BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 11, 2024

Bill: STBTC sub. for SB-72 **Sponsor:** Senator Martin Hickey

Short Title: Tobacco Products Tax Rate

Description: The *Senate Tax, Business and Transportation Committee* substitute amends Section 7-12A-3 NMSA 1978 to increase the tax on e-liquid from 12.5% of wholesale price to 44% of wholesale price and adds a 44% tax on the category of e-cigarettes. The bill adds a new section to the Tax Administration Act to distribute receipts attributable to the tobacco products tax to the Nicotine Use Prevention and Control Fund, which is created in the bill. Prior to July 1, 2026, the distribution is 50%, then beginning July 1, 2026, the distribution is 80%, and then 100% beginning July 1, 2027. The bill amends the definitions of "e-cigarettes", "e-liquids", and "tobacco products" in Section 7-12A-2 NMSA 1978.

Effective Date: July 1, 2024

Taxation and Revenue Department Analyst: Lucinda Sydow

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	**FY2025**	**FY2026**	**FY2027**	**FY2028**		
--	($2,600)	($2,800)	($11,000)	($18,900)	R	General Fund
--	$10,500	$11,600	$20,600	$29,000	R	Nicotine Use Prevention and Control Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (Tax & Rev) used the Tobacco Products Tax forecast from the Consensus Revenue Estimating Group (CREG) in December 2023 to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. Tax & Rev applied 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.) was applied. The study notes that 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 28% for e-liquid and 44% for e-cigarettes, representing around $2 in tax increases for e-liquids and $4 to $5 for 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.

[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-cigarettes as defined in the bill are currently not taxed. Tax & Rev applied data from a study by Wang et al.[2] that has state by state data on various e-cigarette products. The data includes unit sales and prices by the various products. Tax & Rev used the data on unit sales for rechargeables and e-liquids in New Mexico to get a ratio of e-liquids sales to rechargeables sales. Using current taxpayer data on e-liquids, Tax & Rev assumed the sales of rechargeables from that ratio, assuming that ratio has stayed constant, and grew them at the annual rate in the Wang et al. study. Data from a CDC foundation study[3] indicates that states have generally seen the consumption of disposables remain flat. Tax & Rev uses the New Mexico unit sales for disposables from the Wang et. al. study to assume a flat volume of sales in the outlook for disposables e-cigarettes. The volume of sales was then adjusted by the elasticity assumptions laid out above. To forecast the revenue impact, Tax & Rev assumed the unit prices for New Mexico as reported in the Wang et al. study to apply the new proposed rates.

Based on the delayed repeal in Section 5, the General Fund in FY2029 will receive the entire revenue from the Tobacco Products Tax at approximately a level of $32.0 million or $13.5 million more than forecasted FY2028 revenue.

Policy Issues: All states and the federal government tax tobacco products, but only about half of states tax vaping products, with the federal government having no current taxes on vaping products. Among states that tax vaping products, the application of the tax is diverse by taxing by percentage method on the price or taxing by unit and taxing at the wholesaler or at the retail level. New Mexico is one of 6 states that uses both percentage and unit tax rates. The Tax Foundation recommends taxing products similarly to avoid substitution effects between vaping products and cigarettes and other traditional tobacco products.[4] They also recommend taxing by volume as opposed to taxing as a percentage of price as this potentially drives manufacturers to reduce prices to limit tax liability. Differing tax rates would also raise the question of horizonal equity among different products. The bill is increasing the tax on e-liquids while maintaining the same $0.50 tax per closed system cartridge. Finally, one simple taxing methodology would ease the administrative burden for Tax & Rev and provide uniformity for taxpayers.

While it is hard to compare across different state taxing methods, New Mexico's current e-liquid tax of 12.5% of wholesale product value price is considered amongst the lowest of any state or territory that taxes e-cigarettes. Wholesale tax rates on e-cigarettes in other states include 15% in Illinois and Wyoming, 30% in Nevada, 40% in Pennsylvania, 43% in Maine, 56% in Utah, 59.27% in California, 75% in Massachusetts, 96% in the District of Colombia, 92% in Vermont, and 95% in Minnesota.[5] Currently, General Fund revenue from the Tobacco Products Tax is about $12 million a year, or about 0.1% of recurring General Fund.

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

[2] Wang TW, Coats EM, Gammon DG, Loomis BR, Kuiper NM, Rober T, et al. National and State-Specific Unit Sales and Prices for Electronic Cigarettes, United States, 2012-2016. Prev Chronic Dis 2018;15:170555. DOI: https://doi.org/10.5888/pcd15.170555.
[3] https://www.cdcfoundation.org/State-E-CigaretteSales-DataBrief-2022-Octo30?inline
[4] https://taxfoundation.org/research/all/federal/taxing-nicotine-products/
[5] https://www.cdc.gov/statesystem/factsheets/ECigarette/ECigTax.html

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 bill proposes to increase the tax rate on e-liquids from 12.5% of wholesale price to 44% of wholesale price, and to tax e-cigarettes also at 44%, presumably to discourage their consumption, which can lead to negative health outcomes. But by only increasing the rate on e-cigarettes, the bill may not negate substitution effects noted in studies between cigarettes and e-cigarettes (and closed system cartridges). 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. On the other hand, there are arguments that vaping products are less harmful than cigarettes.[6] Depending on the goal of raising taxes to either raise revenue or curb consumption due to health outcomes, looking at the overall interaction of all taxes on vaping products, cigarettes and other tobacco products would be important.

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-cigarette products within the black market. This raises safety concerns for consumers with 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 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 and add complexity to Tax & Rev's distributions.

Technical Issues: [Section 2]: On page 5, subsection L, the definition of "tobacco product" appears to have contradictory definitions under subsection L(1)(a) of what is and under subsection L(2)(a) what is not a "tobacco product". For example, both definitions use "contains" or "containing" "nicotine" with the caveat under subsection L (2) (a) that it is a noncombustible product. Nicotine products under subsection L(1)(a) are also described as noncombustible. Tax & Rev suggests that these sections be clarified and products are placed cleanly in one or the other category.

Other Issues: Under current law, there is a loophole in the statute for remote sellers. To close this loophole, Tax & Rev proposes that on page 6, line 7, the words "the manufacture or acquisition" be struck and that "to be distributed" on page 6, lines 9 and 10, be placed after "products" on line 8. To read in totality: "For tobacco products to be distributed in New Mexico in the ordinary. . . "

Administrative & Compliance Impact: Tax and Rev will update forms, instructions and publications and make information system changes.

Tax & Rev's Information Technology Division (ITD) will implement the changes taking approximately

[6] Public Health England, " E-cigarettes around 95% less harmful than tobacco estimates landmark review," Aug. 19, 2015, https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review.

1,310 hours or about 8 months at a cost of $72,705 in staff workload. With the delayed repeal of the distribution changes, ITD will have $12,200 in staff workload costs in FY2028 to implement that section of the bill. Those costs are outside of the budget timeframe below.

Tax & Rev's Administrative Services Division (ASD) will define and test requirements for a new distribution to the new fund. These new distributions will also require changes to revenue reports and audit financial statements. It is anticipated this work will take approximately 100 hours split between 2 Full-Time Equivalent (FTE) of a pay band 70 and a pay band 80 at a cost of approximately $3,000.

The bill effective date for the rate changes and updates for distribution updates is July 1, 2024. Due to the timeline to implement this bill, Tax & Rev suggests an effective date of January 1, 2025.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2024	**FY2025**	**FY2026**	**3 Year Total Cost**		
$60.5	--	--	$60.5	NR	Tax & Rev – ITD Staff workload
$3	--	--	$3	NR	Tax & Rev – ASD Staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).