

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Tuesday, September 24, 2019
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Jim Grueneich, Chairman, called the meeting to order at 10:00 a.m.

Members present: Representatives Jim Grueneich, Jason Dockter, Sebastian Ertelt, Patrick Hatlestad, Craig Headland, Tom Kading, Ben Koppelman, Alisa Mitskog, Vicky Steiner; Senators Dwight Cook, Jim Dotzenrod, Jordan Kannianen, Curt Kreun, Dale Patten, Jessica Unruh

Members absent: Representatives Jake G. Blum, Matt Eidson, Ron Guggisberg

Others present: Senator Joan Heckaman, New Rockford, and Representative Josh Boschee, Fargo, members of the Legislative Management

See [Appendix A](#) for additional persons present.

It was moved by Representative Mitskog, seconded by Representative Dockter, and carried on a voice vote that the minutes of the July 23, 2019, meeting be approved as distributed.

SPECIAL ASSESSMENT REVENUE REPLACEMENT STUDY

Chairman Grueneich called on Mr. Keith Hunke, City Administrator, City of Bismarck, for a presentation of information ([Appendix B](#)) comparing the number of residences paying special assessments to the number of utility bills on which an additional street utility tax would be imposed, and information on the use of supplemental or replacement taxes in other states. Mr. Hunke said 9,805 parcels are being billed for special assessments for street maintenance. He said 22,182 parcels are receiving a city utility bill on which the additional street utility tax could be applied if the tax was imposed. He said fees other than special assessments are being imposed to fund street maintenance in Oshkosh, Wisconsin and Oregon City, Oregon and by the Montana Department of Transportation.

In response to a question from Representative Headland, Mr. Hunke said the appeals process for the fees imposed in Oregon City allows an individual to file a request for a service charge adjustment with the city manager within 30 days of the billing date. He said the city manager may adjust the charge under certain circumstances. He said city fees charged in Bismarck are approved by the city commission on an annual basis. He said a public hearing is held to provide the public an opportunity to appeal the fees. He said if cities were to receive authorization to proceed with a street utility tax, the specifics of the tax would be vetted through a public hearing process.

In response to a question from Senator Kreun, Mr. Hunke said Bismarck could not impose a street utility tax due to legislation passed during the 2017 legislative session which prevents a city from seeking voter approval for any funding mechanism that was not present in a city's home rule charter before August 1, 2017. He said the city requests the committee recommend legislation to repeal the restriction passed in 2017. He said it might be difficult to outline all the specific details of a street utility tax in statute. He said other city administrators have noted the details relating to the street utility tax envisioned for Bismarck might not work for all cities.

In response to a question from Representative Koppelman, Mr. Hunke said cities are not looking to mandate imposition of the tax, but if a city imposed the tax it would need to refrain from charging special assessments to fund the same purposes. He said the tax would replace special assessment charges for street maintenance if it was imposed in Bismarck. He said special assessments still would be allowed for other purposes. He said he would support legislation that delineated between special assessments for green field development, new development, and infrastructure maintenance.

In response to a question from Senator Cook, Mr. Hunke said he understands the value of having an appeal process outlined in statute. He said the appeals process could be similar to the process for appealing water and sewer charges. He said the appeals process would be separate from the process of taking the question of the tax to the voters for initial approval.

In response to a question from Senator Cook, Mr. Hunke said each community would need to determine how to address existing special assessment debt. He said cities could subsidize a portion of existing special assessments with sales tax collections or dedicate the first of the street utility tax collections to pay off existing debt before starting street maintenance projects. He said using utility tax revenue to pay existing special assessment debt might raise concerns among individuals who prepaid special assessment balances. He said he would prefer legislation that is flexible enough to allow cities to address their own unique needs. He said a list of detailed statutory requirements pertaining to imposition of the tax likely would not meet the needs of all cities.

In response to a question from Representative Koppelman, Mr. Hunke said the task force would need to vet whether the tax would be used to pay existing special assessment debt and whether the use of revenue for that purpose would raise legal concerns.

Senator Unruh said any proposed legislation relating to the tax should contain protections for taxpayers to ensure they have a clear understanding of how the tax would operate and have the opportunity to be heard throughout the process.

Senator Patten said he would like clarity on how a city would transition from imposing special assessments to imposing a street utility tax. He said the committee would need to determine whether proposed legislation would address the treatment of existing special assessment debt.

Representative Koppelman said legislation introduced during the 2019 legislative session allowed special assessment debt to remain on properties but required street utility tax revenue to be used to pay the annual installments on existing debt.

Representative Headland said the committee has several details to sort in regard to the tax and the bill introduced last session might serve as a good starting point for a bill draft. He said he is interested in proposed language relating to an appeals process and the treatment of existing special assessment debt.

Senator Cook said it would be beneficial for committee members to contact the Chairman or the Legislative Council staff with any suggested changes to the language in House Bill No. 1474 (2019) so proposed changes could be discussed at the committee's next meeting.

ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

Chairman Grueneich called on Mr. Ryan Rauschenberger, Tax Commissioner, for a presentation ([Appendix C](#)) of information related to economic development tax incentives and online sales tax collections. Mr. Rauschenberger said the fiscal information on tax incentives supplements information previously provided to the committee. He said the information is being provided due to the department's receipt of a written request for information from the chairman of the Legislative Management. He said legislation enacted during the 2017 legislative session allows the department to disclose data on incentives claimed by five or fewer claimants upon receiving a request from the chairman of the Legislative Management. He said the exemption for data centers has been exhausted as it is limited to the first four claimants. He said no exemptions have been claimed for the fertilizer or chemical processing plant sales tax exemption as the exemption is specific to the feed stock of a certain type of plant. He said the sales tax exemption related to the use of carbon dioxide for enhanced recovery also has not been claimed as most projects associated with this exemption are in the feed study and engineering early project stages.

In response to a question from Representative Ertelt, the Legislative Council staff said North Dakota Century Code Section 57-01-02(17) authorizes the disclosure of information on incentives claimed by five or fewer claimants. She said the letter signed by the chairman of the Legislative Management requested data on all the incentives the committee selected for study this interim. She said the department will continue to provide incentive data throughout the interim.

Mr. Rauschenberger said the department received over 5,000 sales and use tax permit applications from remote sellers from June to August of this year. He said \$16 million in sales tax has been collected from remote sellers during that period and the department expects collections to far exceed the \$25 million collection amount forecast for this biennium.

In response to a question from Senator Cook, Mr. Rauschenberger said the department notified marketplace sellers of their duty to collect sales tax starting October, 1, 2019, as a result of legislation passed during the 2019 legislative session. He said the department has seen evidence that marketplace sellers intend to collect the tax.

CHARITABLE GAMING TAX STUDY

Chairman Grueneich called on the Legislative Council staff for presentation of a background memorandum entitled [Charitable Gaming Background Memorandum](#). The Legislative Council staff said the charitable gaming law

study outlined in Senate Bill No. 2015 (2019) has been assigned in part to this committee and in part to the Judiciary Committee. She said this committee will be studying only the tax aspects of charitable gaming.

Chairman Grueneich called on Ms. Deborah A. McDaniel, Gaming Director, Attorney General's office, for a presentation of information ([Appendix D](#)) relating to charitable gaming tax collections, electronic pull tabs, and issues impacting the gaming division. Ms. McDaniel said gaming activities are expected to generate over \$10 million in revenue for deposit in the general fund during the 2017-19 biennium. She said the gaming division anticipates an estimated \$1 billion in gaming gross proceeds during the 2019-2021 biennium. She said the legalization of electronic pull tabs, combined with recent budget cuts, has placed a strain on the gaming division.

In response to a question from Chairman Grueneich, Ms. McDaniel said the number of staff in the gaming division would need to double for the division to properly monitor and audit charitable gaming activities. She said it would cost roughly \$5 million to double the gaming division's budget.

In response to a question from Senator Heckaman, Ms. McDaniel said federal excise tax is not included in the \$10 million amount deposited in the general fund. She said federal excise is paid by charitable organizations and only applies to certain games, including sports pools.

In response to a question from Representative Ertelt, Ms. McDaniel said the gaming division does not track how cities and counties spend charitable gaming revenue allocations but the North Dakota League of Cities may be able to provide that information. She said gaming revenue is distributed to cities and counties based on the amount of gaming gross proceeds accepted in each city or county during the quarter.

In response to a question from Senator Cook, Ms. McDaniel said the gaming division previously employed two licensed police officers with accounting backgrounds to assist in enforcing gaming laws. She said the gaming division has not employed a police officer in the past 10 years. She said a police officer monitoring gaming compliance would be looking for proper posting at gaming sites and would be comparing the serial numbers and number of devices registered for a location with those actually present at the location. She said she does not know the exact amount it would cost for the division to employ two police officers.

In response to a question from Representative Dockter, Ms. McDaniel said the software purchased with funds appropriated during the 2019 legislative session should be operational within 18 to 24 months. She said the software will allow staff to reallocate time previously spent on data entry. She said the software primarily will benefit charities and distributors by allowing returns to be submitted electronically.

In response to a question from Representative Mitskog, Ms. McDaniel said the number of charitable gaming sites has increased by 6 percent from 2015 to 2019. She said audits of paper pull tabs will not change with the new software because the physical paper tabs still need to be counted. She said audits of electronic pull tabs involve confirming devices are the correct devices registered to be at the location. She said a device can be plugged into each machine to ensure the machine is running the correct programs. She said over 500 sites host electronic pull tab machines and the gaming division should be visiting these sites on a monthly basis to check the machines. She said electronic pull tab machines look like Las Vegas style machines, which you can get on the black market. She said it would be possible for someone to buy one of these machines and install it at a location without the gaming division knowing about the machine or the proceeds from the machine going to charity.

In response to a question from Representative Headland, Ms. McDaniel said the use of paper pull tabs has declined since the Legislative Assembly authorized electronic pull tabs. She said the use of paper pull tabs has declined by 18 percent and the use of jar bars has declined by 25 percent when comparing figures from before the authorization of electronic pull tabs to figures from March 2019. She said the gaming division currently is conducting two audits to verify the accuracy of electronic pull tab figures. She said the gaming division is not aware of any instances in which counterfeit machines have been used in this state.

In response to a question from Representative Mitskog, Ms. McDaniel said other states have encountered counterfeit machines being operated at illegal gaming sites. She said identifying counterfeit operations is labor intensive and with only six auditors and little help from law enforcement it would be difficult for the gaming division to identify illegal operations. She said the charities keep a close eye on the machines located at licensed sites.

In response to a question from Chairman Grueneich, Ms. McDaniel said 33.66 percent of the revenue from electronic pull tabs is derived from the actual cash inserted into the devices and the remainder of the revenue is derived from replaying credits won on the machines.

Senator Cook said he thinks everyone would agree the gaming division should receive an adequate amount of gaming tax revenue to cover the expenses related to regulating and enforcing gaming laws.

In response to a question from Senator Cook, Ms. McDaniel said the gaming division could provide the committee the amount the division would require to properly regulate and enforce charitable gaming laws.

Chairman Grueneich called on Ms. Janelle Mitzel, President, North Dakota Council for Charitable Gaming, for a presentation of information ([Appendix E](#)) regarding the committee's study of charitable gaming tax.

In response to a question from Representative Headland, Ms. Mitzel said several organizations have moved from the lower tier of tax to the higher tier of tax since electronic pull tab devices were authorized. She said most organizations are generating more revenue than before the devices were allowed.

Chairman Grueneich called on Mr. Don Santer, Chief Executive Officer, North Dakota Association for the Disabled, Inc., and Treasurer, Charitable Gaming Association of North Dakota, for a presentation of information ([Appendix F](#)) regarding the charitable gaming tax structure. Mr. Santer said a 92.5 percent prize payout on electronic pull tab machines is the optimal payout percentage for generating the highest amount of revenue. He said he would not favor any legislation requiring lower payout percentages.

In response to a question from Senator Cook, Mr. Santer said the state sets a 90 percent maximum payout percentage. He said the state does not set a minimum payout percentage. He said charities generate more revenue with higher payout percentages.

Senator Cook said he would be interested in data showing the impacts of payout percentages on revenue.

In response to a question from Representative Headland, Mr. Santer said he is asking the committee to consider the best use of charitable gaming revenue rather than asking for an adjustment to the tax rates. He said he agrees there is a need to dedicate adequate funding for regulatory oversight but revenue in excess of the amount needed for regulation should be returned to the charities rather than deposited in the general fund. He said the Charitable Gaming Association of North Dakota would support legislation to increase funding for gambling addiction as long as the funding is not derived from increased taxes. He said the association would prefer a more simplified tax calculated on gross proceeds less cash prizes and the cost of merchandise. He said applying the tax in this manner would eliminate tax on losses and create a fair and balanced system for all gaming organizations. He said the association also would support legislation funding police officer positions for the gaming division. He said charities are struggling to receive help from local law enforcement in larger cities. He said larger cities often have to allocate limited police resources to more serious crimes.

Chairman Grueneich called on Mr. Michael Pollock, Managing Director, Spectrum Gaming Group, for a presentation of information ([Appendix G](#)) via conference call regarding the committee's study of charitable gaming tax. Mr. Pollock said care should be taken when expanding gaming or changing existing laws because once changes are made, it is not easy to undo those changes.

In response to a question from Senator Cook, Mr. Pollock said one of the biggest considerations for a charity when evaluating sports betting as a gaming option is the charity's willingness and ability to absorb a loss. He said the state should consider potential impacts on the North Dakota lottery if sports betting is allowed. He said the state should place limits on the number of sports betting locations in the state because each location will need to have some level of controls in place. He said the state would need to decide if betting would be allowed at self-service terminals or only with licensed individuals and if in play betting would be allowed or only betting on the final outcome of a game.

In response to a question from Representative Headland, Mr. Pollock said sports betting is not a large source of tax revenue but it might spur other forms of economic growth by drawing customers to sports bars and taverns.

In response to a question from Senator Cook, Mr. Pollock said the National Council of Legislators from Gaming States in a nonpartisan organization of lawmakers which focuses on gaming issues and promotes best practices. He said annual membership dues are \$5,000 per state and the organization offers scholarships for travel costs.

Senator Cook said the Legislative Management should consider whether membership would benefit North Dakota.

In response to a question from Chairman Grueneich, Mr. Pollock said 15 states are members of the organization.

Chairman Grueneich called on Ms. Melissa Harvey, Gaming Manager, Horace Lions Club and The Arc, Upper Valley, for a presentation of information ([Appendix H](#)) regarding the committee's study of charitable gaming tax.

Ms. Harvey said she would like to see gaming revenue, in excess of what is needed for regulation and addiction treatment, returned to the charitable organizations.

In response to a question from Representative Headland, Ms. Harvey said one of the organizations she manages will be moving from the lower gaming tax rate to the higher gaming tax rate. She said The Arc, Upper Valley is anticipating paying \$9,000 in taxes this quarter.

In response to a question from Chairman Grueneich, Ms. Harvey said she could provide information regarding the amount of additional revenue, or the number of months it will take at current levels of play, for the organization to break even once it is subject to tax at the higher gaming tax rate.

Chairman Grueneich called on Mr. Bryan Nelson, Owner, Maverick's Saloon, for a presentation of information ([Appendix I](#)) regarding the benefits of charitable gaming in Dickinson.

In response to a question from Chairman Grueneich, Mr. Nelson said a 90 percent prize payout is important because it provides more entertainment for players and keeps them playing longer.

Chairman Grueneich said it is important to hear about the impacts of charitable gaming beyond the benefits derived by the charities. He said sometimes the impact of gaming to help grow small business is overlooked.

In response to a question from Representative Headland, Mr. Nelson said he would not view sports betting as a viable option in his business. He said he would not have the room in his saloon. He said it is unlikely charities would be able to sustain sports betting as a form of gaming due to the extra employee hours that would be required.

Chairman Grueneich called for additional comments from interested persons regarding the committee's study of charitable gaming tax.

Ms. Lisa Vig, Director, Gambler's Choice, Lutheran Social Services of North Dakota, provided information ([Appendix J](#)) on gambling addiction prevention and treatment.

In response to a question from Representative Mitskog, Ms. Vig said she has not seen a significant increase in the number of individuals seeking treatment for gambling addiction, but individuals who have sought treatment have identified electronic pull tabs as the form of gaming that caused them to seek treatment.

In response to a question from Representative Koppelman, Ms. Vig said some individuals seeking gaming addiction treatment have struggled with other forms of addiction in the past, and gaming can trigger a relapse of those addictions.

Mr. Tom Newberger, Chief Executive Officer, Red River Human Services Foundation, said he agrees the gaming division needs more staff. He said the foundation's services are reviewed by a variety of state agencies but it has been 5 to 10 years since the gaming division reviewed the foundation's charitable gaming operations. He said more state oversight is required. He said the foundation has taken it upon itself to close sites that have failed to comply with gaming laws. He said the foundation also supports increased funding for gambling addiction and a change in the gaming tax structure to one based on adjusted gross income. He said the tax structure also would benefit from application of a tiered tax system, similar to the tiered system in place in 1989. He said charities with high revenue should be subject to higher taxes, similar to how high income individuals are subject to higher individual income tax rates. He said applying a flat tax rate regardless of a charity's level of revenue creates inequities. He said the foundation supports lowering the maximum payout percentage from 90 to 85 percent.

In response to a question from Representative Headland, Mr. Newberger said the ability of charities to submit returns electronically eliminates concerns raised in the past regarding tiered gaming tax rates.

In response to a question from Representative Koppelman, Mr. Newberger said there are several options for restructuring the gaming tax. He said one option would be a tiered tax rate for all games except pull tabs. He said the tax rate should be limited so collections remain about the same, rather than increasing collections to further fund the general fund.

Ms. Ann Leuwer, Bismarck, provided information ([Appendix K](#)) regarding her struggles with compulsive gambling. She said she is a recovering compulsive gambler and her most recent relapse was spurred by electronic pull tab machines due to the close resemblance of the machines to slot machines.

Mr. Troy Keeping, member of the North Dakota Committee on Charitable Gaming, representing Diamond Game, provided information ([Appendix L](#)) regarding the effect of prize payout percentages on gaming net revenue and information ([Appendix M](#)) regarding allocation of electronic pull tab revenues. He said he would not be in favor of

legislation mandating a lower payout percentage. He said Diamond Game operates in various markets and markets with payout percentages at 90 percent or above generate more than 200 percent higher net sales than markets with an 80 percent payout percentage. He said of the 10 percent of revenue remaining after 90 percent is paid to the player in prizes, 60 percent is used to pay the charity's expenses, and 40 percent is allocated to the charity's charitable causes. He said he agrees the gaming division needs additional resources.

In response to a question from Representative Headland, Mr. Keeping said he is not aware of states that allow a gaming manufacturer to serve as the distributor as well. He said manufacturers negotiate prices with distributors and distributors negotiate prices with charities. He said he is not aware of any state that applies tax at the distributor level. He said most states tax the beneficiary's proceeds.

In response to a question from Representative Koppelman, Mr. Keeping said the majority of states in which he has operated have imposed gaming tax on adjusted gross proceeds. He said some states apply tax based on gross volume. He said the industry standard is to apply tax to adjusted gross revenue, after paying prizes. He said one option for North Dakota would be to retain the current tax structure but lower the tax rate to the minimum rate required to fund gaming enforcement and addiction services. He said any surplus revenue should be returned to the charitable organizations.

TAXATION OF ELECTRONIC SMOKING DEVICES STUDY

Chairman Grueneich called on the Legislative Council staff for presentation of a background memorandum entitled [Taxation of Electronic Smoking Devices - Background Memorandum](#).

Chairman Grueneich called on Mr. Max Behlke, Director, State Public Policy, JUUL Labs, for a presentation of information ([Appendix N](#)) regarding the committee's study of the taxation of electronic smoking devices. Mr. Behlke said if the Legislative Assembly decides to move forward with a tax on electronic smoking devices, it is important to ensure the tax can be enforced and administered. He said products subject to the tax need to be clearly defined. He said traditional cigarettes are fairly homogenous from manufacturer to manufacturer but electronic cigarette products can vary widely. He said JUUL is committed to preventing the use of vapor products by youth. He said the company voluntarily pulled all flavored products except mint and menthol from shelves in November 2018. He said a number of illegal products compatible with JUUL's products have been marketed since the company's flavored products were removed. He said two compatible products he purchased in Bismarck before the meeting may not be sold legally in the United States because they were introduced into the market after 2016. He said JUUL's products do not contain tetrahydrocannabinol (THC) or vitamin E acetate. He said a higher tax on products often leads to increased black market sales.

In response to a question from Representative Headland, Mr. Behlke said states that have implemented a tax on electronic cigarettes seem to be driven more by a desire to generate additional revenue than a desire to deter access to the products. He said revenue generated from the tax in other states is directed mainly toward the state's general fund rather than earmarked for health or enforcement programs. He said JUUL is not claiming a tax should not be applied to its products, but the company does not believe there should be parity between the tax on electronic cigarettes and the tax on traditional cigarettes. He said revenue generated by the tax should be expended on enforcement and youth education. He said the company's goal is to make society healthier and reduce society's dependence on combustible cigarettes and nicotine, even though nicotine has not been linked to any deaths. He said JUUL does not market nicotine-free products in the United States. He said the company cannot market nicotine-free products legally because it did not market those products before the United States Food and Drug Administration's (FDA) deeming rules went into effect.

Chairman Grueneich said it appears JUUL is being proactive. He said he is uncomfortable setting a precedent of the state determining a product like nicotine is harmful and then taxing the product based on that determination.

In response to a question from Chairman Grueneich, Mr. Behlke said the deaths related to smoking traditional cigarettes are caused by the other chemicals in cigarettes, not the nicotine. He said if the committee decides to recommend a tax on a negative externality, the committee should apply the tax to the degree in which the externality is harmful. He said otherwise it would be comparable to taxing a gallon of alcohol the same as a gallon of milk just because both items are liquid.

Representative Mitskog said she does not think the committee can estimate the future costs to the state, country, and health care system from the lung damage and deaths linked to electronic cigarette products. She said she applauded JUUL for voluntarily removing its flavored products and placing additional limitations on youth access. She said the company still adds nicotine to its pods and the health care costs that arise from the use of these products ultimately will be born by the states.

In response to a question from Representative Mitskog, Mr. Behlke said 50 percent of adult smokers will suffer injury or death as a result of using combustible cigarettes. He said JUUL's products are geared toward adult smokers as a means of providing a less harmful alternative to smoking. He said he shares the committee's concerns regarding youth access and understands the reasons why the products need to be regulated.

Representative Koppelman said he knows nicotine is addictive but does not know if it is harmful. He said if the committee recommends taxing any substance in cigarettes as a tobacco product, the committee would have to tax butane as a tobacco product because butane is present in cigarettes.

In response to a question from Representative Koppelman, Mr. Behlke said the benefits of regulating electronic cigarettes as a tobacco product would be applying the existing regulatory structures for tobacco products in regard to licensing, permitting, fees, and locations at which the products can be sold. He said it would be appropriate to apply the same tax that is applied to other tobacco products. He said a separate tax structure should be applied to electronic cigarettes if the committee moves forward with recommending the products be taxed.

In response to a question from Senator Cook, Mr. Behlke said many of the electronic cigarette products being sold illegally, including those he purchased in Bismarck, are manufactured in China. He said in the past 3 months JUUL has initiated 23 raids on companies illegally selling counterfeit products. He said JUUL has encouraged state Attorneys General to review the products available online and hold sellers accountable for the counterfeit products entering the state. He said the retailers from which he purchased the illegal products in Bismarck likely purchased the products online because no licensed wholesaler would be selling the illegal products.

Senator Cook said he is not sure how the state can stop individuals from ordering illegal products online and shipping them to their homes but the committee should try to find a way to stop licensed retailers from selling illegal products in their stores.

Mr. Behlke said he could provide the committee with regulatory options being considered by other states.

Senator Cook said the committee has been tasked with drafting legislation that could be introduced during the 2021 legislative session. He said much could change between now and then and the committee needs to keep that in mind as it proceeds with its study.

Chairman Grueneich called on Mr. Myles Vosberg, Director of Tax Administration, Tax Department, for a presentation of cigarette and tobacco tax collection information ([Appendix O](#)) and comments regarding the administration of an alternative or additional tax on electronic smoking devices. Mr. Vosberg said the figures on his handout exclude the three cents of tax allocated to cities from each pack of cigarettes.

In response to a question from Senator Unruh, Mr. Vosberg said an individual purchasing tobacco products online should be remitting use tax on the purchase voluntarily. He said products that flow through a wholesaler are taxed but it is difficult for the department to detect untaxed tobacco product sales made online.

In response to a question from Representative Koppelman, Mr. Vosberg said he is not aware of the department finding use tax due on tobacco products purchased by an individual because an individual's tobacco product purchases generally are not audited. He said out-of-state sellers making \$100,000 or more in sales into this state in the current or previous year would be required to collect sales tax. He said it is debatable whether those sellers also would be required to collect tobacco wholesale taxes. He said individuals buying electronic cigarettes over the Internet and skirting the tax would be a concern if a tax were imposed.

In response to a question from Representative Headland, Mr. Vosberg said there are significant differences between the electronic cigarette industry and traditional tobacco industry. He said the electronic cigarette industry does not have a well developed distribution system of manufacturers, wholesalers, and retailers. He said most electronic cigarette products do not go through the traditional distribution channels. He said in some cases, such as vape shops, the same entity is the manufacturer, wholesaler, and retailer. He said it will be more difficult to administer a tax on electronic cigarettes than traditional cigarettes. He said administration of the tax would be easier and less expensive if the tax is applied at the wholesale level rather than the retail level because the department would be dealing with far fewer companies. He said wholesalers likely would be better equipped to file the returns and pay the tax than retailers. He said if a tax is applied at the wholesale level, the department would recommend the tax be applied to the liquid at a single rate on a volume basis to be comparable with other types of wholesale taxes. He said if the tax is applied to the liquid, it should be applied to all of the components that go into the liquid. He said in the case of a vape shop, the tax should be applied either on all the liquid products the shop purchased and mixed together or on the volume of the final salable product. He said this approach would help equalize the tax between the different products available for sale. He said existing wholesalers are used to remitting

the tax on a volume basis for cigarette and tobacco products so they would be familiar with this method of taxation. He said purchases over the Internet and purchases in instances in which there is not an established wholesaler will present administrative challenges for the department.

In response to a question from Chairman Grueneich, Mr. Vosberg said he is not aware of any licensing provisions that apply to vapor product wholesalers or retailers. He said licensing requirements would help the department administer the tax by identifying wholesalers and retailers. He said bills proposed on this topic in the past contained licensing requirements. He said any new laws pertaining to vapor products could reference the licensing, administration, and return filing provisions in the cigarette and tobacco tax laws but the department would prefer the vapor product tax provisions and definitions be placed in a separate section rather than incorporated throughout the cigarette and tobacco tax chapter. He said the department also would request a grace period between the time any new law is enacted and time in which the department would have to implement the new law. He said the grace period would give the department time to register wholesalers and develop reporting forms.

In response to a question from Representative Headland, Mr. Vosberg said a product taxed based on its use makes the tax more difficult to administer.

In response to a question from Senator Cook, Mr. Vosberg said he could work with the Legislative Council staff to prepare a bill draft the committee could review at the next meeting.

Chairman Grueneich said committee members have copies of testimony ([Appendix P](#)) provided in advance from Debbie Swanson, Director, Grand Forks Public Health Department, regarding the committee's study of the taxation of electronic smoking devices. He called for additional comments from interested persons regarding the committee's study.

Ms. Heather Austin, Executive Director, Tobacco Free North Dakota, provided information ([Appendix Q](#)) recommending the state's laws relating to tobacco taxation and regulation be updated to include electronic tobacco products.

In response to a question from Chairman Grueneich, Ms. Austin said her organization would recommend a 28 percent tax on vapor products, similar to the tax imposed on other tobacco products. She said the Centers for Disease Control and Prevention (CDC) indicates a \$1.50 increase is needed before a tax will positively impact consumer health. She said her organization would be open to working with the committee to find an appropriate level of tax that would work for the state while still inducing health benefits. She said her organization did not have a specific recommendation for how tax revenue should be expended but noted the state might be facing future health costs related to the use of vapor products.

In response to a question from Representative Koppelman, Ms. Austin said because the majority of vapor products contain nicotine derived from tobacco, her organization believes these products should be treated like tobacco products to allow the state to license, regulate, and monitor the products. She said her organization would be open to the tax applying to the liquid or the liquid and component parts of the devices.

In response to a question from Representative Headland, Ms. Austin said the CDC has yet to identify a common element among the cases of serious lung injuries tied to vaping. She said her organization believed vapor products were dangerous before lung injuries were reported and believes all tobacco products are dangerous.

Ms. Austin distributed information ([Appendix R](#)) compiled by the Department of Public Instruction showing trends in the use of electronic vapor products by youth. She said 52 percent of students in this state have used an electronic vapor product. She said the number of students who report using vapor products daily has tripled since 2017. She said she hopes the committee can determine which types of vapor products are being sold in the state and find a way to license and tax those products in a manner comparable to the treatment of other tobacco products.

In response to a question from Representative Boschee, Ms. Austin said there is no way to know which retailers are selling vapor products in this state because retailers are not required to be licensed to sell the products. She said it would be easier for police and regulators to monitor compliance if licensing regulations were in place.

In response to a question from Senator Unruh, Ms. Austin said only a miniscule percentage of vapor products contain nicotine not derived from tobacco because nicotine is very expensive to synthesize. She said nicotine is poisonous and her organization views nicotine as a product detrimental to an individual's health.

Mr. Cap O'Rourke, President, Midwest Vapor Coalition and O'Rourke Strategic Consulting, said nearly 500,000 people die each year as a result of tobacco addiction. He said adults overwhelming are choosing vapor products as

an alternative to smoking. He said the majority of the deaths tied to vaping were associated with the use of illegal THC products. He said he shares the committee's concerns regarding youth access to vapor products and would support further measures to reduce youth access. He said it costs about \$60 to purchase a vapor device and the liquid used in the device. He said at this price, adding a few extra dollars of tax is not going to impact youth purchasing the products online. He said the tax will negatively impact adults who use vapor products as an alternative to smoking and will encourage the entry of counterfeit products into the market. He said applying a tax per milliliter of liquid encourages manufacturers to produce highly concentrated nicotine, which can be dangerous. He said he is not opposed to an equitable tax on vapor products but does not think it will serve to alleviate health concerns relating to the products.

Chairman Grueneich requested Mr. Vosberg to work with the Legislative Council staff to prepare a bill draft for the committee to review and discuss.

Representative Headland said the committee might be getting ahead of itself in preparing a bill draft and questioned if the committee should take a vote on whether a bill draft should be prepared on this topic. He said the state should regulate vapor products before it taxes vapor products. He said it is not clear whether vapor products or the THC being used in vapor products are causing negative health impacts. He said he has not heard enough evidence to justify a punitive tax being applied to vapor products. He said the committee should be focusing on the regulatory side of this issue.

Senator Cook said he agrees the issues with vapor products center more around regulation than taxation but it appears the way the product would be regulated is through the imposition of tax, which may or may not be the right approach. He said if there is a better way to regulate these products, the committee should review those options as well. He said the committee needs a bill draft for purposes of review and discussion, regardless of whether the bill draft is recommended for introduction.

Representative Steiner said she also does not think the committee has enough information regarding the long-term health problems associated with nicotine or the causes of lung injuries associated with the use of vapor products to justify taxing vapor products. She said she would prefer the committee limit its recommendations to regulating the products rather than taxing the products.

Representative Koppelman said he is concerned with the state having to assume the role of the FDA in regulating vapor products. He said he does not know if it is a good use of the committee's time to prepare a bill draft aimed at deterring certain behaviors when it is not yet clear which substance or product is causing the harm. He said it already is illegal for those under the age of 18 to purchase these products. He said policy issues such as whether the legal age to purchase these products should be raised to the age of 19 is a discussion for a different day and a different committee.

Representative Ertelt said the committee does not have enough information. He said the only reason he would entertain a bill draft to tax vapor products derived from tobacco is because vapor products are competing with other tobacco products but not being taxed as a tobacco product.

Representative Boschee said he can understand some of the concerns, but the public has a strong track record of taking matters into their own hands in North Dakota. He said the committee is in the position to learn more about the topic and try to produce meaningful legislation. He said in 2017, before lung injuries and deaths were reported in the news, 76 percent of North Dakotans thought electronic cigarettes should be taxed at the same rate at which tobacco is taxed and 57 percent thought the age to purchase electronic cigarettes should be raised to the age of 21. He said if the committee fails to act, the public might initiate action.

Senator Cook said the use of electronic cigarettes, especially by youth, is a serious issue on the minds of many of the state's citizens. He said he understands some of the concerns raised in regard to imposing a tax but it would be foolish for the committee not to proceed to study this topic. He said he hopes the committee can move forward with having a bill draft prepared for the committee to review.

Representative Headland said if the taxation committee is the only interim committee studying electronic cigarettes, he would agree it is important for the committee to review a bill draft. He said he hopes the draft would be something of merit and more than a means to generate tax revenue. He said the committee should try to focus on the real issues associated with vaping, even though committee members might not have as much expertise in areas outside taxation. He said the committee will need to reach out to the State Department of Health and the Department of Human Services for data that might help the committee make informed decisions, including whether the committee makes a recommendation to increase taxes.

Chairman Grueneich said the committee has not completed its work on the study and agreed if the committee did not do its due diligence, the public might proceed to address the issue on its own. He said committee members raised good points and he would like to hear from those more knowledgeable on the topic.

Representative Koppelman said he did not think the study assigned to the committee extended to looking at anything beyond imposing a tax. He questioned whether the chairman of the Legislative Management should be contacted to see if the study should be expanded and assigned to a different interim committee. He said he does not see much interest in raising revenue so the aim of a bill draft would be to manipulate the behavior of adults, which is why he is opposed to moving forward with the study.

Senator Cook requested the Legislative Council staff contact the Superintendent of Public Instruction to see if information could be added to the handout ([Appendix R](#)) distributed by Ms. Austin regarding the manner in which underage individuals are obtaining vapor products.

No further business appearing, Chairman Grueneich adjourned the meeting at 4:05 p.m.

Emily L. Thompson
Code Revisor

ATTACH:18