regulatory changes that has rocked the tobacco industry is the Food and Drug Administration ("FDA") issuing its so-called "deeming regulations", effective August 8, 2016, which allowed the FDA, for the first time, to formally regulate *all* tobacco products, including cigars, pipe tobacco, e-cigarettes, and other forms of tobacco products not previously under its purview. As a result of the deeming regulations, there were several new restrictions and requirements for tobacco product manufacturers and retailers, the most important being the filing of a formal application to get approval before all "new" tobacco products (i.e., those not "grandfathered" by being sold prior to February 15, 2007) could be, or continue to be, sold in the United States. **20**

As most would expect, there has been substantial litigation and legislative efforts over the past few years to mitigate (or abolish) the regulations which, as initially proposed, would have put many smaller businesses involved in the manufacture or sale of these non-cigarette tobacco products out of business given the high cost and administrative burden of complying with these new rules. **21** Most recently, the vaping industry has petitioned the U.S. Supreme Court to strike down the deeming regulations, but that is likely a long shot. **22** These efforts have caused many of the deadlines for application and compliance with the FDA deeming rules to be delayed, or even removed for certain products (particularly premium cigars); however, many regulatory issues continue to lurk for most in the industry. Also, although those in the "premium" cigar business got a very late, and unexpected continued extension on the application and approval process, most manufacturers and importers of non-cigarette tobacco products still filed "substantial equivalence" reports (applications) to the FDA in September 2020 as a precaution to ensure their products were not considered contraband and pulled off the market by the FDA. Along those same lines, both the FDA and state and local government agencies also have an increasing concern with any "flavored" tobacco products as part of the FDA deeming regulation, as well as through legislation that has been proposed to outright ban any flavor products which likewise must be closely monitored for various types of tobacco-related products currently on the market. **23**

In addition the enormous issues caused by the FDA's deeming regulations (which are far from settled), a tobacco-product business must also worry about other Federal, state and local regulations and limitations on the marketing and sale of their products, including the Prevent All Cigarette Trafficking ("PACT") Act which imposes several restrictions on "delivery sales"

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of cigarettes and smokeless tobacco (e.g., prohibiting the shipment and transport of the product through U.S. mail, requiring identity verification for all sales and shipping service of age at delivery, restrictive shipping requirements, labeling packages as containing tobacco, paying all state taxes, reporting sales to all relevant state tobacco tax administrators and obtaining appropriate licenses, etc.). **24** Additionally, although the PACT Act historically only applied to cigarettes and smokeless tobacco, as part of the "Consolidated Appropriations Act, 2021" and the COVID-19 relief bill signed into law on December 27, 2020, Congress amended the PACT Act to include electronic delivery systems (although it was written broadly enough to include non-nicotine vaping liquids, such as CBS, THC, etc.), and as a result would also prohibit the United States Postal Service from shipping such products starting April 2021. **25**

Another recent issue that may surprise many companies is that "adult-signatures" are now not only required for tobacco products purchased online, but also many states and common carriers either prohibit such sales all together or require adult signatures upon delivery. For example, in addition to cigarettes and "little" cigars generally not being able to be shipped directly to consumers, FedEx banned most shipments of tobacco products in 2016, and UPS announced just last year that it was requiring a 21+ adult signature for all tobacco shipments. **26** The latter restriction has also become popular for many states which now not only require adult signatures upon delivery but also impose hefty fines, penalties, and even criminal implications if violated. **27** Even more recently, UPS made big news again by updating its policies to prohibit the domestic shipment of vaping products, effective April 5, 2021 (likely as a result of the PACT Act extension), which will include any and all noncombustible liquid or gel, regardless of the presence of nicotine, capable of being used with or for the consumption of nicotine, and all related vape devices, products and accessories. **28**

Licensing and Registration Issues - I Have to Get How Many Licenses Again?

At the Federal level, any manufacturer or importer of tobacco-related products must qualify for and obtain a permit from the Alcohol and Tobacco Tax and Trade Bureau ("TTB") to engage in such activities, all of which are subject to suspension or revocation if certain violations are committed by the permit holder. **29** The permit process through the TTB takes a minimum of sixty (60) days to process, but is typically much longer, on average, based upon the documentation requested by the TTB, with the current wait time ranging from four months up to two years. **30**

In addition to FET collection authority for domestically manufactured tobacco products, the TTB is also charged with permitting, registration and bonding authority over tobacco product manufacturers, importers and exporters, as well as Federal authority to regulate the production, packaging, labeling and storage of tobacco products. **31** Note, however, that the enforcement agency is different for importers of tobacco products, as the U.S. Customs and Border Patrol is tasked with the responsibility for collecting the FET on such products at the border. **32** In addition to the TTB's authority over these products, one must also be aware of other registration, payment, reporting, etc. requirements from other federal agencies (e.g., U.S. Department of Agriculture, Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)) and state agencies and laws (e.g., federal legislation requiring certain state reporting requirements, state departments of revenue, state attorney general offices, local government, Master Settlement Agreement, etc.) for the sale of such products.

From a state and local perspective, not only must a business in the tobacco product industry worry about the continuously increasing multistate tax and doing business registration requirements that have its own scary potholes and consequences **33** , but each jurisdiction also has its own rules and requirements for types of registration and licensing (and taxes, fees and other costs related thereto) depending upon the type of product being sold.

As is true for any business operation, a company involved in the manufacturing, distribution and/or selling of tobacco products in a particular state typically must register with the respective state's department of revenue, as well as apply for and obtain one, or several, licenses/permits to legally operate and/or distribute tobacco products within the state. If a company has multi-state operations, such as a multi-state cigar wholesaler, the company likely must apply for and obtain the proper permit/license for engaging in its resident and non-resident wholesale business.

Alternatively, if a company is involved in more than one type of tobacco product operation (*e.g.*, wholesale and retail sales, or manufacture and wholesales), the company typically must obtain the proper permit for each specific operation (and potentially for each location/warehouse the company has within a state). Particular attention must be given to each state's statutory permit/license requirements, as penalties (including criminal in some states) may apply if a company fails to obtain the proper permit or to obtain any permit whatsoever.

Likewise, many states are not only requiring a wholesale/distributor and/or retailer tobacco product license(s), but also a separate vaping/ENDS license to lawfully sell products in the jurisdictions. These new licensing requirements can catch many in the industry by surprise as several large traditional tobacco product companies are beginning to slowly gobble up smaller tobacco/nicotine/CBD/THC product companies with popular vaping products.

Slow Burn - Above Issues Unlikely to Go Away, So Vigilance is Key

The tobacco industry has always been a highly complex and regulated world, and the adding of new types of tobacco or nicotine-based products, as well as continued complexities related to e-commerce, online sales and new and innovative ways for state and local jurisdictions to tax, regulate and license these businesses and products, has only added fuel to the fire. Businesses must continue to be aware of these reporting, payment, and compliance issues to allow their new products to continue to catch fire, because if not, it may all go up in smoke.

1 26 U.S.C. § 5702 (a)- (f), (m)-(o).

2 26 U.S.C. § 5701(a)(1) & (2).

3 *See e.g.*, H.R. 293, 116th Congress (2019-2020), Youth Vaping Prevention Act of 2019, available at https://www.congress.gov/bill/116th-congress/house-bill/293?fbclid=IwAR0UTacEkGeeHJcaa1lH0xp4alu6s7DnOqNi8I1 ; H.R. 4742, 116th Congress (2019-2020), Protecting American Lungs Act of 2019, available at https://www.congress.gov/bill/116th-congress/house-bill/4742/all-info; S.2463, 116th Congress (2019-2020), E-Cigarette Tax Parity Act, available at https://www.congress.gov/bill/116th-congress/senate-bill/2463?s=1&r=9.

4 26 U.S.C. § 5703(a) & (b). Moreover, although outside the scope of this article, note that Sections 5731-34 of the Code imposes an annual special occupational tax on manufacturers and export warehouse proprietors (not importers).

5 26 U.S.C. § 5723(a) & (b); 27 CFR §§ 40.211- 40.217, 41.71-41.75.

6 26 U.S.C. 5721-22 & 5741; 27 CFR §§ 40.181- 40.187, 40.201 & 40.202; 41.181-41.182.

7 See State System Excise Tax Fact Sheet, Center for Disease Control and Prevention (data as of September 2020), available at https://www.cdc.gov/statesystem/factsheets/excisetax/ExciseTax.html.

8 For example, Connecticut taxes both per milliliter on e-liquid in "closed-system" products (e.g., pods, cartridges, etc.) and 10% wholesale on "open-system" products, including bottled e-liquid and devices. See State of Connecticut, Department of Revenue Services, Electronic Cigarette Products Tax, Special Notice 2019(7) (Sep. 4, 2019), available at https://portal.ct.gov/-/media/DRS/Publications/pubssn/2019/SN-2019(7).pdf?la=en#:~:text=Beginning%20on%20Octobe .

9 See 2020 HB 351, amending KRS 138.130, 138.140 and 138.143.

10 California Department of Tax and Fee Administration, Tax Rates - Special Taxes and Fees, available at https://www.cdtfa.ca.gov/taxes-and-fees/tax-rates-stfd.htm.

11 See Oregon Department of Revenue, Oregon Cigarette and Tobacco Tax Changes (confirming the passing of Measure 108 in 2020 imposed the 65% tax on vaping products, effective January 1, 2021), available at https://www.oregon.gov/dor/programs/businesses/Documents/tobacco-tax-measure-108_105-007.pdf.

12 See Proposition EE, passed via HB20-1427, available at https://leg.colorado.gov/bills/HB20-1427.

13 See Massachusetts Department of Revenue Cigarette, Tobacco and Vaping Excise Taxes FAQs (Jan. 19, 2021), available at https://www.mass.gov/info-details/cigarette-tobacco-and-vaping-excise-taxes-frequently-asked-questions#:~:text=Effec ; Vermont Department of Taxes, Electronic Cigarettes FAQs, available at https://tax.vermont.gov/business-and-corp/miscellaneous-taxes/e-cigarettes/faqs; District of Columbia, Office of Tax and Revenue, Tax Changes Effective October 1, 2019, available at https://otr.cfo.dc.gov/release/district-columbia-tax-changes-take-effect-october-1; Minn. Stat. Ann. § 297F.05(3) (2020).

14 For example, Alaska does not have a state-level tax, but does have several municipalities with its own vape tax, including Juneau Borough, NW Arctic Borough and Petersburg Borough with a 45% wholesale taxes, and a 55% wholesale tax by Anchorage Borough (effect. Jan. 1, 2021), and Matanuska-Susitna Borough has a 55% wholesale tax. See e.g., Jim McDonald, "Anchorage Passes a 55% Tax on Vaping Products: (Niv. 13, 2020), available at https://vaping360.com/vape-news/106963/anchorage-passes-a-55-tax-on-vaping-products/. Another example is Illinois which in addition to its statewide 15 wholesale tax on vaping products, the sale of such products in Chicago are subject not only to the county (Cook) level tax ($0.20 per milliliter on products containing nicotine), but also the city of tax of $0.80 per bottle tax on nicotine-containing liquid and also $0.55 per milliliter. See "Chicago and Cook County Impose Tax on Electronic Cigarettes," The Civic Federation, (Feb. 25, 2016), *available at* https://www.civicfed.org/civic-federation/blog/chicago-and-cook-county-impose-tax-electronic-cigarettes; City of Chicago Revenue Department, Municipal Code 3-47, Form 7514, available at https://www.chicago.gov/city/en/depts/fin/supp_info/revenue/tax_list/LiquidNicotineProductTax.html.

15 Tennessee Dep't of Revenue, Notice #20-21, Taxability of Hemp and Nicotine products (Dec. 2020), available at https://www.tn.gov/content/dam/tn/revenue/documents/notices/tobacco/20-21tob.pdf.

16 See ORC 5743.62.

17 See 2020 Va. Acts, Ch. 56, Item § 3-5.21(F) (spec. session I), available at https://budget.lis.virginia.gov/item/2020/2/HB5005/Chapter/3/3-5.21/. *See also*, Virginia Department of Tax, Tobacco products Tax page, available at https://www.tax.virginia.gov/tobacco-products-tax.

18 2021 South Dakota H.B. 1098, available at https://mylrc.sdlegislature.gov/api/Documents/218410.pdf.

19 See Minnesota Department of Revenue, Revenue Notice No. 20-03 (Oct. 12, 2020), available at https://www.revenue.state.mn.us/revenue-notice/20-03-out-state-retailers-collection-responsibility.

20 See 79 Fed. Reg. 23,142 (Apr. 25, 2014); Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, § 3, 123 Stat. 1776,1781-82 (2009), amending the Federal, Food, Drug and Cosmetic Act; 21 U.S.C. § 387a(b) (authorizing the Tobacco Control Act to later extend to "any other tobacco products that the Secretary [of Health and Human Services] by regulation *deems* to be subject to this chapter"). *See also*, U.S. Food & Drug Administration, "FDA's Deeming Regulations for E-Cigarettes, Cigars, and All Other Tobacco Products, available at https://www.fda.gov/tobacco-products/rules-regulations-and-guidance/fdas-deeming-regulations-e-cigarettes-cigars-and
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21 See e.g., *Cigar Association of America et al. v. United States Food and Drug Administration et al*., Docket No. 1:16-cv-1460, 964 F.3d 56 (D.C. Cir. 2020); *En Fuego Tobacco Shop et al. v. United States Food and Drug Administration et al.*, Docket No. 4:18-cv-00028 (E.D. Tex.), transferred Docket No. 1:18-cv-01797 (D.C. Cir.); *American Academy of Pediatrics et al. v. United States Food and Drug Administration et al.*, No. 8:18-cv-00883 (D. Md. Mar 27, 2018), No. 19-02198 (4th Cir. Oct 30, 2019) consolidated with *In re: American E-Liquid*, Docket No. 19-02242 (4th Cir. Nov 06, 2019); *American Academy of Pediatrics v. American E-Liquid*, Docket No. 19-02132 (4th Cir. Oct 16, 2019); and *In re: Cigar Association*, Docket No. 19-02130 (4th Cir. Oct 16, 2019).

22 Charlie Minato, "Vape Companies Ask Supreme Court to Throw Out FDA's Deeming Regulations" (Mar. 8, 2021), available at https://halfwheel.com/vape-companies-asks-supreme-court-to-throw-out-fdas-deeming-regulations/390942/
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23 At the federal level, the FDA has continued to pay particular attention and scrutiny to any products considered to be flavored in the FDA deeming regulations, in addition to President Trump's proposed ban on all flavored vaping products (other than menthol and tobacco flavors) in late 2019. The U.S.

House of Representatives also passed H.R. 2339, the "Protecting American Lungs and Reversing the Youth Tobacco Epidemic Act" on Feb. 28, 2020 to prohibit all flavored tobacco products - including flavored e-cigarettes, menthol cigarettes and flavored cigars, but it did not get enacted into law. H.R. 2339, 116th Congress (2019-2020), available at https://www.congress.gov/bill/116th-congress/house-bill/2339. From a state and local tax perspective, Massachusetts, New Jersey, New York, Rhode Island, California, and the cities of San Francisco, Philadelphia, New York, and Chicago have all passed legislation to ban the sale of flavored tobacco products. See "Ending the Sale of Flavored Tobacco Products, Campaign for Tobacco-Free Kids, available at https://www.tobaccofreekids.org/what-we-do/us/flavored-tobacco-products.

24 See 15 U.S.C. §§ 375 to 378.

25 See Preventing Online Sales of E-Cigarettes to Children Act, available at https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-116HR133SA-RCP-116-68.pdf.

26 See UPS, Shipping Tobacco, available at https://www.ups.com/us/en/help-center/packaging-and-supplies/special-care-shipments/tobacco.page#:~:text=All%20T
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27 Several states, such as Minnesota, Delaware, California, Hawaii, Oregon, Texas, and most recently South Dakota, (effective January 1, 2022), for example, require the adult signature for tobacco product delivery sales, and the consequence for violating include civil penalties, injunctions and potential criminal sanctions, but many other states likewise do so. *See* Minn. 325F.871, Subd. 3; Del. Code Ann. tit. 30, § 5361; Cal. Bus. & Prof. Code § 22963; Haw. Rev. Stat. Ann. § 245-17; Or. Rev. Stat. Ann. §§ 323.700 - 323.740; Texas Admin. Code § 3.1205; 2021 South Dakota H.B. 1098, available at https://mylrc.sdlegislature.gov/api/Documents/218410.pdf.

28 See supra, n. 26.

29 *See* 26 U.S.C. §§ 5712 & 5713; 27 CFR §§ 40.61(a), 41.190 & 191.

30 See TTB website, Average Days to process Permits Online Original Applications, available at https://www.ttb.gov/nrc/statistics-original-applications-to-operate.

31 *See e.g.*, 27 CFR §§ 40.61 - 40.76; 40.161-40.257; 41.71-41.75; 41.181-182.

32 27 CFR § 41.62.

33 See my prior article for the Journal, "Not Registered in All States You Operate - What's the Big Deal? Sometimes it Can Be," for more on these issues, available at 30 J Multistate Tax'n (June 2020) JMT06202009.