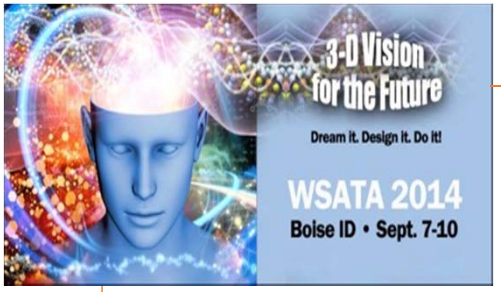


Regulating Electronic Cigarettes (E-cigs)

Stuart Thronson - Brett DeLange - Don Anderson
WSATA
September 2014

An e-cig is an electronic inhaler that vaporizes a liquid nicotine solution, simulating the act of tobacco smoking. Like cigarettes, users get a nicotine fix. Unlike cigarettes, there is no smoke.

Combustibles vs. Vapor products

Combustibles and Vapor Products are not the same.

Different from a Traditional Cigarette

- Tobacco
- Burns tobacco
- Cigarette smoke, secondhand smoke
- Cigarette ashes, odor & butts
- Burning tip

- No tobacco leaf
- Heats a liquid solution producing vapor
- No lighting, No fire
- No SMOKE or secondhand smoke
- No ashes, No odor, No cigarette butts

Different from traditional "Other Tobacco Products."

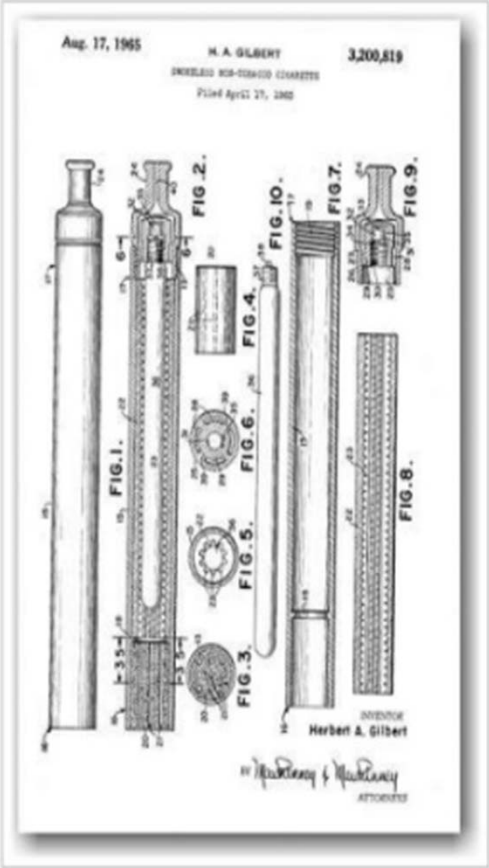
- Contains tobacco
- Tobacco leaf is the consumable material
- Tobacco is the component
- No alternative source of nicotine
- Taxable at the Federal level

- Contains no tobacco
- Nicotine (not tobacco) is the consumable material
- Nicotine is not the largest component
- Nicotine sources other than tobacco
- Not taxable at the Federal level

“Consumption of e-cigs may overtake traditional cigarettes in the next decade.”

-Bonnie Herzog,
Analyst & Director of
Tobacco, Beverage & Consumer Research
Wells Fargo Securities LLC

History of E-cigs



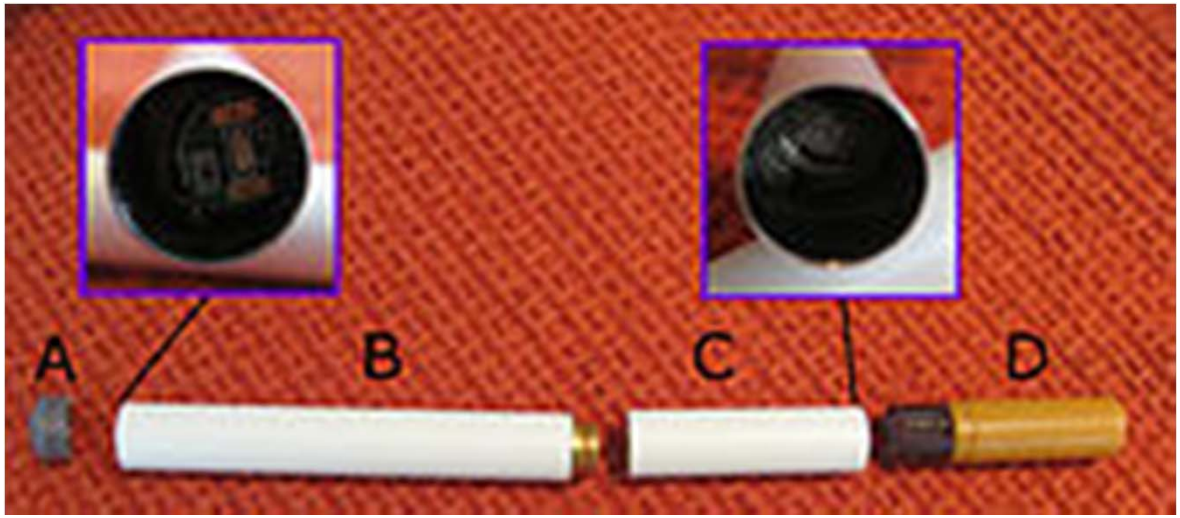
- Herbert A. Gilbert patented his “smokeless nontobacco cigarette” in 1963.
- His device heated the nicotine solution and produced steam.

History of E-cigs (cont'd)

- In 2000, Hon Lik, a Chinese pharmacist, is credited with manufacturing the first generation e-cig.

- His inventions are the basis of the present-day electronic cigarettes.

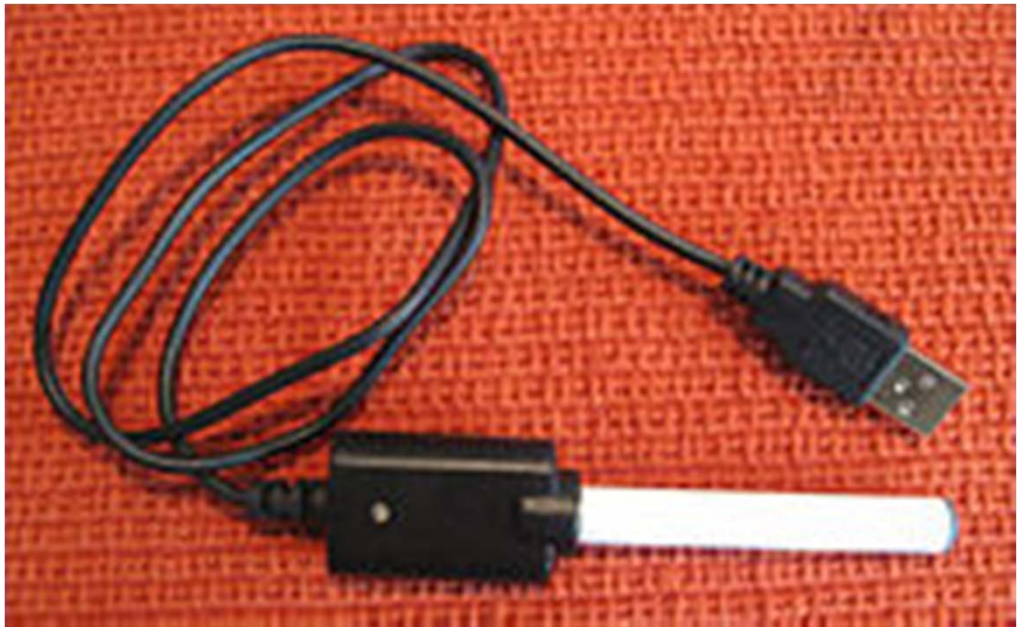
E-cig Products



A disassembled e-cig.

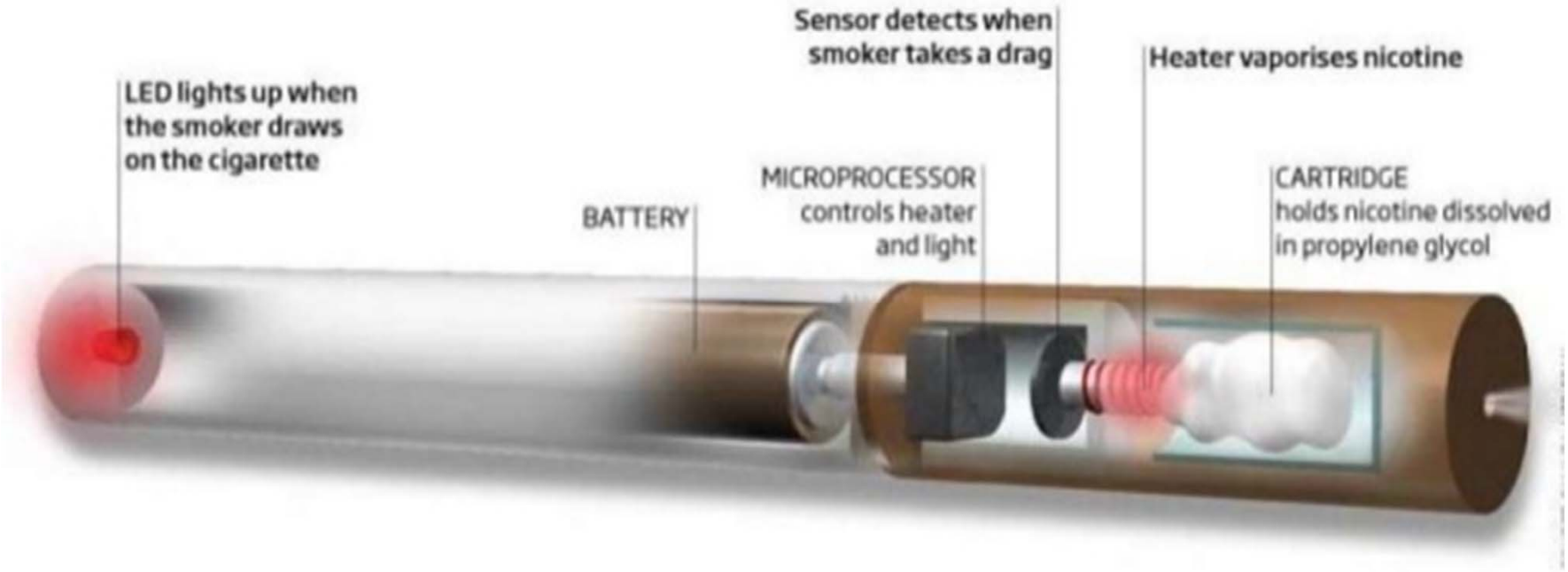
A. LED light cover
B. Battery (also houses circuitry)
C. Atomizer (heating element)
D. Cartridge (mouthpiece)

E-cig Products (cont'd)



An e-cig battery connected to a USB charger.

E-cig Products (cont'd)



How they work.

E-cig Products (cont'd)

A standard e-cig (cig-alike) sells for around $7.99 -$9.99 and will last about 400 puffs, which is equivalent to a pack or a pack and a half of traditional cigarettes.

Closed Systems

Open Systems

Atomizers, Cartomizers, Tanks, Mods, and Vaporizers (Vaping)

Open Systems (cont'd)

Non-traditional Use of Open Systems

"hash oil"

Nineteen with a prescription

- Vape pens for marijuana
  - Uses the same mechanism, but optimized to vaporize the active molecules in concentrated marijuana oils
- There's still no fire or smoke.

E-cig Products (cont'd)

DIY Kit offered for $15.49. Must specify:

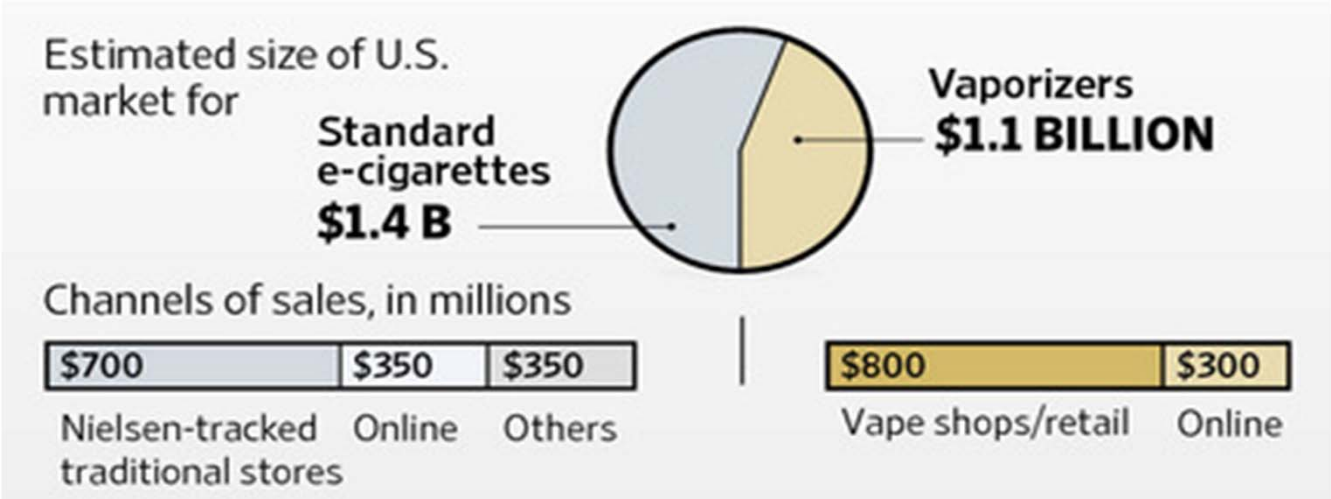
- Nicotine strength (36, 54, or 100 mg)
- Dilution option (Propolyne Glycol or Vegetable Glycerin)
- Two flavors of your choice!

Vape pipes, Hookah pens, & E-hookahs

Heat-not-burn Technology

The next generation.

Battle for the Market



Big Tobacco vs. Entrepreneurs

Currently 466 brands of e-cigs in 7700 flavors

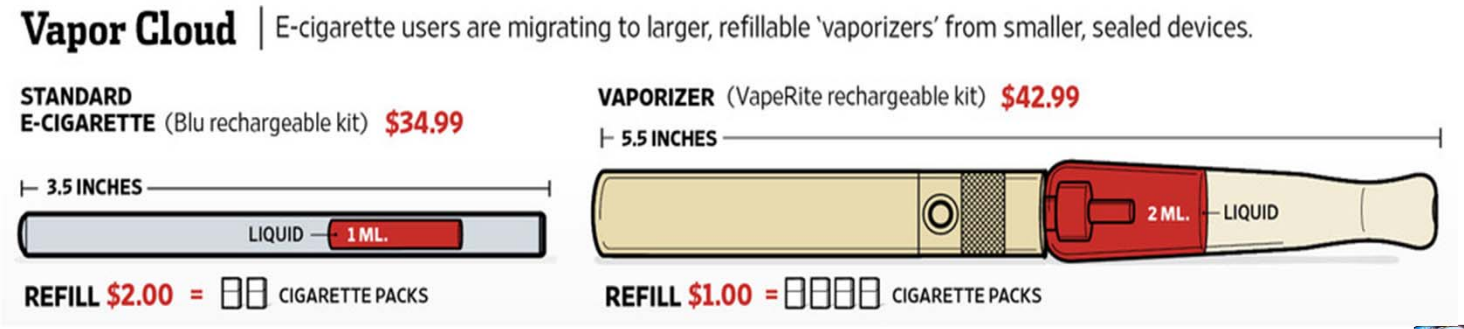
Closed Systems vs. Open Systems

Standard vs. Changeable

Impact of Tanks & Mods on Cig-alikes

Big tobacco admits being "late to the game"

- Losing to entrepreneurs
  - Tanks and mods are cheaper in long run and can be customized
- Current regulation and taxation is to their advantage



Big Tobacco's Role

Manufacturer – Lorillard Tobacco Company

Overall Tobacco Industry Ranking - #3

Date entered e-cig market – 08/2012

Big Tobacco's Role (cont'd)

Manufacturer – RJ Reynolds Tobacco Company

Overall Tobacco Industry Ranking - #2

Date entered e-cig market – 07/2013

Big Tobacco's Role (cont'd)

Manufacturer – Altria Group Distribution Co/NuMark

Overall Tobacco Industry Ranking - #1

Date entered e-cig market – 08/2013

Smoking Cessation or Tobacco Product?

In December 2010, NJOY, one of the largest manufacturers of e-cigs, won its case before the U.S. Court of Appeals for the District Court of Columbia. The Decision confirmed e-cigs *are not* smoking cessation products, but rather are tobacco products.

Food and Drug Administration's (FDA) Role

- April 2011 - FDA announced:
- Plans to -
  - Regulate e-cigs as tobacco products.
  - Work with the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) to tax and regulate distribution of e-cigs.
- E-cig importers must have tobacco importing licenses, and sellers must have tobacco licenses in all 50 states.

FDA Proposed Regulations ("Deeming Rules")

- "Deeming Rules" issued on April 25, 2014
- Comment period closed August 8, 2014
- Over 80,000 comments were submitted
- Two options:
  - Assert rules over all products that contain tobacco (cigars, e-cigs, pipe tobacco, etc.)
  - Exempt premium cigars
- What's next?
  - Address all substantive comments
  - Take effect 30 days after publishing FINAL Rules
  - Compliance up to 3 years for some provisions

The Deeming Rules

- Requires registration, product listing, ingredient disclosure, etc.
- National minimum age of 18
- No free samples
- Warnings on packaging and advertising
- No using the words “mild” or “light”

WARNING: This product contains nicotine derived from tobacco. Nicotine is an addictive chemical.

Until then, FDA and States Lack Oversight

Unlike cigarette and other tobacco products,

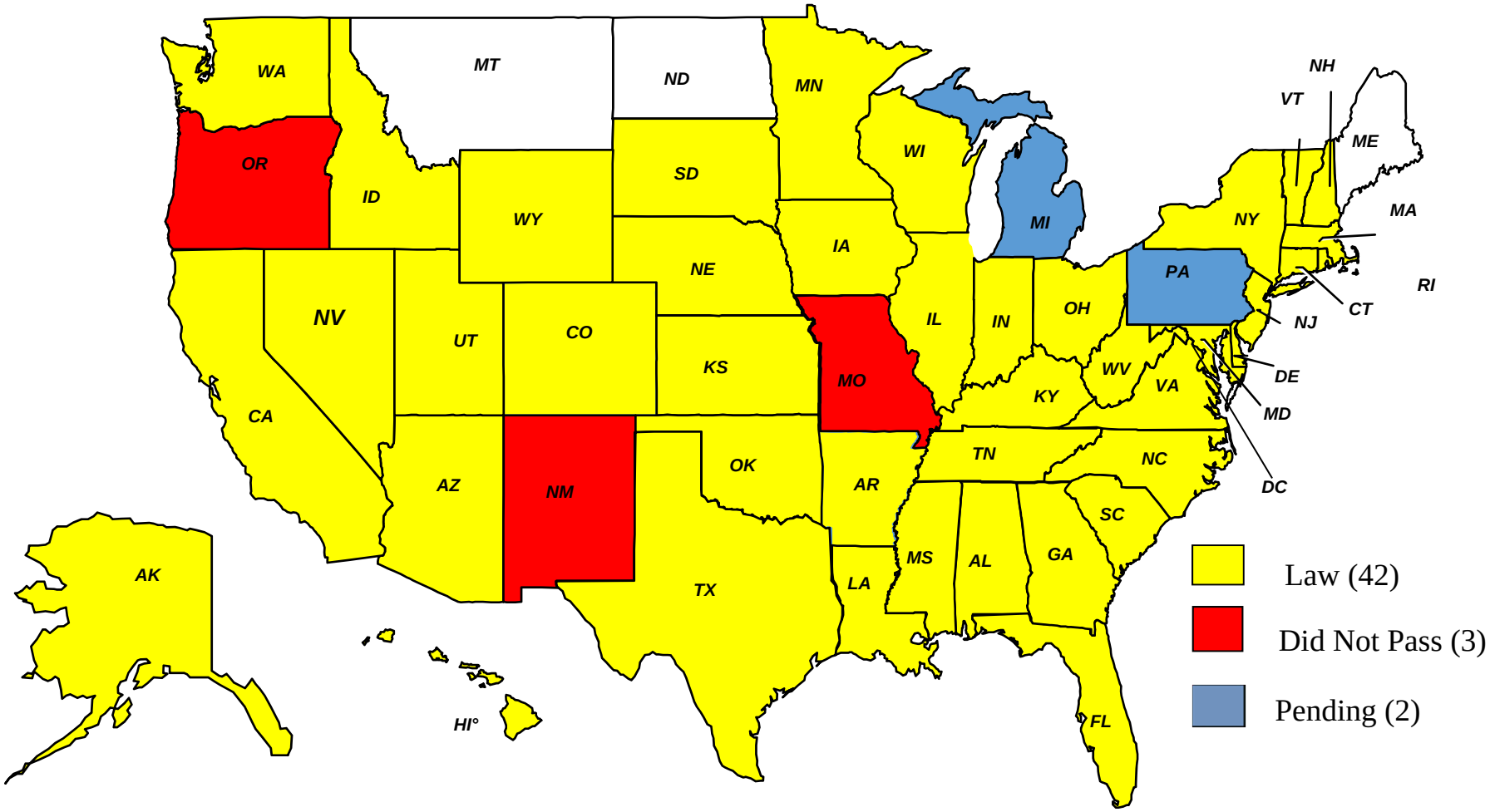
E-cig manufacturers are allowed unrestricted:

- Television advertising
- Fruit and candy flavorings (extracts)
- Internet sales
- Open air vs. clean labs

State Laws Governing E-cigarettes

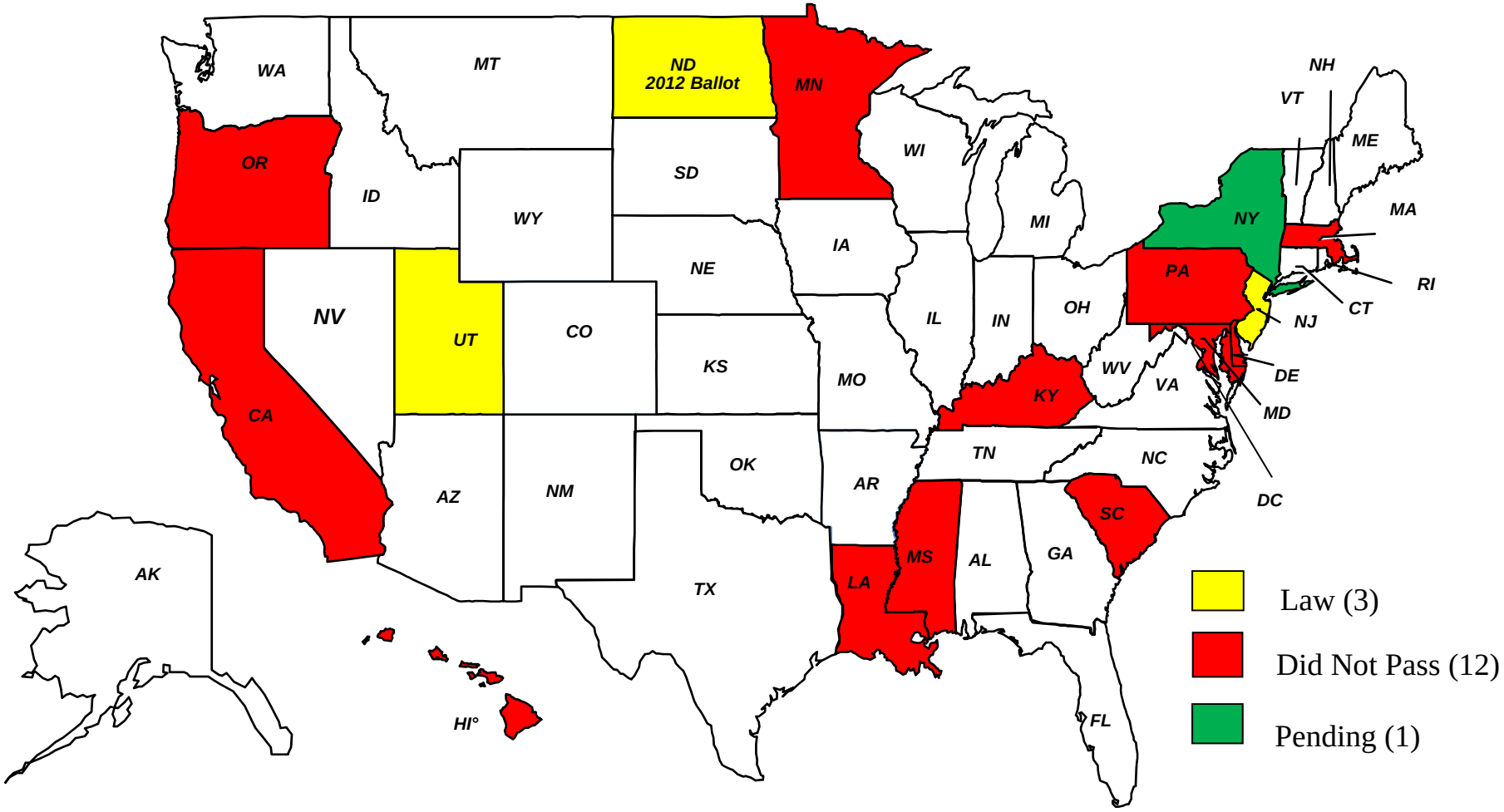
- Sales & use taxes are due on all sales.

2014 State E-Cigarette Legislation
Minimum Age to Purchase



August 1, 2014

2014 State E-Cigarette Legislation Smoking Ban



August 1, 2014

State Laws Governing E-cigs (cont'd)

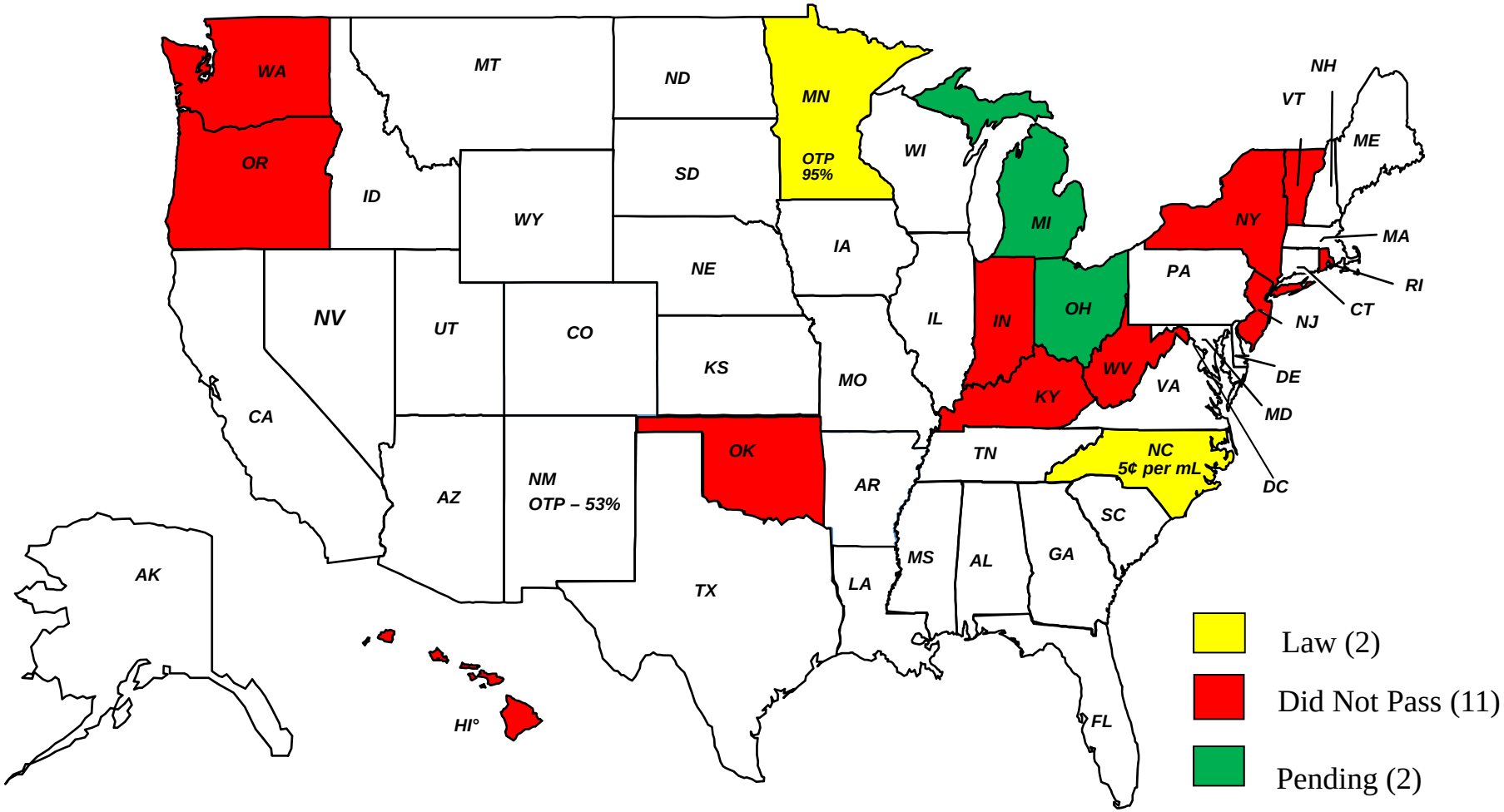
Minnesota Department of Revenue

- Effective July 1, 2013, E-cigs:
  - Meet the definition of Other Tobacco Products.
  - Are taxed at 95% of the wholesale price.

State Laws Governing E-cigs (cont'd)

- North Carolina passed a tax of .05 cents/ml of consumable nicotine material ("niquid") ≤ 10% of current cigarette tax rate.

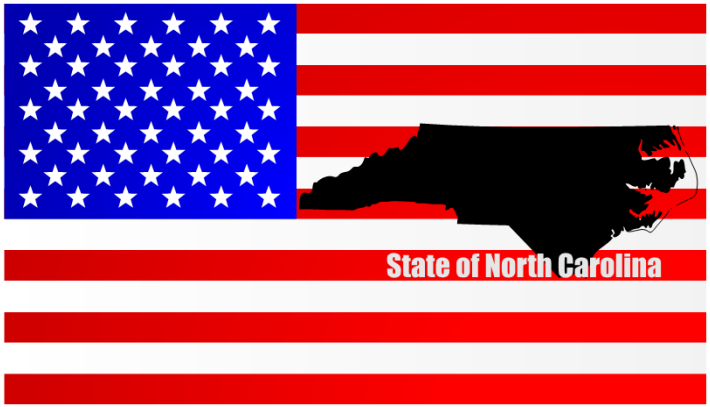
2014 State E-Cigarette Legislation Excise Taxes



August 1, 2014

Taxation and Vapor Products

- Minnesota is the only state that currently taxes vapor products
  - Adopted in 2010, taxes vapor products as OTP
  - In 2013, increased rate from 70% of wholesale price to 95% of wholesale price



- North Carolina will assess excise tax on vapor products effective July 1, 2015
  - Signed into law in May 2014
  - Adds vapor products to definition of tobacco products
  - Imposes $0.05 per fluid milliliter of consumable product
  - Requires manufacturer invoices to display the amount of consumable product in milliliters

Two Different Approaches

Example	MN	NC
Manufacturer Price	$7.00	$7.00
Excise Tax	$6.65	$0.03
Wholesale Markup (10%)	$0.70	$0.70
Wholesale Price	$14.35	$7.73
Retail Markup (10%)	$1.44	$0.78
Retail Price	$15.79	$8.51

What Big Tobacco Wants

- A Unique tax category & tax rate
  - Don't want to be a cigarette or tobacco product
- A volume or weight based measure of tax
  - Don't want price based tax (MN)
- A low tax rate
  - Recognize the risk continuum in establishing a tax rate (NC)

What Big Tobacco Wants (cont.)

- FDA regulation (in part)
  - Standards for ingredients, however
  - Oppose limits on advertising
- Youth access laws
  - They only market to adults
- All flavors should be legal
  - They argue:
    - Lozenges and gums have flavors
    - Flavors are necessary to distinguish products
    - Customers want them

"Don't use taxes to push e-cig consumers back to smoking".

- RJ Reynolds

What Entrepreneurs Want

- No unique tax category (sales tax only)
  - Believe taxes are pro-cigarette
    - Increased price means non-competitive
  - Most support youth access limits
- No licensing or product regulation
  - Wary of FDA regulation
  - Regulations mean increased costs
- No limits on flavors

Taxation Issues

- Should states tax? If so, how?
  - Per fluid milliliter (NC - .05)
  - % of wholesale value (MN - 95%)
  - Per milligram (WA - .08 SHB2795)
- Wholesale price based tax (like OTP)
  - Who do you tax? Outside tobacco distribution channels?
  - What do you tax? Juice bundled with hardware (tanks/mods)?
- Volume or weight based tax
  - No standard labeling
- 25 to 30% of market is online

12 Gallons of 100mg/ml Unflavored Liquid Nicotine ($2,760 at cost)

Sample Legislation

"Tobacco products" shall mean any cigars, smoking tobacco, chewing tobacco, and snuff, however prepared; and shall include any other articles or products made or derived from ~~of~~ tobacco except cigarettes excluding smoking cessation products as regulated under the drug/device provisions of the Federal Food, Drug, and Cosmetic Act (FDCA).

Possible effects on the Master Settlement Agreement (MSA)

- Participating Manufacturers under the MSA pay the States based upon "the total number of individual cigarettes shipped in or to the fifty United States".
- E-cigarettes do not appear to fit under the MSA's definition of a cigarette.
- If true, MSA payments are not triggered by e-cigarette usage.
- Thus to the degree e-cigarettes displace and reduce cigarette usage, then MSA payments will go down.

Other Issues?
Any questions ?

Contact Information

Stuart Thronson

Assistant Director

State of Washington

Department of Revenue

360-534.1300

stuartt@dor.wa.gov

Contact Information

Brett DeLange
Deputy Attorney General
Consumer Protection Division
Idaho Office of the Attorney General
208.334.4114
brett.delange@ag.idaho.gov

Contact Information

Don Anderson

Excise Tax Specialist

Tax Discovery Bureau

Idaho State Tax Commission

208.334.7614

208.334.7655 FAX

don.anderson@tax.idaho.gov

3-D Vision
for the Future
Dream It. Design It. Do It!
WSATA 2014
Boise ID • Sept. 7-10

3-D Vision
for the Future
Dream It, Design It, Do It!
WSATA 2014
Boise ID • Sept. 7-10