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FISCAL IMPACT REPORT

ORIGINAL DATE 03/10/09

SPONSOR HJC **LAST UPDATED** _____ **HB** CS/287/HJCS

SHORT TITLE Tobacco Sales and Manufacturing Requirements **SB** _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
				NFI General Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to SB219

SOURCES OF INFORMATION

LFC Files

Response Received on HJC substitute

Taxation and Revenue Department (TRD)

Responses Received From on Original Bill

New Mexico Corrections Department (NMCD)

Attorney General's Office (AGO)

Department of Health (DOH)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HJC Substitute

The House Judiciary Committee substitute for the House Business and Industry substitute for House Bill 287 strengthens the enforcement of the tobacco master settlement agreement (MSA) compliance for non-participating manufacturers. The bill makes changes that are necessary for the diligent enforcement of the 1998 Master Settlement Agreement (MSA) with states' attorneys general, including New Mexico, and major tobacco manufacturers. The MSA has a provision where "participating manufacturers," the parties to the lawsuit at the time or manufacturers that has joined since, can reduce the amount of the payment if they have lost market share to non-participating manufacturers because of lax enforcement of the MSA and tobacco statutes.

Key components of HB287/HJCS:

- Clarifies units of tobacco product refers to individual cigarettes and ounces of “roll your own” tobacco or sales of products bearing a tax-exempt stamp.
- Requiring certification of compliance with the Tobacco Escrow Fund Act from newly qualified non-participating members.
- Updating the Directory of Tobacco Product Manufacturers and Cigarette Brands to include assurances of compliance of newly qualified and elevated risk non-participating manufacturers.
- Providing for bond requirements of newly qualified and elevated risk non-participating manufacturers.
- Requiring non-participating manufacturers located outside the United States, including its importers, to provide for an agent for service of process.
- Disallowing any variations in reporting of cigarette sales from newly qualified non-participating manufacturers or other tobacco product manufacturers as defined in Section 6-4-12 NMSA 1978.
- Creating a provision of Attorney General authority for audit and investigation of suspected violations of the Tobacco Escrow Fund Act.
- Establishes that the Attorney General may require a newly qualified and elevated risk non-participating manufacturer to post a bond for the first three years or longer of listing in the directory. HB287 delineates conditions related to the posting of a bond.
- Creating a provision for proper documentation of Internet or mail-order sale of cigarettes.
- Establishing civil and criminal penalties for violations of the Tobacco Escrow Fund Act and including such violations in the Unfair Trade Practices Act.
- Makes knowingly making a materially false statement a fourth degree penalty.

The substitute amends the Cigarette Tax Act redefine “cigarette” to include those rolled with reconstituted tobacco, little cigars and any other rolled tobacco defined in Section 6-4-12 NMSA 1978, which governs the tobacco settlement permanent fund. Section 6-12 NMSA 1978 defines cigarette as:

any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette", 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette";

Contraband cigarettes now include cigarettes that are not in the Attorney General’s directory of approved brands or manufacturers for the purposes of the cigarette excise tax.

Differences from prior versions:

- The HJC substitute removed language indicating that a civil investigative demand will not be disclosed except on court order.
- Removes the subpoena power for the AGO
- Removes the provision that each record or report that is false be a separate offense

FISCAL IMPLICATIONS

The fiscal impact is indeterminate but there is litigation pending arising from lax enforcement of the MSA regarding market share and non-participating manufacturers. For the last three years and probably this year, there has been an amount withheld from the participating manufacturers from the annual payment. According to the terms of the litigation, New Mexico could potentially be exposed to a loss equal to a full year’s payment or \$48 million. In the table below, the row titled “NPM Adjustments” are the amounts that have been withheld and are estimated to be withheld. Shoring up the enforcement of the MSA is a key component to defending against these charges.

The AGO reports these changes will make its enforcement of the tobacco statutes more efficient and effective and could lead to financial recovery for the state.

History and Forecast of MSA Payments to New Mexico

<i>in millions of dollars</i>	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08
Base Payments (1)	14.70	34.30	36.20	41.30	34.20	37.10	38.00	39.70	40.42	48.10
NPM Adjustment (2)								(4.90)	(4.20)	(3.20)
Actual Payments to Permanent Fund (3)		48.80	37.40	43.70	43.80	37.50	35.40	34.80	36.22	44.90
Distribution to General Fund (4)					65.65	37.50	35.40	34.80		
Distribution to Program Fund (5)			24.40	18.70					18.11	22.45
Forecast										
Base with Adjustments (6)	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10
NPM Adjustment	(3.20)	(3.20)								
Net Estimated Payment to Permanent Fund	44.90	44.90	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10
Distribution to Program Fund (7)	44.90	44.90	24.05	24.05	24.05	24.05	24.05	24.05	24.05	24.05

Notes:

(1) National payment multiplied by 0.5936 percent NM Allocation share

(2) NPM = Non Participating Manufacturer. From 2006 to 2008, part of the payments were withheld pending determination of market share loss caused by NPMs.

(3) Net Contributions reported in State Investment Council FY2007 Annual Report

(4) In 2003, the distribution was changed to 100 percent to the general fund until 2007.

(5) In 2007, the distribution reverted to 50 percent to the tobacco program fund and the balance remaining in the permanent fund.

(6) Assumes 3 percent positive inflation adjustment cancels out 3 percent negative volume adjustment applied to base prior to NPM adjustment.

(7) SB 79 passed in February 2009 distributes the entire payment to the program fund for two years.

SIGNIFICANT ISSUES

AOG:

It is important to expressly include “little cigars” in the definition of “cigarettes” because several tobacco manufacturers are selling little cigars because cigars are taxed at a much lower rate than cigarettes and because cigar manufacturers are not required to make the same escrow and health-related payments that cigarette manufacturers are required to pay. These manufacturers are selling tobacco products with small amounts of tobacco in

the wrapping of the cigarette. They then argue that, because of that tobacco in the wrapping, the product is properly considered a cigar and subject to significantly lower taxes. Those little cigars are, however, not cigars at all; they are cigarettes. The amendment to Section 7-12-2(A)(3) makes this unquestionably clear.

ADMINISTRATIVE IMPLICATIONS

According to NMCD, “the additional felony convictions resulting from this bill would increase the Department’s costs by leading to minimal to moderate increases to the inmate population and probation/parole caseloads. The bill seems unlikely to lead to a substantial number of new convictions, or to result in a substantial increase in the Department’s inmate population or probation/parole caseloads. However, it is always difficult to predict or estimate the ultimate effect of any new crime bill with any certainty. As is almost always the case, there is no appropriation in the bill to the Department to cover any of the Department’s increased costs associated with the creation of this new crime.”

According to TRD, the bill requires licensees that import cigarettes into the United States and sells or delivers them in New Mexico to file reports with TRD monthly in a new provision of the Cigarette Enforcement Act. It also adds the attorney general to TRD as enforcement agencies of the Cigarette Enforcement Act.

TECHNICAL ISSUES

TRD:

Section 11 conflicts with the SB-219 definition of “cigarette” preferred by the TRD and endorsed by the Revenue Stabilization and Tax Policy interim Committee. The HBIC Substitute adds an amended definition of “cigarette” that is almost identical to the definition put forth by SB-219 except for two features:

- 1) addition of the word “non-reconstituted” (on page 23, line 12) when describing a 100% natural leaf wrapping; and,
- 2) addition of “and little cigars” (on page 23, line 18).

The word “non-reconstituted” is probably superfluous in the context of a 100% natural leaf tobacco wrapping. The reference to “and little cigars” probably creates an unanticipated problem in terms of definitions. The term “little cigar” is not defined in state statute but is defined in federal tax law and that definition is based on weight. Without inclusion of this term, the state definition would not be limited to any specific weight, but would be more inclusively defined as anything that resembles a cigarette (see the current regulation on the definition of a “cigarette” in 3.9.1.7 NMAC).

To avoid potential conflicts between HB-287 and SB-219, the Department recommends that Section 11 of the HB-287 Substitute be amended to be identical to Section 1 of SB-219.

RELATIONSHIP

AGO reports the provisions of SB219 will complement the provisions here and will provide the necessary tools to enforce the statutes effectively.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Enforcing the tobacco statutes including provisions relating to non-participating manufacturers is critical to defending against litigation by the participating manufacturers regarding loss of market share. These changes allow the AGO to go after violations more effectively and efficiently and will bolster the state's case. As the table above shows, the state has a chance to recoup over \$12 million (excluding the forecasted withheld amounts) of segregated payments. More importantly, the state needs to defend against the possibility of a \$48 million loss, which will affect both the tobacco fund and the general fund.

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