FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Hickey	**ORIGINAL DATE**	2/28/23
SHORT TITLE	Tobacco Tax & Definitions	**BILL NUMBER**	Senate Bill 235
		ANALYST	Faubion

APPROPRIATION*
(dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY23	FY24		
	$500.0	Nonrecurring	RLD – General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	($12,900.0)	($13,500.0)	($14,200.0)	($15,100.0)	Recurring	General Fund
	$17,800.0	$19,200.0	$20,800.0	$23,000.0	Recurring	nicotine use prevention and control fund - DOH

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
	$75.8	--	--	$75.8	Nonrecurring	TRD - ITD/ASD
Total	$75.8	--	--	$75.8		

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Relates to House Bill 94.
Conflicts with House Bill 123 and House Bill 124.

Sources of Information

LFC Files

<u>Responses Received From</u>
Department of Health (DOH)
Taxation and Revenue Department (TRD)

Regulation and Licensing Department (RLD)
Public Education Department (PED)
Higher Education Department (HED)

SUMMARY

Synopsis of Senate Bill 235

Senate Bill 235 (SB235) 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 creates the nicotine use prevention and control fund and distributes all tobacco products tax to the new fund.

Senate Bill 235 appropriates $500 thousand from the general fund to the Regulation and Licensing Department for expenditure in fiscal year 2024 to expand the department's licensure and enforcement duties in regard to nicotine sales and use.

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

FISCAL IMPLICATIONS

SB235 does not include a recurring appropriation but does create the nicotine use prevention and control fund and distributes all tobacco excise tax revenues to that fund. The fund allows for continuing appropriations, donations, investment interest, and other sources and is subject to appropriation by the Legislature to the Department of Health, Public Education Department, and Higher Education Department. The revenue distributions contained in this bill are a recurring expense to the general fund. Any unexpended or unencumbered balances remaining at the end of the fiscal year shall revert to the general fund. LFC has concerns with including continuing distribution language in the statutory provisions for newly created funds because earmarking reduces the ability of the Legislature to establish spending priorities.

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 and not 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

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[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

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 "Significant 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.

The appropriation of $500 thousand contained in this bill is a nonrecurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of FY24 shall revert to the general fund.

SIGNIFICANT ISSUES

TRD notes the following policy issues:

> New Mexico's current e-cigarette tax of 12.5 percent of product value price is amongst the lowest of any state or territory that taxes e-cigarettes. According to the Centers for Disease Control, 33 states and territories currently tax e-cigarettes on a percentage of price. Price subject to tax varies by retail or wholesale price. Wholesale tax rates in other states include 15 percent in Illinois and Wyoming, 30 percent in Nevada, 40 percent in Pennsylvania, 43 percent in Maine, 56 percent in Utah, 59.27 percent in California, 75 percent in Massachusetts, 96 percent in the District of Colombia, 92 percent in Vermont, and 95 percent in Minnesota.[2]
>
> 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, the bill may cause consumers to substitute cigarettes for 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 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 with a question of the quality of products being supplied and what may be contained, for example, within e-liquids with no oversight.
>
> The distribution of revenue to a targeted nicotine prevention fund and subsequent

[2] https://www.cdc.gov/statesystem/factsheets/ECigarette/ECigTax.html

> appropriations from the fund may directly support state and community programs to prevent nicotine addiction. This would establish a consistent future fund balance for budgeting appropriations from these funds but would permanently divert gross receipts revenue from the general fund.
>
> New Mexico's tax code is out of line with most states in that more complex distributions are made through the tax code. The Tobacco Products Tax is currently distributed to the general fund. As an alternate to this proposal and revenue earmarks, it is recommended that the amount distributed to the general fund be appropriated annually through regular appropriations in HB2. The more complex the tax code's distributions, the costlier it is for TRD to maintain the GenTax system and the more risk is involved in programming changes.

The Department of Health (DOH) notes the following:

> To support the increase in taxes, the World Health Organization 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.
>
> The CDC recommends that state and community interventions promote tobacco use cessation, prevent tobacco use initiation, eliminate secondhand smoke exposure, and identify and eliminate tobacco-related disparities. This also includes marketing that counteracts the tobacco industry's marketing tactics to increase in tobacco use initiation. The counter marketing can be a valuable tool that aims to reduce the prevalence rate of tobacco use.
>
> Achieving equity by reducing tobacco-related disparities is a key goal for comprehensive tobacco control programs. Programs can achieve this goal through surveillance, partnerships (including funding) with disparate population groups and organizations that serve these groups, strategic plans that address disparities, and culturally competent technical assistance and training.

ADMINISTRATIVE IMPLICATIONS

Existing administrative resources within the DOH Nicotine Use Prevention and Control Program could absorb any proposed allocations to further existing prevention programming.

RLD will receive a one-time appropriation from the general fund in an amount of $500 thousand. With increased operations for licensure and enforcement, the Alcoholic Beverage Control Division ("ABC") of RLD, which also administers and regulates tobacco in the State of New Mexico, anticipates that there will be an increase in the number of establishments that will be properly licensed, resulting in more licensure fees. An increase in enforcement operations may result in an increase in monetary administrative penalties, as well. An increased number of penalties being issued for tobacco violations can be expected to result in an increased dollar amount of funds ultimately received into the tobacco products fund when those penalties are paid by violators.

Under the bill, DOH would administer the funds through its Nicotine Use Prevention and Control (NUPAC) Program, which provides guidance on comprehensive, evidence-based approaches to promote healthy lifestyles that are free form tobacco abuse and addiction among all New Mexicans. NUPAC follows recommendations from the Centers for Disease Control and Prevention (CDC), which is congruent with tobacco and nicotine prevention strategies adopted by PED. With the increased revenue from the tax increase and other resources, guidance, and marketing collateral provided by NUPAC, the PED Safe & Healthy Schools Bureau could expand its assistance with promoting the nicotine prevention resources and messages to public schools and charter schools throughout the state.

SB235 provides a mechanism for material to be developed to prevent the use of tobacco products for persons five to 25 years old. These programs are to be developed by the DOH. Focus on persons aged five through 17 or 18 would likely be coordinated with PED, and focus on persons 18 through 25 would likely be coordinated with PED. HED does not currently have staff or programs designed to develop educational materials, so HED would likely partner with one or more public higher education institutions (HEIs) on this development. Any coordination and allocation of funds for the implementation of SB235 by HED would be borne by existing staff and resources.

Since the appropriation to RLD to licensure and enforcement is for all nicotine sales and use, RLD actions in these areas will help with TRD registration requirements under Section 7-12A NMSA 1978 and tax compliance under Section 7-12 NMSA 1978 as well. TRD also has a license administered under the Cigarette Tax Act and may benefit from funds for licensure and enforcement of that act. Compliance language should be added as a stipulation of RLD licensure.

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, requiring development and testing of TRD's GenTax system. TRD's Information Technology Division (ITD) estimates that the changes would incur approximately 350 hours or about two months of development with contractual hours for a cost of $73,500. TRD's Administrative Services Division (ASD) will have 40 hours of staff workload between 2 full-time equivalent (FTE) staff, with effort related to testing new distributions and reports 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:

SB235 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.

SB235 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 SB235, would be an important public health strategy to stemming the youth vaping epidemic in the state and in reducing disparities in vaping.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 235 relates to HB94 which would ban flavored tobacco products.

Senate Bill 235 conflicts with HB123 and HB124 which would also change the tobacco excise tax rate and/or the distributions of the tax.

TECHNICAL ISSUES

On page 6, 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.

On page 4, 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.

On page, 5, line 25, TRD recommends striking the word “and” and replacing it with “or.” Out-of-state online manufactures and retailers have found a loophole in taxability when selling directly to the consumer.

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

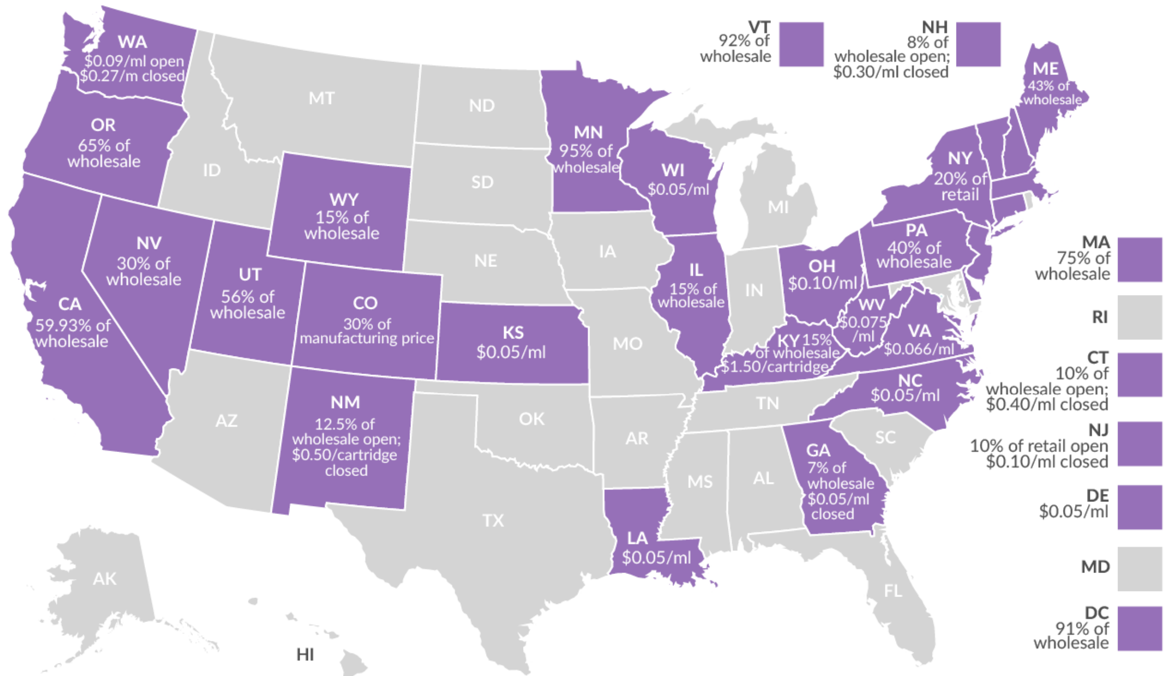
1. Attachment A- How High are Vapor Taxes in Your State?

JF/al/ne/mg

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

TAX FOUNDATION @TaxFoundation