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FISCAL IMPACT REPORT

SPONSOR	<u>Ferry/Thomson/Jaramillo/Cates/Chasey</u>	LAST UPDATED	1/31/23
SHORT TITLE	<u>Tobacco Tax Rates & Definitions</u>	ORIGINAL DATE	1/29/23
BILL NUMBER		BILL	
		NUMBER	House Bill 124
		ANALYST	Faubion

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	\$4,900.0	\$5,700.0	\$6,600.0	\$7,900.0	Recurring	General Fund

Parenthesis () indicate revenue decreases

*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	\$6.0	--	--	\$6.0	Nonrecurring	TRD - ITD/ASD
Total	\$6.0	--	--	\$6.0		

Parentheses () indicate expenditure decreases.

*Amounts reflect most recent version of this legislation.

Relates to HB94.

Conflicts with HB123 and SB235.

Sources of Information

LFC Files

Responses Received From

Department of Health (DOH)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 124

House Bill 124 (HB124) raises the tax on tobacco products to an excise tax rate of 31 percent and removes all other tobacco taxing structures, except for little cigars, which are taxed at the same rate as cigarettes. This bill does not change the cigarette tax rate or distributions.

The effective date of this bill is July 1, 2023.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) uses the Tobacco Products Tax forecast from the Consensus Revenue Estimating Group (CREG) in December 2022 to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. The Tobacco Products Tax covers a variety of products. The bill proposes tax increases to all the categories based on the “wholesale price” of the tobacco products, which is not defined in the bill (see “Technical Issues”). TRD assumes the fiscal impact based on the current defined “product value” and applies the new rates. TRD applies different demand elasticities to the products. Based on a recent study of the impact of e-cigarette taxes on e-cigarette and other tobacco consumption by Cotti et al.¹, an average elasticity impact for different varieties of e-cigarettes (flavored, non-flavored, etc.) is applied. The study notes cigarettes and e-cigarettes represent substitutable products. Due to the bill only increasing e-cigarette taxes, the fiscal impact does not take into account any substitution impacts to consumption of cigarettes, possibly impacting revenue from the cigarette tax. In addition, the price increase proposed in the bill for e-cigarette products is approximately 15 percent to 25 percent, representing around \$1 to \$2 in tax increases for various e-cigarette products depending on product values. The elasticity assumption from empirical work looked at a \$1 increase in taxes. The drop-in consumption could be higher than what is modeled. Also, if consumption moves to the black market (see “Policy Issues” below), then the assumed drop in consumption could also be higher.

The Cotti et al. study notes consumption of chewing tobacco, loose tobacco, and other tobacco products is not significantly impacted by an increase in price. This appears logical given that users of these products are most likely older, established users. The price increase to the other tobacco products is relatively small at approximately 5 percent to 10 percent. TRD applied an elasticity for smokers from the Franz study assuming it would take a large increase in the tax rate to elicit a lower consumption rate among this population.

SIGNIFICANT ISSUES

According to the Tax Foundation, 20 states and territories currently tax e-liquid and closed system cartridges for use in e-cigarettes on a percentage of price (See Attachment A). Price subject to tax varies by retail or wholesale price. New Mexico’s e-liquid tax of 12.5 percent of wholesale price is among the lowest of any state or territory that taxes e-liquid by price. Wholesale tax rates in other states include 15 percent in Illinois and Wyoming, 30 percent in Nevada, 56 percent in Utah, 59.9 percent in California, 92 percent in Vermont, and 95 percent in Minnesota.

The bill proposes to increase the tax rate on e-cigarettes from 12.5 percent of wholesale price to 31 percent of wholesale price, presumably to discourage their consumption, which can lead to negative health outcomes. But by only increasing the rate on e-cigarettes and not on regular cigarettes, the bill may not negate substitution effects noted in studies between cigarettes and e-cigarettes. From a health policy standpoint, this is especially important for younger users who have become a larger market share of e-cigarettes and are more sensitive to price increases. By

¹ Cotti, C.D., Courtemanche, C.J., Maclean, J.C., Nesson, E.T., Pesko, M. F., Tefft, N. (2020). The Effects of E-Cigarette Taxes on E-Cigarette Prices and Tobacco Products Sales: Evidence from Retail Panel Data. National Bureau of Economic Research, Cambridge, MA. Working paper 26724, <http://www.nber.org/papers/w26724>

raising taxes on most tobacco products, it would presumably encourage overall lower consumption of the various products.

Significant increases in taxes may encourage consumers to buy products on the black market. The increased demand by consumers would presumably be met by an increased supply of e-cigarettes products within the black market. This raises safety concerns for consumers related to the quality of products being supplied and their contents—within e-liquids, for example—with no oversight.

The Department of Health (DOH) notes evidence shows that significantly increasing tobacco excise taxes and prices is the single most effective and cost-effective measure for reducing tobacco use. Raising taxes on tobacco products, which lead to increases in their price, makes tobacco less affordable. When tobacco becomes less affordable, people use it less and youth initiation is prevented. Because youth and low-income groups are more responsive to increases in tobacco prices, they disproportionately enjoy the health and economic benefits of quitting and not starting.

ADMINISTRATIVE IMPLICATIONS

TRD will conduct staff training, update forms, instructions, and publications. TRD will also need to produce communications to impacted taxpayers, including specifications of the proposed changes to definitions and tax rates. Changes would be made to TRD's GenTax system, the system of record, to update tax rates, which would require development and testing of the system. TRD's Information Technology Division (ITD) estimates the changes would incur approximately 100 hours of development with staff workload hours for a cost of \$5,554. TRD's Administrative Services Division (ASD) would need eight hours of staff workload for 1 full-time equivalent (FTE) staff related to testing distributions in the GenTax system.

Due to the effective date of July 1, 2023, for this bill and other proposed bills, any changes to rates, deductions, and distributions adds to the complexity and risk TRD faces July 1, 2023, to ensure complete readiness and testing of all processes. If several bills with similar effective dates become law, there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective dates of each bill.

OTHER SUBSTANTIVE ISSUES

TRD notes the following:

The following changes to definitions are recommended per the Federation of Tax Administrators to be broad enough to withstand product innovations and enable tax application of these products.

- Electronic Nicotine Delivery Systems (ENDS) are noncombustible tobacco products, which include devices, components, and/or parts that deliver aerosolized e-liquid when inhaled. Examples include vape or vape pens, personal vaporizers, electronic cigarettes, cigalikes, e-pens, e-hookahs, e-cigars and e-pipes.
- Electronic Cigarettes, also known as E-Cigarettes, are handheld battery-powered vaporizers that stimulate smoking but without tobacco combustion, and are any

device that can be used to deliver aerosolized or vaporized nicotine, or any other substance, to the person inhaling from the device and includes any component, part or accessory of such a device that is used during the operation of the device but does not include a battery or battery charger.

- E-liquids are a type of ENDS products which generally refer to liquid nicotine and nicotine-containing e-liquids or liquid nicotine substitutes. Significantly, the deletion of, “not including any substance containing cannabis or oil derived from cannabis,” is not recommended. This could question whether cannabis e-liquids are subject to both the Tobacco Products Tax Excise Tax and Cannabis Excise Tax.

The proposed change to contain all tobacco products except little cigars in the same tax rate is administratively more efficient and holds to the tax policy concepts of simplicity and equity in the tax code.

DOH notes the following:

HB124 would likely have a significant impact on youth, as nearly 3 in 10 (27 percent) of New Mexico high school youth use some form of tobacco, and most (93 percent) of that tobacco is in the form of e-cigarettes. Youth are more likely than adults to reduce tobacco use in response to price increases. Reduced e-cigarette use among New Mexico youth could translate into fewer youth, and eventually adults, who are addicted to nicotine and experience the negative health consequences.

HB124 proposes to increase the existing tax on tobacco products other than cigarettes from 25 percent to 31 percent of the wholesale price and equalize the tax rate on each little cigars with the rate imposed on a cigarette. Increasing the price of tobacco products could positively impact health disparities by decreasing the appeal of tobacco products, and especially of e-cigarettes, and especially among youth. E-cigarettes use in New Mexico is prevalent among high school youth (25 percent), and particularly high in certain counties such as Grant County (40 percent) Guadalupe County (35 percent), Luna County (37 percent), Mora County (37 percent) and Taos County (44 percent). Vaping is more prevalent among girls (29 percent) than boys (21 percent). Vaping is particularly prevalent among Black or African American youth (28 percent) and Hispanic youth (29 percent); among LGBTQ+ youth (34 percent); and among youth experiencing unstable housing (42 percent). Increasing the price of e-cigarette liquids and cartridges and other tobacco products except cigarettes, as proposed in HB124, would be an important public health strategy to stemming the youth vaping epidemic in the state and in reducing disparities in vaping.

TECHNICAL ISSUES

On page 5, line 3, the incidence of tax is now on the “wholesale price” of the tobacco products, replacing the “product value” in Section 7-12-A-3 NMSA 1978. However, in the definitions under 7-12A-2 NMSA 1978, no definition is provided for “wholesale price” and the definition of “product value” remains in statute. TRD recommends making the language consistent.

House Bill 124 – Page 5

On page 3, lines 3 through 8, TRD recommends the following revision to the definition of “first purchaser” to address tobacco product purchases for resale from exempt entities. The following change to add more specific verbiage would read as follows:

§ 7-12A-2 (H) NMSA 1978, "first purchaser" means a person engaging in business in New Mexico that manufactures tobacco products or that purchases or receives on consignment tobacco products from any person outside of New Mexico **or from any person exempt per § 7-12A-4 NMSA 1978**, which tobacco products are to be distributed in New Mexico in the ordinary course of business.

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

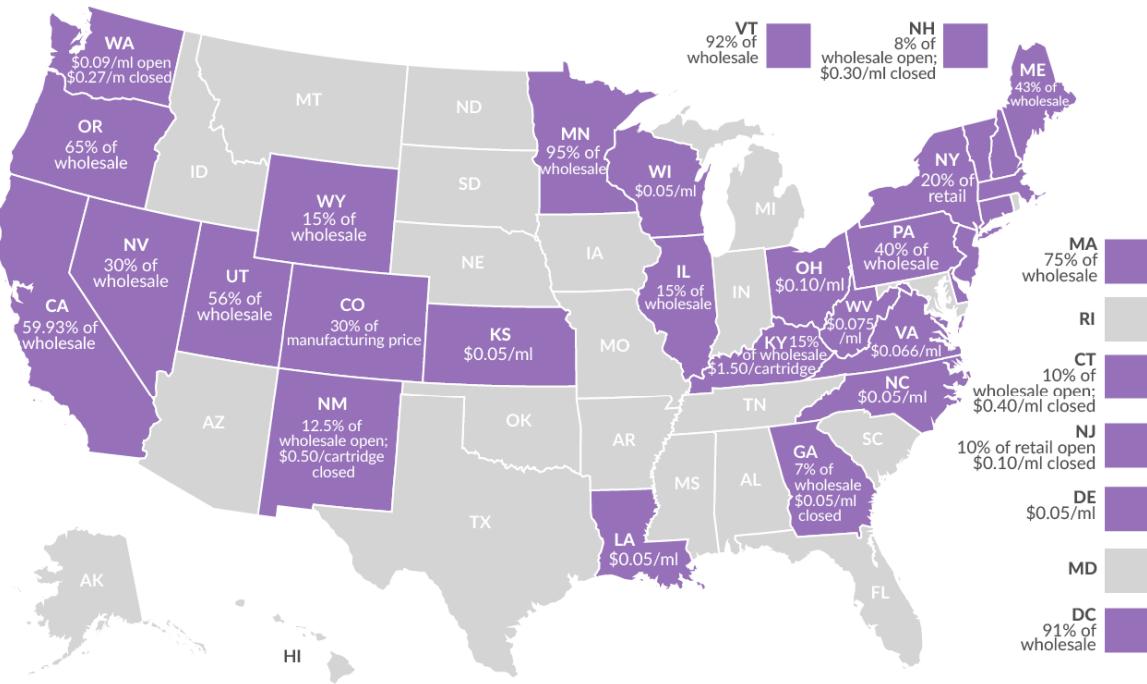
1. Attachment A- How High are Vapor Taxes in Your State?

JF/rl/ne/al/hg

ATTACHMENT A

How High are Vapor Taxes in Your State?

State Vapor Products Excise Tax Rates, January 1, 2021



Note: Several states levy general sales taxes in addition to the excise tax. Those are not included on the map.

Open: An open tank allows the consumer to refill the liquid and allows more freedom in voltage and nicotine levels.

Closed: Normally sold as pods or cartridges. Closed systems typically have higher nicotine levels to allow for consumption of the desired amount of nicotine in shorter sessions.

Source: State Statutes & Bloomberg Tax

Has a Statewide Vapor Excise Tax

No Vapor Excise Tax