F I S C A L   I M P A C T   R E P O R T

		LAST UPDATED	
SPONSOR	STBTC	**ORIGINAL DATE**	2/11/24
SHORT TITLE	Tobacco Products Tax Rate	**BILL NUMBER**	Senate Bill 72
		ANALYST	Gray

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	FY29	Recurring or Nonrecurring	Fund Affected
Tobacco Products Tax		($2,600.0)	($2,700.0)	($9,700.0)	($18,900.0)	$14,300.0	Recurring	General Fund
Tobacco Products Tax		$10,500.0	$11,500.0	$20,560.0	$29,000.0		Recurring	Nicotine use prevention and control fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information

LFC Files

<u>Agency Analysis Received on Original Bill From</u>
Tax and Revenue Department (TRD)
Department of Health (DOH)
Regulation and Licensing Department (RLD)

Because of the short timeframe between the substitution of this bill and its subsequent hearing, LFC has yet to receive analysis from state, education, or judicial agencies. This analysis could be updated if that analysis is received.

SUMMARY

Synopsis of STBTC Substitute of Senate Bill 72

The Senate Tax, Business, and Transportation Committee substitute for Senate Bill 72 raises the excise tax on e-liquid from 12.5 percent of the wholesale price to 44 percent and adds a 44 percent tax on the category of e-cigarettes.

This bill creates the nicotine use prevention and control fund and distributes a portion of the tobacco products tax revenues to the new fund following the below schedule:

Fiscal Year	Nicotine use prevention and control fund	General Fund
FY25	50%	50%
FY26	50%	50%
FY27	80%	20%
FY28	100%	0%
FY29 and thereafter	0%	100%

The effective date of this bill is July 1, 2024.

FISCAL IMPLICATIONS

The bill does not include a recurring appropriation, but diverts or "earmarks" revenue, representing a recurring loss from the general fund. LFC has concerns with including continuing distribution language in the statutory provisions for funds because earmarking reduces the ability of the Legislature to establish spending priorities.

This analysis uses the tobacco products tax forecast from the December 2023 Consensus Revenue Estimating Group (CREG) forecast to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. The bill raises the excise tax rate on e-cigarettes and e-liquid.

The bill creates 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 2023 to estimate the revenue impact of the proposed tax increases under the Tobacco Products Tax Act. 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

[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

consumption of cigarettes, possibly impacting revenue. In addition, the price increase proposed in the bill for e-cigarette products is approximately 28 percent for e-liquid and 44 percent 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 "Significant Issues" below), then the assumed drop in consumption could also be higher.

This analysis applies the new distributions to the TRD estimates of the original bill. They may be updated should subsequent analysis from TRD be received.

E-cigarettes as defined in the bill are currently not taxed. TRD 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. TRD 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, TRD assumed the sales of rechargeables from that ratio, assuming that ratio has stayed constant, and grew 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. TRD 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 disposable e-cigarettes. The volume of sales was then adjusted by the elasticity assumptions laid out above. To forecast the revenue impact, TRD assumed the unit prices for New Mexico as reported in the Wang et al. study to apply the new proposed rates. TRD assumes that the rate is on the "product value" of e-liquids and "e-cigarettes" but that needs to be clarified in the bill (see *Technical Issues* below). Finally, the price of e-cigarettes varies tremendously depending on what is sold at the retailer level.

SIGNIFICANT ISSUES

The Department of Health notes that in 2021, 25.3 percent of New Mexico high school youth used e-cigarettes and 27.3 percent of youth used at least one form of tobacco, including e-cigarettes, cigarettes, cigars, spit tobacco, or hookah). The agency writes:

> To further 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."
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> 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. Counter

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[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

> 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.

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.

TRD writes:

> 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 TRD and provide uniformity for taxpayers.
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> While it is hard to compare across different state taxing methods, New Mexico's current e-liquid tax of 12.5 percent 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 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.5 Currently, General Fund revenue from the Tobacco Products Tax is about $12 million a year, or about 0.1 percent of recurring general fund.
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> 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.
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> - 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

[4] https://taxfoundation.org/research/all/federal/taxing-nicotine-products/

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 percent of wholesale price to 44 percent of wholesale price, and to tax e-cigarettes also at 44 percent, 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. 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 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 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 TRD’s distributions.

TECHNICAL ISSUES

TRD analysis makes note of several technical issues:

Section 3: Page 3, lines 7 through 21, the definition of “e-cigarettes” includes on line 19, “any component, part or accessory” of an e-cigarette, but does not include on lines 20-21, battery or battery charges are not e-cigarettes. “Component, part or accessory” and “battery or battery charger” both need definitions to clarify what would encompass these pieces. The battery charger or battery is often part of a pre-packaged e-cigarette that also includes e-liquids. As the tax is imposed on the product value and a purchase of an e-cigarette can include batteries or battery chargers, the bill does not direct how to determine the value of the battery or battery charger when determining the final value of the product to be taxed.

Sections 3 and 4: The valuation and imposition of a tax on the separate parts of a vaping product will be difficult for the taxpayer to comply with and for TRD to administer. TRD recommends the following definition of an electronic smoking device to include all three components:

“Electronic smoking device” means a device that may be used to deliver an aerosolized, vaporized, or heated substance containing nicotine, regardless of whether the nicotine is natural or synthetic, to an individual inhaling from the device, and includes an electronic cigarette, e-cigar, e-pipe, vape pen, and ehookah. The term includes any substance containing nicotine, regardless of whether the nicotine is natural or synthetic, that may be aerosolized, vaporized, or heated by the device, regardless of whether the device is sold separately.

One tax rate could then be imposed on the electronic smoking device, and the rate could be increased to account for the separate components. To do so: 1. On page 6, line 10, replace “e-liquid” with “electronic smoking device” (and possibly change the rate) 2. On page 6, remove lines 11-13.

Section 4: On page 6, lines 10 and 11, the bill does not specify what the excise tax rate for e-liquid and e-cigarettes is to be applied against. For the fiscal impact, the rate is assumed to be applied against the “product value.”

Other Issues: Under current law, there is a loophole in the statute for remote sellers. To close this loophole, TRD proposes the following language change to Section 7-12-A-3 (A) NMSA 1978, page 5, line 25, change the “and” after “course of business” to an “or.”

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

BG/al/ne/hg