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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/01/19  
 LAST UPDATED 3/06/19

SPONSOR Sanchez HB \_\_\_\_\_

SHORT TITLE Increase Cigarette & E-cigarette Tax Rates SB 166/aSCORC/aSFC

ANALYST Iglesias

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0.0	\$12,560.0	\$12,160.0	\$11,610.0	\$11,010.0	Recurring	General Fund (Cig)
\$0.0	(\$3,200.0)	(\$3,300.0)	(\$3,410.0)	(\$3,500.0)	Recurring	General Fund (TPT)
\$0.0	\$5.0	\$5.0	\$5.0	\$5.0	Recurring	Credit Enhancement Account
\$0.0	\$10.0	\$10.0	\$10.0	\$10.0	Recurring	UNM Cancer Center
\$0.0	\$10.0	\$10.0	\$10.0	\$10.0	Recurring	NM Finance Auth./UNM Health Sciences
\$0.0	\$5.0	\$5.0	\$5.0	\$5.0	Recurring	Rural County Cancer Treatment
\$0.0	\$10.0	\$10.0	\$10.0	\$10.0	Recurring	Department of Health Facilities
\$0.0	\$9,360.0	\$8,860.0	\$8,200.0	\$7,510.0	Recurring	Subtotal (General Fund)
<b>\$0.0</b>	<b>\$9,400.0</b>	<b>\$8,900.0</b>	<b>\$8,240.0</b>	<b>\$7,550.0</b>	<b>Recurring</b>	<b>TOTAL</b>

Conflicts with HB261 and SB72.

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

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Department of Health (DOH)

Human Services Department (HSD)

New Mexico Finance Authority (NMFA)

Taxation and Revenue Department (TRD)

## SUMMARY

### Synopsis of SFC Amendment

The Senate Finance Committee (SFC) amendment to Senate Bill 166 adjusts the distributions for non-general fund beneficiaries of the cigarette tax to hold revenues to those entities harmless from the tax increase. The results in sending all new cigarette tax revenue to the general fund.

### Synopsis of SCORC Amendment

The Senate Corporation and Transportation Committee Amendment to Senate Bill 166 adds a new section to the bill that changes Section 7-12-3.1 NMSA 1978 to apply the tax increase only to cigarette inventories that do not currently have a tax stamp. The avoids the potential for double taxation of cigarette inventories for which the previous tax had already been paid.

The amendment also adds a new section to the bill to adjust downward the percentages on which the Taxation and Revenue Department may sell tax stamps to distributors. It appears the intent is hold harmless any departmental revenues for selling tax stamps.

This amendment also adds e-liquids to the definition of tobacco product and specifies that cigars are to be taxed at a rate equal to 25 percent of the product value of the cigar, not to exceed \$0.50 per cigar. This provision appears to exclude cigars from the bill's increase of the tobacco products tax. TRD research on sales in other states and rough estimates of average prices determines that just over two-thirds of tobacco product tax wholesale value is in cigars, and just over 10 percent of that value would qualify as small cigars. TRD applied the bill's new tax rate to small cigars and assumed most other cigars would be taxed at the amendment's new maximum rate of \$0.50 per cigar. TRD estimates this results in a loss of about \$3.2 million in tobacco products revenue.

### Synopsis of Original Bill

Senate Bill 166 changes the cigarette tax rates to \$0.10 per cigarette (an increase to \$2 per 20 pack, up from \$1.66) and allows for a 50 percent tax rate reduction for cigarettes that have been issued a modified risk tobacco product order. The bill requires all cigarettes to be sold in packs of 20 or 25, removing the current ability to sell cigarettes in smaller packs of 5 or 10.

This bill also changes the tax on little cigars to be equivalent to the 10 cent tax on cigarettes, instead of the current 25 percent wholesale tax on tobacco products. The bill imposes an excise tax of 5 cent per milliliter on e-liquids (defined as liquids intended for use in an e-cigarette and specifically excluding those containing cannabis). The bill also allows for a 50 percent tax rate reduction on tobacco products for which a modified risk tobacco product order has been issued.

The effective date of this bill is July 1, 2019.

## FISCAL IMPLICATIONS

This bill is estimated to generate about \$13.9 million annually. The fiscal impact table represents LFC staff analysis using the December 2018 consensus revenue forecast for revenue from cigarettes as a starting point. Based on the continued trend of declines of cigarette consumption

seen since FY07, the estimate also incorporates the consensus forecasted declines in cigarette tax revenues for FY20-FY23. The estimates also assume price increases will have an inverse effect on consumption (higher prices will reduce consumption) of cigarettes, tobacco products, and e-cigarettes. These estimates assume all consumption for cigarettes come from packs of 20, which is how the large majority of cigarettes are sold.

LFC staff, in consultation with the Department of Finance and Administration economists, estimated the effect of incorporating e-liquids 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. The estimates then add yearly growth estimates for the U.S. market, which are relatively strong (about 20 percent).

While the estimated fiscal impact only considers consumers' direct price responses (e.g. reducing consumption based price increases), it does not consider the potential for consumers to seek out lower-taxed cigarettes and tobacco products (e.g. purchases on tribal lands or online). If taxable volumes of cigarette and 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 \$5 million to \$10 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).

Without specific information on little cigars sold in New Mexico, the analysis assumes the revenue impact of taxing little cigars at the 10 cent per unit rate, versus the current 25 percent wholesale tax rate, will be approximately neutral.<sup>1</sup> However, the Taxation and Revenue Department estimates just over 10 percent of cigar sales value would qualify as small cigars, and switching to a cigarette style tax would result in a net loss of revenue for these products, mostly balancing out the revenue gain from adding the tax to vaping fluids.

The New Mexico Finance Authority (NMFA) issues cigarette tax revenue bonds and structures those bonds to withstand an annual 3 percent decline in revenue as a result of declined cigarette consumption over time. The current fiscal estimates reflect a revenue increase for all cigarette tax beneficiaries. However, if cigarette tax increases result in lower consumption such that cigarette tax revenues fall, NMFA states the changes in this bill could impair outstanding NMFA cigarette tax revenue bonds in violation of several New Mexico statutory provisions, as well as Article I, Section 10 of the United States Constitution and Article II, Section 10 of the New Mexico Constitution.

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<sup>1</sup> Little cigars and cigarettes consist of different tobacco and wrappers. Little cigars consist of air-cured or fermented tobaccos with a stronger taste and lower sugar content. They are primarily alkaline and are either wrapped in natural leaf, or a wrapper consisting of at least 2/3 tobacco by weight, as required by the federal government. Cigarettes on the other hand consist primarily of flue-cured tobaccos, are primarily acidic, have a higher sugar content and are wrapped in paper.

## 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 Appendix B). 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.

Modified risk tobacco products (MRTPs) are tobacco products that are sold or distributed for use to reduce harm or the risk of tobacco-related disease associated with commercially marketed tobacco products. The U.S. Food and Drug Administration (FDA) can issue an order authorizing the marketing of an MRTP only if the evidence submitted in the application meets the requirements of Section 911 of the Federal Food, Drug and Cosmetic Act.<sup>2</sup> For example, an MRTP application must demonstrate that the product will or is expected to benefit the health of the population as a whole. An order permitting the sale of an MRTP refers to a single specific product, not an entire class of tobacco products (e.g., all smokeless products). In addition, an FDA order permitting marketing of an MRTP is valid only for the fixed time period specified in the order and is not permanent. To continue marketing an MRTP after the set term, the company must seek renewal of the order, and FDA must determine that the product still satisfies the requirements in section 911. The following MRTP applications are currently under review with the FDA.

Product/ Company	Comment Period Closes	Regulations.gov Docket #	TPSAC Meeting Date/Info
<a href="#">Swedish Match North America Inc.</a>	TBD	<a href="#">FDA-2014-N-1051</a>	<a href="#">February 6-7, 2019</a>
<a href="#">Copenhagen Snuff Fine Cut/U.S. Smokeless Tobacco Company</a>	TBD	<a href="#">FDA-2018-N-3261</a>	<a href="#">February 6-7, 2019</a>
<a href="#">IQOS System with Marlboro HeatSticks/Philip Morris Products S.A.</a>	February 11, 2019	<a href="#">FDA-2017-D-3001</a>	<a href="#">January 24-25, 2018</a>
<a href="#">Camel Snus/ R.J. Reynolds Tobacco Company</a>	TBD	<a href="#">FDA-2017-N-4678</a>	<a href="#">September 13-14, 2018</a>

Because no products have yet qualified for the FDA’s modified risk program, the effect of the reduced tax rates for these products is not included in this estimate.

The 5 cent per milliliter tax on e-liquids is irrespective of the nicotine content in those liquids. E-liquids can contain a variety of nicotine contents, ranging from nicotine-free to over double the nicotine content of a typical cigarette (most cigarettes contain 12mg to 16mg of nicotine).

<sup>2</sup> <https://www.fda.gov/TobaccoProducts/Labeling/TobaccoProductReviewEvaluation/ucm304465.htm>

Therefore, e-liquids with very high nicotine content (e.g. 24mg or more) would be taxed at the same rate as those with low nicotine contents (8mg or less).

## ADMINISTRATIVE IMPLICATIONS

According to TRD, this bill has a moderate impact on the Information Technology and the Audit and Compliance Divisions of TRD, but will not require additional effort beyond soft costs.

## RELATIONSHIP

House Bill 261 and Senate Bill 72 also seek to amend the cigarette tax rates and include e-cigarettes in the tobacco products tax.

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.

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

## OTHER SUBSTANTIVE ISSUES

The New Mexico Department of Health (DOH) provided the following discussion regarding this bill:

In December 2018, the Surgeon General officially declared e-cigarette use among youth an "epidemic" in the United States and asked officials to act now by making e-cigarettes more expensive through pricing policies that could include taxes and minimum price requirements.<sup>3</sup>

The use of emerging tobacco products, such as e-cigarettes, is a fast-growing trend. The most commonly used and sold e-cigarette on the market today is the JUUL. The JUUL, which had a 600 percent spike in sales during 2016-2017, is sleek and small, resembles a USB flash drive, and is very easy to conceal, making this particular nicotine product very attractive to youth.

[This bill] proposes to tax e-liquids at a rate of \$0.05 per milliliter. According to the *Surgeon General's Advisory on E-cigarette Use Among Youth*, "all JUUL products have high levels of nicotine." The amount of nicotine in one JUUL "pod" or cartridge is equivalent to a pack of 20 traditional cigarettes. A single JUUL pod contains 0.7 milliliters (ml) of liquid nicotine. JUUL pods are sold in packs of four. Under the tax structure proposed by [this bill], a pack of

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<sup>3</sup> <https://e-cigarettes.surgeongeneral.gov/documents/surgeon-generals-advisory-on-e-cigarette-use-among-youth-2018.pdf>

four JUUL pods would be taxed at a maximum of \$0.14, compared to a tax of \$8.00 for its nicotine-equivalent of four packs of cigarettes. This price disparity would make JUUL and other similar cartridge-based tobacco products even more attractive to price-sensitive youth, thereby likely increasing the prevalence of use and nicotine addiction among youth in NM.

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.

According to the 2014 Surgeon General’s Report on The Health Consequences of Smoking, there is evidence to conclude “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>5</sup>

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

This bill exempts from the tobacco products tax “any product that has been approved by the United States food and drug administration (FDA) for sale as a tobacco cessation product or for other therapeutic purposes where such product is marketed and sold solely for such an approved use.” If vapor products were to become officially approved by the FDA as a tobacco cessation product, then they would not be subject to the excise tax.

**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

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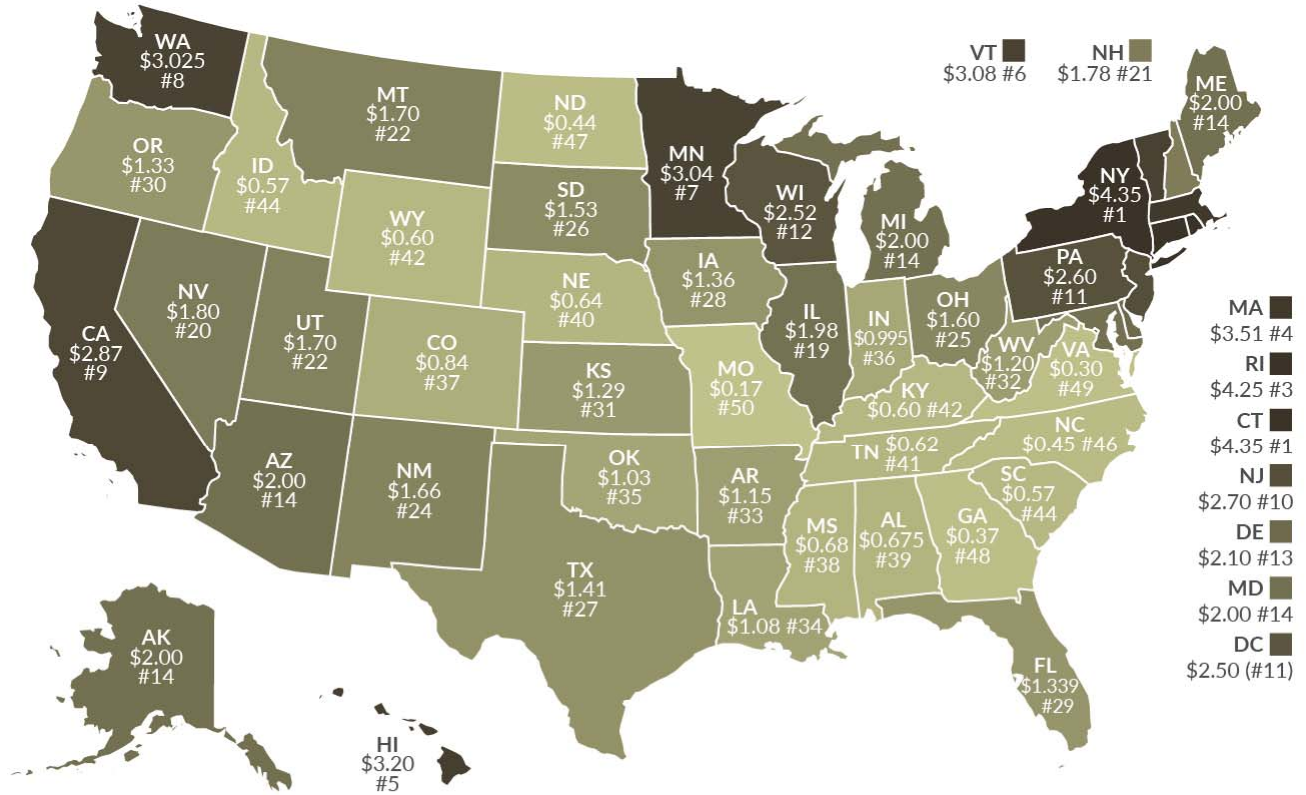
<sup>4</sup> <http://youthrisk.org/tables/#/2017>

<sup>5</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)

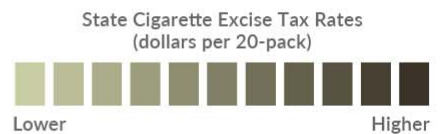
APPENDIX A

# How High Are Cigarette Taxes in Your State?

State Cigarette Excise Tax Rates, 2018 (dollars per 20-pack)



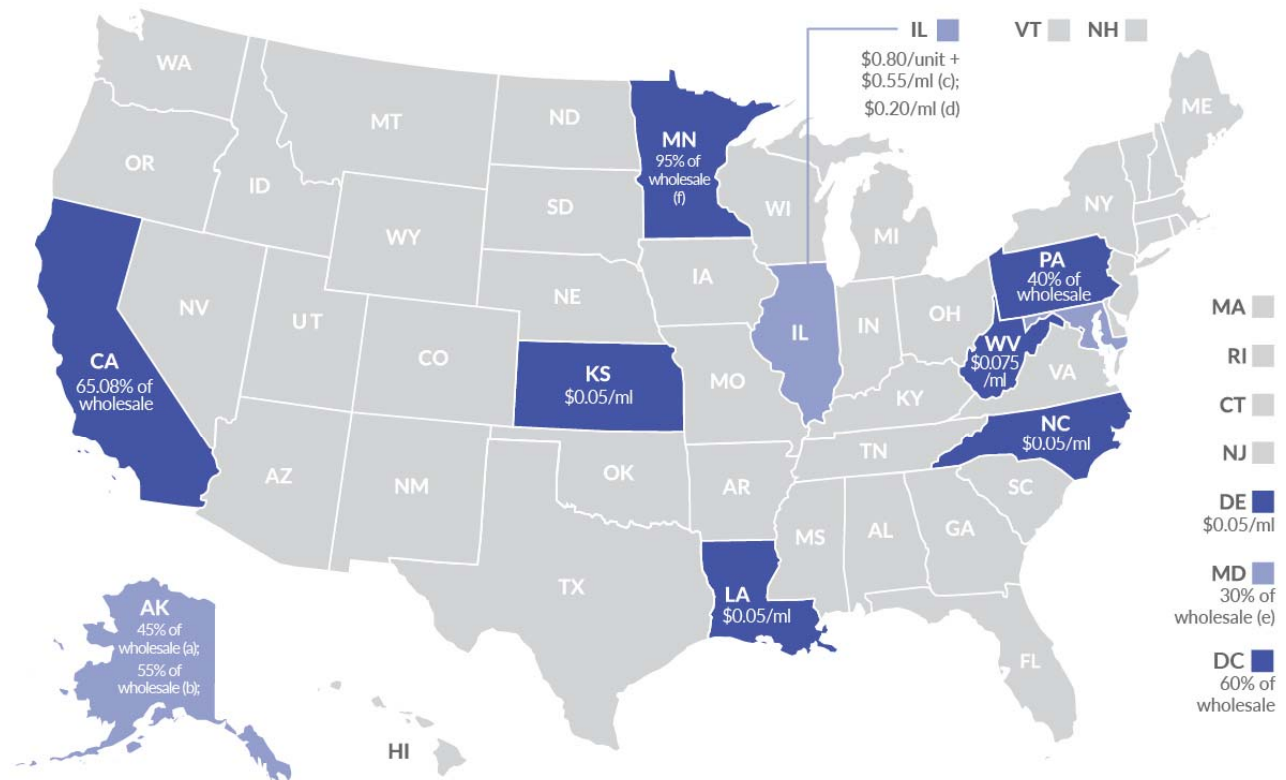
Note: Local taxes are not included and can be substantial. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.  
 Source: Bloomberg BNA; state statutes.



APPENDIX B

# 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.

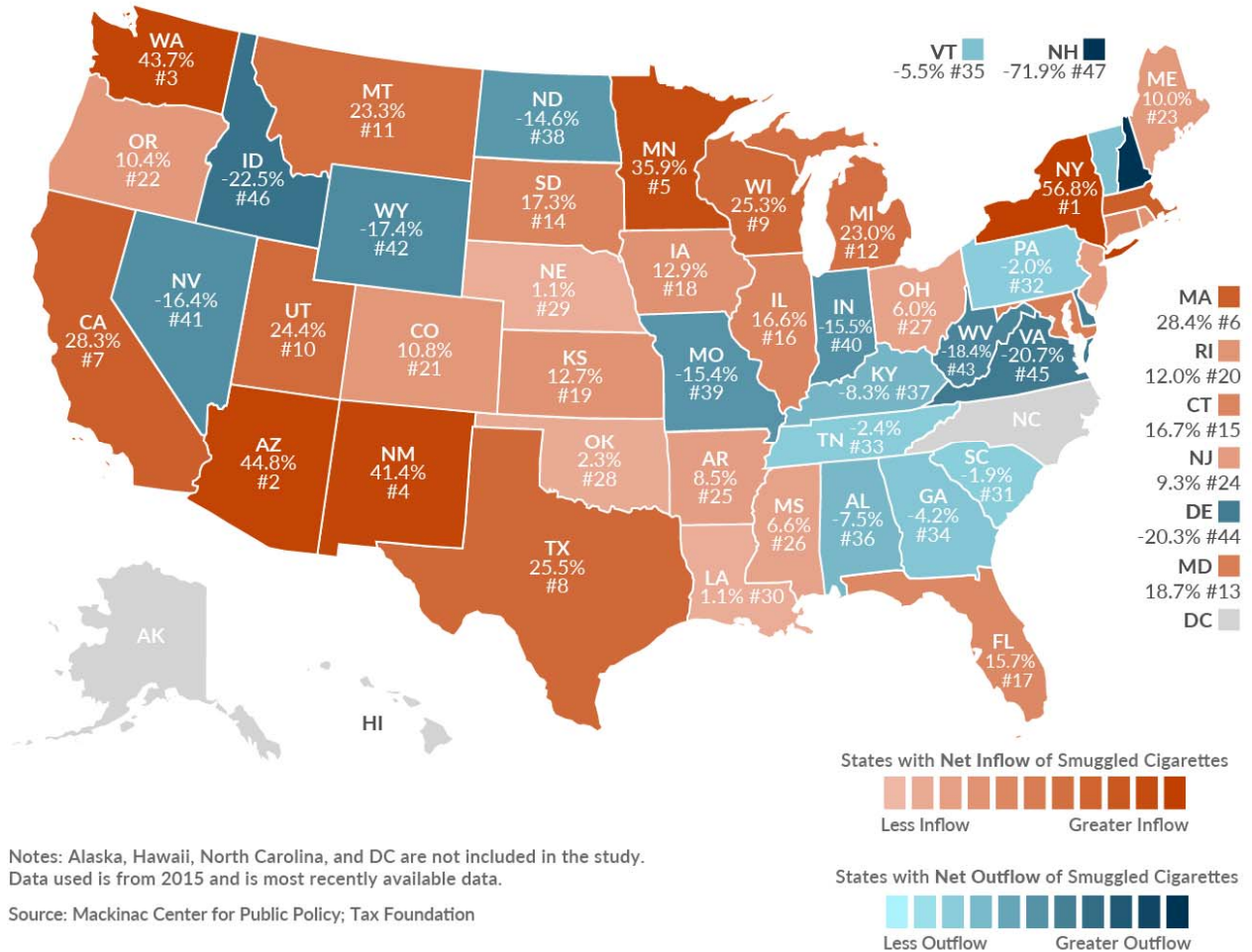
Statewide Vapor Excise Tax  
 Municipal Vapor Excise Tax



APPENDIX C

Cigarette Smuggling by State

Smuggled Cigarettes Consumed As a Percentage of Total Cigarettes Consumed, 2015



Tax Foundation, Cigarette Taxes and Cigarette Smuggling by State, 2014, <https://taxfoundation.org/cigarettetaxes-and-cigarette-smuggling-state-2014/> .

According to this report, New York and Arizona rank 1st and 2nd in cigarette smuggling activity, respectively, and New Mexico ranks 3rd. This report includes both legal and illegal sales in their definition of smuggling, with “casual smuggling” identified as military and tribal sales.