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FISCAL IMPACT REPORT

SPONSOR <u>Thomson/Ferrary/Jaramillo/Cates/Chasey</u>	LAST UPDATED <u>1/31/2023</u>
	ORIGINAL DATE <u>1/29/2023</u>
SHORT TITLE <u>Tobacco Tax Rates & Definitions</u>	BILL NUMBER <u>House Bill 123</u>
	ANALYST <u>Faubion</u>

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	\$490	\$480	\$470	\$460	Recurring	New Mexico Finance Authority (NMFA)/Credit Enhancement – Cigarette Tax
--	\$54	\$53	\$52	\$50	Recurring	UNM Cancer Center – Cigarette Tax
--	\$460	\$450	\$440	\$430	Recurring	NMFA/UNM Health Sciences – Cigarette Tax
--	\$210	\$200	\$200	\$190	Recurring	NMFA/Department of Health – Cigarette Tax
--	\$60	\$60	\$50	\$50	Recurring	Rural County Cancer Treatment Fund – Cigarette Tax
--	\$69,200	\$67,080	\$64,920	\$62,940	Recurring	General Fund – Cigarette Tax
--	\$24,600	\$26,600	\$29,300	\$33,000	Recurring	General Fund – Tobacco Products Tax

Parenthesis () indicate revenue decreases
 *Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	\$23.1	--	--	\$23.1	Nonrecurring	TRD - ITD/ASD
Total	\$23.1	--	--	\$23.1		

Parentheses () indicate expenditure decreases.
 *Amounts reflect most recent version of this legislation.

Relates to HB 94.
 Conflicts with HB 124 and SB 235.

Sources of Information

LFC Files

Responses Received From

Human Services Department (HSD)
New Mexico Attorney General (NMAG)
New Mexico Finance Authority (NMFA)
Department of Health (DOH)
University of New Mexico (UNM)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 123

House Bill 123 (HB123) doubles the cigarette tax rate and decreases the distribution percentages of cigarette tax revenue for non-general fund recipients. This bill also raises the tax on tobacco products to an excise tax rate of 71 percent on the product's wholesale value and removes all other tobacco taxing structures, except for little cigars, which are taxed at the same rate as cigarettes.

The delayed repeal date of this bill is July 1, 2023

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) notes the following methodology:

TRD used the Cigarette Tax forecast published by the Consensus Revenue Estimating Group (CREG) in December 2022 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 sold 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 from the CREG in December 2022 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 the categories based on the ‘wholesale price’ of the tobacco products, which is not defined in the bill (see *Technical Issues*). TRD assumed the fiscal impact based on the current defined ‘product value’ and applied the new rates. TRD applied different demand elasticities to the 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

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>

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 price increase proposed in the bill for e-cigarette products is very significant, approximately 50 percent to 60 percent, representing around \$4 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 elasticity assumptions 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 approximately 40 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.

SIGNIFICANT ISSUES

According to the Federation of Tax Administrators, as of January 1, 2023, 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 currently tied with four other states for the 19th highest rate in the nation.

This bill's proposed tax rate would make New Mexico's cigarette tax rate the 5th highest in the nation and would substantially exceed the tax rate of surrounding states (see Attachment A). A report published by the Tax Foundation, a non-partisan tax policy research organization, states New Mexico currently ranks 3rd in the nation for inbound cigarette smuggling activity, with an estimated 44 percent of cigarettes consumed in the state derived from smuggled sources in 2020 (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 in 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 standpoint, 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.

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 Human Services Department (HSD) notes the following:

The Centers for Disease Control and Prevention's (CDC) Best Practices for Comprehensive Tobacco Control Programs concludes that the more states spend on comprehensive tobacco control programs, the greater the reductions in smoking. According to the US Surgeon General, increasing the price of cigarettes through strategies such as excise tax increases are an effective policy intervention to prevent initiation of tobacco use, promote cessation, and reduce the prevalence and intensity of tobacco use among adolescents and young adults. For example, CDC found that an increase in excise taxes in Massachusetts, when combined with an antismoking campaign, produced a 19.7 percent decline in cigarette consumption per capita four years after the tax increase was initiated.

The largest impact on cigarette demand for youths is the perceived price of cigarettes. Young people are particularly sensitive to tobacco product price increases and a study by the independent CDC Task Force on Community Preventive Services concluded that increasing the unit price for tobacco products is an effective method for reducing tobacco use among young adults and adolescents. Increasing excise taxes on tobacco products is especially effective in discouraging initiation among young people who have not developed an addiction to tobacco, thus protecting their health and increasing their likelihood of remaining tobacco-free.

The Department of Health (DOH) notes the following:

According to the World Health Organization, evidence shows that significantly increasing tobacco excise taxes and prices is the single most effective and cost-effective measure for reducing tobacco use. Raising taxes on tobacco products, which lead to increases in their price, makes tobacco less affordable. When tobacco becomes less affordable, people use it less and youth initiation is prevented. Because youth and low-income groups are more responsive to increases in tobacco prices, they disproportionately enjoy the health and economic benefits of quitting and not starting.

According to the Centers for Disease Control and Prevention (CDC), cigarette smoking kills more than 480,000 Americans each year. Cigarette smoking cost the United States more than \$600 billion in 2018, including more than \$240 billion in healthcare spending and nearly \$372 billion in lost productivity. According to American Lung Association, increasing taxes on cigarettes results in fewer kids starting to smoke, and in more adults quitting. Every 10

percent increase in the price of cigarettes reduces consumption by about 4 percent among adults and about 7 percent among youth.

PERFORMANCE IMPLICATIONS

Pursuant to various pieces of legislation, the New Mexico Finance Authority (NMFA) has issued cigarette tax bonds for several identified projects, and NMFA purchased these bonds with the Public Project Revolving Fund (PPRF) loans. The payments from loans secured by cigarette tax revenues have been pledged to publicly marketed bonds sold by the NMFA. Cigarette tax loans have traditionally been structured to withstand an annual 3 percent decline in revenue as a result of declines in cigarette consumption over time. Cigarette tax collections are notoriously volatile. For example, tax receipts increased 22.4 percent from FY20 to FY21, followed by a 12.7 percent decline from FY21 to FY22. Consequently, revenue generated from changes in tax rates is very difficult to predict. An increase in the cigarette tax by 100 percent would magnify the challenge in predicting future tax collections.

The following summarizes the outstanding bonds made by NMFA secured by cigarette tax revenues:

NMFA/UNM Health sciences Center

- PPRF-3424 Series 2016A Cancer Center Bonds (\$8.845 million principal outstanding through maturity in 2025).
- PPRF-5586 UNM Cancer Center Expansion (\$22.0 Million principal outstanding through maturity of 2036).

NMFA/Department of Health

- PPRF-2668 Series 2012A Las Vegas Meadows Bonds (\$7.648 million principal outstanding through maturity in 2037).
- PPRF-4432 Series 2018A Cig Tax Refunding Bonds for the State Laboratory (\$3.1 million principal outstanding through maturity in 2028).

NMFA/Rural County Cancer Treatment

- PPRF-5196 Series 2020 Gila Regional Medical Center Bonds, (\$2.3 million principal outstanding through maturity in 2033).
- PPRF-5396 Series 2020, (\$1.2 million principal outstanding through maturity in 2040).

NMFA notes that HB123 attempts to hold the various beneficiary fund distributions neutral by increasing cigarette tax rates while decreasing the percentage distributions to those benefitting cigarette tax revenue funds. However, given the unpredictability of cigarette tax collections in the face of a doubling of the tax rate, changes contemplated by HB123 could negatively impact outstanding NMFA cigarette tax revenue bonds. The cigarette tax bonds issued on behalf of the UNM Health Sciences Center (for the Cancer Treatment Center) and the Department of Health (for the State Laboratory and Las Vegas Meadows Center) are backed by a distribution of cigarette tax that comes monthly to the NMFA in the event that the distributions dedicated to these bonds is insufficient to meet debt coverage. If not needed for debt services, the cigarette tax revenue flows back to the State general fund. If revenue estimates fall short of expectations and fail to meet projections, NMFA would draw upon the credit enhancement fund, which would impact revenues currently flowing to the State general fund.

The University of New Mexico Comprehensive Cancer Center (UNMCCC) is a recipient of cigarette tax revenues in support of funding debt service of existing NMFA capital bonds and clinical research and basic research programs. The increased cost of cigarettes as a result of passage of this bill could result in a reduction in the purchase of cigarettes and other tobacco related products. While this bill changes the distribution percentage to the UNMCCC of the net receipts from tobacco sales to address estimated reductions in sales caused by the increase in taxation, it is possible that passage of this bill could result in a decrease in the amount of cigarette tax revenue received by the UNMCCC.

Cigarette tax proceeds currently fund debt service on bonds that were issued by the New Mexico Finance Authority for UNM Comprehensive Cancer Center capital projects. The funds also support cancer center operations. During the 2021 session, the legislature authorized the NMFA to issue new bonds for the UNM Comprehensive Cancer Center radiation oncology and laboratory expansion in the amount of \$22 million (SB223, Regular Session 2021). The bonds backed by these revenues were issued in 2016 and 2021 with maturity dates of 2025 and 2036 respectively. The net proceeds of the cigarette tax proceeds to UNM Health Sciences and Cancer Center after bond repayment over the last three fiscal years were: \$3.3 million in FY20, \$3.7 million in FY21 and \$2.3 million in FY22.

ADMINISTRATIVE IMPLICATIONS

This bill will likely have an impact on TRD to implement the new tax rates. In a similar bill proposed during the 2022 legislative session, TRD quoted the following expenses:

TRD will conduct staff training, update forms, instructions, and publications. TRD will also need to produce communications to impacted taxpayers, including specifications of the proposed changes to definitions and tax rates. 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 400 hours of development with staff workload hours for a cost of \$22,216. TRD's Administrative Services Division (ASD) will have 16 hours of staff workload across 2 full-time equivalent (FTE) staff, with effort related to updating and testing distributions in the GenTax system, including modifications to revenue and general ledger transactions and multiple revenue reports.

Due to the effective date of July 1, 2023, for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces July 1, 2023 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.

OTHER SUBSTANTIVE ISSUES

TRD notes the following:

The following changes to definitions are recommended per the Federation of Tax Administrators to be broad enough to withstand product innovations and enable tax application of these products.

- Electronic Nicotine Delivery Systems (ENDS) are noncombustible tobacco products, which include devices, components, and/or parts that deliver aerosolized e-liquid when inhaled. Examples include vape or vape pens, personal vaporizers, electronic cigarettes, cigalikes, e-pens, e-hookahs, e-cigars and e-pipes.
- Electronic Cigarettes, also known as E-Cigarettes, are handheld battery-powered vaporizers that stimulate smoking but without tobacco combustion, and are any device that can be used to deliver aerosolized or vaporized nicotine, or any other substance, to the person inhaling from the device and includes any component, part or accessory of such a device that is used during the operation of the device but does not include a battery or battery charger.
- E-liquids are a type of ENDS products which generally refer to liquid nicotine and nicotine-containing e-liquids or liquid nicotine substitutes. Significantly, the deletion of, “not including any substance containing cannabis or oil derived from cannabis,” is not recommended. This could question whether cannabis e-liquids are subject to both the Tobacco Products Tax Excise Tax and Cannabis Excise Tax.

The proposed change to contain all tobacco products except cigarettes and little cigars in the same tax rate is administratively more efficient and holds to the tax policy concepts of simplicity and equity in the tax code.

On page 3, starting with line 2 through page 4, line 4, the bill strikes out modified tax for cigarette stamps. The Revenue Processing Division (RPD) of TRD is in process of establishing new stamps for Modified 1 and Modified 2 cigarette stamps that will be affixed to cartons. This is an increased cost of \$1,500 per cylinder for a total of \$3,000 and new stamp inventory to be determined. If this bill is adopted, these products are not needed. The office of Attorney General has established a directory for approved cigarette manufactures that meet this requirement. There is a growing interest for this product to be on the market in New Mexico. Please see <https://www.nmag.gov/get-help/tobacco-manufacturers-directory/> and the company VLN, which has the first approved product.

HSD notes the following:

Increasing state tax on cigarettes and simultaneously raising the tax on other tobacco products will increase tax revenue while decreasing smoking, which in turn will decrease healthcare costs. According to the white paper titled, “The Economic Impact of Raising the State Tax on Cigarettes and Other Tobacco Products in Michigan,” a \$1.00 per pack increase in the cigarette tax will:

- Decrease the prevalence of adult smoking by 2.4 percent to 3.2 percent and daily cigarette consumption by continuing smokers by an equivalent amount;
- Thereby decrease the medical costs associated with smoking, including savings for state taxpayers through a reduction in smoking-produced Medicaid health care services, and additional savings for the private sector;
- Increase productivity by reducing smoking-related absenteeism, on-the-job productivity deficits (e.g., due to smoking breaks), and work loss due to premature deaths;
- Through increased productivity, increase the state’s tax revenues through higher income tax collections; and, importantly,

- Decrease youth smoking by 11 percent to 21 percent.

In general, a price increase of 10 percent will reduce adults' demand for cigarettes by 3-4 percent. Approximately half of that decrease will reflect smokers' decisions to quit smoking, while the remaining half represents a reduction in daily cigarette smoking among continuing smokers. Low-income smokers are more price-responsive than high-income smokers. Youth are far more price responsive than adults, with estimates suggesting that a 10 percent price increase will decrease demand for cigarettes among young people by 7-13 percent.

DOH notes the following:

Increasing the price of cigarettes and other tobacco products could positively impact health disparities by decreasing the appeal of all tobacco products, and especially of e-cigarettes, and especially among youth. Use of any form of tobacco in New Mexico is prevalent among high school youth (27 percent) and particularly high in certain counties such as Grant County (41 percent), Hidalgo County (36 percent), Luna County (38 percent), Mora County (42 percent), Socorro County (40 percent), Taos County (47 percent) and Torrance County (39 percent). Use of any form of tobacco is more prevalent among girls (31 percent) than boys (24 percent). Use of any form of tobacco is particularly prevalent among Black or African American youth (32 percent) and Hispanic youth (30 percent); among LGBTQ+ youth (37 percent); among youth living with physical disabilities or long-term health problems (31 percent); and among youth experiencing unstable housing (53 percent). E-cigarettes use in New Mexico is prevalent among high school youth (25 percent), and particularly high in certain counties such as Grant (40 percent) Guadalupe (35 percent), Luna (37 percent), Mora (37 percent) and Taos (44 percent). Vaping is more prevalent among girls (29 percent) than boys (21 percent). Vaping is particularly prevalent among Black or African American youth (28 percent) and Hispanic youth (29 percent); among LGBTQ+ youth (34 percent); and among youth experiencing unstable housing (42 percent). Increasing the price of all tobacco products, including e-cigarette liquids and cartridges, as proposed in HB123, would be an important public health strategy to stemming tobacco use and youth vaping epidemic in the state and in reducing disparities in tobacco and vaping use.

TECHNICAL ISSUES

On page 9, line 5, the incidence of tax is now on the “wholesale price” of the tobacco products replacing the “product value” in Section 7-12-A-3 NMSA 1978. However, in the definitions under 7-12A-2 NMSA 1978, no definition is provided for “wholesale price” and the definition of “product value” remains in statute. TRD recommends making the language consistent.

TRD recommends the following revision to the definition of “first purchaser” to address tobacco product purchases for resale from exempt entities. The following change to add more specific verbiage would read as follows:

§ 7-12A-2 (H) NMSA 1978, "first purchaser" means a person engaging in business in New Mexico that manufactures tobacco products or that purchases or receives on consignment tobacco products from any person outside of New Mexico *or from any person exempt per § 7-12A-4 NMSA 1978*, which tobacco products are to be distributed in New Mexico in the ordinary course of business.

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

Attachments

1. Attachment A- State Excise Tax Rates on Cigarettes
2. Attachment B- Cigarette Smuggling by State
3. Attachment C- How High are Vapor Taxes in Your State?

JF/rl/ne/al

ATTACHMENT A

STATE EXCISE TAX RATES ON CIGARETTES

(January 1, 2023)

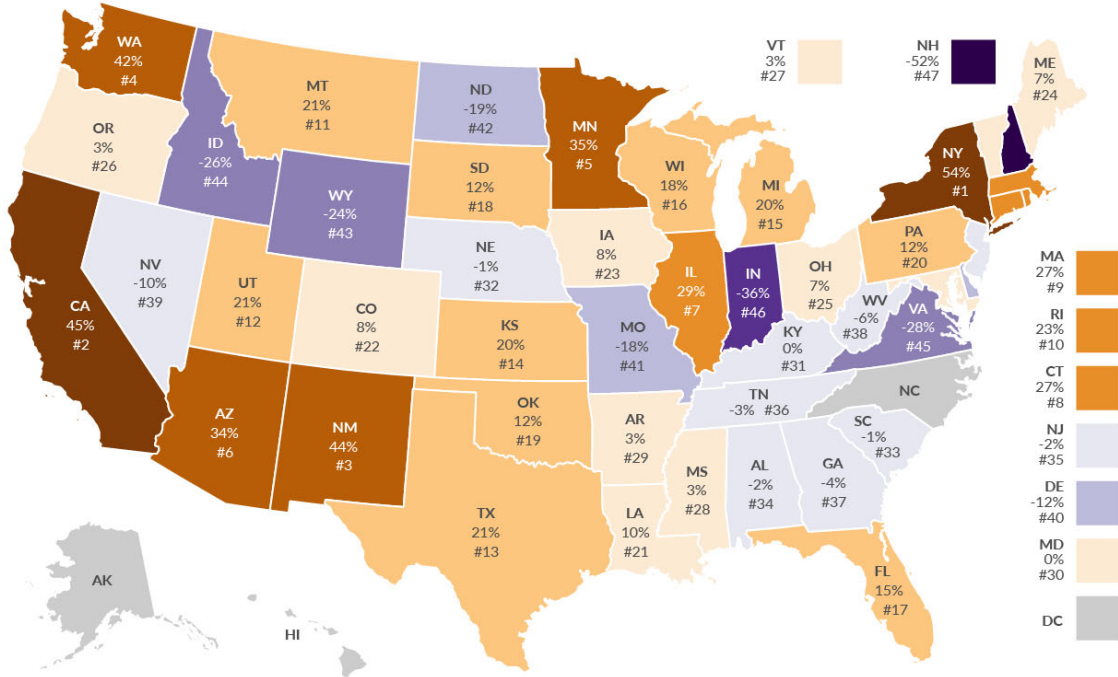
STATE	TAX RATE (¢ per pack)	RANK	STATE	TAX RATE (¢ per pack)	RANK
Alabama (a)	67.5	41	Nebraska	64	42
Alaska	200	19	Nevada	180	25
Arizona	200	19	New Hampshire	178	26
Arkansas	115	36	New Jersey	270	14
California	287	13	New Mexico	200	19
Colorado	194	24	New York (a)	435	2
Connecticut	435	2	North Carolina	45	48
Delaware	210	17	North Dakota	44	49
Florida (b)	133.9	33	Ohio	160	29
Georgia	37	50	Oklahoma	203	18
Hawaii	320	8	Oregon	333	7
Idaho	57	46	Pennsylvania	260	15
Illinois (a)	298	12	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	19	Vermont	308	9
Maryland	375	5	Virginia (a)	60	44
Massachusetts	351	6	Washington	302.5	11
Michigan	200	19	West Virginia	120	35
Minnesota (d)	304	10	Wisconsin	252	16
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.

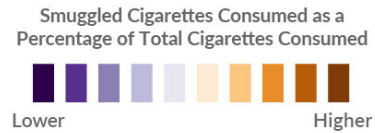
ATTCHMENT B

Cigarette Smuggling by State

Smuggled Cigarettes Consumed as a Percentage of Total Cigarettes Consumed, 2020



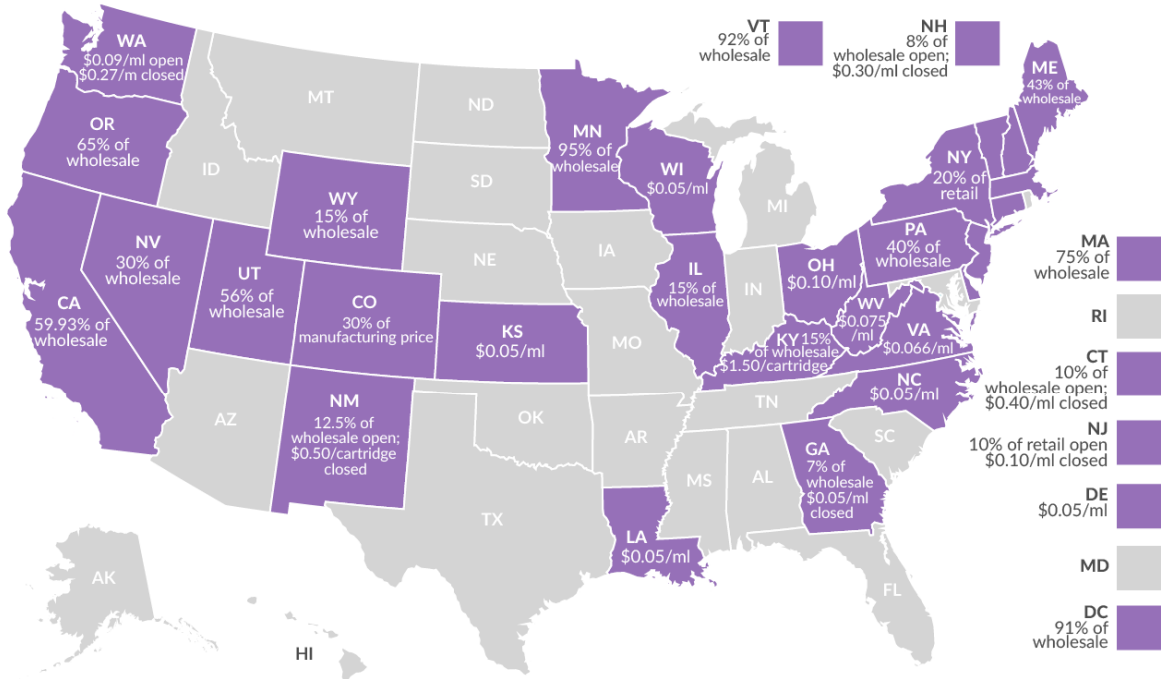
Note: Alaska, Hawaii, North Carolina, and DC are not included in the study. Data used is from 2020 and is most recently available data. Source: Mackinac Center for Public Policy; Tax Foundation.



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