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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/08/17

SPONSOR Morales LAST UPDATED 3/13/17 HB 231/aSCORC/aSFC/

SHORT TITLE Increase Cigarette & E-Cigarette Taxes SB aSFL#1

ANALYST Iglesias

### REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$ 0.0	\$ 2,699.0	\$ 1,943.0	\$ 2,629.0	\$ 2,576.0	Recurring	General Fund (Cigarette)
\$ 0.0	\$ (566.0)	\$ (586.0)	\$ (607.0)	\$ (628.0)	Recurring	General Fund (TPT)
\$ 0.0	\$ (226.0)	\$ (318.0)	\$ (220.0)	\$ (219.0)	Recurring	Credit Enhancement Account
\$ 0.0	\$ (14.0)	\$ (22.0)	\$ (14.0)	\$ (14.0)	Recurring	UNM Cancer Center
\$ 0.0	\$ (26.0)	\$ (37.0)	\$ (25.0)	\$ (25.0)	Recurring	NM Finance Authority
\$ 0.0	\$ (202.0)	\$ (285.0)	\$ (196.0)	\$ (195.0)	Recurring	NM Finance Auth./UNM Health Sciences
\$ 0.0	\$ (83.0)	\$ (118.0)	\$ (81.0)	\$ (80.0)	Recurring	NM Finance Auth./DOH
\$ 0.0	\$ (9.0)	\$ (15.0)	\$ (9.0)	\$ (9.0)	Recurring	Rural County Cancer Treatment Fund
\$ 0.0	\$ 63,438.0	\$ 62,668.0	\$ 61,740.0	\$ 60,841.0	Recurring	NEW Public School Fund (cigarette)
\$ 0.0	\$ 23,710.0	\$ 25,728.0	\$ 28,054.0	\$ 30,746.0	Recurring	NEW Public School Fund (TPT)
\$ 0.0	\$ 1,907.0	\$ 1,039.0	\$ 1,802.0	\$ 1,729.0	Recurring	Subtotal (General Fund)
\$ 0.0	\$ 87,148.0	\$ 88,396.0	\$ 89,794.0	\$ 91,587.0	Recurring	Subtotal (NEW Public School Fund)
\$ 0.0	\$ 88,721.0	\$ 88,958.0	\$ 91,271.0	\$ 92,993.0	Recurring	TOTAL

Parenthesis ( ) indicate expenditure decreases. \*\* R = recurring; NR = non-recurring

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
\$212.0	\$0.0	\$0.0	\$212.0	Nonrecurring	TRD/General Fund
\$100.0	\$100.0	\$100.0	\$300.0	Recurring	TRD/General Fund

Parenthesis ( ) indicate expenditure decreases. \*\* R = recurring; NR = non-recurring

Partially duplicates HB282; relates to HB8 and SB319.

## SOURCES OF INFORMATION

LFC Files

### Responses Received From

Taxation and Revenue Department (TRD)  
New Mexico Department of Health (DOH)  
New Mexico Finance Authority (NMFA)  
New Mexico Human Services Department (HSD)

## SUMMARY

### Synopsis of SFL Amendment #1

The Senate Floor Amendment to Senate Bill 231 sends the new revenue from the cigarette tax and tobacco products tax to the public school fund for the state equalization guarantee distribution. The losses shown to the other cigarette tax beneficiaries are due to projected decreases in volumes as a result of elasticity.

### Synopsis of SFC Amendment

The Senate Finance Committee (SFC) amendment to Senate Bill 231 sends 86.76 percent of the cigarette tax and 100 percent of the tobacco products tax to the public school fund for the state equalization guarantee distribution. Revenues from the cigarette tax and tobacco products tax will no longer be distributed to the general fund.

### Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee's (SCORC) amendment to this bill corrects a technical issue by inserting the word "not" on page 16, line 8, after the word "does". This item now reads, "...used to consume tobacco but does not include any product that has been approved by the United State food and drug administration..."

### Synopsis of Original Bill

This bill amends the Cigarette Tax Act to increase the excise tax on cigarettes, amends the Tobacco Products Act to include e-cigarettes and other vapor products, and taxes tobacco products at an increased rate. Specifically, the bill:

- Increases the excise tax on packs of 25 cigarettes by \$1.88 and on packs of 20, 10, and 5 cigarettes by \$1.50;
- Increases the tobacco products tax from 25 percent to 76 percent of the product value of the tobacco products;
- Revises the cigarette tax distributions with the intent of new revenues from the tax increase to be distributed to the general fund; and
- Expands the definition of "tobacco product" significantly, to include:
  - A product that is made of or derived from tobacco or nicotine and that is intended for human consumption, whether smoked, heated, chewed, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means;

- An electronic device that delivers nicotine or other substances to the person inhaling from the device;
- A component, part, or accessory of a tobacco product; and,
- A cigar, chewing tobacco, pipe tobacco, snuff, electronic cigarette, electronic cigar, or electronic pipe.

The effective date of this bill is July 1, 2017.

## **FISCAL IMPLICATIONS**

The fiscal impact estimate uses the Consensus Revenue Estimating Group's (GREG) December 2016 forecast of cigarette and tobacco products revenues for FY18-FY21 as a starting point. Based on historical changes in consumer demand after a cigarette tax increase in New Mexico, the estimate assumes the price increases would result in a 3 percent decrease in consumption of cigarettes and a 7 percent decrease in consumption of tobacco products (excluding e-cigarettes). Additionally, the estimate assumes a 12 percent reduction in e-cigarette consumption. Even with the decrease in consumption, the total revenues from the tax increase on cigarettes and tobacco products will increase by 73 percent, and general fund revenues from the two taxes in FY18 and beyond will reach about \$155 million annually. Revenues in the fiscal impact table are rounded to the nearest \$1 thousand.

Based on the continued trend of declines of cigarette consumption seen since FY07, the estimate also incorporates the consensus forecasted declines in cigarette tax revenues for FY18-FY21. While the bill as amended by the Senate Floor amends cigarette tax distributions with the intent of distributing all new revenues to the public school fund and holding other accounts harmless, declines in cigarette consumption due to the tax increase will cause the other cigarette tax beneficiaries to lose money if the bill passes.

Conversely, revenues from tobacco products consumption have continued to grow, and the estimate continues this trend for the forecast period. The effect of incorporating e-cigarettes in the tobacco products tax is estimated using data on U.S. sales for e-cigarettes, adjusted for the New Mexico population, and then adds yearly growth estimates for the U.S. market, which are relatively strong (about 20 percent). When factoring in adjustments for consumer price responses, it is expected that taxing e-cigarettes will add \$7 million to \$12 million in revenues between FY18-FY21.

TRD provided their own analysis of the impact of the tax increase, estimating that total new revenues received would fall between \$85 million and \$98 million in FY18-FY20. TRD's analysis includes stronger growth assumptions for the consumption of e-cigarettes and greater price elasticity in the demand for cigarettes, which makes up the largest difference the LFC and TRD estimates.

In both LFC and TRD estimates, all consumption for cigarettes was assumed to come from packs of 20, which is how the large majority of cigarettes are sold.

The New Mexico Finance Authority (NMFA) issues cigarette tax revenue bonds (as set forth below) and structures those bonds to withstand an annual 3 percent decline in revenue as a result of declined cigarette consumption over time. For the last several years, cigarette tax revenue generation has been volatile, with certain years declining beyond the bond structured decline.

Declines in consumption as a result of the bill are expected to result in about 2 percent to 4.5 percent declines in revenues for NMFA. The following summarizes the outstanding cigarette tax revenue bonds outstanding by distribution:

NMFA

- 2002 UNM Law Library Bonds (\$227 thousand outstanding through maturity in 2017)
- 2006 Behavioral Health Bonds (defeased - with expense expected to be recouped in 2017)

NMFA/UNM Health Sciences Center

- 2008 Redemption and Reimbursement Bonds (~\$2.3 million outstanding through maturity in 2019)
- Series 2016A Cancer Center Bonds (\$26.2 million outstanding through maturity in 2025)

NMFA/Department of Health Facilities

- Series 2008 State Lab Bonds, \$7.8 million outstanding to 2028.
- Series 2008 Southern Rehab Bonds (\$6.8 million outstanding through maturity in 2028)
- Series 2012 Las Vegas Meadows Bonds (\$8.3 million outstanding through maturity in 2037)

NMFA/Rural County Cancer Treatment

- Series 2013 Gila Regional Medical Center Bonds (\$3.1 million outstanding through maturity in 2033)

This bill as amended by the Senate Floor earmarks revenues for the public school fund. LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the Legislature to establish spending priorities.

## SIGNIFICANT ISSUES

Currently, New Mexico imposes an excise tax for each cigarette sold, given or consumed at the rates below, through section 7-12-3 NMSA 1978 of the Cigarette Tax Act:

- \$.083 if the cigarettes are packaged in lots of twenty or twenty-five (\$1.66 and \$2.08 per pack, respectively);
- \$.166 if the cigarettes are packaged in lots of ten (\$1.66 per pack); or
- \$.332 if the cigarettes are packaged in lots of five (\$1.66 per pack).

This bill raises the per pack tax of cigarettes to \$3.95 for lots of twenty-five and to \$3.16 for lots of 20, 15 and 10 cigarettes; and it raises the tax on the product value of tobacco products to 76 percent. The increased tax results in a 20 percent price increase on cigarettes, a 41 percent price increase on tobacco products (excluding e-cigarettes), and a 76 percent price increase on e-cigarettes. TRD indicates increasing cigarette stamp taxes may further promote internet sales and use of counterfeit stamps.

By expanding the definition of tobacco products, the intent of this bill is to create tax equity across all types of tobacco products. While the estimated fiscal impact only considers consumers' direct price responses (e.g. reducing consumption based price increases), it does not consider the potential for consumers to seek out lower-taxed cigarettes and tobacco products

(e.g. purchases on tribal lands or online). If taxable volumes of cigarette and tobacco products decrease by an additional 5-10 percent as a result of such lower-price-seeking behavior, then total new revenues could be reduced by \$9 million to \$19 million.

A report published by the Tax Foundation, a non-partisan tax policy research organization, states New Mexico currently ranks 3rd in the nation for inbound cigarette smuggling activity, with an estimated 46.2 percent of cigarettes consumed in the state derived from smuggled sources in 2014.<sup>1</sup> Raising tax rates substantially higher than surrounding areas may exacerbate the issue. The proposed tax rate of \$3.16 per pack of 20 cigarettes would exceed the tax rate of surrounding states and would make New Mexico cigarette taxes 6th in the nation (see appendix). Inclusion of e-cigarettes in the tobacco products tax would make New Mexico an outlier among surrounding states, although Arizona has proposed similar legislation to impose an excise tax on e-cigarettes.

NMFA expresses concern that the changes in consumption and revenues as a result of this bill “could impair outstanding NMFA cigarette tax revenue bonds in violation of several New Mexico statutory provisions, as well as Article I, Section 10 of the United States Constitution and Article II, Section 10 of the New Mexico Constitution, if revenue estimates fall short of expectations and fail to meet projections.”

NMFA adds:

*“The concept in [this bill], specifically, the decrease in the cigarette tax distribution accompanied by an increase in cigarette tax rates and the inclusion of e-cigarette products, raises issues related to whether the legislation would be held by a court to be a violation of the non-impairment statutory provisions in the NMFA Act, the Tax Administration Act or the prohibition in the United States and State Constitution of the impairment of obligations under existing contracts, or each of them, thus giving rise to potential bondholder litigation claims. The existence of those legal issues would have a substantial impact on the NMFA’s bond rating, and ability to issue the NMFA’s PPRF Bonds in the form of higher interest rates due to a market perception that the New Mexico Legislature has impaired NMFA’s obligations to its bond holders.”*

This bill does not distribute tax revenue to support enforcement of the Synar amendment and oversight activities, which at present are sustained by state general funds. The Behavioral Health Division within the New Mexico Human Services Department (HSD) is the state entity that oversees compliance with the Synar amendment, as part of federal block grant requirements. The Synar amendment is aimed at decreasing youth access to tobacco and requires that states enact and enforce laws prohibiting any manufacturer, retailer, or distributor of tobacco products from selling or distributing such products to any individual younger than age 18.

## ADMINISTRATIVE IMPLICATIONS

TRD states the bill will have a high impact on the Information Technology Division, requiring the efforts of both state and FAST resources and requiring over 6 months to implement.

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<sup>1</sup> Tax Foundation, *Cigarette Taxes and Cigarette Smuggling by State, 2014*, <https://taxfoundation.org/cigarette-taxes-and-cigarette-smuggling-state-2014/>. According to this report, New York and Arizona rank 1st and 2nd in cigarette smuggling activity, respectively, and New Mexico ranks 3rd.

Therefore, TRD states the effective date of July 1, 2017 is not feasible, and instead recommends the effective date to be July 1, 2018.

TRD also states the bill will have a moderate impact on the Audit and Compliance Division, requiring two new full time employees to increase compliance efforts. Additionally, TRD states this bill has a moderate impact to the Revenue Processing Division, such that implementing the changes by the effective date will be difficult.

## **TECHNICAL ISSUES**

TRD notes that the definition of e-cigarettes in Section 7(C), page 14 of the bill is very broad: "...any electronic oral device that can be used to provide a vapor or aerosol of nicotine or any other substance to the person inhaling from the device..." The connector "or" makes any electronic oral device that can be used to provide a vapor or aerosol of any substance an e-cigarette. In short, the definition would include devices that do not deliver nicotine. If that is not the intent, then TRD suggests amending the bill to remove the phrase after the "or".

## **DUPLICATION and RELATIONSHIP**

This bill partially duplicates House Bill 282.

House Bill 8 proposes that NMFA's current 1.25% distribution of cigarette tax revenue be directed to the State General Fund.

Senate Bill 319 would increase the minimum age to buy tobacco products from 18 to 21. Both this bill and SB319 are intended to reduce tobacco use.

## **OTHER SUBSTANTIVE ISSUES**

The New Mexico Department of Health (DOH) states this bill is related to the NM DOH 2017-2019 Strategic Health Plan's initiative to improve the health status for New Mexicans by decreasing the percent of adults who smoke and percent of adolescents who smoke.

DOH states that significantly higher hookah use is seen among youth who earn mostly D's and F's (29 percent) and lesbian, gay, or bisexual youth (25 percent), compared to the general youth population (11 percent). E-cigarette use is also especially high among youth earning D's and F's (43 percent) and lesbian, gay, or bisexual youth (36 percent), compared to the general youth population (24 percent).

HSD notes cigarette use among New Mexico high school youth declined to a historic low of 11.4 percent in 2015. Declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes and hookah. In 2015, 24 percent of NM high school youth used e-cigarettes and 11.4 percent used hookah. Altogether, one-third of NM youth still use at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes), and about half of youth tobacco users use more than one tobacco product. Factors that may be influencing these trends in youth tobacco product use include pricing differences among tobacco products (i.e., higher

taxes on cigarettes compared to other tobacco products), availability of products in flavors that appeal to youth, and increased marketing of e-cigarettes.<sup>2</sup>

Among adults in the state, DOH notes cigarette smoking remains disproportionately high among African Americans (24 percent), lesbian, gay, and bisexual people (29 percent), and people experiencing poverty (25 percent), compared to 17.5 percent of all adults (2015 Behavioral Risk Factor Surveillance System).<sup>3</sup> Groups at increased risk for e-cigarette use include cigarette smokers (18 percent) and young adults ages 18-29 (12 percent), compared to only 5 percent of all adults. There are also higher rates of spit tobacco use among men (8 percent) and American Indians (8 percent) than the general population (4 percent). Hookah use among adults is concentrated among young adults, 18-29 year olds (9 percent).

According to the 2014 Surgeon General’s Report on The Health Consequences of Smoking, there is evidence to conclude “increases in the prices of tobacco products, including those resulting from excise tax increases, prevent initiation of tobacco use, promote cessation, and reduce the prevalence and intensity of tobacco use among youth and adults.”<sup>4</sup>

According to the U.S. Food and Drug Administration (FDA), e-cigarettes have not been fully studied, so consumers currently do not know the potential risks when used as intended, how much nicotine or other potential harmful chemicals are being inhaled during use, and whether there are any benefits associated with using these products. The FDA adds it is unknown whether e-cigarettes may lead young people to try other tobacco products, including conventional cigarettes, which are known to cause disease and lead to premature death.

A 2016 Tax Foundation report titled *Vapor Products and Tax Policy*, states “vapor products are generally found to have a much lower risk profile than traditional incinerated cigarettes” and “punitive taxes on vapor products could inadvertently close out options for cigarette users looking to quit.” This report notes that the Public Health England, a subset of the British Department of Health, “issued findings that vapor products are 95 percent less harmful than cigarettes and can serve as an effective tobacco-cessation method.”<sup>5</sup> Lawmakers who wish to tax vapor products while encouraging the use of these products as means of quitting traditional cigarette smoking may consider taxing vapor products at a lower rate.

HSD states this bill aligns with the research and recommendations of the Tobacco Control Legal Consortium regarding the regulation of e-cigarettes and similar devices.<sup>6</sup>

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

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<sup>2</sup> *Youth Risk & Resiliency Survey*. Available at <http://youthrisk.org/>

<sup>3</sup> <https://www.cdc.gov/brfss/index.html>

<sup>4</sup> [www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf](http://www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf)

<sup>5</sup> <https://taxfoundation.org/vapor-products-and-tax-policy/>

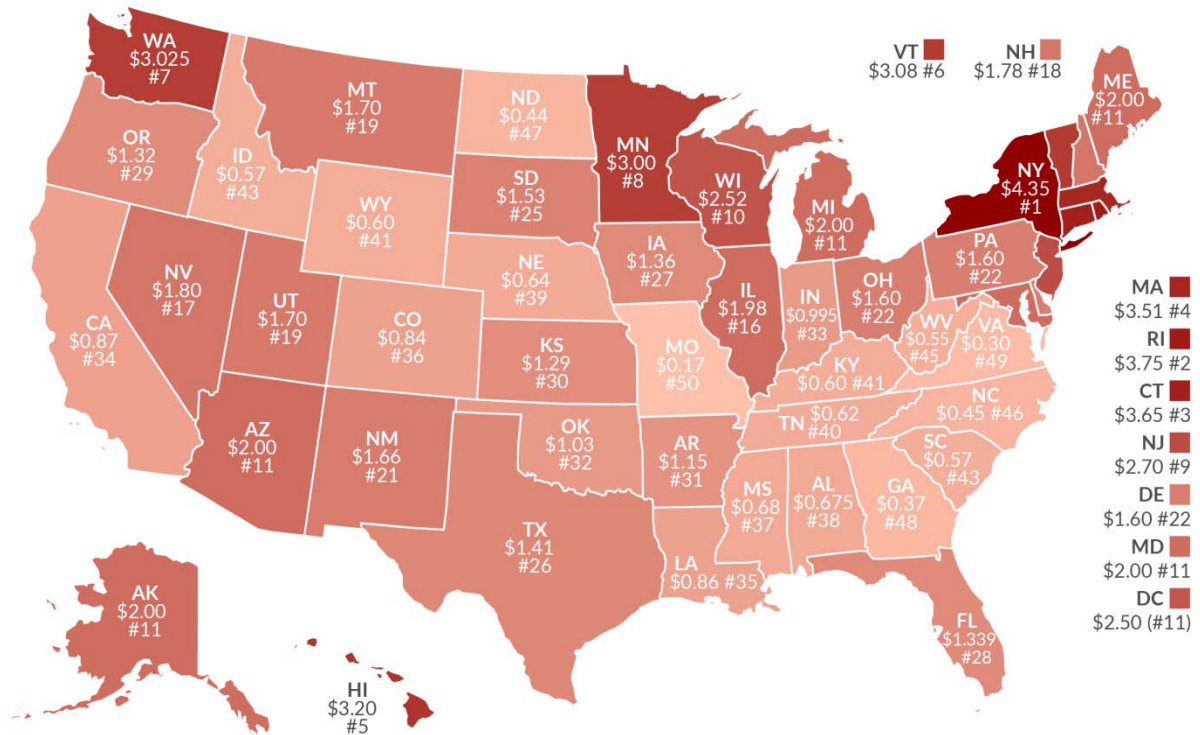
<sup>6</sup> [publichealthlawcenter.org/sites/default/files/resources/tclc-guide-reg-ecigarettes-2014.pdf](http://publichealthlawcenter.org/sites/default/files/resources/tclc-guide-reg-ecigarettes-2014.pdf)

APPENDIX

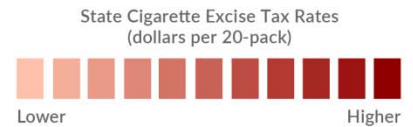
The following pages include a comparison of cigarette and vapor products taxes in other states.

### How High Are Cigarette Taxes in Your State?

State Cigarette Excise Tax Rates as of Jan. 1, 2016 (dollars per 20-pack)



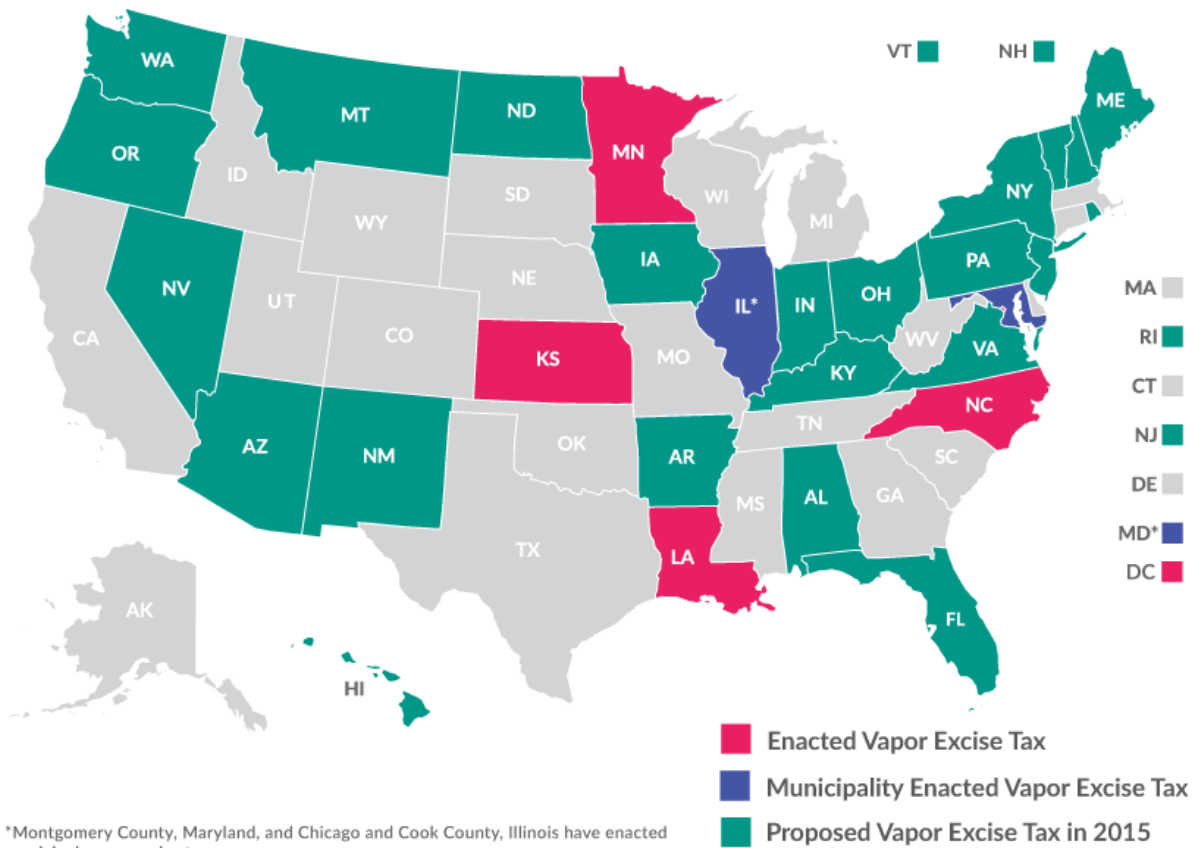
Note: Local taxes are not included and can be substantial. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.  
 Source: Tax Foundation; RJ Reynolds; state revenue departments.



SB231 proposed tax rate per 20-pack: \$3.16



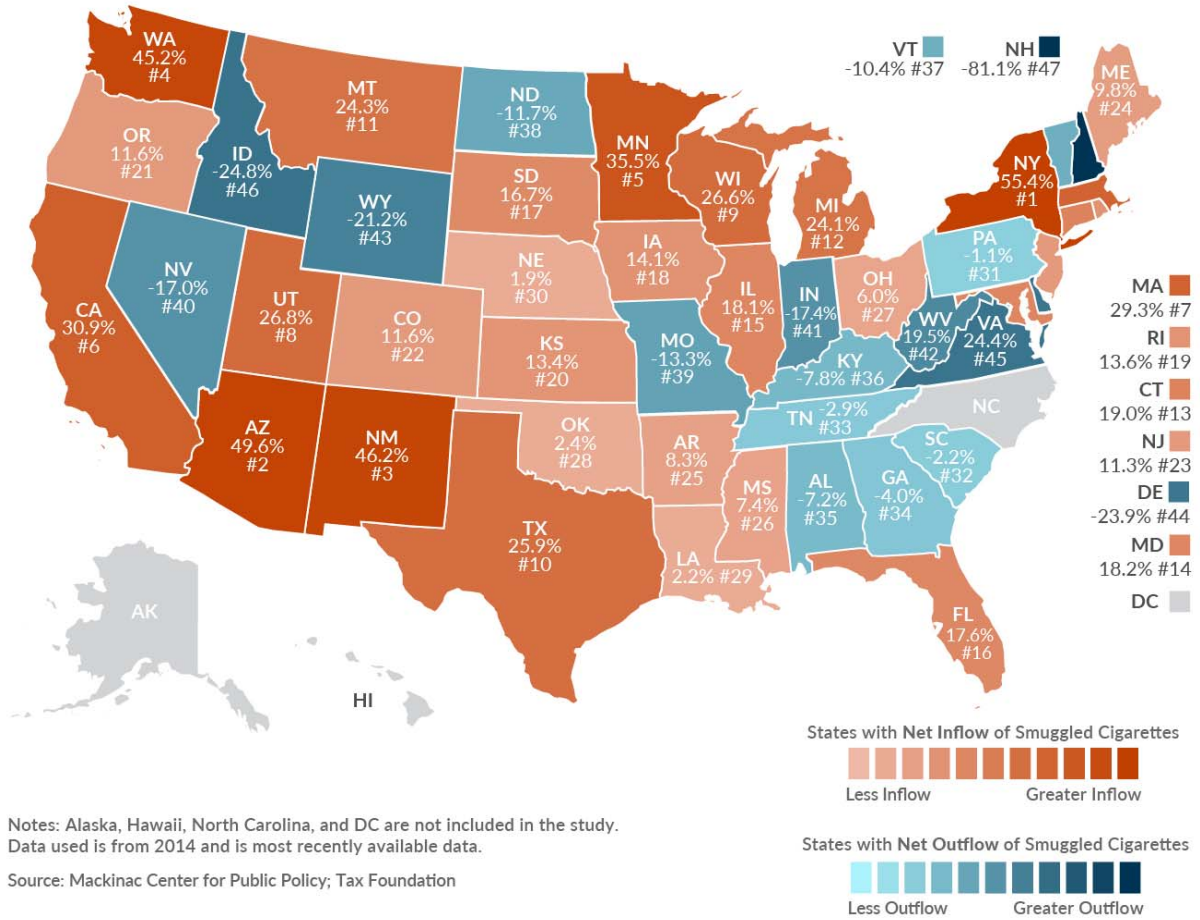
## Enacted and Proposed Vapor Excise Taxes as of January 1, 2016



SB231 proposed tax rate: 76% of product value

# Cigarette Smuggling by State

Smuggled cigarettes consumed as a percentage of total cigarettes consumed, 2014



Notes: Alaska, Hawaii, North Carolina, and DC are not included in the study. Data used is from 2014 and is most recently available data.

Source: Mackinac Center for Public Policy; Tax Foundation