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F I S C A L I M P A C T R E P O R T

SPONSOR Morales ORIGINAL DATE 1/27/16 LAST UPDATED 2/2/16 HB _____
SHORT TITLE Increase Tobacco Products Tax SB 77
ANALYST Malone

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18		
\$0.0	\$14,075.9-\$18,979.1	\$14,075.9-\$18,979.1	Recurring	General Fund
\$0.0	\$40,100.5-\$42,127.1	\$40,100.5-\$42,127.1	Recurring	CYFD Early Childhood Services
\$0.0	\$6,949.3-\$8,015.4	\$6,949.3-\$8,015.4	Recurring	Other State and Local Funds

(Parenthesis () Indicate Revenue Decreases)

Note: Range determined by assuming between a 5 percent and 0 percent reduction in demand due to increased tax rates.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$40.0	\$0.0	\$0.0	\$40.0	Nonrecurring	TRD Operating Fund

(Parenthesis () Indicate Expenditure Decreases)

Relates to SB 4

SOURCES OF INFORMATION

LFC Files

Responses Received From

Children, Youth, and Families Department (CYFD)
Department of Health (DOH)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 77 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 tax tobacco products at an increased rate, and amends the Tax Administration Act to distribute tax receipts from cigarette and tobacco sales to the Children, Youth, and Families Department (CYFD). Specifically, the bill:

- Increases the excise tax on packs of 25 cigarettes by \$1.25 and on packs of 20, 10, and 5 cigarettes by \$1.
- Increases the tobacco products tax from 25 percent to 66 percent of the product value of the tobacco products.
- Expands the definition of “tobacco product” significantly, to include:
 - A product that is made of, contains, or is derived from tobacco or nicotine and that is intended for human consumption through means that include smoking, heating, chewing, absorption, dissolution, inhalation, snorting, and sniffing;
 - 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, an electronic cigarette, and electronic cigar, an electronic pipe, and an electronic hookah.
- Distributes 23 percent of net cigarette tax receipts and 41 percent of net tobacco product receipts to CYFD for early childhood education.

FISCAL IMPLICATIONS

LFC and TRD staff used projected FY17 cigarette volumes from the consensus revenue estimate to project revenue generation from the proposed new tax levels. LFC built in a range demonstrating revenues if the increased taxes had between a 5 percent and 0 percent impact on demand.

LFC and TRD staff used projected FY17 tobacco product volumes from the consensus revenue estimate to project revenue generation from the proposed new tax levels. Additionally, LFC staff estimated the impact of expanding the definition of “tobacco product” as called for by the legislation, although there is not sufficient data to complete a precise analysis of the impact of this part of the bill. In 2013, the e-cigarette industry recorded \$1 billion in revenue nationwide with an average growth of about 120 percent over the past six years. LFC staff used the overall size of the industry, scaled to be proportional to the percent of national smokers the state has, to determine the additional revenue impact of expanding the definition, and thus taxation, of tobacco products. LFC staff notes this may be a conservative estimate when compared with annual national growth, which has ranged between 95 and 156 percent over the last six years.

Distributions of the new revenues were calculated including the distributions to CYFD proposed by the legislation.

The bill provides for continuing appropriations. The LFC has concerns with including continuing appropriations in statutory provisions as it reduces the ability of the legislature to establish spending priorities.

SIGNIFICANT ISSUES

Currently, New Mexico imposes an excise tax for each cigarette sold, given or consumed at the rates below, through 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, 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).

In its analysis of the bill, DOH notes that in New Mexico, cigarette use among high school youth declined to 14.4% in 2013. Although cigarette smoking has declined, the use of other products has remained steady (spit/chew tobacco) or increased dramatically (hookah and e-cigarettes) in recent years. A national study showed an eight-fold increase (1.5% to 13.4%) in e-cigarette use and a more than doubling of hookah use (4.1% to 9.4%) use among high school youth between 2011 and 2014, even surpassing use of traditional cigarettes (9.2%) in 2014. The result is that the rate of use of any tobacco product by NM high school youth has increased to 28.4% (2013 NM Youth Risk and Resiliency Survey).

DOH observes that SB 77 aligns with the research and recommendations of the Tobacco Control Legal Consortium (Consortium) regarding the regulation of e-cigarettes and similar devices. However, the Tobacco Control Legal Consortium recommends that when analyzing a state's tobacco tax laws for possible reform, it is essential to examine the state's entire regulatory scheme affecting cigarettes and non-cigarette tobacco products, including not only tobacco tax laws but also tobacco retailer licensing, retail sales, youth access, and other tobacco control measures.

ADMINISTRATIVE IMPLICATIONS

TRD estimates an overall FY16 budget impact of \$40 thousand for implementation of the bill. The agency notes a moderate IT impact (400 hours and estimated cost \$21,000). The bill requires changes to GenTax tax rate configuration for the cigarette tax and the tobacco products tax programs.

The bill produces a high impact in TRD's Revenue Processing Division (RPD) because it will require a form, instructions, and publication announcing the inventory tax. The cigarette inventory tax pursuant to Section 7-12-3.1 NMSA 1978, will need to be established in a very short period of time based on the bill's proposed effective date of July 1, 2016.

There's a moderate impact to TRD's financial distribution business processes (40 hours or less). Once programming changes (i.e., tax rate, distribution calculation, reports) are made to GenTax by IT, the Financial Distributions Bureau staff will need to verify the changes by performing selected tests of data, functionality and reports, prior to authorizing IT to move changes into production.

RELATIONSHIP

SB 77 relates to SB 04, which would amend and enact new sections of the Tobacco Products Tax Act to: 1) change the title of the act to the “Tobacco and Nicotine Products Tax Act”; 2) define and impose a tax on nicotine products; 3) require nicotine content labeling on all nicotine products; and 4) permit the Taxation and Revenue Department to conduct periodic compliance checks to ensure accurate nicotine content labeling on nicotine products. Compliance checking of nicotine content of nicotine products would be conducted by the Department of Health Scientific Laboratory Division.

OTHER SUBSTANTIVE ISSUES

According to the U.S. Food and Drug Administration (FDA), e-cigarettes have not been fully studied, so consumers currently don't 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 ecigarettes may lead young people to try other tobacco products, including conventional cigarettes, which are known to cause disease and lead to premature death.

Only e-cigarettes that are marketed for therapeutic purposes are currently regulated by the FDA Center for Drug Evaluation and Research. Currently, the FDA Center for Tobacco Products (CTP) regulates cigarettes, cigarette tobacco, and smokeless tobacco. FDA has issued a proposed rule that would extend the agency's tobacco authority to cover additional products that meet the legal definition of a tobacco product, such as e-cigarettes. The proposed rule would empower FDA to issue restrictions to individuals under the age of 18, require the display of health warnings on tobacco product packages and advertisements. It would also allow the agency to evaluate claims of new tobacco products to reduce tobacco-related disease and death, through rigorous scientific review and to prohibit the sale of e-cigarettes through vending machines, unless in a facility that never admits youth.

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

Attachment 1: E-Cigarette Taxation in Other States

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E-Cigarette Taxation in Other States.

New Jersey - Legislators announced they want to place a 75 percent wholesale tax on e-cigarettes and related accessories in parity with taxes on traditional cigarettes, currently \$2.70 for a pack of 20. No special tax is currently imposed on e-cigarettes. According to the Wall Street Journal, Governor Christie says the tax on e-cigarettes could bring in \$35 million a year. New Jersey has banned people from smoking them indoors in public places and requires buyers to be at least 19 years old.

Minnesota - E-cigarettes and liquid capsules are considered tobacco products and are subject to the tobacco tax, which is currently 95 percent of the wholesale cost of any product containing or derived from tobacco. Distributors who do not pay tobacco tax on these products are subject to penalties, interest, license revocation, and possible criminal charges. Retailers are required to purchase the tax paid product. If they do not comply, they are subject to penalties, interest, license revocation, and possible criminal charges. Consumers who purchase from someone who has not paid the tobacco tax must pay a tobacco consumer use tax. The state requires child resistant packaging for liquid nicotine containers.

The tobacco tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax would only be on the nicotine cartridge value. Similarly, a disposable e-cigarette may have the tax calculated on its nicotine cartridge value if the cartridge is replaceable.

North Carolina - The top tobacco-producing state passed a measure this spring in which a tobacco product is defined as a cigarette, a cigar, or any other product that contains tobacco and is intended for inhalation or oral use, including a vapor product. The excise tax of \$0.45 levied on every pack of traditional cigarettes did not change with the measure. The measure stipulates an excise tax is levied on tobacco products other than cigarettes and vapor products at the rate of 12.8 percent of the cost price of the products. This tax does not apply to the following:

- A tobacco product sold outside the State;
- A tobacco product sold to the federal government; or
- A sample tobacco product distributed without charge.

Further, the measure imposes an excise tax on vapor products at the rate of five cents (5¢) per fluid milliliter of consumable product. All invoices for vapor products issued by manufacturers must state the amount of consumable product in milliliters. Taxes imposed under this section do not apply to:

- A tobacco product sold outside the State;
- A tobacco product sold to the federal government; or
- A sample tobacco product distributed without charge.

Missouri - The general assembly voted on September 10 to override the executive's veto of SB 841, a bill banning sales of e-cigarettes and similar "vaping" products to minors. The bill also carries a provision that bans the state from regulating e-cigarettes like tobacco is regulated. Even as cigarette tax revenue falls, the new law means the booming e-cigarette market won't bolster the state's income. Missouri's tobacco tax revenues have fallen every year since 2006 and were \$99.5 million in FY14, according to the Missouri Department of Revenue. An FDA decision could call Missouri's deregulation into question. At 17 cents a pack, Missouri's cigarette tax is the lowest in the nation. Voters have defeated cigarette tax increase referendums three times since 2002.