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FISCAL IMPACT REPORT

ORIGINAL DATE 01/24/22

SPONSOR Ferrary LAST UPDATED _____ HB 33

SHORT TITLE Cigarette and Tobacco Products Tax SB _____

ANALYST Faubion

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
--	\$146.0	\$144.0	\$142.0	\$141.0	Recurring	New Mexico Finance Authority (NMFA)/Credit Enhancement – Cigarette Tax
--	\$27.0	\$27.0	\$26.0	\$26.0	Recurring	UNM Cancer Center – Cigarette Tax
--	\$145.0	\$143.0	\$142.0	\$140.0	Recurring	NMFA/UNM Health Sciences – Cigarette Tax
--	\$78.0	\$77.0	\$77.0	\$76.0	Recurring	NMFA/Department of Health – Cigarette Tax
--	\$39.0	\$38.0	\$38.0	\$38.0	Recurring	Rural County Cancer Treatment Fund – Cigarette Tax
--	\$74,500.0	\$73,600.0	\$72,900.0	\$72,200.0	Recurring	General Fund – Cigarette Tax
--	\$25,840.0	\$26,490.0	\$27,370.0	\$28,530.0	Recurring	General Fund – Tobacco Products Tax

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
\$1.7.0	-	-	\$1.7.0	Nonrecurring	TRD - ASD
\$40.0	-	-	\$40.0	Nonrecurring	TRD - ITD

Parenthesis () indicate expenditure decreases

Conflicts with SB49.

SOURCES OF INFORMATION

TRD Files and Tax Data

CREG December 2021 Cigarette Tax Estimate

Responses Received From

New Mexico Attorney General (NMAG)

Department of Health (DOH)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 33 (HB33) increases the excise tax rate for cigarettes, tobacco products, and e-liquids and closed system cartridges for use in electronic cigarettes while removing cigars from excise taxes. HB33 also decreases discounts for tax stamps sold in larger quantities during a calendar month. Lastly, HB33 adjusts the percentages of the cigarette tax revenue distributed to the related healthcare entities.

NMAG summarizes the bill as follows:

Section 1 of the bill amends Section 7-1-6.11 NMSA 1978; the distributions would change as follows:

- Statute Section A- to the board of regents of the University of New Mexico for the benefit of the comprehensive cancer center at the University of New Mexico health sciences center, decrease from .71 to .4 percent of the net receipts;
- Statute Section B- decrease from 7.52 to 4.15 percent on behalf of and for the benefit of the University of New Mexico health sciences center for its comprehensive cancer center, until payment of all principal, interest and other expenses or obligations related to the bonds authorized pursuant to Section 6-21-6.15 NMSA 1978 and the New Mexico finance authority certifies to the secretary of taxation and revenue that all obligations for the bonds have been fully discharged, to the credit enhancement account;
- Statute Section C- decrease from 3.17 to 1.76 percent to the New Mexico finance authority for land acquisition and the planning, designing, construction and equipping of department of health facilities or improvements to such facilities;
- Statute Section D- decrease from 8.26 to 4.55 percent of the net receipts, exclusive of penalties and interest, attributable to the cigarette tax made to the New Mexico finance authority for deposit in the credit enhancement account created in the authority; and
- Statute Section E- decrease from .53 to .31 percent for the benefit of the rural county cancer treatment fund, to the New Mexico finance authority.

Section 2 of the bill amends Section 7-12-3 NMSA 1978 to increase the excise tax rate on cigarettes from 10 cents per cigarette to 20 cents per cigarette.

Section 3 of the bill amends Section 7-12-7 NMSA 1978 and halves the three-tiered discount rate on tax stamps as follows:

- from .46 to .23 percent less than the face value of the first thirty thousand dollars (\$30,000) of stamps purchased in one calendar month;
- from .36 to .18 percent less than the face value of the second thirty thousand dollars (\$30,000) of stamps purchased in one calendar month; and
- from .22 to .11 percent less than the face value of stamps purchased in excess of sixty thousand dollars (\$60,000) in one calendar month.

Section 4 of the bill modifies and streamlines the definitions section of Section 7-12A-2 NMSA 1978 by: (1) deleting the section of the definition of e-cigarette that excluded them as a product regulated as a drug or device by the FDA, (2) adding any product containing nicotine from any source to the definition of tobacco product, and (3) narrowing the definition of tobacco product to exclude cigarettes, cigars, little cigars, and any tobacco product regulated as a drug or device by the FDA.

Section 5 of the bill amends Section 7-12A-3 NMSA 1978 by removing cigars from excise taxes, increasing the excise tax rates on the manufacture or acquisition of tobacco products from 25 percent to 77 percent of the product value and including e-liquids in this category, and increasing the excise tax rates for the manufacture or acquisition of closed system cartridges from .50 cents to \$3.32 per cartridge.

The effective date of this bill is July 1, 2022.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) used the Cigarette Tax forecast published by the Consensus Revenue Estimating Group (CREG) in December 2021 to calculate the fiscal impact. Starting with the forecasted sales volumes of cigarette packs, TRD applied demand elasticities to estimate how many fewer packs of cigarettes would be bought because of the increased price of 20 cents per cigarette. TRD used an elasticity of -0.284 which is an average for active smokers and for the total population published by G.A. Franz in the study “Price Effects on the Smoking Behavior of Adult Age Groups” (2008). Given the decline in cigarette consumption, TRD assumes a higher proportion of cigarette smokers are active smokers and weighted them more heavily in the elasticity. The next step was to apply the new tax of 20 cents per cigarette on the forecasted volumes with elasticity applied to them. Next, TRD applied the new discount rates to the estimated revenue. Lastly, TRD’s analysis applied the new distribution percentages from the bill.

TRD used the Tobacco Products Tax forecast published by the CREG in December 2021 to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. The Tobacco Products Tax covers a variety of products. The bill proposes tax increases to all but one of the categories, cigars. Based on the bill language, cigars are no longer taxed at all and represent revenue lost for the Tobacco Products Tax. (See technical issues below.) TRD applied different demand elasticities to the remaining products: little cigars, e-liquid – for use in e-cigarettes, closed system cartridges – a single use e-cigarette and all other tobacco products. Based on a recent study of the impact of e-cigarette taxes on e-cigarette and other tobacco

consumption by Cotti et al.¹, an average elasticity impact for different varieties of e-cigarettes (flavored, non-flavored, etc.) was applied. The study notes that cigarettes and e-cigarettes represent substitutable products. Due to the bill increasing both cigarette and e-cigarette taxes, the fiscal impact does not assume any substitution impacts to consumption between the two products. In addition, the overall price increase proposed in the bill for e-cigarette products is very significant, around 35 percent for closed system cartridges and 57 percent for e-liquid, representing around \$3 to \$5 in tax increases for various e-cigarette products depending on product values. The elasticity assumption from empirical work looked at a \$1 increase in taxes. Given the large increase in taxes, the drop-in consumption could be higher than what is modeled. Also, if consumption moves to the black market (see policy issues below), then the assumed drop in consumption could also be higher.

Little cigars are tied in statute to the rate charged on cigarettes. The consumption pattern has shown a decline like that of cigarettes. TRD applied the same elasticities assumption to little cigars as applied to cigarettes.

The Cotti et al. study noted that for other tobacco products such as chewing tobacco and loose tobacco, there was no significant impact to consumption with an increase in price. This appears logical given that users of these products are most likely older established users. The price increase to the other tobacco products is significant at 42 percent. TRD applied an elasticity for smokers from the Franz study assuming that such a large increase in the tax rate may elicit a lower consumption rate among this population.

The Covid-19 pandemic and economic recession have altered consumption patterns for cigarettes and tobacco products. There was evidence of hoarding purchasing prior to the spring 2020 stay-at-home order. The continued economic impacts and stress associated with the pandemic and financial concerns could further alter the consumption of these products both upwardly and downwardly. The December 2021 accounts for the current pattern of consumption but, depending on the path of the pandemic, consumption could deviate from current assumptions.

Related Healthcare Entities. While HB33 adjusts the distribution percentages in existing law in such a way that decreases the percent of revenues disbursed to NMFA and other healthcare entities, the increase in revenues more than offsets the lower share resulting in higher disbursements.

SIGNIFICANT ISSUES

According to the Federation of Tax Administrators, as of January 1, 2022, the median tax on cigarettes in the United States was \$1.78 per pack. The lowest rate was \$0.17 per pack in Missouri, while the highest was \$4.50 in the District of Columbia. New Mexico's Cigarette Tax is tied currently with 5 other states for the 18th highest rate in the nation.

This bill's proposed tax rate would make New Mexico's rate the 5th highest in the nation and would substantially exceed the tax rate of surrounding states (see Attachment A). A report

¹ Cotti, C.D., Courtemanche, C.J., Maclean, J.C., Nesson, E.T., Pesko, M. F., Tefft, N. (2020). The Effects of E-Cigarette Taxes on E-Cigarette Prices and Tobacco Products Sales: Evidence from Retail Panel Data. National Bureau of Economic Research, Cambridge, MA. Working paper 26724, <http://www.nber.org/papers/w26724>

published by the Tax Foundation, a non-partisan tax policy research organization, states New Mexico currently ranks 5th in the nation for inbound cigarette smuggling activity, with an estimated 37.2 percent of cigarettes consumed in the state derived from smuggled sources in 2019 (see Attachment B). The Tax Foundation states one notable consequence of high state cigarette excise tax rates has been increased smuggling as people procure discounted packs from low-tax states and sell them in high-tax states. Raising tax rates substantially higher than surrounding areas is likely to exacerbate the issue.

According to the Tax Foundation, 20 states and territories currently tax e-liquid and closed-system cartridges for use e-cigarettes on a percentage of price (See Attachment C). Price subject to tax varies by retail or wholesale price. New Mexico's e-liquid tax of 12.5 percent of wholesale price is among the lowest of any state or territory that taxes e-liquid by price. Wholesale tax rates in other states include 15 percent in Illinois and Wyoming, 30 percent in Nevada, 56 percent in Utah, 59.9 percent in California, 92 percent in Vermont, and 95 percent in Minnesota.

The bill proposes to increase the tax rate on cigarettes, presumably to discourage their consumption, which can lead to negative health outcomes. By increasing the rate on cigarettes and e-cigarettes, the bill presumably negates substitution effects noted in studies between these products. From a health policy stand point, this is especially important for younger users who have become a larger market share of e-cigarettes and are more sensitive to price increases. By raising taxes on most tobacco products, it would presumably encourage overall lower consumption of the various products. It is notable then, that cigars are no longer taxed, and consumers could increase consumption of cigars if seen as a potential substitute. (See technical issues below.)

Significant increases in taxes may encourage consumers to buy products on the black market. The increased demand by consumers would presumably be met by an increased supply of e-cigarettes products within the black market. This raises safety concerns for consumers with a question of the quality of products being supplied and what may be contained, for example, within e-liquids with no oversight.

The following significant issues were raised by the Department of Health:

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."² 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 effective tool for reducing tobacco use."³

Cigarette use among New Mexico high school youth declined to a historic low of 8.9

² <https://www.hhs.gov/sites/default/files/consequences-smoking-exec-summary.pdf>

³ https://cancercontrol.cancer.gov/brp/tcrb/monographs/21/docs/m21_complete.pdf, p 151

percent in 2019.⁴ However, declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes. In 2019, 34 percent of New Mexico high school youth surveyed reported using e-cigarettes, and 38 percent of youth reported using at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes). Factors contributing to these trends include pricing differences among tobacco products (i.e. higher taxes on cigarettes compared to other tobacco products), increased marketing of e-cigarettes, and the appeal of flavored e-cigarettes.

The tax increase of \$2.00 per pack of 20 cigarettes proposed in HB33 is estimated to reduce youth smoking in New Mexico by about 19 percent, preventing about 8,100 youth from becoming adult smokers. Among adults, it is estimated that 14,000 would quit smoking cigarettes. Five-year health care cost savings from the cigarette tax increase are estimated at \$13.7 million for fewer smoking-caused lung cancer cases, heart attacks, strokes, and fewer smoking-affected pregnancies, and births. Five-year Medicaid program savings are projected to be \$10.85 million.⁵

HB33 also proposes to increase the excise tax on other tobacco products to create tax equity between cigarettes and other tobacco products. As a result, the price of other tobacco products would increase and potentially lower their attractiveness among price-sensitive consumers, such as youth and low-income adults.⁶ In New Mexico, 80 percent of adults favor increasing the tax on the other tobacco products (cigars, chewing tobacco and e-cigarettes) to a level that would match the cigarette tax if the money were used to increase funding for health programs and education.⁷

The intent of HB33 to create tax equity across all types of tobacco products could positively impact health disparities by decreasing the appeal of lower-priced tobacco products such as spit/chew, e-cigarettes, especially among youth. E-cigarettes use in New Mexico is prevalent among high school youth (34 percent and particularly high in certain counties such as Taos (58 percent Guadalupe (47 percent and Valencia (47 percent)).⁸

HB33 would likely have a significant impact on youth, as nearly 4 in 10 (38 percent) of NM high school youth reported using some form of tobacco, and most (90 percent) of that tobacco is in the form of e-cigarettes.⁹ HB33 would not only increase the tax on cigarettes and other tobacco products, but more importantly, bring about tax equity across all tobacco products. Reduced e-cigarette use among New Mexico youth could translate into fewer youth, and eventually adults, who are addicted to nicotine and experience the negative health consequences.

⁴http://youthrisk.org/pdf/connections/YRRS_Connections_v7n2_July%202020_Tobacco%20Trends%202019_071420.pdf

⁵ <https://www.fightcancer.org/tobacco-control-and-prevention>

⁶ www.tobaccofreekids.org/assets/factsheets/0180.pdf

⁷ <https://www.nupacnm.com/wp-content/uploads/2021/01/Public-Opinion-on-Tobacco-Policies-in-NM-2020.pdf>

⁸ <https://youthrisk.org/>

⁹ <https://www.nupacnm.com/wp-content/uploads/2021/09/2022-Tobacco-Program-Fact-Sheet.pdf>

TECHNICAL ISSUES

The language between the definition of “tobacco product” on page 8, Section 4 (L) and the imposition of the tobacco product tax on tobacco products on page, Section 5 (A) appears to have inadvertently left cigars with no tax imposition at all. The sections are written such that cigars are not subject to the rate of the tobacco products in Section 5(A) and the previous separate rate for cigars has been struck under Section 5(B). Whether this is the intent, the two sections are not clearly written for the administration of this tax. In addition to the language around cigars, TRD assumes that e-liquids are taxed at the proposed “tobacco product” rate of 77 percent and the original 12.5 percent of wholesale tax rate for e-liquids has been struck on page 9, Section 5 (D). If the sponsor of the bill would like to propose that cigars be taxable under the tobacco products excise tax rate of 77 percent, TRD recommends striking “cigars” on page 8, line 9.

To prevent hoarding of stamps before the tax increase effective date, TRD recommends amending Section 7-12-3.1 NMSA 1978 to include non-affixed and affixed stamps for the Cigarette Inventory Tax which is imposed when the cigarette rate increases. Currently, the statute only applies to non-affixed stamps.

ADMINISTRATIVE IMPLICATIONS

TRD will conduct staff training, update forms, instructions, and publications. Changes would be made to TRD’s GenTax system, the system of record, to update tax rates, discount rates, and revenue distribution per the new percentages, requiring development and testing of TRD’s GenTax system. TRD’s Information Technology Division (ITD) estimates that the changes would incur approximately 200 hours of development with contractual services for a cost of \$40 thousand. TRD’s Administrative Services Division (ASD) will have 40 hours of staff workload effort related to updating and testing distributions in the GenTax system, including modifications to revenue and general ledger transactions and multiple revenue reports. The total estimated cost for ASD is \$1,724.

Due to the effective date of July 1, 2022, for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces July 1, 2022 to ensure complete readiness and testing of all processes.

If several bills with similar effective dates become law there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill.

Attachments

1. State Excise Tax Rates on Cigarettes
2. Cigarette Smuggling by State
3. Vapor Taxes by State

ATTACHMENT A

STATE EXCISE TAX RATES ON CIGARETTES

(January 1, 2021)

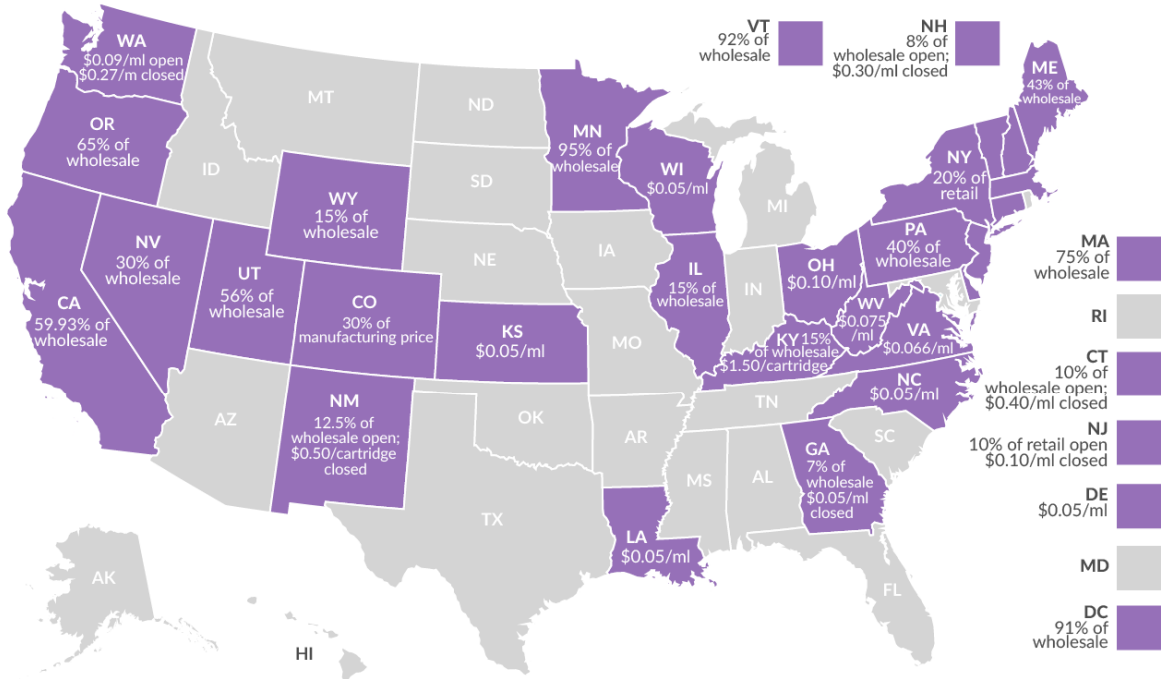
STATE	TAX RATE (¢ per pack)	RANK	STATE	TAX RATE (¢ per pack)	RANK
Alabama (a)	67.5	41	Nebraska	64	42
Alaska	200	18	Nevada	180	25
Arizona	200	18	New Hampshire	178	26
Arkansas	115	36	New Jersey	270	13
California	287	12	New Mexico	200	18
Colorado	194	24	New York (a)	435	2
Connecticut	435	2	North Carolina	45	48
Delaware	210	16	North Dakota	44	49
Florida (b)	133.9	33	Ohio	160	29
Georgia	37	50	Oklahoma	203	17
Hawaii	320	7	Oregon	333	6
Idaho	57	46	Pennsylvania	260	14
Illinois (a)	298	11	Rhode Island	425	4
Indiana	99.5	39	South Carolina	57	46
Iowa	136	32	South Dakota	153	30
Kansas	129	34	Tennessee (a) (c)	62	43
Kentucky	110	37	Texas	141	31
Louisiana	108	38	Utah	170	27
Maine	200	18	Vermont	308	8
Maryland	200	18	Virginia (a)	60	44
Massachusetts	351	5	Washington	302.5	10
Michigan	200	18	West Virginia	120	35
Minnesota (d)	304	9	Wisconsin	252	15
Mississippi	68	40	Wyoming	60	44
Missouri (a)	17	51			
Montana	170	27	Dist. of Columbia (e)	450	1
			U. S. Median	178	

Source: Compiled by FTA from state sources.

ATTACHMENT C

How High are Vapor Taxes in Your State?

State Vapor Products Excise Tax Rates, January 1, 2021



Note: Several states levy general sales taxes in addition to the excise tax. Those are not included on the map.

Open: An open tank allows the consumer to refill the liquid and allows more freedom in voltage and nicotine levels.

Closed: Normally sold as pods or cartridges. Closed systems typically have higher nicotine levels to allow for consumption of the desired amount of nicotine in shorter sessions.

Source: State Statutes & Bloomberg Tax

Has a Statewide Vapor Excise Tax

No Vapor Excise Tax