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## FISCAL IMPACT REPORT

SPONSOR	Trujillo, J.	ORIGINAL DATE	2/13/19	LAST UPDATED		HB	502
SHORT TITLE	Increase Tobacco Products Tax					SB	
						ANALYST	Iglesias

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0.0	\$5,950.0	\$5,800.0	\$6,050.0	\$6,300.0	Recurring	General Fund (Tobacco Products Tax Increase)
\$0.0	\$2,600.0	\$2,850.0	\$3,100.0	\$3,450.0	Recurring	General Fund (E-cigarettes)
<b>\$0.0</b>	<b>\$8,550.0</b>	<b>\$8,650.0</b>	<b>\$9,150.0</b>	<b>\$9,750.0</b>	<b>Recurring</b>	<b>TOTAL General Fund</b>

Parenthesis ( ) indicate revenue decreases

Conflicts with HB261 and SB166.

Relates to HB256, HB259, HB260, SB338, SB342, SB343, and SB450.

## SOURCES OF INFORMATION

LFC Files

### Responses Received From

Department of Finance and Administration (DFA)

Taxation and Revenue Department (TRD)

Human Services Department (HSD)

Department of Health (DOH)

## SUMMARY

### Synopsis of Bill

House Bill 502 amends the tobacco productions tax (Section 7-12A-3 NMSA 1978) to increase the tax rate to 45 percent of the wholesale price from 25 percent and add e-cigarette products to the definition of tobacco products, including the electronic delivery device as well as the nicotine product (i.e. e-liquid). The effective date of this bill is July 1, 2019.

## FISCAL IMPLICATIONS

The fiscal impact table represent LFC staff analysis using the December 2018 consensus revenue forecast for tobacco products tax (TPT) revenue as the starting point. The estimates assume price

increases will have an inverse effect on consumption of tobacco products and e-cigarettes (higher prices will reduce consumption). New revenues from increasing the TPT and expanding the tax base to include e-cigarettes and e-liquids are estimated at \$8.5 million for FY20.<sup>1</sup>

Unlike cigarette consumption, revenues from tobacco products consumption have continued to grow, and the estimate continues this trend for the forecast period. LFC staff, in consultation with the Department of Finance and Administration (DFA) economists, estimated the effect of incorporating e-cigarettes in the tobacco products tax using sales and tax revenue data from other states that have implemented a vaping products tax, adjusted for the New Mexico population. Both LFC and DFA economists used a price of \$2.75 to produce the e-cigarette revenue estimate, with the price expressed as annual wholesale per capita expenditures on e-cigarette products. This price represents a midpoint estimate given the available data. The minimum e-cigarette consumption scenario of \$1.34 per capita would reduce the FY20 new revenue projection by about \$1.3 million. Conversely, the maximum e-cigarette consumption scenario of \$4.16 per capita would increase the FY20 estimate by about \$1.3 million.

While the estimated fiscal impact only considers consumers' direct price responses (e.g. reducing consumption due to price increases), it does not consider the potential for consumers to seek out lower-taxed tobacco products and e-cigarettes (e.g. purchases on military bases, tribal lands, or online). If taxable volumes of tobacco products decrease by an additional 5-10 percent as a result of such lower-price-seeking behavior, then total new revenues could be reduced by an additional \$1 million to \$2 million.

Additionally, the estimate does not consider potential impacts of tax increases on tobacco product and e-cigarette businesses (e.g. cigar shops, "vape shops", etc.). To the extent that tax increases causes businesses to contract or close, new revenues could be lower than estimated. For example, industry data shows about one-fourth of Pennsylvania's vape shops closed following the 2016 passage of a 40 percent wholesale excise tax on vaping products (about 100 of the state's 400 vaping businesses).

## **SIGNIFICANT ISSUES**

Electronic nicotine delivery systems, also known as electronic cigarettes or e-cigarettes, are a relatively new product in the U.S. market. Data regarding health effects and tax revenues are currently limited. Some consumers use e-cigarettes as a means to reduce use of or to quit smoking combustible cigarettes. Many experts contend that e-cigarette vapor is less harmful than cigarette smoke since it does not contain most of the cancer causing byproducts; however, research is extremely limited on the long-term effects of the chemicals in e-liquids.

States have only recently begun taxing e-cigarette products (see attachment). The tax has been applied as either a percentage of the wholesale price or as a fixed tax per milliliter of nicotine product (cent/ml of e-liquid). A wholesale tax strategy has been adopted by California, Minnesota, and Pennsylvania. A fixed tax per milliliter (cent/ml) has been adopted by Delaware, Kansas, Louisiana, New Jersey, North Carolina, and West Virginia.

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<sup>1</sup> The DFA analysis submitted for this bill does not consider a reduction in tobacco products consumption due to tax increases; therefore, the DFA estimate is higher than the LFC estimate, with DFA estimating a total of \$10 million in revenue for FY20. The TRD analysis for this bill estimates this bill will generate \$14 million in FY20 due to stronger assumptions for the e-cigarette market in New Mexico.

The difficulty when it comes to e-cigarette taxation is establishing the most effective tax rate. The major problem with analyzing e-cigarette tax rates is that there is not a clean conversion between traditional cigarettes and e-liquid. This makes it challenging to evaluate the price point at which traditional tobacco cigarettes become the more cost effective option for nicotine consumers, potentially causing many e-cigarette users to switch or revert to traditional tobacco cigarettes. Ideally, the tax on e-cigarette products would be high enough to limit overall usage, especially for younger users that as a group are largely very sensitive to price, but not high enough to make e-cigarettes cost prohibitive. Given that e-cigarettes may be less harmful and help some cigarette users quit smoking, an e-cigarette tax rate that is too high could be counterproductive to public health objectives.

According to the 2014 Surgeon General's Report on The Health Consequences of Smoking, there is sufficient evidence to conclude that “increases in the prices of tobacco products, including those resulting from excise tax increases, prevent initiation of tobacco use, promote cessation, and reduce the prevalence and intensity of tobacco use among youth and adults”.<sup>2</sup> In 2016, the National Cancer Institute and the World Health Organization reaffirmed that “significantly increasing the excise tax and price of tobacco products is the single most consistently effective tool for reducing tobacco use”.<sup>3</sup>

Current cigarette use among New Mexico (NM) high school youth declined to a historic low of 10.6 percent in 2017.<sup>4</sup> However, the Department of Health (DOH) notes declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes. In 2017, 24.7 percent of NM high school youth used e-cigarettes. Altogether, one-third of NM youth still use at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes). About half of youth tobacco users use more than one tobacco product. Factors that may be influencing these trends in youth tobacco product use include pricing differences among tobacco products (i.e., higher taxes on cigarettes compared to other tobacco products) and increased marketing of e-cigarettes.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Senate Bill 166 and House Bill 261 seek to include e-cigarettes in the tobacco products tax, but also increase the cigarette excise tax. SB166 does not change the tax rate for the TPT, while HB261 increases the tax rate to 76 percent of wholesale.

House Bill 256 and Senate Bill 338 add e-cigarettes and their vapors to the Dee Johnson Clean Indoor Air Act.

House Bill 259 and Senate Bill 342 seek to ban certain tobacco product sales to persons under 21 years of age.

House Bill 260 and Senate Bill 343 seek to ban the sale, purchase, or provision of free samples of flavored tobacco products, including e-cigarettes and e-liquids.

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<sup>2</sup> [www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf](http://www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf), p. 18

<sup>3</sup> [http://cancercontrol.cancer.gov/brp/tcrb/monographs/21/docs/m21\\_complete.pdf](http://cancercontrol.cancer.gov/brp/tcrb/monographs/21/docs/m21_complete.pdf), p.151

<sup>4</sup> <http://youthrisk.org/tables/#/2017>

Senate Bill 450 creates the E-Cigarette and Nicotine Liquid Act, but does not impose a tax on e-cigarettes or e-liquids.

## **TECHNICAL ISSUES**

The definition of e-cigarettes in Section 5(c) of the bill could inadvertently capture electronic aerosol asthma inhalers and other devices that do not deliver nicotine. The bill defines e-cigarette as “any electronic oral device that can be used to provide a vapor or aerosol of nicotine or any other substance to the person inhaling from the device.” LFC staff recommend the bill be amended such that unintended and/or medically necessary devices are not captured.

## **OTHER SUBSTANTIVE ISSUES**

Other states have chosen to institute a tax based on the volume of e-liquid rather than implementing a wholesale tax. DFA points out several benefits to the wholesale tax:

- A wholesale tax makes it harder for distributors and consumers to bypass. Taxation based on e-liquid volume might trigger some distributors to sell nicotine separately from the liquid in order to sidestep the tax. Additionally, the potential handling and mixing of pure nicotine poses a danger to e-cigarette consumers who could face a higher risk of nicotine poisoning.
- The wholesale tax proposed in this bill more cost effective for TRD to administer since the current wholesale tobacco products tax is already established within the GenTax system. Folding e-cigarette products into the TPT rather than establishing a tax based on e-liquid volume would save TRD roughly \$4 million in implementation costs.

## **ALTERNATIVES**

To address the technical issues with the bill’s definition of e-cigarette, the bill could use the current definition of e-cigarette under the Tobacco Products, E-Cigarette and Nicotine Liquid Container Act (Section 30-49-2 NMSA 1978), which defines e-cigarette as “any electronic oral device, whether composed of a heating element and battery or an electronic circuit, that provides a vapor of nicotine or any other substances the use or inhalation of which simulates smoking”. This would address the issue of capturing electronic asthma inhalers, as the use of these products is not intended to simulate smoking.

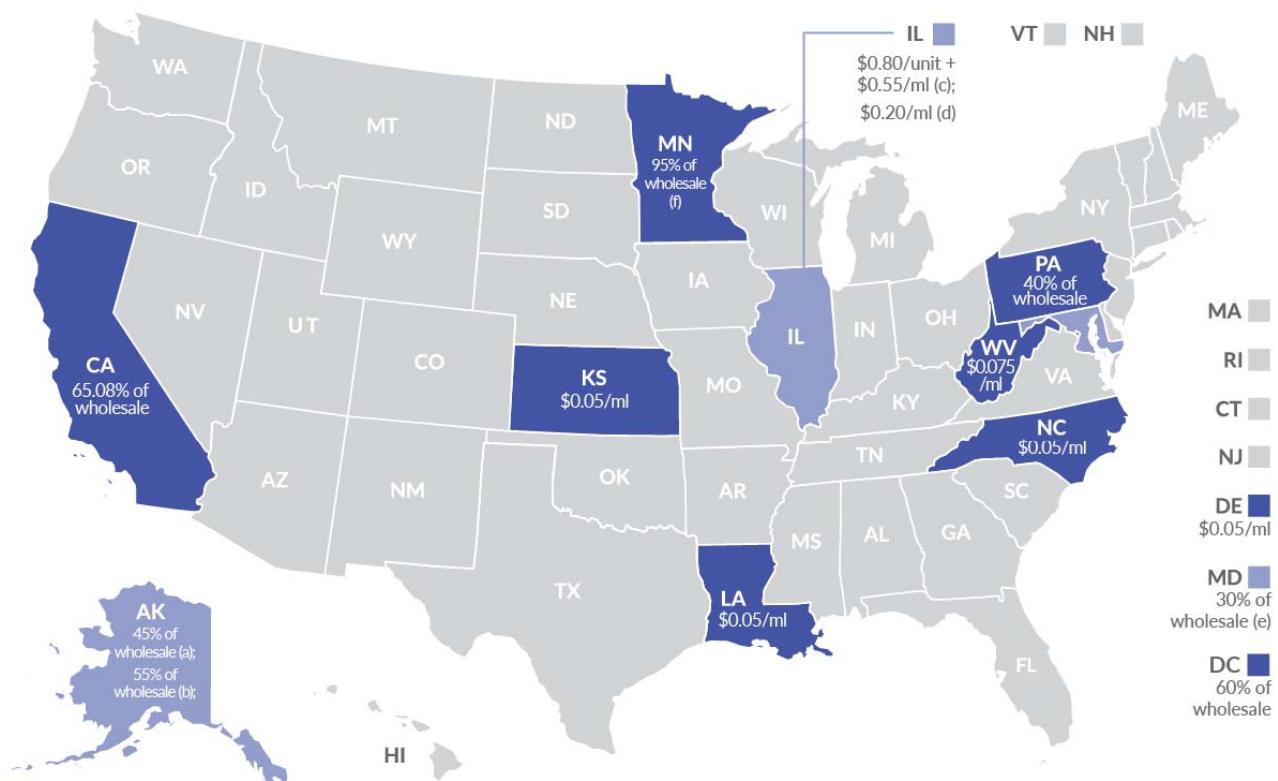
### **Does the bill meet the Legislative Finance Committee tax policy principles?**

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

## How High Are Vapor Excise Taxes in Your State?

State & Local Vapor Excise Tax Rates, as of January 1, 2018



Note: (a) Tax is only applicable in Juneau, NW Arctic Borough, and Petersburg. (b) Tax is only applicable in Mat-Su Valley. (c) Tax is only applicable in the city of Chicago. (d) Tax is only applicable in Cook County. (e) Tax is only applicable in Montgomery County. (f) Tax is on the wholesale cost of any product containing or derived from tobacco. The tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax is levied only on the value of the nicotine cartridge.

Source: State statutes; Bloomberg BNA.

- Statewide Vapor Excise Tax
- Municipal Vapor Excise Tax