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## FISCAL IMPACT REPORT

SPONSOR Romero, A./ Thompson ORIGINAL DATE 1/31/19 LAST UPDATED 2/13/19 HB 261

SHORT TITLE Increase Cigarette Taxes SB \_\_\_\_\_

ANALYST Iglesias

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0.0	(\$4,884.0)	(\$4,693.0)	(\$4,487.0)	(\$4,274.0)	Recurring	General Fund (Cig)
\$0.0	\$2,607.0	\$2,618.0	\$2,867.0	\$3,159.0	Recurring	General Fund (TPT)
\$0.0	(\$650.0)	(\$625.0)	(\$597.0)	(\$569.0)	Recurring	Credit Enhancement Account
\$0.0	(\$43.0)	(\$41.0)	(\$39.0)	(\$38.0)	Recurring	UNM Cancer Center
\$0.0	(\$582.0)	(\$560.0)	(\$535.0)	(\$510.0)	Recurring	NM Finance Auth./UNM Health Sciences
\$0.0	(\$24.0)	(\$23.0)	(\$22.0)	(\$21.0)	Recurring	Rural County Cancer Treatment
\$0.0	(\$235.0)	(\$226.0)	(\$216.0)	(\$206.0)	Recurring	Department of Health Facilities
\$0.0	\$57,569.0	\$55,321.0	\$52,889.0	\$50,381.0	Recurring	NEW Public School Fund/SEG (Cig)
\$0.0	\$17,970.0	\$18,553.0	\$19,519.0	\$20,549.0	Recurring	NEW Public School Fund/SEG (TPT)
\$0.0	(\$2,927.0)	(\$2,700.0)	(\$2,217.0)	(\$1,684.0)	Recurring	Subtotal (General Fund)
\$0.0	\$75,539.0	\$73,874.0	\$72,408.0	\$70,930.0	Recurring	Subtotal (NEW Public School Fund/SEG)
<b>\$0.0</b>	<b>\$71,728.0</b>	<b>\$70,324.0</b>	<b>\$69,379.0</b>	<b>\$68,471.0</b>	<b>Recurring</b>	<b>TOTAL</b>

Parenthesis ( ) indicate revenue decreases

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

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>	\$70.0	\$100.0	\$0.0	\$170.0	Nonrecurring	TRD

Parenthesis ( ) indicate expenditure decreases

## House Bill 261 – Page 2

Conflicts with SB166

Duplicates SB72

Relates to HB256, HB259, HB260, SB338, SB342, SB343, and SB450

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

New Mexico Finance Authority (NMFA)

Human Services Department (HSD)

Department of Health (DOH)

### SUMMARY

#### Synopsis of Bill

House Bill 261 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, and proportionally increases the tax rates under the definition for a “qualifying tribal cigarette tax”;
- 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 public school fund for the state equalization guarantee (SEG); 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, 2019.

### FISCAL IMPLICATIONS

The fiscal impact table represents LFC staff analysis using the December 2018 consensus revenue forecast for revenue from cigarettes and tobacco products as a starting point. The estimates assume price increases will have an inverse effect on consumption (higher prices will reduce consumption) of cigarettes, tobacco products, and e-cigarettes. These estimates assume all

consumption for cigarettes come from packs of 20, which is how the large majority of cigarettes are sold. New revenues from the tax increases are expected to total about \$70 million annually.<sup>1</sup> 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 FY20-FY23. While it appears the bill intends to distribute all new revenues to the public school fund, the estimated additional declines in cigarette consumption due to this bill result in some negative impacts to other beneficiaries of the cigarette tax (see *Significant Issues* section).

Unlike cigarette consumption, revenues from tobacco products consumption have continued to grow, and the estimate continues this trend for the forecast period. LFC staff, in consultation with the Department of Finance and Administration economists, estimated the effect of incorporating e-cigarettes in the tobacco products tax using sales and tax revenue data from other states that have implemented a vaping products tax, adjusted for the New Mexico population. When factoring in adjustments for consumer price responses, it is expected that taxing e-cigarettes will add \$5.5 million to \$7 million in revenues between FY20-FY23.

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 \$10 million to \$20 million.

Additionally, the estimate does not consider potential impacts of tax increases on tobacco product and e-cigarette businesses (e.g. cigar shops, "vape shops", etc.). To the extent that tax increases causes businesses to contract or close, new revenues could be lower than estimated. For example, industry data shows about one-fourth of Pennsylvania's vape shops closed following the 2016 passage of a 40 percent wholesale excise tax on vaping products (about 100 of the state's 400 vaping businesses).

## **SIGNIFICANT ISSUES**

This bill generates about \$75 million in revenue for the public school fund and will accordingly increase the unit value and therefore the SEG amounts that are allocated to school districts and charter schools.

This bill attempts to hold the various beneficiary fund distributions neutral by having the increases in cigarette tax rate and inclusion of electronic smoking devices in the tobacco products definition offset the decreases to the percentage of benefitting cigarette tax revenue distributions. However, the current estimates reflect a negative fiscal impact to these beneficiaries; therefore, adjustments to the distribution percentages could be considered to mitigate the estimated negative impact.

Electronic nicotine delivery systems, also known as electronic cigarettes or e-cigarettes, are a relatively new product in the U.S. market. Data regarding health effects and tax revenues are

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<sup>1</sup> The analysis provided by the Taxation and Revenue Department (TRD) assumes the cigarette tax increase will result in smaller declines in consumption than the LFC analysis. Combined with differing assumptions for revenues from e-cigarettes, this results in TRD's estimate being about \$14 million higher than the LFC estimate.

currently limited. Some consumers use e-cigarettes as a means to reduce use of or to quit smoking combustible cigarettes. Many experts contend that e-cigarette vapor is less harmful than cigarette smoke since it does not contain most of the cancer causing byproducts; however, research is extremely limited on the long-term effects of the chemicals in e-liquids.

States have only recently begun taxing e-cigarette products (see Appendix B). The tax has been applied as either a percentage of the wholesale price or as a fixed tax per milliliter of nicotine product (cent/ml of e-liquid). A wholesale tax strategy has been adopted by California, Minnesota, and Pennsylvania. A fixed tax per milliliter (cent/ml) has been adopted by Delaware, Kansas, Louisiana, New Jersey, North Carolina, and West Virginia.

The difficulty when it comes to e-cigarette taxation is establishing the most effective tax rate. The major problem with analyzing e-cigarette tax rates is that there is not a clean conversion between traditional cigarettes and e-liquid. This makes it challenging to evaluate the price point at which traditional tobacco cigarettes become the more cost effective option for nicotine consumers, potentially causing many e-cigarette users to switch or revert to traditional tobacco cigarettes. Ideally, the tax on e-cigarette products would be high enough to limit overall usage, especially for younger users that as a group are largely very sensitive to price, but not high enough to make e-cigarettes cost prohibitive. Given that e-cigarettes may be less harmful and help some cigarette users quit smoking, an e-cigarette tax rate that is too high could be counterproductive to public health objectives.

The New Mexico Finance Authority (NMFA) issues cigarette tax revenue bonds and structures those bonds to withstand an annual 3 percent decline in revenue as a result of declined cigarette consumption over time. The current fiscal estimates reflect about a 5 percent to 8 percent decline in revenue. NMFA states that, if revenue estimates fall short of expectations and fail to meet projections, the changes contemplated in 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.

## **ADMINISTRATIVE IMPLICATIONS**

TRD estimates this bill to have a high impact on the Information Technology Division, requiring over 6 months to implement. TRD also states the effective date of July 1, 2019 is not feasible and instead recommends an effective date of July 1, 2020.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Senate Bill 166 also seeks to amend the cigarette tax rates and include e-cigarettes in the tobacco products tax. Senate Bill 72 is a duplicate of this bill. House Bill 256 and Senate Bill 338 add e-cigarettes and their vapors to the Dee Johnson Clean Indoor Air Act. House Bill 259 and Senate Bill 342 seek to ban certain tobacco product sales to persons under 21 years of age. House Bill 260 and Senate Bill 343 seek to ban the sale, purchase, or provision of free samples of flavored tobacco products, including e-cigarettes and e-liquids. Senate Bill 450 creates the E-Cigarette and Nicotine Liquid Act, but does not impose a tax on e-cigarettes or e-liquids.

## TECHNICAL ISSUES

The definition of e-cigarettes in Section 5(c) of the bill could inadvertently capture electronic aerosol asthma inhalers and other devices that do not deliver nicotine.

## OTHER SUBSTANTIVE ISSUES

Current cigarette use among New Mexico (NM) high school youth declined to a historic low of 10.6 percent in 2017.<sup>2</sup> However, the Department of Health (DOH) notes declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes. In 2017, 24.7 percent of NM high school youth used e-cigarettes. Altogether, one-third of NM youth still use at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes). 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) and increased marketing of e-cigarettes.

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>3</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.

This bill exempts from the tobacco products tax “any product that has been approved by the United States food and drug administration (FDA) for sale as a tobacco cessation product or for other therapeutic purposes where such product is marketed and sold solely for such an approved use.” If vapor products were to become officially approved by the FDA as a tobacco cessation product, then they would not be subject to the excise tax.

### **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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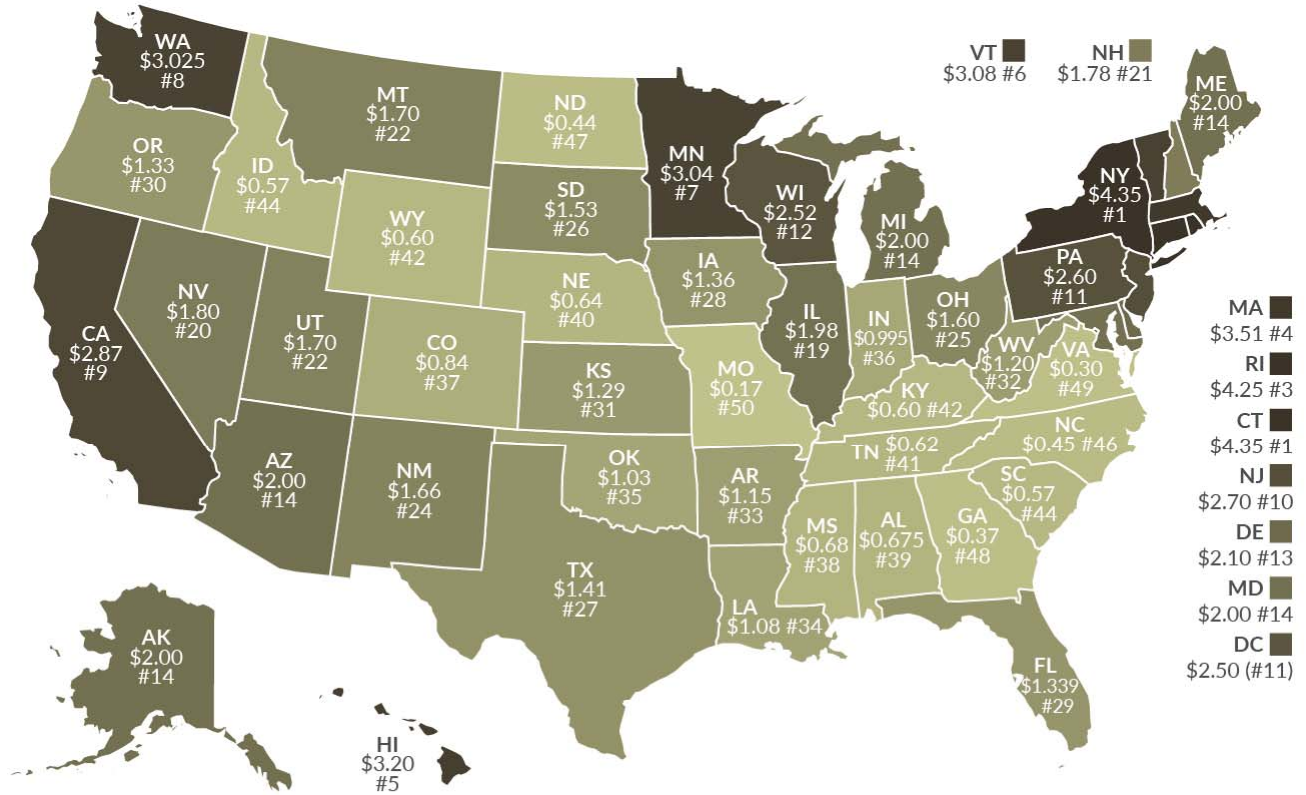
<sup>2</sup> <http://youthrisk.org/tables/#/2017>

<sup>3</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)

APPENDIX A

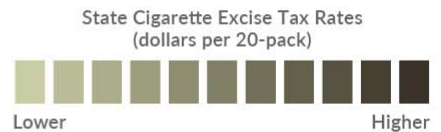
# How High Are Cigarette Taxes in Your State?

State Cigarette Excise Tax Rates, 2018 (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.

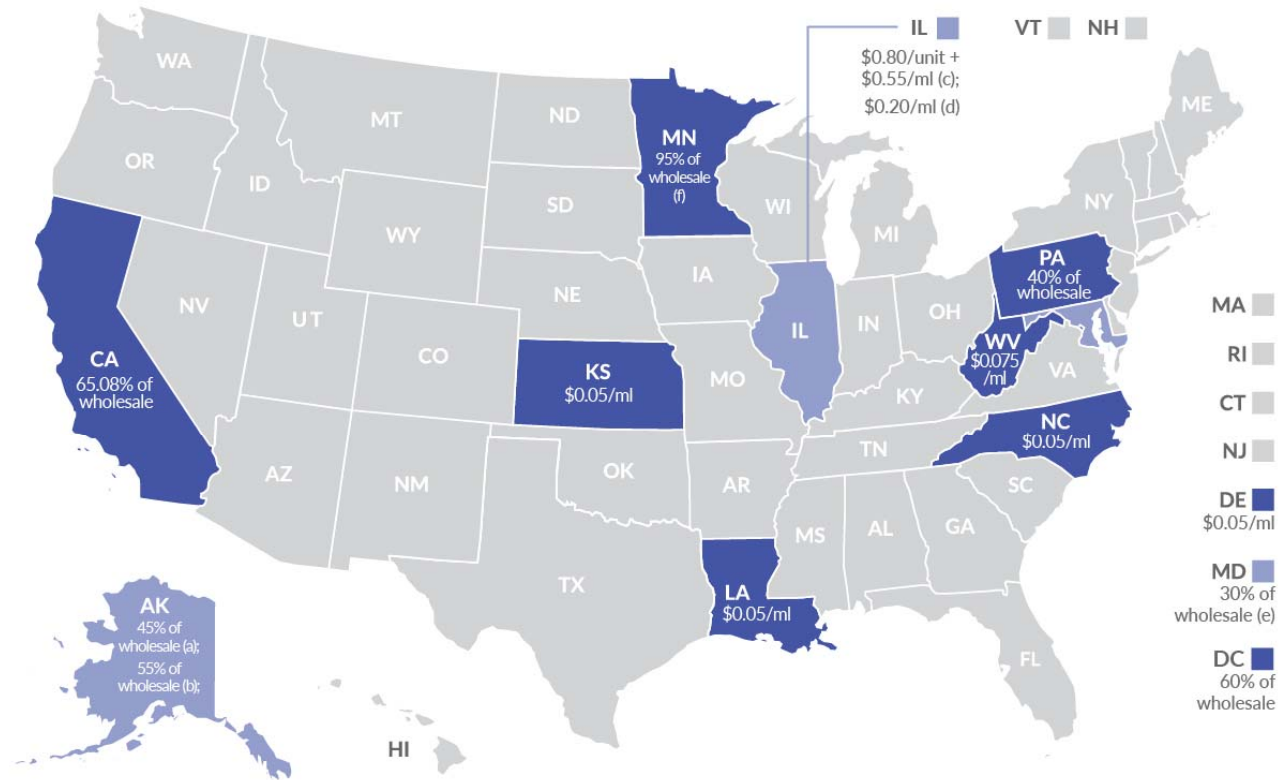
Source: Bloomberg BNA; state statutes.



APPENDIX B

# How High Are Vapor Excise Taxes in Your State?

State & Local Vapor Excise Tax Rates, as of January 1, 2018



Note: (a) Tax is only applicable in Juneau, NW Arctic Borough, and Petersburg. (b) Tax is only applicable in Mat-Su Valley. (c) Tax is only applicable in the city of Chicago. (d) Tax is only applicable in Cook County. (e) Tax is only applicable in Montgomery County. (f) Tax is on the wholesale cost of any product containing or derived from tobacco. The tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax is levied only on the value of the nicotine cartridge.

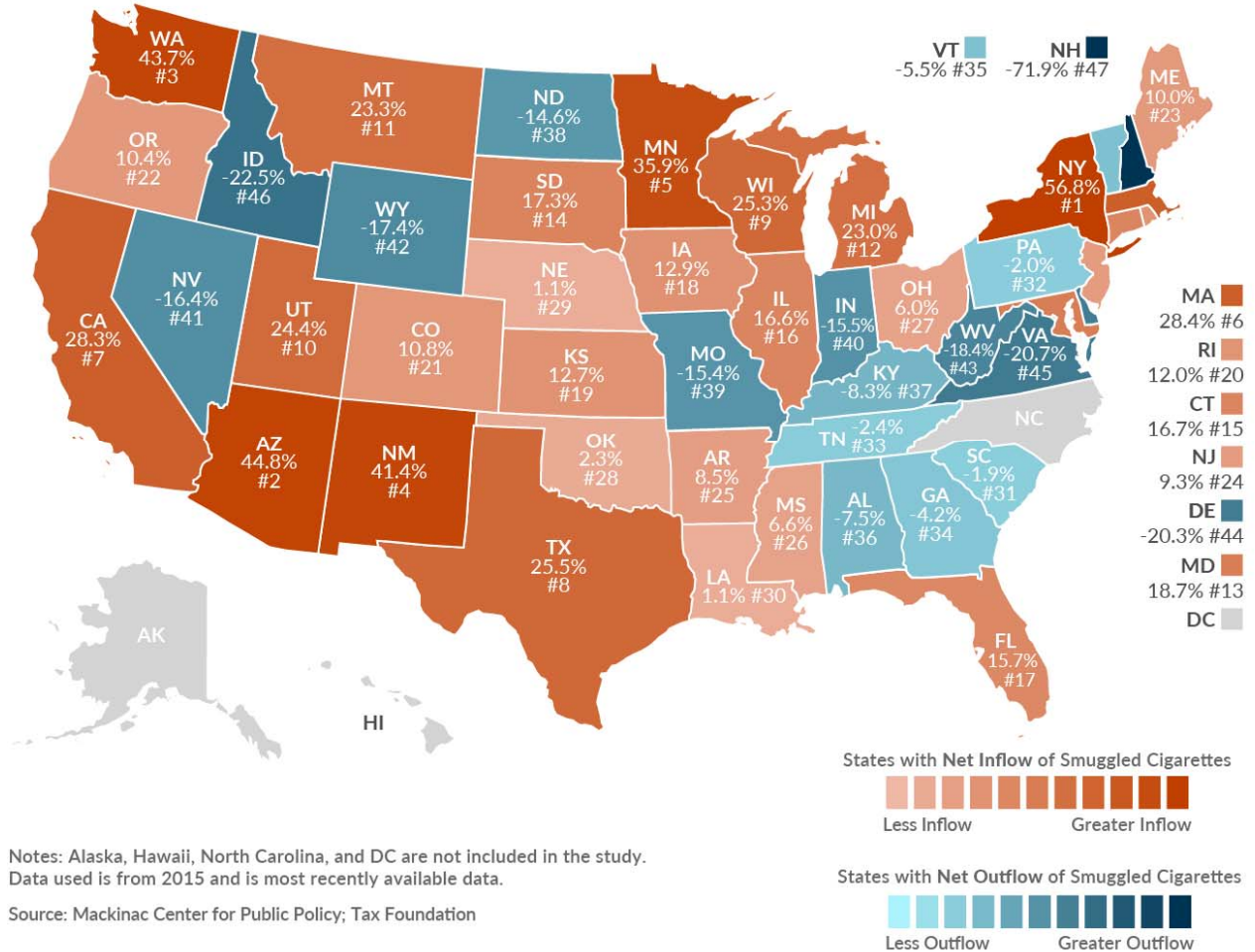
Source: State statutes; Bloomberg BNA.

- Statewide Vapor Excise Tax
- Municipal Vapor Excise Tax

APPENDIX C

Cigarette Smuggling by State

Smuggled Cigarettes Consumed As a Percentage of Total Cigarettes Consumed, 2015



Tax Foundation, Cigarette Taxes and Cigarette Smuggling by State, 2014, <https://taxfoundation.org/cigarettetaxes-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. This report includes both legal and illegal sales in their definition of smuggling, with “casual smuggling” identified as military and tribal sales.