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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 02/08/09  
**LAST UPDATED** 03/19/09    **HB** \_\_\_\_\_

**SPONSOR** Morales

**SHORT TITLE** Cigarette Tax Act Changes    **SB** 219/aHBIC

**ANALYST** Francis

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	NFI			

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB287

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Department of Health (DOH)  
 Taxation and Revenue Department (TRD)  
 Department of Finance and Administration (DFA)  
 Attorney General's Office (AGO)  
 New Mexico Finance Authority (NMFA)

### SUMMARY

#### Synopsis of HBIC Amendment

The House Business and Industry Committee amended Senate Bill 219 adding several provisions to make it similar to HB287/HJCS.

Senate Bill 219 as amended strengthens the enforcement of the tobacco master settlement agreement (MSA) compliance for non-participating manufacturers. The bill makes changes that are necessary for the diligent enforcement of the 1998 Master Settlement Agreement (MSA) with states' attorneys general, including New Mexico, and major tobacco manufacturers. The MSA has a provision where "participating manufacturers," the parties to the lawsuit at the time or manufacturers that has joined since, can reduce the amount of the payment if they have lost market share to non-participating manufacturers because of lax enforcement of the MSA and tobacco statutes.

Key components of the amendments to SB219:

- Clarifies units of tobacco product refers to individual cigarettes and ounces of “roll your own” tobacco or sales of products bearing a tax-exempt stamp.
- Requiring certification of compliance with the Tobacco Escrow Fund Act from newly qualified non-participating members.
- Updating the Directory of Tobacco Product Manufacturers and Cigarette Brands to include assurances of compliance of newly qualified and elevated risk non-participating manufacturers.
- Providing for bond requirements of newly qualified and elevated risk non-participating manufacturers.
- Requiring non-participating manufacturers located outside the United States, including its importers, to provide for an agent for service of process.
- Disallowing any variations in reporting of cigarette sales from newly qualified non-participating manufacturers or other tobacco product manufacturers as defined in Section 6-4-12 NMSA 1978.
- Creating a provision of Attorney General authority for audit and investigation of suspected violations of the Tobacco Escrow Fund Act.
- Establishes that the Attorney General may require a newly qualified and elevated risk non-participating manufacturer to post a bond for the first three years or longer of listing in the directory. HB287 delineates conditions related to the posting of a bond.
- Creating a provision for proper documentation of Internet or mail-order sale of cigarettes.
- Establishing civil and criminal penalties for violations of the Tobacco Escrow Fund Act and including such violations in the Unfair Trade Practices Act.
- Makes knowingly making a materially false statement a fourth degree penalty.

### Synopsis of Original Bill

Senate Bill 219 makes several changes to the Cigarette Tax Act [Section 7-12 NMSA 1978] and the Tobacco Products Tax Act [Section 7-12A NMSA 1978]. Some of the changes align these acts with the Tobacco Escrow Fund Act (TEFA) [Section 6-4-12 NMSA 1978] which is the act governing the administration of the 1997 state attorneys general litigation against major tobacco manufacturers. One of the conditions of complying with the master settlement agreement from that litigation (MSA) is the state must diligently enforce the parameters by passing model legislation.

One of the provisions required for the MSA is to create a directory of authorized manufacturers and brand families allowed for sale and distribution in the state. SB219 conforms the definition of “cigarette” to TEFA and expands the definition of “contraband cigarettes” to include those not found in the directory. SB219 allows sales of five and ten count packages of cigarettes.

SB219 prohibits a distributor from affixing tax stamps on cigarette packages that are not in the directory and allows 30 days instead of 10 to affix stamps on packages. The bill also clarifies transactions among distributors should be treated the same as transactions between distributors and manufacturers or importers and requires reporting on transactions among distributors.

SB219 clarifies that renewals of licenses are also for a term not to exceed one year and that a license can be revoked by TRD if the licensee violates TEFA as well as the cigarette tax act. Retailers are now required to retain documentation of transactions with distributors and manufacturers but are not required to keep invoices of final sales to consumers.

SB219 exempts tribal entities from the tobacco products tax and expands the imposition of the tobacco products tax on products that are distributed for consumption which, combined with redefining distribute as selling or giving, would impose the tax on gift cigarettes or free samples.

The effective date for the provisions of SB219 is July 1, 2009.

### FISCAL IMPLICATIONS

The fiscal impact is indeterminate but there is litigation pending arising from lax enforcement of the MSA regarding market share and non-participating manufacturers. For the last three years and probably this year, there has been an amount withheld from the participating manufacturers from the annual payment. According to the terms of the litigation, New Mexico could potentially be exposed to a loss equal to a full year’s payment or \$48 million. In the table below, the row titled “NPM Adjustments” are the amounts that have been withheld and are estimated to be withheld. Shoring up the enforcement of the MSA is a key component to defending against these charges.

The AGO reports these changes will make its enforcement of the tobacco statutes more efficient and effective and could lead to financial recovery for the state.

### History and Forecast of MSA Payments to New Mexico

<i>in millions of dollars</i>	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08
Base Payments (1)	14.70	34.30	36.20	41.30	34.20	37.10	38.00	39.70	40.42	48.10
NPM Adjustment (2)								(4.90)	(4.20)	(3.20)
Actual Payments to Permanent Fund (3)		48.80	37.40	43.70	43.80	37.50	35.40	34.80	36.22	44.90
Distribution to General Fund (4)					65.65	37.50	35.40	34.80		
Distribution to Program Fund (5)			24.40	18.70					18.11	22.45
<b>Forecast</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>
Base with Adjustments (6)	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10
NPM Adjustment	(3.20)	(3.20)								
Net Estimated Payment to Permanent Fund	44.90	44.90	48.10	48.10	48.10	48.10	48.10	48.10	48.10	48.10
Distribution to Program Fund (7)	44.90	44.90	24.05	24.05	24.05	24.05	24.05	24.05	24.05	24.05

Notes:

- (1) National payment multiplied by 0.5936 percent NM Allocation share
- (2) NPM = Non Participating Manufacturer. From 2006 to 2008, part of the payments were withheld pending determination of market share loss caused by NPMs.
- (3) Net Contributions reported in State Investment Council FY2007 Annual Report
- (4) In 2003, the distribution was changed to 100 percent to the general fund until 2007.
- (5) In 2007, the distribution reverted to 50 percent to the tobacco program fund and the balance remaining in the permanent fund.
- (6) Assumes 3 percent positive inflation adjustment cancels out 3 percent negative volume adjustment applied to base prior to NPM adjustment.
- (7) SB 79 passed in February 2009 distributes the entire payment to the program fund for two years.

## **RELATIONSHIP**

SB219 as amended includes most of the provisions of HB287, which would change the Cigarette Enforcement Act to use the directory of tobacco product manufacturers and brand families in enforcement of MSA payments and Tobacco Escrow Fund payments by tobacco manufacturers.

SB219 did not include the expanded definition of “cigarette” found in HB287 that included little cigars.

## **TECHNICAL ISSUES**

AGO suggests adding the definition of little cigars and including penalties for false reporting:

Section 7-12-02 should be revised to include “Little Cigars” on page 2 line 10 after “kreteks; or. This change will require the distributor and manufacturer to report Little Cigars as cigarettes.

## **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

For the past three years, the tobacco manufacturers that participate in the MSA have withheld payment due to loss of market share arising from inadequate enforcement of the MSA nationally. Beginning with 2003, each year will likely be subject to litigation and, if NM is found to have lax enforcement, the state could lose up to an entire annual payment (around \$45 million) that goes

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