

**DESCRIPTION OF H.R. 4742,  
TO AMEND THE INTERNAL REVENUE CODE OF 1986  
TO IMPOSE A TAX ON NICOTINE USED IN VAPING, ETC.**

Scheduled for Markup  
by the  
HOUSE COMMITTEE ON WAYS AND MEANS  
on October 23, 2019

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



October 21, 2019  
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## INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 4742, to amend the Internal Revenue Code of 1986 to impose a tax on nicotine used in vaping, etc. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 4742, To Amend the Internal Revenue Code of 1986 to Impose a Tax on Nicotine Used in Vaping, Etc.* (JCX-44-19), October 21, 2019. This document can also be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov). All section references herein are to the Internal Revenue Code of 1986, as amended (herein “Code”), unless otherwise stated.

## A. Imposition of Tax on Nicotine for Use in Vaping

### Present Law

Federal excise taxes are imposed upon various types of tobacco products and cigarette papers and tubes.<sup>2</sup> Tobacco products are cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco. A “cigar” is any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco, other than any roll of tobacco which is a cigarette. A “cigarette” is (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; and (ii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette. “Smokeless tobacco” is any snuff or chewing tobacco. “Pipe tobacco” is any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe. “Roll-your-own tobacco” is any tobacco, which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. “Cigarette paper” is paper, or any other material except tobacco, prepared for use as a cigarette wrapper. A “cigarette tube” is cigarette paper made into a hollow cylinder for use in making cigarettes.<sup>3</sup>

The following table lists the rates on tobacco products and cigarette papers and tubes.

<b>Tobacco Product</b>	<b>Present Law Tax Rates</b>
“Small cigars” (weighing three pounds or less per thousand) <sup>1</sup>	\$50.33 per thousand
“Large cigars” (weighing more than three pounds per thousand) <sup>2</sup>	52.75 percent of manufacturer’s sale price, but not more than 40.26 cents per cigar
“Small cigarettes” (weighing three pounds or less per thousand) <sup>3</sup>	\$50.33 per thousand
“Large cigarettes” (weighing more than three pounds per thousand) <sup>4</sup>	\$105.69 per thousand
Snuff <sup>5</sup>	\$1.51 per pound <sup>6</sup>
Chewing tobacco <sup>7</sup>	50.33 cents per pound
Pipe tobacco <sup>8</sup>	\$2.8311 per pound
Roll-your-own tobacco <sup>9</sup>	\$24.78 per pound

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<sup>2</sup> Sec. 5701.

<sup>3</sup> Sec. 5702.

Tobacco Product	Present Law Tax Rates
Cigarette papers <sup>10</sup>	3.15 cents for each 50 papers (or fractional part thereof)
Cigarette tubes <sup>11</sup>	6.30 cents for each 50 tubes (or fractional part thereof)

<sup>1</sup> Sec. 5701(a)(1).

<sup>2</sup> Sec. 5701(a)(2).

<sup>3</sup> Sec. 5701(b)(1).

<sup>4</sup> Large cigarettes more than 6.5 inches in length are taxed as small cigarettes, counting each 2.75 inches (or fraction thereof) of the length of each as one cigarette. Sec. 5701(b)(2).

<sup>5</sup> Sec. 5701(e)(1).

<sup>6</sup> Each of the tax rates on snuff, chewing tobacco, pipe tobacco, and roll-your-own tobacco is applied proportionately to fractional parts of a pound.

<sup>7</sup> Sec. 5701(e)(2).

<sup>8</sup> Sec. 5701(f).

<sup>9</sup> Sec. 5701(g).

<sup>10</sup> Cigarette papers measuring more than 6.5 inches in length are taxed at the rate prescribed, counting each 2.75 inches (or fraction thereof) of the length of each as one cigarette paper. Sec. 5701(c).

<sup>11</sup> Cigarette tubes measuring more than 6.5 inches in length are taxed at the rate prescribed, counting each 2.75 inches (or fraction thereof) of the length of each as one cigarette tube. Sec. 5701(d).

The excise tax liability arises when the tobacco products or cigarette papers and tubes are manufactured or imported, but the requirement to pay the tax is not triggered until the product is removed from the taxpayer's premises or, in the case of an imported product, from customs custody or bond. The tax is determined and paid at the time of removal unless the taxpayer has a deferral bond in place, in which case the taxes are paid on the basis of semi-monthly return periods.<sup>4</sup> Any taxpayer who is liable for a gross amount of taxes equal to or exceeding \$5,000,000 during a calendar year must make deposits of tax for the following year by electronic funds transfer.<sup>5</sup>

### **Transfer rules and removals without tax**

Tobacco products and cigarette papers and tubes may be transferred between bonded premises of manufacturers of tobacco products and export warehouse proprietors without payment of the tax; the transferee is liable for the tax on the transferred tobacco products and papers and tubes.<sup>6</sup> Tobacco products and cigarette papers and tubes may also be removed without payment of tax for exportation; the exporter is relieved from the tax once proof of

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<sup>4</sup> Sec. 5703.

<sup>5</sup> Sec. 5703(b).

<sup>6</sup> Sec. 5703(a) and 5704.

exportation is obtained.<sup>7</sup> Tax-paid product exported from the United States is eligible for drawback of the tax under certain conditions.<sup>8</sup> Imported tobacco products may be released from customs custody in bulk for transfer to the bonded premises of a manufacturer or export warehouse proprietor without payment of the tax; the transferee is then responsible for the taxes.<sup>9</sup> Generally, previously exported domestic tobacco products may be relanded<sup>10</sup> in the United States only if they are transferred to the original manufacturer or to an export warehouse proprietor authorized by the original manufacturer.<sup>11</sup> To prevent the diversion of tobacco products destined for export without payment of tax, however, packages bearing export marks are not allowed in the domestic marketplace.<sup>12</sup> The tax is refunded or credited (without interest) for products withdrawn from the market and returned to bonded premises.<sup>13</sup> Tax-paid products that are lost by casualty or certain disasters are eligible for tax refunds or credits.<sup>14</sup>

### **Permits and bonds**

Manufacturers and importers of tobacco products, processed tobacco, and proprietors of export warehouses must obtain permits to engage in such businesses.<sup>15</sup> A permit is obtained by application to the Secretary. The Secretary may deny the application if (1) the business premises are inadequate to protect the revenue; (2) the activity to be carried out at the business premises does not meet such minimum capacity or activity requirements as prescribed by the Secretary; (3) the applicant is, by reason of his business experience, financial standing, or trade connections, not likely to maintain operations in compliance with the applicable provisions of the Code; (4) the applicant has been convicted of a felony violation of Federal or state criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes; or (5) the applicant has failed to disclose any material information required or made any material false statement in the application. In the case of a corporation, an applicant includes any officer, director, or principal stockholder and, in the case of a partnership, a partner.<sup>16</sup>

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<sup>7</sup> Sec. 5704(b).

<sup>8</sup> Sec. 5706.

<sup>9</sup> Sec. 5704(c).

<sup>10</sup> A good is relanded if it is marked for export, but is returned to the United States without payment of duty. See 18 U.S.C. sec. 544.

<sup>11</sup> Secs. 5754 and 5761(c).

<sup>12</sup> Secs. 5754(a) and 5761(c).

<sup>13</sup> Sec. 5705.

<sup>14</sup> Secs. 5705 and 5708.

<sup>15</sup> Sec. 5713(a).

<sup>16</sup> Sec. 5712.

A permit is conditioned upon compliance with relevant provisions of the Code and related regulations pertaining to tobacco products and cigarette papers and tubes. The Secretary may suspend or revoke a permit after a notice and hearing if the holder (1) has not in good faith complied with those rules or has violated any other provision of the Code involving intent to defraud; (2) has violated the conditions of the permit; (3) has failed to disclose any material information required or made any material false statement in the permit application; (4) has failed to maintain the business premises in such a manner as to protect the revenue; (5) is, by reason of previous or current legal proceedings involving a felony violation of any other provision of Federal criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes, not likely to maintain operations in compliance with the applicable provisions of the Code; or (6) has been convicted of a felony violation of Federal or state criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes.<sup>17</sup>

A surety bond is required to be furnished by manufacturers of tobacco products or cigarette papers and tubes and export warehouse proprietors before they commence business.<sup>18</sup> Importers are not required to post a surety bond because the requirement to pay the tax is triggered at the time the tobacco products or cigarette papers or tubes are released from customs custody. Prior to that time, the customs bond is applicable.

### **Occupational tax**

An occupational tax of \$1,000 per year is imposed on manufacturers of tobacco products, cigarette papers and tubes, and export warehouse proprietors.<sup>19</sup> A reduced rate of \$500 per year applies to taxpayers with excise tax liability in the prior year of less than \$500,000.<sup>20</sup> Controlled groups are treated as a single person. Any person engaged in business subject to the occupational tax who willfully fails to pay the tax imposed is subject to a fine of not more than \$5,000 or imprisonment of not more than two years, or both, for each such offense.<sup>21</sup>

### **Miscellaneous rules, including operational, reporting, and recordkeeping requirements**

Before removal, tobacco products, processed tobacco, and cigarette papers and tubes must be in packages and bear such marks, labels, and notices as required by the regulations.<sup>22</sup>

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<sup>17</sup> Sec. 5713.

<sup>18</sup> Sec. 5711.

<sup>19</sup> Sec. 5731(a).

<sup>20</sup> Sec. 5731(b).

<sup>21</sup> Sec. 5731(c).

<sup>22</sup> Secs. 5723(a) and (b).

The Code prohibits lottery features and indecent or immoral material from being contained in or attached to a package of tobacco products or cigarette papers or tubes.<sup>23</sup>

Manufacturers, importers, and export warehouse proprietors are required to keep records, file operating reports, and make accurate inventories as required by regulations.<sup>24</sup> Tobacco products may be furnished by a manufacturer to its employees or put to experimental use without payment of tax under conditions set forth in regulations.<sup>25</sup>

### **Fines and penalties**

The Code contains provisions relating to the purchase, receipt, possession, sale, or disposal of certain tobacco products and cigarette papers and tubes.<sup>26</sup> It also imposes restrictions on importation of previously exported tobacco products.<sup>27</sup> Civil and criminal penalties and forfeiture provisions apply for failure to comply with the tobacco provisions.<sup>28</sup> The criminal and forfeiture provisions of subtitle F of the Code that apply to taxes in general also apply to tobacco taxes.

Civil penalties apply to certain actions including the willful failure to comply with the duties imposed (such as recordkeeping and labeling), failure to pay tax, and for the illegal sale of tobacco products.<sup>29</sup> Criminal penalties apply to certain actions including engaging in business unlawfully, failing to furnish certain information or furnishing false or fraudulent information, tax evasion, unlawful removal of tobacco products or cigarette papers or tubes, and for purchasing, receiving, possessing, or selling tobacco products or cigarette papers or tubes unlawfully.<sup>30</sup> Tobacco products and cigarette papers and tubes are subject to forfeiture if they are possessed with the intent to defraud the United States, or are not in packaging as required under the law.<sup>31</sup> Additional property may also be subject to forfeiture if it is used to engage in the manufacturing business unlawfully, or if the proprietor makes false or fraudulent records or reports with the intent to defraud the United States. Certain forfeited, condemned, or abandoned

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<sup>23</sup> Secs. 5723(c) and (d).

<sup>24</sup> Secs. 5721-22 and 5741.

<sup>25</sup> Sec. 5704(a).

<sup>26</sup> Sec. 5751.

<sup>27</sup> Sec. 5754.

<sup>28</sup> Secs. 5751-52 and 5761-63.

<sup>29</sup> Sec. 5761.

<sup>30</sup> Sec. 5762.

<sup>31</sup> Sec. 5763.

tobacco products or cigarette papers and tubes may be disposed of in accordance with regulations.<sup>32</sup>

### **Description of Proposal**

The proposal imposes a new excise tax on taxable nicotine. The amount of tax is the greater of (i) the dollar amount specified for small cigarettes in section 5701(b)(1) or (ii) \$50.33 per 1,810 milligrams of nicotine (and a proportionate tax on any fractional part thereof).

The proposal defines taxable nicotine as any nicotine which has been extracted, concentrated, or synthesized. However, the definition excludes any nicotine if the manufacturer or importer demonstrates to the satisfaction of the Secretary that such nicotine will be used in a product which has been approved by the Food and Drug Administration for sale as a nicotine replacement therapy. Additionally, other tobacco products that are currently subject to tax shall not be treated as containing taxable nicotine solely because the nicotine naturally occurring in the tobacco from which such product is manufactured has been concentrated during the ordinary course of manufacturing.

Under the proposal, general provisions that apply to tobacco products, such as the (i) packaging requirements, (ii) provisions relating to the purchase, receipt, possession, or sale, and (iii) provisions relating to civil and criminal penalties, apply to taxable nicotine.

Additionally, references in the Code to a manufacturer of tobacco products or to manufacturing tobacco products include references to a manufacturer of taxable nicotine or to manufacturing taxable nicotine, respectively. Therefore, a manufacturer of taxable nicotine is subject to the occupational tax and other requirements that apply to manufacturers of tobacco products. Under the proposal, a manufacturer of taxable nicotine includes any person who extracts, concentrates, or synthesizes nicotine.

### **Effective Date**

The provision applies to articles manufactured or imported in calendar quarters beginning more than 90 days after the date of enactment.

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<sup>32</sup> Sec. 5753.

**B. Estimated Revenue Effect of the Proposal**

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**Fiscal Years**  
**[Millions of Dollars]**

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<u>Item</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2020-24</u>	<u>2020-29</u>
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**NOTE:** Details do not add to totals due to rounding.