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FISCAL IMPACT REPORT

ORIGINAL DATE 2/26/19

SPONSOR Padilla LAST UPDATED _____ HB _____

SHORT TITLE Tobacco Products Definitions and Tax SB 527

ANALYST Chenier/Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0.0	\$432.0	\$435.6	\$463.6	\$496.0	Recurring	DOH Tobacco Use Prevention and Cessation Programs
\$0.0	\$4,968.0	\$5,009.4	\$5,331.4	\$5,704.0	Recurring	General Fund
\$0.0	\$5,400.0	\$5,445.0	\$5,795.0	\$6,200.0	Recurring	Total Revenue

(Parenthesis () Indicate Revenue Decreases)

Related to an appropriation in the General Appropriations Act that would distribute \$6.6 million from tobacco settlement revenue to the Department of Health that includes \$5.4 million for tobacco cessation services.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Health (DOH)

Tax and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 527 increases the rate of the tobacco products tax from 25 to 36 percent and adds a new Section to the Tax Administration Act providing for a distribution to the Department of Health (DOH) for tobacco use prevention and cessation programs in an amount equal to eight percent of the net receipts attributable to the tobacco products tax. Section 7-12A-2 NMSA 1978 is amended to include a definition for “electronic smoking device”, and also to expand the definition of “tobacco product”.

FISCAL IMPLICATIONS

The fiscal impact table represents LFC staff analysis using the December 2018 consensus revenue forecast for tobacco products tax (TPT) revenue as the starting point. The estimates assume price increases will have an inverse effect on consumption of tobacco products and e-cigarettes (higher prices will reduce consumption). New revenues from increasing the TPT rate to 36 percent (from the current 25 percent rate) and expanding the tax base to include e-cigarettes are estimated at \$5.4 million for FY20.¹

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 (DFA) 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. Both LFC and DFA economists used a price of \$2.75 to produce the e-cigarette revenue estimate, with the price expressed as annual wholesale per capita expenditures on e-cigarette products. This price represents a midpoint estimate given the available data. The minimum e-cigarette consumption scenario of \$1.34 per capita would reduce the FY20 new revenue projection by about \$1 million. Conversely, the maximum e-cigarette consumption scenario of \$4.16 per capita would increase the FY20 estimate by about \$1 million.

While the estimated fiscal impact only considers consumers' direct price responses (e.g. reducing consumption due to price increases), it does not consider the potential for consumers to seek out lower-taxed tobacco products and e-cigarettes (e.g. purchases on military bases, tribal lands, or online). If taxable volumes of 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 an additional \$1 million to \$1.5 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 may cause 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

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 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.

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

¹ The TRD analysis for this bill estimates this bill will generate a total of about \$9 million in FY20 due to stronger assumptions for the e-cigarette market in New Mexico.

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.

DOH provided the following:

The bill would include “electronic smoking device” in the definition of “tobacco product.” The bill is in line with the Tobacco Control Legal Consortium (Consortium) recommendation that, in most circumstances, existing definitions of “tobacco products” in tobacco control laws should be broadened to include e-cigarettes and similar products (<https://publichealthlawcenter.org/sites/default/files/resources/tclc-guide-reg-ecigarettes-2014.pdf>). Broadening the general definition of “tobacco products” to clearly include e-cigarettes and other electronic nicotine delivery systems would subject them to the same legal restrictions applied to other tobacco products, such as youth access, sales, and marketing restrictions.

According to the 2014 Surgeon General’s Report on The Health Consequences of Smoking, there is sufficient evidence to conclude that “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” (www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf, p. 18).

In 2016, the National Cancer Institute and the World Health Organization reaffirmed that “significantly increasing the excise tax and price of tobacco products is the single most consistently effective tool for reducing tobacco use” (cancercontrol.cancer.gov/brp/tcrb/monographs/21/docs/m21_complete.pdf, p.151).

Current cigarette use among New Mexico (NM) high school youth declined to a historic low of 10.6 percent in 2017 (<http://youthrisk.org/tables/#/2017>). However, reductions 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.

The bill proposes to increase the excise tax on other tobacco products to 36 percent. Although this increase would reduce the tax disparity between the existing tax on cigarettes and other tobacco products, it does not create tax equity. Achieving true tax equity between cigarettes and other tobacco products, including electronic smoking devices, would substantially lower the attractiveness of these products among price-sensitive consumers, such as youth and low income adults

(www.tobaccofreekids.org/assets/factsheets/0180.pdf) and could result in decreased tobacco use rates. In New Mexico, 80 percent of adults “favor increasing the tax on other tobacco products (cigars, chewing tobacco and e-cigarettes), to a level that would match the tax on cigarettes if the money were used to increase funding for health programs and education” ([2018 Tobacco Evaluation Survey](#)).

DISPARITIES ISSUES

DOH said the new tax rate proposed by the bill would reduce the tax disparity between the existing tax on cigarettes and other tobacco products but would not create tax equity between other tobacco products and the existing \$1.66 per pack tax on cigarettes. True tax equity could decrease the appeal of what have been traditionally lower-priced products (spit/chew, hookah, e-cigarettes) among youth, young adults, and other price-sensitive consumers.

The funds directed to DOH in the bill could be used to increase targeted media, marketing, and outreach to populations at increased risk for tobacco use, including raising awareness of and utilization of proven tobacco cessation services, such as QUIT NOW or DEJELO YA.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 166 and House Bill 261 seek to include e-cigarettes in the tobacco products tax, but also increase the cigarette excise tax. SB166 does not change the tax rate for the TPT, while HB261 increases the tax rate to 76 percent of wholesale.

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.

OTHER SUBSTANTIVE ISSUES

States have only recently begun taxing e-cigarette products (see state-by-state comparison chart below). 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.

While, other states have chosen to institute a tax based on the volume of e-liquid rather than implementing a wholesale tax, a wholesale tax has some specific advantages for New Mexico:

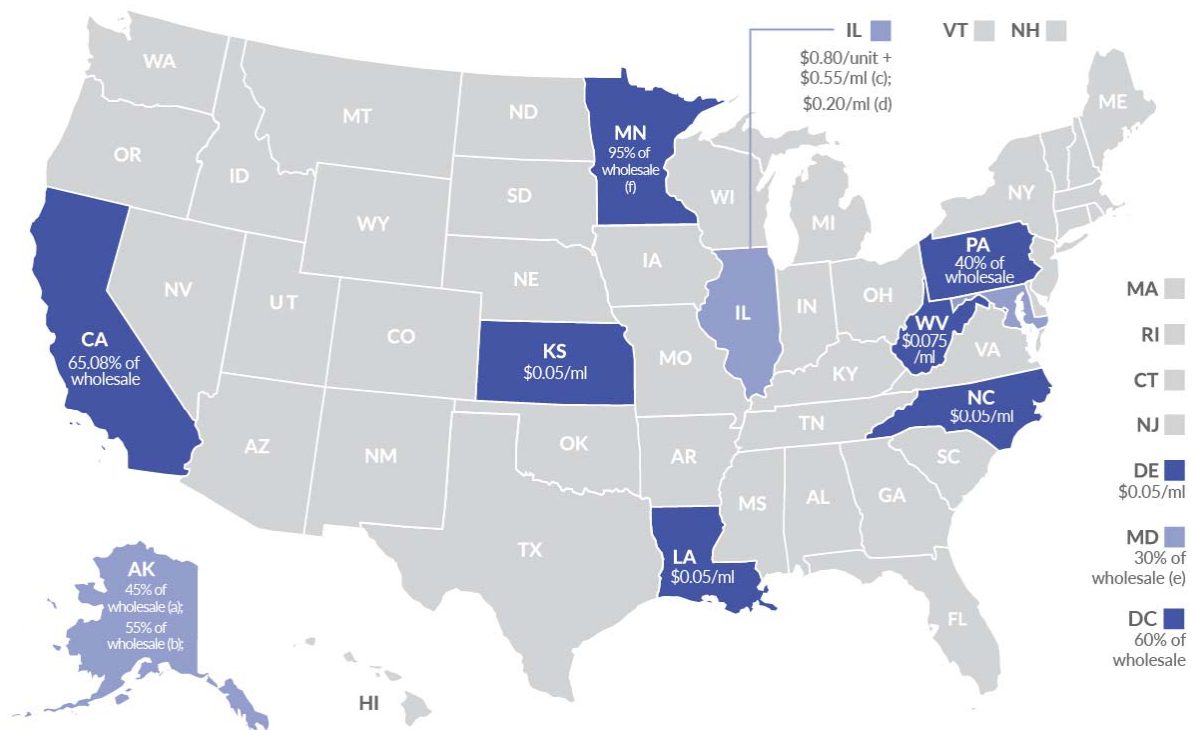
- Makes it harder for distributors and consumers to bypass a tax. Taxation based on e-liquid volume might trigger some distributors to sell nicotine separately from the liquid in

order to sidestep the tax. Additionally, the potential handling and mixing of pure nicotine poses a danger to e-cigarette consumers who could face a higher risk of nicotine poisoning.

- The wholesale tax proposed in this bill more cost effective for TRD to administer since the current wholesale tobacco products tax is already established within the GenTax system. Folding e-cigarette products into the TPT rather than establishing a tax based on e-liquid volume would save TRD roughly \$4 million in implementation costs.

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