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## FISCAL IMPACT REPORT

ORIGINAL DATE 01/30/11

SPONSOR Feldman LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Tobacco Products Tax & Definitions SB 81

ANALYST Burrows

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	\$6,720.0	\$6,970.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB264

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Department of Health (DOH)

Department of Taxation and Revenue (TRD)

#### Responses Not Received From

Department of Finance and Administration (DFA)

### SUMMARY

#### Synopsis of Bill

Senate Bill 81 proposes to raise the excise tax rate on tobacco products from 25 percent of product value to 57 percent of product value. The bill will also set a minimum tax rate of \$1.66 per unit on tobacco products sold in retail units of 1.2 ounces or less. The bill provides definition of "retail unit" as a single lot of a tobacco product that can be sold, and clarifies the definition of "tobacco product" to include cigars and any product smokeless tobacco product, but exclude products used in smoking cessation.

The effective date of the provisions of this bill is July 1, 2011.

## **FISCAL IMPLICATIONS**

Tobacco demand is responsive to price changes and it is important to recognize that when prices go up demand will do down, thereby affecting the fiscal impact.

Impacts were calculated based on the effect of the tax increase on price and the correlated decrease in demand for tobacco products. Demand elasticity, the ratio of the change in purchases to the change in price, was assumed to be -0.40. This estimate is consistent with those reported in economic studies of tobacco use.

No impacts are estimated from the new minimum tax on smokeless products in small quantities due to lack of information on current consumption of these products.

## **SIGNIFICANT ISSUES**

Senate Bill 81 would create tax equity between cigarettes and other tobacco products, and subsequently lower the attractiveness of tobacco products among price-sensitive consumers, such as youth. Moreover, the minimum tax rate on small quantities could prevent brands sold at low predatory or anti-competitive prices from evading reasonable taxation.

## **ADMINISTRATIVE IMPLICATIONS**

According to TRD, the provision on page 3, lines 21-23, which creates a new rate of tax for certain products, will be difficult for TRD to administer and may cause compliance issues. TRD reports that the tax is imposed on the “first purchaser” who may be a wholesaler; the retailer may later divide the wholesale unit into smaller quantities for resale. In such case, the ultimate retail form of the tobacco unit may be unknown at the point of taxation, and it will be unclear which tax rate should apply. Moreover, audits will be more time consuming.

## **RELATIONSHIP**

Senate Bill 264 proposes to impose excise taxes on cigarette vendors selling cigarettes to non-tribal members on tribal land, and proposes to remove the requirement that tribes impose an excise tax.

## **TECHNICAL ISSUES**

According to TRD, on page 2, line 25, the word “can” should be changed to “will” to make the application of the statute clearer.

TRD also reports:

“To clarify the point in the product chain where the tax is imposed, the phrases “at the time of delivery” could be added after “tobacco products” [on page 3, line 20]. It is easier to tax the bulk purchase than to tax the smaller, split up purchases. Loose tobacco “can” be sold in smaller quantities to make cigarettes, creating a potential loophole. Retailers buying large quantities of tobacco to “roll your own” cigarettes could avoid tax by arguing that the tobacco “can” be used for cigarettes.”

**OTHER SUBSTANTIVE ISSUES**

According to the Department of Health (DOH), raising tobacco taxes is widely regarded as one of the most effective tobacco prevention strategies, but it is important to place comparable taxes on cigarettes, as well as other tobacco products, to prevent users from substituting one form of tobacco for another.

According to DOH, chew tobacco use by New Mexico high school youth increased by 34 percent between 2003 and 2009, ranking New Mexico with the 11<sup>th</sup> highest rate in the country. In addition, New Mexico is ranked the highest in the country among cigar use by high school youth at 18.1 percent.

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

The tobacco product excise tax will remain at 25 percent of product value.

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