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Alcohol, Cigarette, and Cannabis Taxes

New Mexico Revenue Stabilization and Tax Policy Committee

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Overview

- Why do we tax it?
- Alcohol taxes
- Cigarette taxes
- Cannabis taxes
- Conclusions

Why do we tax it?

Different taxes for different policy goals

- **General sales tax** (or a GRT) is used to raise revenue from economic activity; it is not used to discourage purchases or account for negative externalities
- **Hotel and restaurant taxes** are typically higher than general sales taxes but are not used to discourage purchases. In fact, we want them low enough that they do *not* affect consumer choices. Instead, these taxes are ways to collect revenue from non-residents and account for services used by non-residents
- **Motor fuel taxes** are not used (at least in the US) to discourage gas purchases, but resulting revenue typically funds transportation projects, making it a type of “user fee”
- Some **cigarette taxes** (e.g., \$4.50 per pack in DC) are set purposefully high so that they discourage consumers from even buying the product (and thus paying the tax)

What do you want to achieve with taxes on alcohol, cigarettes, and cannabis?



- **Prevent consumption:** Use an exorbitantly high tax
 - Tradeoff: Little to no consumption means little to no revenue; could also possibly push users to illegal sellers
- **Account for externalities:** Dedicate revenue from the tax to related services (i.e., cigarette tax revenue pays for health care programs)
 - Tradeoff: If sole source of funding, you risk harming the service if revenue declines
- **Raise revenue:** Get as much revenue from the tax as possible
 - Tradeoff: If government becomes dependent on the revenue, the government might encourage the consumption of these products
- **Reduce illegal sales:** Keep taxes as low as possible
 - Not discouraging use of possibly dangerous products or accounting for costs with taxes

Note on earmarking

- Nearly every state with a cannabis tax dedicates some of its revenue to specific programs
 - *New Mexico is the notable exception!*
- Some states also do this for cigarette taxes, especially when ballot measures approve rate hikes
- This is almost always political—i.e., done to gain support in the legislature or at the ballot box
- There are some advantages:
 - Funding programs that otherwise would not exist without the revenue
 - Providing services related to the negative public costs of the product
- Major disadvantage: You make the program vulnerable. That is, funding for the program drops if consumption of the product (that you may want to discourage) falls
- Recommendation: Fund programs you think are helpful (e.g., drug prevention, alcohol counseling) with general fund dollars and do not make them solely reliant on consumption of these products

Alcohol taxes

Basics of alcohol taxes

- Alcohol taxes are typically per gallon, with different tax rates for different types of alcohol
 - Liquor is taxed at a higher rate than wine which is taxed at a higher rate than beer
 - Some states apply tiered taxes based on alcohol content in wine and beer
- This tax is levied on the wholesale transaction (not the retail transaction), but it's assumed most of the tax is passed onto the consumer in the purchase price
 - Some states and localities also levy a percentage-of-price tax on alcohol
 - And in 22 states a governments (state or local) collects revenue from gov-owned liquor stores
- The federal government also taxes alcohol:
 - Liquor: \$13.50 per gallon
 - Wine: \$1.07 to \$3.40 per gallon (depending on alcohol content)
 - Beer: \$0.58 per gallon

State alcohol tax rates: Per gallon, low to high

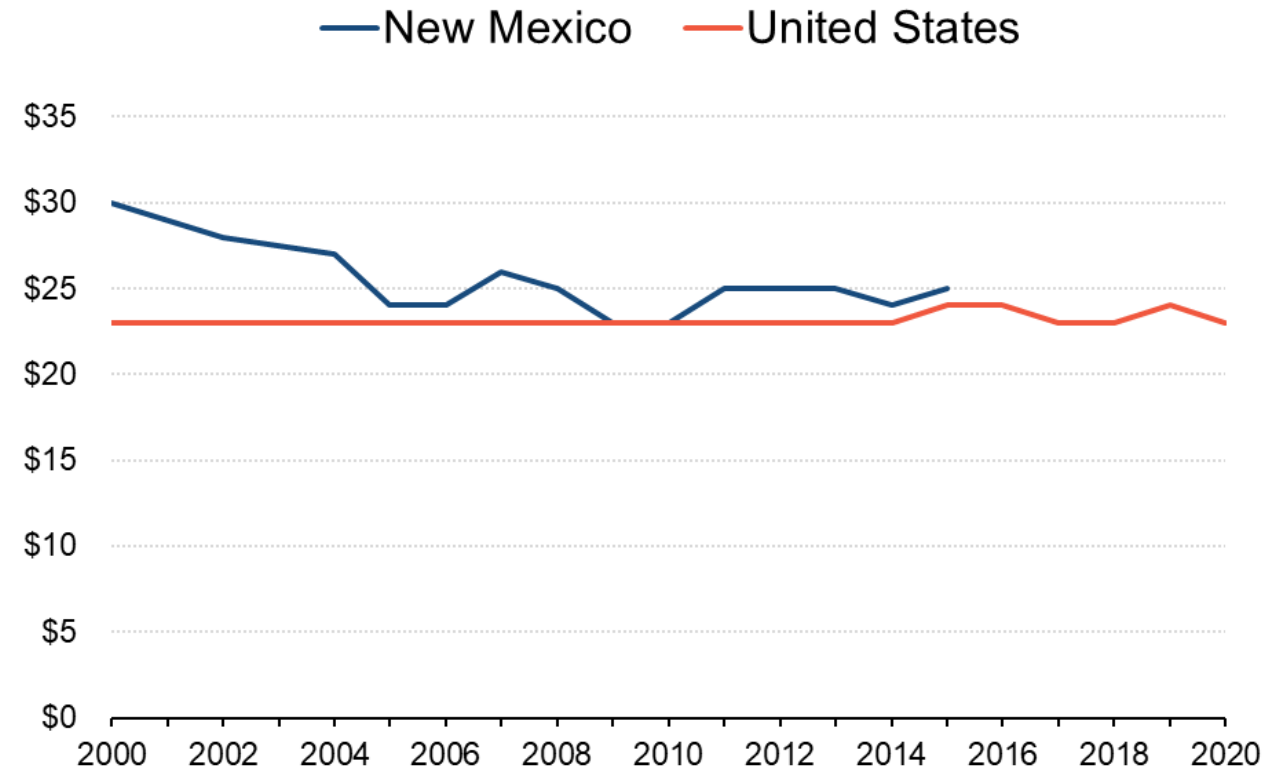
- Liquor: \$1.50 in the District of Columbia/Maryland to \$14.27 in Washington
 - New Mexico: \$6.06
 - *NM's rate is 5th highest (WA is an outlier)*
- Wine: \$0.20 in California/Texas to \$2.50 in Alaska
 - New Mexico: \$1.70
 - *NM's rate is 4th highest*
- Beer: \$0.02 in Wyoming to \$1.29 in Tennessee
 - New Mexico: \$0.41
 - *NM's rate is 9th highest*

State alcohol tax increases are uncommon

- Since 2010, only Connecticut, Delaware, Louisiana, and Rhode Island have increased their (per gallon) alcohol excise tax rates on beer, wine, or liquor
 - That data was collected as part of an in-depth study of alcohol taxes in 2017 (TPC: McClelland, Iselin)
 - To my limited knowledge, no state has increased its per-gallon alcohol taxes since 2017
- In fact, the 2017 study found that in most states consumers are paying less in alcohol excise taxes than in 1982 (after adjusting for inflation)
- Overall, the taxation of alcohol, at the federal and state level, is relatively low when compared with the taxation of cigarettes

State and local alcohol tax revenue: Per capita, adjusted for inflation

- National real state and local alcohol tax revenue has essentially been flat for two decades. FWIW, liquor store revenue steadily increased from \$24 to \$34
- **NOTE:** I'm using Census data because it provides national S&L data and allows for easy comparisons. But Census data is flawed. And NM's post 2016+ alcohol data is almost certainly, and significantly, wrong. Thus, it is omitted from the graph.
- However, New Mexico's slight downward *trend* in alcohol tax collections over time is correct



Source: US Census.

Note: No data are available for New Mexico (or any other state) for 2001 and 2003. New Mexico's 2017 to 2020 Census data is inaccurate and omitted.

Reforms and rate hikes?

- **Increase per gallon taxes?** New Mexico's rates are high compared with other states, but state taxes are generally low—New Mexico could push its rates toward top of state rates
- **Percentage-of-price tax?** DC (10.25%) and MD (9%) levy an additional tax on price
 - Caveat: Taxes built into the price (i.e., wholesale) are typically more effective at discouraging purchases than taxes applied at checkout—let the consumer account for tax when making a decision
 - This type of tax will have a larger effect on more expensive alcohol
- **Do taxes work?** Strong evidence alcohol taxes improve health and well-being (TPC 2015: Marron, Gearing, Iselin), but less evidence they reduce drunk driving (TPC 2017: McClelland, Iselin)
- **Tradeoffs?**
 - Alcohol businesses, bars, restaurants, etc. oppose higher taxes because it increases their costs
 - Are there possibly public programs and services that could do a better job at curbing the harms of drinking? If so, fund them—and not necessarily solely with alcohol taxes

Cigarette taxes

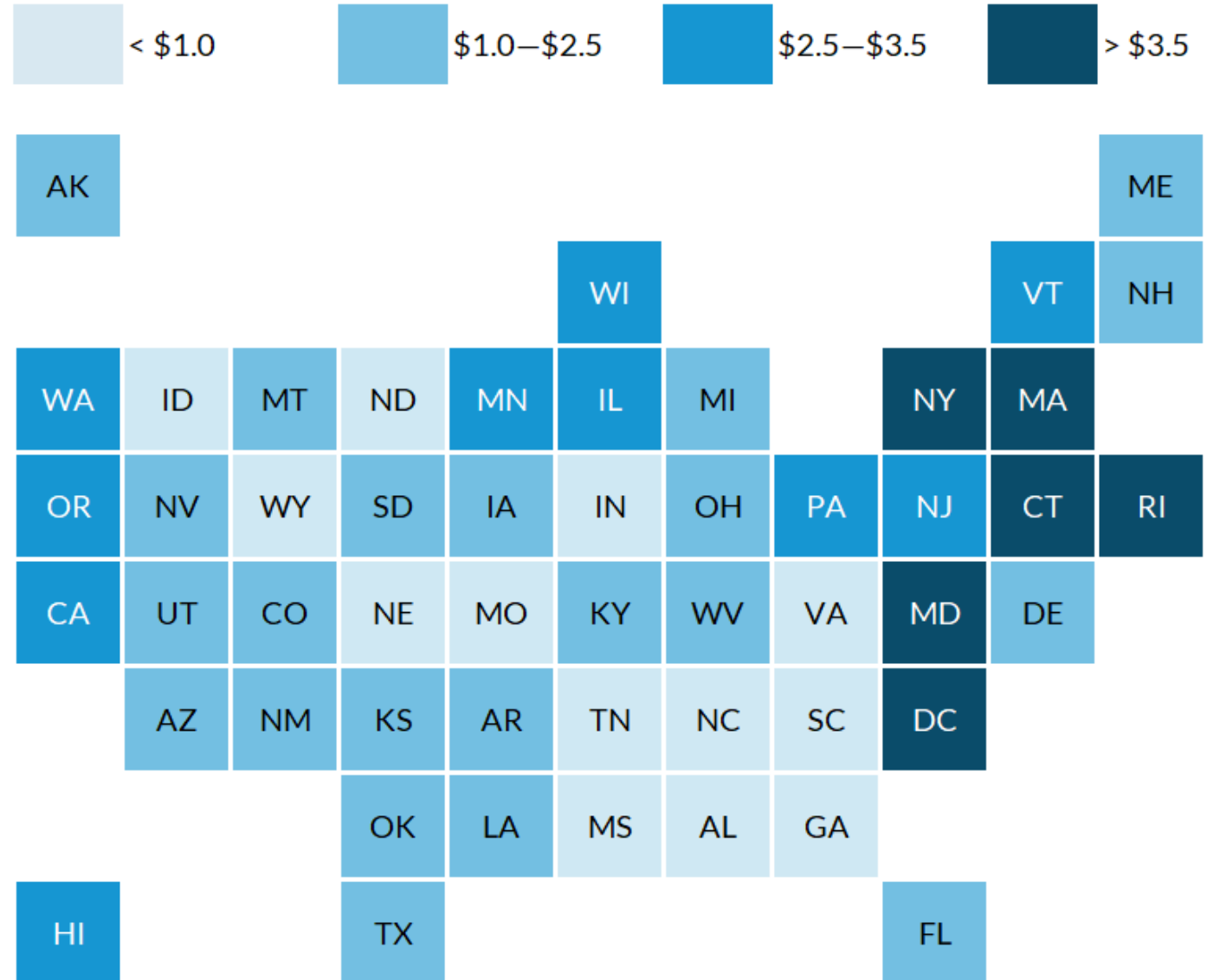
Basics of cigarette taxes

- Cigarettes are taxed per pack
- The tax is levied on the wholesale transaction (not retail transaction), but it's assumed most of the tax is passed onto the consumer in the purchase price
- The federal government levies a \$1.01 per pack tax on cigarettes
- States also tax “other tobacco products” (OTP) such as chewing and smokeless tobacco
 - These are levied on wholesale transactions, but the tax is typically calculated as a percentage of the product's price
- Increasingly, states are also taxing vape products (or e-cigarettes)
 - There are both percentage-of-price and per-unit taxes on vaping products

State cigarette tax rates

- Rates range from \$0.17 in Missouri to \$4.50 in DC*
- CT, DC, NY, RI > \$4.00
- GA, MO, NC, ND < \$0.50
- New Mexico's rate is \$2.00 (19th highest state rate)

**There are also local taxes in 9 states*



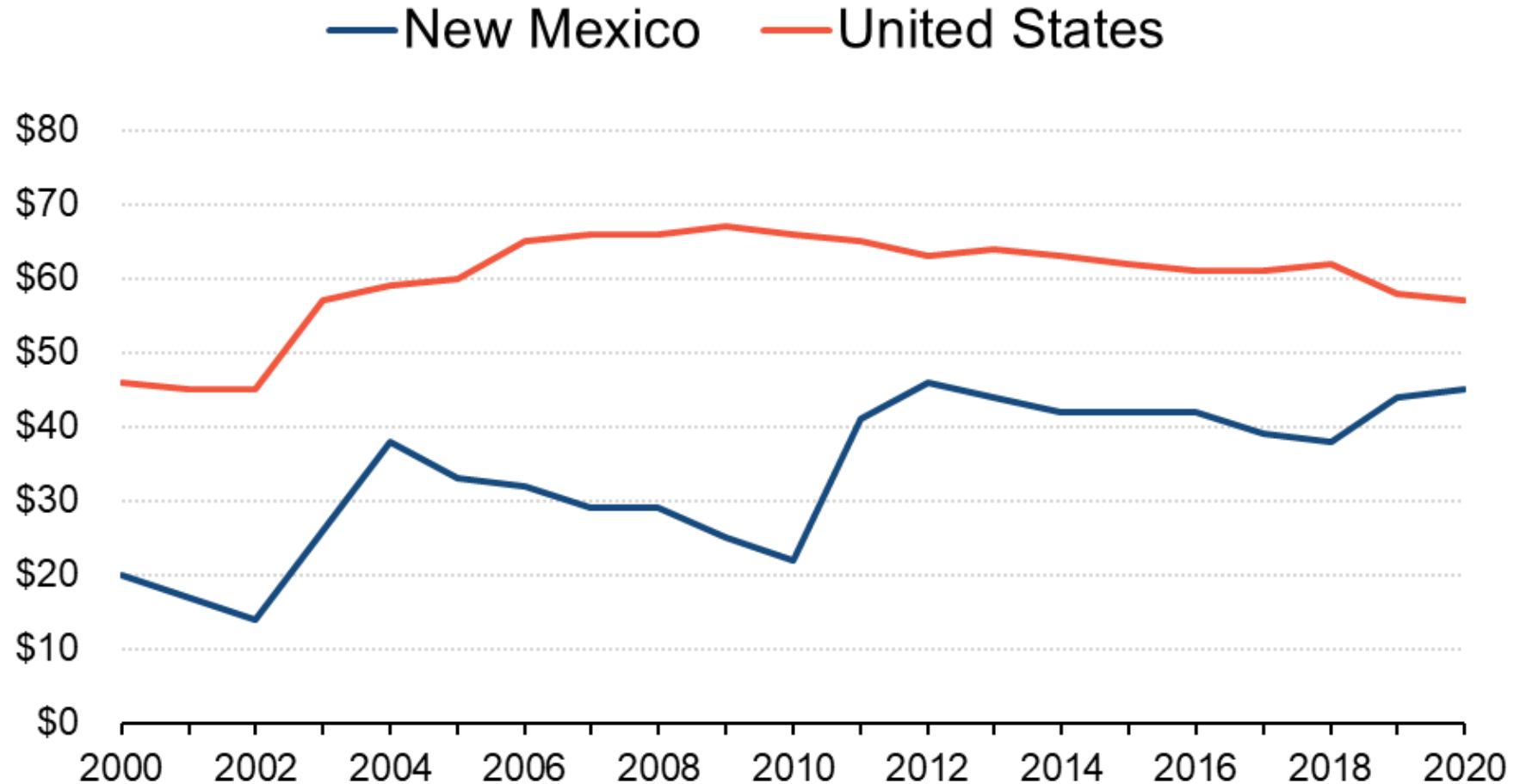
State cigarette tax increase are common

- 49 states and DC have increased their state cigarette tax since 2000
 - Missouri is the only state that did not increase its cigarette tax during that period
 - Numerous states increased their tax multiple times over that period
- Largest one-time, per-pack increases since 2000:
 - California: \$2.00 (2017)
 - DC: \$2.50 (2018)
 - Maryland: \$1.75 (2021)
 - Minnesota: \$1.60 (2013)
 - New York: \$1.60 (2010)
 - Oregon: \$2.00 (2021)

State and local cigarette tax revenue: Per capita, adjusted for inflation



- National real state and local cigarette tax revenue peaked in 2009
- CDC: Share of smokers in the US declined from 21% in 2005 to 13% in 2020
- New Mexico increased its tax rate in 2003, 2010, and 2019

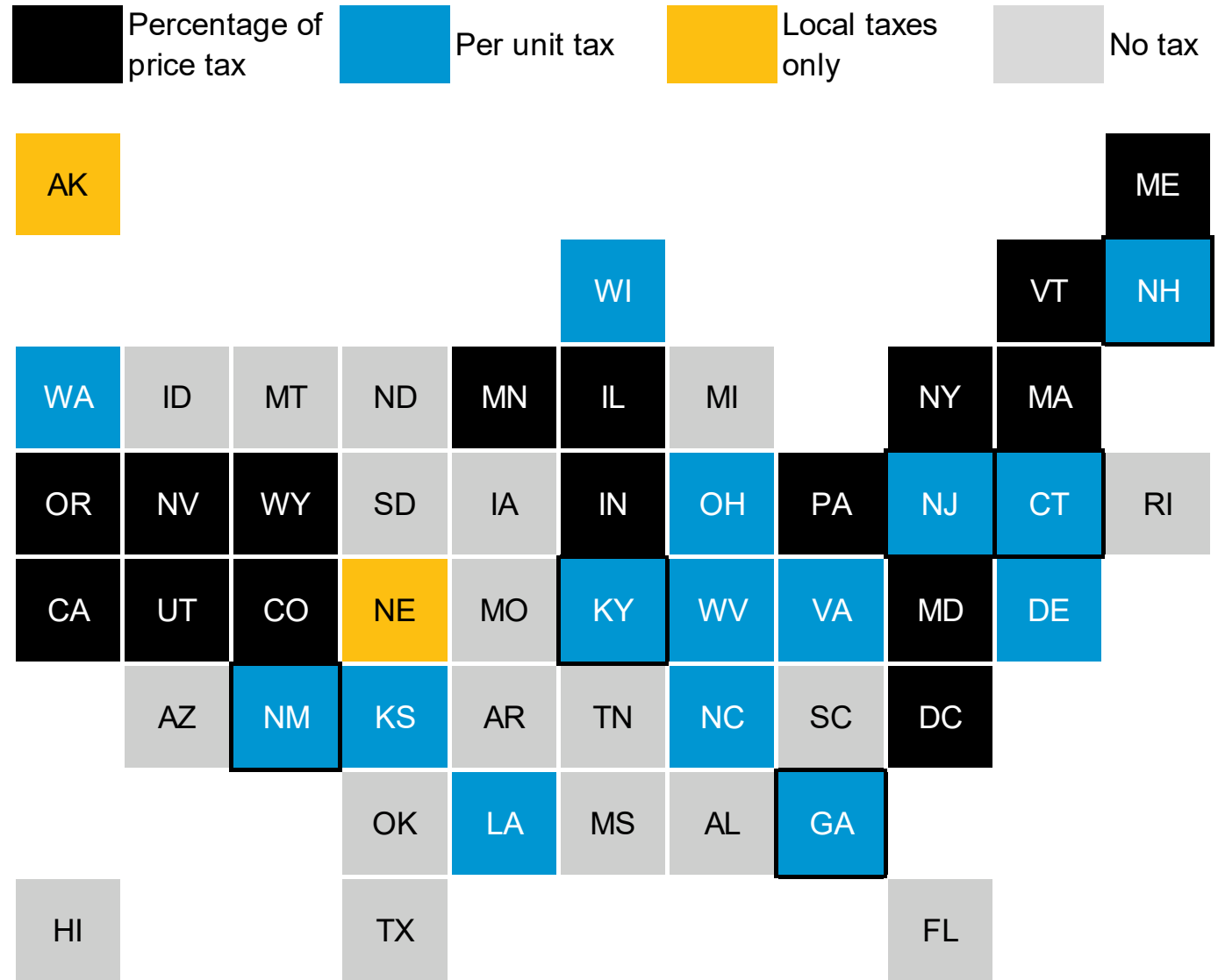


Source: US Census.

Note: No data are available for New Mexico (or any other state) for 2001 and 2003.

Vaping taxes

- 30 states and DC levy a tax on vaping products (local governments in AK & NE also levy a tax)
- Some use percentage-of-price taxes (like other OTPs), some use per-unit taxes (i.e., cents per milliliter of the liquid in the vape pen), and some use both (often to discourage the use of “closed” products like JUUL)
- Vaping is increasingly popular but use and tax revenue relatively small (~\$1M to \$10M in revenue per state)



Reforms and rate hikes?

- **Increase per pack rate?** New Mexico's rate (\$2) is roughly equal with tax rates in Arizona and Colorado but well below national leaders (\$4+)
- **Inflation?** A per-unit tax loses value as inflation increases. The state could create automatic, annual rate increases tied to inflation (Minnesota previously did this)
- **Do taxes work?** Yes, cigarette taxes reduce smoking (TPC 2015: Marron, Gearing, Iselin)
- **Tradeoffs?**
 - Reducing smoking reduces cigarette tax revenue, so be careful with earmarking
 - High state cigarette taxes can lead to smuggling (Tax Foundation 2019: Boesen)
- **Vape taxes?**
 - Vaping is popular among both young adults and people trying to quit smoking
 - Try to ensure your tax system strikes a balance between the two

Cannabis taxes

Basics of cannabis taxes

- There are three types of cannabis taxes:
 1. **Percentage-of-price tax:** Similar to a sales tax but at higher rates; collected at retail
 2. **Weight-based tax:** State calculations differ, but per unit (e.g., per ounce) and often with different rates on different parts of the plant; always collected at wholesale transaction
 3. **Potency-based tax:** Rate affected by the marijuana product's THC level (e.g., 20% or 20 milligrams); this tax can be collected at wholesale or retail
 - Local governments also levy cannabis taxes, typically relatively low percentage-of-price tax
- Marijuana is still prohibited under federal law

New TPC report: “The Pros and Cons of Cannabis Taxes”

<https://www.taxpolicycenter.org/publications/pros-and-cons-cannabis-taxes>

State and Local Taxes on Cannabis in Each State

2022

- There are too many variations in cannabis taxes across states for simple tax rate comparisons
- But there are simple tradeoffs
- High tax vs. low tax
- Complex tax (with multiple goals) vs. simple tax (only goal is revenue)
- Tax that allows broad consumption of all products vs. tax that discourages consumption of high-THC products

| State | Percentage-of-price | | Weight-based | Potency-based | General sales tax | |
|---------------|---------------------|-------|--------------|---------------|-------------------|-------|
| | State | Local | | | State | Local |
| Alaska | | ✓ | ✓ | | | ✓ |
| Arizona | ✓ | | | | ✓ | ✓ |
| California | ✓ | ✓ | | | ✓ | ✓ |
| Colorado | ✓ | | ✓ | | | ✓ |
| Connecticut | | ✓ | | ✓ | ✓ | |
| Illinois | ✓ | ✓ | | ✓ | ✓ | ✓ |
| Maine | ✓ | | ✓ | | | |
| Massachusetts | ✓ | ✓ | | | ✓ | |
| Michigan | ✓ | | | | ✓ | |
| Montana | ✓ | ✓ | | | | |
| Nevada | ✓ | | ✓ | | ✓ | ✓ |
| New Jersey | | ✓ | ✓ | | ✓ | |
| New Mexico | ✓ | | | | ✓ | ✓ |
| New York | ✓ | ✓ | | ✓ | | |
| Oregon | ✓ | ✓ | | | | |
| Rhode Island | ✓ | ✓ | | | ✓ | |
| Vermont | ✓ | | | | ✓ | ✓ |
| Virginia | ✓ | ✓ | | | ✓ | ✓ |
| Washington | ✓ | | | | ✓ | ✓ |

Cannabis tax revenue is significant, but not endless

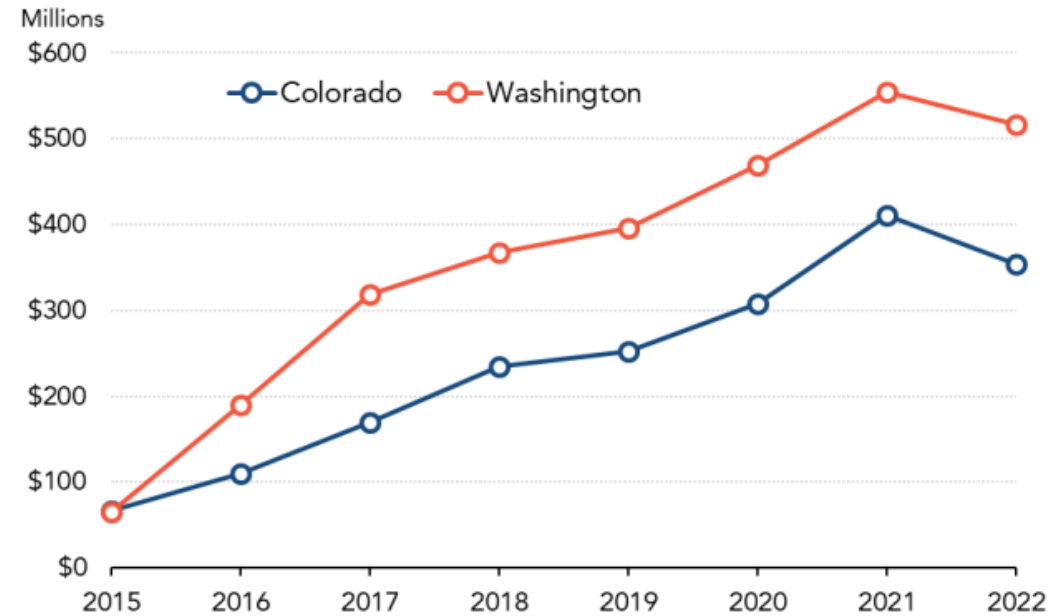
State Tax Revenue from Cannabis Excise Taxes, FY 2022

| State | Total (millions) | Per capita | Share of state tax revenue |
|---------------|------------------|------------|----------------------------|
| Alaska | \$28.9 | \$39 | 1.2% |
| Arizona | \$132.8 | \$18 | 0.6% |
| California | \$774.4 | \$20 | 0.3% |
| Colorado | \$353.7 | \$61 | 1.7% |
| Illinois | \$466.8 | \$37 | 0.8% |
| Maine | \$18.2 | \$13 | 0.3% |
| Massachusetts | \$156.7 | \$22 | 0.4% |
| Michigan | \$163.5 | \$16 | 0.4% |
| Nevada | \$152.3 | \$48 | 1.7% |
| Oregon | \$170.6 | \$40 | 1.0% |
| Washington | \$517.0 | \$67 | 1.5% |

Source: State tax websites or direct contact with the state tax department and US Census Bureau.

Cannabis Tax Collections in Colorado and Washington, FY 2015–2022

Totals do not include revenue from general sales tax collections



Source: Colorado Department of Revenue and Washington State Liquor and Cannabis Board.

Notes: FY = fiscal year; nominal dollars and fiscal years. Only the state government levies a cannabis excise tax in both states.

- AZ, CA, CO, IL, MA, NV, OR, and WA collected more from cannabis taxes than alcohol taxes in FY 2022
- CO, NV, and WA collected more from cannabis taxes than cigarette taxes in FY 2022

Reforms and rate hikes?

- New Mexico only started taxable sales in April, so no need to reform its taxes
- In fact, New Mexico's decision to enact automatic, one-point rate increases (tax rate will grow from 12% to 18% between 2025 and 2030) is a smart way to address a possible decline in cannabis tax revenue as the state's marijuana market evolves and its prices decline
- That said ...
 - Five states saw cannabis tax revenue fall for the first time in FY 2022
 - Advances in THC testing could make potency-based taxes more appealing
 - Federal reforms, from allowing marijuana businesses access to banking services to full federal legalization, could affect every state's cannabis market
- So be sure to continuously monitor New Mexico's marijuana market and tax system
- Upside: Because New Mexico does not dedicate its cannabis tax revenue, cannabis tax reform could be far easier here than in other states

Conclusions

Take-aways

- Taxes on alcohol, cigarettes, and cannabis can reduce consumption, and that can have large benefits for public health and well-being (reduction in smoking, drinking)
 - But these taxes also can have negative consequences, like harming local businesses (alcohol) or pushing users to illegal sellers (cannabis)
- Taxes on alcohol, cigarettes, and cannabis can generate revenue for public services, and particularly for services that address the public costs created by these products
 - But the revenue is possibly low (alcohol) or hard to predict (cannabis) or reduced by significant tax increases (cigarettes). And if programs are solely reliant on revenue from these taxes, it could harm the programs (not enough funding) or force the government into tough situations (becoming dependent on the use of these products)
- Taxes are only one policy tool. There are possibly government programs and services that achieve your goals better than taxes
 - If so, fund those programs. And do not make them entirely reliant on these taxes



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Thank you

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