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FISCAL IMPACT REPORT

ORIGINAL DATE 01/25/16
LAST UPDATED _____

SPONSOR McSorley, C. **HB** _____

SHORT TITLE Taxation of Nicotine Products **SB** 4

ANALYST Keyes

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
\$120	\$700	\$690	\$680	\$670	Recurring	General Fund

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$365	\$450	\$450	\$1,285	Recurring	Taxation and Revenue
Total	\$100	\$102.5	\$102.5	\$305	Recurring	General Fund

Parenthesis () indicate expenditure decreases

Relates to SB77

SOURCES OF INFORMATION

LFC Files

Responses Received From

Human Services Department (HSD)

Taxation and Revenue Department (TRD)

Department of Health (DOH)

SUMMARY

Senate Bill 4 (SB4) would amend and enact new sections of the Tobacco Products Tax Act Section 7-1-2 NMSA 1978 to become the Tobacco and Nicotine Products Tax Act. It adds new Section 7-12A-11 to impose tax on nicotine products at a rate of \$0.04 per milligram of nicotine as contained in the nicotine product. Nicotine product is defined as a liquid solution containing nicotine that is intended for human consumption via an electronic delivery device.

The bill adds new Section 7-12A-12 to impose nicotine products labeling requirements on manufacturers identifying the quantity of milligrams of nicotine contained in the nicotine product. It requires the Taxation and Revenue Department (TRD) to periodically obtain samples of nicotine products from retail locations throughout the state to ensure compliance and accurate reporting of nicotine content. The Scientific Laboratory Division of the Department of Health (DOH) will review the samples provided by TRD to determine the difference (if any) between the nicotine content of the product and the content on the product's label. DOH will deliver the results to TRD for reporting purposes.

There is no effective date of this bill, thus the effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

To calculate the estimated revenue impact, TRD used both actual and projected cigarette volumes from the December 2015 Consensus Revenue Estimate and acknowledges there is a potential correlation between the decline of tobacco tax revenue collections and the increase in sales of electronic cigarettes (e-cigarettes). The estimate considers the fact that despite strong sales growth of e-cigarettes in recent years, the Food and Drug Administration (FDA) could soon start regulating this industry in such a way that discourages consumer demand of certain e-cigarette products currently in the market. TRD also considered the decline in the consumption of traditional cigarettes could be related to changes in consumer behavior due to increased levels of education and to health-related concerns. TRD assumes that on average, a traditional cigarette contains about 2 milligrams of nicotine. If the proposed legislation aims at taxing nicotine products, specifically nicotine sold in liquid form, in the same magnitude it taxes conventional cigarettes, the equivalent tax of \$0.04 on one milligram of nicotine is expected to generate approximately \$120,000 in FY16 (partial impact) and \$700,000 in FY17. The e-cigarette industry is expected to continue to grow at a rate of 10 percent per year in New Mexico but that could change if the FDA restrictions on which type of products can be sold go into effect.

This bill serves the dual tax policy of objectives of adequacy and equity. With respect to adequacy, it helps ensure state revenues are collected from all nicotine products, as e-cigarettes gain more market share. With respect to equity, it ensures that all nicotine products are subject to taxation, rather than creating a disparity between conventional tobacco products and e-cigarettes. As detailed below, this bill would require significant IT changes within TRD's system as well as the development of a regulatory structure. Therefore, TRD recommends a delayed effective date of July 1, 2017, so that IT systems can be adequately updated and tested and regulations can be promulgated before the bill becomes effective.

SB 4 would establish a nicotine product excise tax in the amount of \$.04 per milligram of nicotine. The American Cancer Society at the last meeting of the New Mexico Allied Council on Tobacco) stated they believed the rate at \$.04/milligram was sufficient and could help to reduce use, a similar tactic as used on cigarettes.

Federal law requires the Behavioral Health Services Division (BHSD) to conduct Synar merchant education visits of all tobacco retailers to ensure that retailers are not selling tobacco products to minors. With the new regulation of e-cigarettes, the Synar inspection requirement was extended to e-cigarettes retailers. SB 4 would add Nicotine Products to state regulation, and BHSD would be required to inspect the Nicotine Product Retailers. This inspection is expected to cost about \$350 per new retailer.

The measurement of nicotine content of retail products by the Department of Health Scientific Laboratory Division (SLD) in order to ensure accurate reporting of nicotine product for the TRD would cost the SLD \$65 per analysis (reagents, standards, and supplies). The testing instrument would need to be purchased and is an estimated \$100 thousand and maintenance fees. The Scientific Laboratory Division is not funded to perform the compliance testing proposed in SB4; assistance needed to help supplement costs. While the annual number of retail products to be tested would be determined by TRD, a compliance program that tested 500 retail product samples per year could cost approximately \$32.5 thousand for work performed by the Scientific Laboratory Division. This amount does not include the cost of staff time which would be dedicated to completing the tests.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

Nicotine products (liquid nicotine for use in e-cigarettes) are not currently regulated by the State. Requiring retailer registration, accurate product labeling, and compliance checking, will provide the state and consumers with additional information.

In its analysis of the bill, HSD cites a 2015 national youth survey, Monitoring the Future, which found that while cigarette use is down among teens, a substantially higher number used e-cigarettes due to a perception that they do not harm health. About 9.5 percent vs. 3.6 percent of 8th graders, 14 percent vs. 6.3 percent of 10th graders, 16.2 percent vs. 11.45 percent of 12th graders used e-cigarettes vs. smoked cigarettes. 19 percent of 8th graders believed there was great risk of harm with regular e-cigarette use versus 63 percent who believed great risk exists for smoking a pack or more of cigarettes per day.

HSD reports the American Lung Association states e-cigarettes that use unregulated nicotine products have been shown to contain harmful chemicals such as antifreeze and formaldehyde along with flavorings known to cause lung damage. In addition, nicotine is an addictive substance known to cause poisoning in large doses, particularly for children; harm to developing fetuses potentially resulting in low birth weight, preterm delivery and stillbirth; and associated with cognitive and behavioral impairments on adolescent brain development (<http://www.lung.org/stop-smoking/smoking-facts/e-cigarettes-and-lung-health.htmls>).

The registration process for nicotine products would identify e-cigarette retailers and allow the BHSD-HSD to comply with the federal SYNAR requirements to ensure that retailers are not selling nicotine products to minors.

PERFORMANCE IMPLICATIONS

SB4 relates to the FY17-FY19 NM Department of Health Strategic Plan: Result 1: Improved health status for New Mexicans.

Indicators: Percent of adults who smoke; Percent of adolescents who smoke.

SB4 also relates to the NM Department of Health, Public Health Division Performance Indicator: Percent of QUIT NOW enrollees who successfully quit using tobacco at 7-month follow-up.

ADMINISTRATIVE IMPLICATIONS

TRD estimates a high overall impact from the bill. ITD impact of approximately 2,000 hours includes the addition of a new tax type under the cigarette tax program requiring the creation of a new GenTax document and Taxpayer Access Point document; new return transactions and revenue would need to be configured as well. These changes require new return generation letters and separate reports to list the details. All these necessary changes cannot be accomplished efficiently and accurately assuming the effective date of the bill is 90 days following the end of the 2016 legislative session. TRD recommends establishing an effective date of July 1, 2017.

The impact of the bill on the Revenue Processing Division at TRD would be recurring costs related to five new FTEs to educate the general public which entails the preparation of forms, instructions, educational materials, and to develop the back-end systems for processing. Additionally, there will be a need to set up the payments for processing. A new FTE would also be needed for the collection of samples forwarded to the Department of Health, and for recording the results.

BHSD-HSD would be required to conduct federal Synar inspections to ensure the retailers are not selling nicotine products to minors. BHSD does not receive funding for these inspections which are anticipated to cost about \$350 for each new retailer. Tobacco and e-cigarette retailers registration information is not shared between TRD and BHSD-Synar currently.

No HSD IT impact. Synar information is kept in a contractor database and any impact to that database is not related to HSD IT.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB4 is related to SB77 which proposes to expand the types of products subject to the tobacco products tax to include nicotine products and the delivery mechanisms such as an electronic device.

TECHNICAL ISSUES

The bill should conform the use of the word “nicotine” to conform to the federal definition:” NICOTINE.--The term ‘nicotine’ means the chemical substance named 3-(1-Methyl-2-pyrrolidiny) pyridine or C[10]H[14]N[2], including any salt or complex of nicotine. TOBACCO REGULATION, FEDERAL RETIREMENT REFORM, PL 111-31, June 22, 2009, 123 Stat 1776.

Regulation is needed for clarification as to who TRD will consider a “first purchaser.”

Section 7-12A-12(A) indicates the manufacturer shall affix a label specifying the amount of nicotine contained in the nicotine product; however Subsection (B) indicates samples will be obtained from the retailers and tested. If the manufacturers are responsible for affixing the label with the nicotine content, then the samples should be taken from the manufacturer rather than the retailer.

There is no provision for additional auditing, penalty, or consequence if the product is mislabeled.

Regulations would need to be developed and clarification on the mechanics of the collection of the samples would be needed based on the general practice that retail shops mix the nicotine with the liquid at the time of sale, per the customer’s request. Furthermore, a definition of manufacturer would assist with administration to ensure that a retailer who combines the nicotine product with a liquid made for the electronic cigarette, is not considered a manufacturer.

AMENDMENTS

TRD recommends an effective date of July, 1, 2017.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The Tobacco Products Tax Act would remain unchanged. Nicotine products would not be taxed as a tobacco product. There would be no requirement for manufacturer to affix a content labeling on all nicotine products. E-cigarettes will continue to not be labeled with nicotine concentrations. Periodic compliance checks to ensure accurate nicotine content labeling on nicotine products would not be conducted.

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