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FISCAL IMPACT REPORT

SPONSOR Thomson/Armstrong, **ORIGINAL DATE** 2/4/17
 D **LAST UPDATED** 2/9/17 **HB** 282

SHORT TITLE Increase Cigarette & E-Cigarette Taxes **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$ 0.0	\$ 66,137.3	\$ 64,610.7	\$ 64,369.7	\$ 63,417.7	Recurring	General Fund (Cigarette)
\$ 0.0	\$ 23,719.8	\$ 26,020.9	\$ 28,640.2	\$ 31,636.3	Recurring	General Fund (TPT)
\$ 0.0	\$ (226.3)	\$ (317.9)	\$ (219.9)	\$ (218.7)	Recurring	Credit Enhancement Account
\$ 0.0	\$ (14.4)	\$ (22.3)	\$ (14.0)	\$ (14.0)	Recurring	UNM Cancer Center
\$ 0.0	\$ (25.6)	\$ (37.3)	\$ (24.8)	\$ (24.7)	Recurring	NM Finance Authority
\$ 0.0	\$ (201.7)	\$ (285.1)	\$ (196.0)	\$ (194.9)	Recurring	NM Finance Auth./UNM Health Sciences
\$ 0.0	\$ (83.2)	\$ (118.3)	\$ (80.9)	\$ (80.4)	Recurring	NM Finance Auth./DOH
\$ 0.0	\$ (8.9)	\$ (14.8)	\$ (8.6)	\$ (8.6)	Recurring	Rural County Cancer Treatment Fund
\$ 0.0	\$ 89,297.0	\$ 89,835.9	\$ 92,465.6	\$ 94,512.6	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
\$184.0	\$0.0	\$0.0	\$184.0	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

Duplicates SB231

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

New Mexico Department of Health (DOH)

Responses Not Received From
New Mexico Finance Authority (NMFA)

SUMMARY

House Bill 282 amends the Cigarette Tax Act to increase the excise tax on cigarettes, amends the Tobacco Products Act to include all products, other than cigarettes, that contain or are derived from tobacco or nicotine in the definition of tobacco product, 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;
- Intends to distribute the revenues from the tax increase 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.

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 amends cigarette tax distributions with the intent of distributing all new revenues to the general fund and holding other accounts harmless, declines in cigarette consumption due to the tax increase will cause the other funds 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, which is reflected in the general fund estimate.

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.

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 points out that 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.

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).

Additionally, DOH notes that among adults in the state, 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).¹ 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).

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. 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

On page 16, line 8, insert the word “not” after the word “does” and before the word “include”. This item should read, “...used to consume tobacco but does not include any product that has been approved by the United State food and drug administration...”

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”.

OTHER SUBSTANTIVE ISSUES

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.

¹ <https://www.cdc.gov/brfss/index.html>

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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