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FISCAL IMPACT REPORT

ORIGINAL DATE 2/18/09

SPONSOR Gonzales LAST UPDATED _____ HB 742

SHORT TITLE Cigarette Tax Rate and Distribution SB _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	\$33,231.0	\$32,951.6	Recurring	General Fund
	\$46.8	\$64.2	Recurring	Co. & Muni Recreation Fund
	\$90.6	\$125.3	Recurring	Co. & Muni Cigarette Fund
	\$46.8	\$64.2	Recurring	UNM Cancer Fund
	\$68.7	\$94.8	Recurring	NMFA
	\$473.3	\$658.6	Recurring	NMFA/UNM HSC
	\$203.1	\$281.2	Recurring	NMFA/DOH
	\$35.6	\$48.5	Recurring	Rural County Cancer Treatment

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Department of Health (DOH)

No Response Received From

New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

House Bill 742 increases the excise tax rates on cigarettes and other tobacco products and adjusts the distributions to the beneficiaries so that the revenue from the increase goes to the general fund.

New Distributions under HB742

	Current Law	HB742
County/Municipal Recreational Fund	1.35%	0.93%
County/Municipal Cigarette Tax Fund	2.69%	1.85%
UNM HSC	1.35%	0.93%
NMFA	2.20%	1.39%
NMFA/HSC	14.37%	9.87%
NMFA/DOH	6.50%	4.16%
NMFA/CEA (general fund)	15.79%	10.85%
NMFA/rural county cancer treatment	1.00%	0.69%
General Fund	54.75%	69.33%

Changes to Excise Taxes and Vendor Discounts

<i>Changes tax rate on cigarettes</i>	Current Law	HB742
Cigarette	\$ 0.0455	\$ 0.0955
Pack of 20	\$ 0.9100	\$ 1.9100
Cigarette in packs of five	\$ 0.1820	\$ 0.3820
Pack of 5	\$ 0.9100	\$ 1.9100
 <i>Changes tax rate on other tobacco products</i>	 Current Law	 HB742
Tobacco products tax	25%	40%
 <i>Changes the discounts for stamps</i>	 Current Law	 HB742
Less than \$30,000 of stamps	1.00%	0.50%
\$30,000 to 60,000	0.80%	0.40%
\$60,000 or more	0.50%	0.25%

According to TRD, the bill decreases the discount granted to distributors who affix tax stamps on cigarette packages by 50% to offset the approximate doubling of the tax, leaving the value of the discount to cigarette distributors approximately unchanged.

The effective date is July 1, 2009, but distributions will apply to revenue earned on the modified accrual basis after June 30, 2009.

FISCAL IMPLICATIONS

TRD assumed that revenue generated from an increased tax rate would be partially offset by a decline in demand for cigarettes in general and *taxable* cigarettes in particular. The fiscal impact also includes a one time increase in the cigarette inventory tax which is included in the general fund amount. The percentage distributions are adjusted so that the beneficiaries other than the general fund are not impacted by the increase.

TRD:

The “Cigarette Inventory Tax” (Section 7-12-3.1 NMSA 1978) is distinctly separate from the “Cigarette Tax” and is distributed entirely to the State General Fund. The estimate has assumed that approximately one-half of the first month of additional revenue may be collected as inventory tax, and that retailer purchases in the first month will be weaker than normal after stocking to capacity in June to beat the tax increase. Thus, some strength in FY2009 June revenue may be expected, but that impact has not been included in the estimated revenue.

State General Fund (direct distribution) includes \$29,457.3 thousand from cigarette tax and \$2,766.6 thousand from Tobacco Products Tax in FY2011 (the FY2010 impact is slightly different due to the Cigarette Inventory Tax). Subsequent years are similar, with some growth expected in Tobacco Products Tax revenue and no growth in Cigarette Tax revenue.

Revenue to the NMFA Credit Enhancement Account is ultimately forwarded to the State General Fund. The total General Fund impact with inclusion of the NMFA Credit Enhancement Account is shown as “General Fund (combined)”.

Revenue to other recipient funds from the Cigarette Tax represents an intention to hold harmless those funds from the expected consumption declines associated with the 62 cent federal tax increase (effective March 31, 2009). The 62 cent federal tax increase is expected to lead to a decline in cigarette consumption of about 8%. The revenue gains to these funds are designed to offset the potential losses to these funds as a result of the federal tax increase.

SIGNIFICANT ISSUES

The increase in the cigarette excise tax will be in addition to the recently signed federal tax increase of \$0.62 per pack that was part of the State Childrens Health Insurance Program (SCHIP) reauthorization. The increase in the state tax would move New Mexico from 29th highest excise tax to 15th. Colorado has an 84 cent tax, Arizona taxes at \$2.00, Utah taxes at \$0.695, and Texas taxes \$1.41 per pack.

DOH:

Raising cigarette taxes is widely regarded as one of the most effective tobacco prevention strategies, with such increases leading to “substantial long-run improvements in health”

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc

(Reducing Tobacco Use, Surgeon General, 2000). Increasing the state cigarette excise tax and tobacco products tax would result in an increase in revenue for the state General Fund and an anticipated decrease in tobacco consumption by youth and adults. Every state that has significantly increased its cigarette tax has seen substantial increases in revenue, even as rates of smoking are decreased. The substantially higher revenue levels experienced by those states that significantly increase their cigarette tax rates persist over time, while the cost savings from the related smoking declines grow rapidly (<http://www.tobaccofreekids.org/research/factsheets/pdf/0098.pdf>).

A dollar-per-pack cigarette excise tax increase would have its greatest public health effect by discouraging people from ever starting to smoke. Numerous economic studies in peer-reviewed journals have documented that cigarette tax or price increases reduce both adult and underage smoking. However, youth are more sensitive to the price of tobacco than adults. A 10% increase in the price of tobacco products will result in a median 6.5% decrease in youth cigarette demand (The Guide to Community Preventive Services, 2001). This is a conservative estimate; some studies report up to a 15% decrease in youth cigarette demand (Reducing Tobacco Use, Surgeon General, 2000).

It is important to place comparable taxes on cigarettes and as well as “other tobacco products” to prevent users from simply substituting one form of tobacco addiction for another one (Guidelines for Controlling & Monitoring the Tobacco Epidemic, 1998). The tax increase proposed in HB742 from 25% to 40% of product value represents an important step in taxing other tobacco products comparably to cigarettes.

Because of the 62-cent federal cigarette tax increase approved on February 4, 2009, the total revenue generated should be larger despite an anticipated drop in consumption and the change in distributions of the Cigarette Tax Act proposed by HB742.

Recently, the Campaign for Tobacco-free Kids commissioned Research & Polling Inc. to conduct a survey of attitudes in NM about increasing the cigarette tax. The results showed that there is significant support, even among smokers, for an increase in the excise tax.

ADMINISTRATIVE IMPLICATIONS

TRD reports some administrative impact as a result of the proposed changes:

Increasingly stringent oversight of tax-exempt cigarette stamps may be appropriate. Revisions to forms, instructions and publications related to the Cigarette Tax Act and the Tobacco Products Tax Act would require approximately 80 person-hours of tax administrator work. Additional printing and postage costs would be relatively minor. An additional 200 hours of computer systems work would be required to implement the Cigarette Inventory Tax.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB243 and HB70 require cigarettes to be made more safely. HB287 makes changes to enforce the tobacco master settlement agreement. HB298/a requires unexpended funds to revert to the tobacco settlement program fund.

OTHER SUBSTANTIVE ISSUES

TRD:

- State *taxable* cigarette consumption is expected to decline by about 25% as a result of the \$1.00 per pack state tax increase, however, much of that consumption will likely be shifted to Tribal tax-exempt sales. Currently, *taxable* cigarette volume accounts for about 64% of cigarette consumption, and “tax-exempt” stamps account for about 34% of cigarette consumption.
- The current federal cigarette tax rate of 39 cents per pack will increase to \$1.01 effective March 31, 2009. Cigarette consumption is expected to decline by about 8% as a result of that 62 cent per pack federal tax increase. The federal tax increase should affect both state taxable cigarettes and Tribal tax-exempt sales.
- Revenue to other recipient funds from the Cigarette Tax represents an intention to hold harmless those funds from the expected consumption declines associated with the 62 cent federal tax increase (effective March 31, 2009). This should serve to protect those current revenue streams that may be dedicated to debt service or other budgetary uses that may be awkward to scale down.
- The Cigarette Inventory Tax applies to cigarette distributors, but not to cigarettes held by retailers. Some extraordinary stocking-up by retailers to beat the tax increase would be expected, however, storage capacities and shelf-life limitations would limit such activity.

NF/mt