

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (www.nmlegis.gov). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

ORIGINAL DATE 2/11/2015

SPONSOR McSorley LAST UPDATED _____ HB _____

SHORT TITLE Regulation & Labeling of Nicotine Products SB 65

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
\$0.0	\$260.0	\$700.0	\$740.0	\$750.0	Recurring	General fund

(Parenthesis () indicate revenue decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$138.0	\$223.0	\$223.0	\$584.0	Recurring	TRD Operating Fund

(Parenthesis () indicate expenditure decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
Department of Health (DOH)

SUMMARY

Synopsis of Bill

Senate Bill 65 amends the Tobacco Products Tax Act to impose a tax on certain nicotine products and to require nicotine content labeling on containers of liquid that contain nicotine. Specifically, the bill:

- Imposes an excise tax on nicotine products manufactured or acquired in New Mexico and for the consumption of nicotine products in New Mexico. The tax is imposed at a rate of \$0.04 per milligram of nicotine contained in the nicotine product.
- Makes deductible from the tax the milligrams of nicotine in nicotine products sold and shipped or given and shipped out of state.

- Requires every manufacturer of nicotine products to identify nicotine content, in milligrams, of each unit it sells.
- Requires TRD to conduct periodic compliance checks to ensure accurate reporting of nicotine content by obtaining samples from retail locations throughout the state and sending them to the Scientific Laboratory Division of DOH for testing.
- Requires sellers of nicotine products to register with the state and retain records of sales.
- Adds “Nicotine Products” to the name of the Tobacco Products Tax Act.
- Defines “nicotine product” as a liquid solution containing nicotine that is intended for human consumption via an electronic delivery device.
- Defines "electronic delivery device" as any electronic device, whether composed of a heating element and battery or an electronic circuit, that provides a vapor of nicotine, the use or inhalation of which simulates smoking.
- Clarifies the definition of “tobacco product” to exclude nicotine products as defined above.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

TRD reports it does not have the necessary data to complete a precise analysis of the impact of this bill. However, the department combined national studies and trends in state tobacco revenue to estimate the fiscal impact. In making this estimate, TRD assumed there is a relationship between the decline in tobacco revenues and increase in sales of e-cigarettes liquid and equipment.

In 2013, the e-cigarette industry recorded \$1 billion in revenue nationwide with an average growth of about 120 percent over the past six years. TRD used both actual and projected cigarette volumes from the February 2015 consensus revenue estimate and assumed the part of the decline in cigarette volume is due to an uptake in e-cigarette consumption, and part is due to smoking cessation. TRD also assumed that one cigarette contains about 1.2 milligrams of nicotine products and used this estimate to determine the equivalent tax on one milligram of nicotine in e-cigarettes liquid. TRD notes it expects the e-cigarette industry to grow at a rate of 10 to 25 percent per year in New Mexico. TRD adds this may be a conservative estimate when compared with annual national growth, which has ranged between 95 and 156 percent over the last six years. TRD adds that the estimated impact in FY16 is a partial-year impact.

DOH reports measuring nicotine content of retail products by the Scientific Laboratory Division in order to ensure accurate reporting of nicotine product for the Taxation and Revenue Department would cost the Scientific Laboratory Division an estimated \$65 per analysis (reagents, standards, supplies and analytical instrumentation) in 2014 dollars. Because the bill does not propose funds for the Scientific Laboratory Division to perform the compliance testing, the Laboratory would bill TRD for this work. While the annual number of retail products to be tested would be determined by TRD, a compliance program that tested 500 retail product samples per year would require an estimated annual funding of \$32,500 for laboratory services.

SIGNIFICANT ISSUES

Currently, New Mexico imposes an excise tax for each cigarette sold, given or consumed at the

rates below, through 7-12-3 NMSA 1978 of the Cigarette Tax Act:

- \$.083 if the cigarettes are packaged in lots of twenty or twenty-five;
- \$.166 if the cigarettes are packaged in lots of ten; or
- \$.332 if the cigarettes are packaged in lots of five.

This bill would attempt to impose a tax on e-cigarette solution at parity with cigarettes (sold in lots of 20-25), based on an assumption that cigarettes contain approximately 2mg of nicotine.

In its analysis of the bill, DOH cites a 2014 national youth survey, Monitoring the Future, which found that more teens are smoking e-cigarettes than tobacco cigarettes. Among 12th-graders, 17 percent used an e-cigarette, compared with 14 percent using a tobacco cigarette. A Centers for Disease Control and Prevention national study showed a three-fold increase, from 2011 to 2013, in the number of youth (from 79,000 to over 263,000) who had tried an e-cigarette but had never smoked a tobacco cigarette.

DOH cites the World Health Organization in reporting that youth are more affected by price increases; therefore, increasing the cost of nicotine helps the poor to stop using tobacco. This allows tobacco users who quit to reallocate their money to essential goods, including food, shelter, education and health-care.

E-Cigarette Taxation in Other States.

New Jersey Legislators announced they want to place a 75 percent wholesale tax on e-cigarettes and related accessories in parity with taxes on traditional cigarettes, currently \$2.70 for a pack of 20. No special tax is currently imposed on e-cigarettes. According to the Wall Street Journal, Governor Christie says the tax on e-cigarettes could bring in \$35 million a year. New Jersey has banned people from smoking them indoors in public places and requires buyers to be at least 19 years old.

Minnesota. E-cigarettes and liquid capsules are considered tobacco products and are subject to the tobacco tax, which is currently 95 percent of the wholesale cost of any product containing or derived from tobacco. Distributors who do not pay tobacco tax on these products are subject to penalties, interest, license revocation, and possible criminal charges. Retailers are required to purchase the tax paid product. If they do not comply, they are subject to penalties, interest, license revocation, and possible criminal charges. Consumers who purchase from someone who has not paid the tobacco tax must pay a tobacco consumer use tax. The state requires child-resistant packaging for liquid nicotine containers.

The tobacco tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax would only be on the nicotine cartridge value. Similarly, a disposable e-cigarette may have the tax calculated on its nicotine cartridge value if the cartridge is replaceable.

North Carolina. The top tobacco-producing state passed a measure this spring in which a tobacco product is defined as a cigarette, a cigar, or any other product that contains tobacco and is intended for inhalation or oral use, including a vapor product. The excise tax of \$0.45 levied on every pack of traditional cigarettes did not change with the measure. The measure stipulates an excise tax is levied on tobacco products other than cigarettes and vapor products at the rate of

12.8 percent of the cost price of the products. This tax does not apply to the following:

- A tobacco product sold outside the State;
- A tobacco product sold to the federal government; or
- A sample tobacco product distributed without charge.

Further, the measure imposes an excise tax on vapor products at the rate of five cents (5¢) per fluid milliliter of consumable product. All invoices for vapor products issued by manufacturers must state the amount of consumable product in milliliters. Taxes imposed under this section do not apply to:

- A tobacco product sold outside the State;
- A tobacco product sold to the federal government; or
- A sample tobacco product distributed without charge.

Missouri. The general assembly voted on September 10 to override the executive’s veto of SB 841, a bill banning sales of e-cigarettes and similar “vaping” products to minors. The bill also carries a provision that bans the state from regulating e-cigarettes like tobacco is regulated. Even as cigarette tax revenue falls, the new law means the booming e-cigarette market won't bolster the state's income. Missouri's tobacco tax revenues have fallen every year since 2006 and were \$99.5 million in FY14, according to the Missouri Department of Revenue. An FDA decision could call Missouri's deregulation into question. At 17 cents a pack, Missouri's cigarette tax is the lowest in the nation. Voters have defeated cigarette tax increase referendums three times since 2002.

ADMINISTRATIVE IMPLICATIONS

TRD reports a high administrative impact. Adding a new tax type under the cigarette tax program requires creating new a Gentax document and Taxpayer Access Point document. New return transactions and revenue will need to be configured, which will require new return generation letters, and separate reports to list the details.

As this would be a new tax program, TRD estimates a high administrative impact, citing costly public education needs and difficult implementation because of the limited amount of time allowed for preparing forms, instructions, educational materials, and to develop the back-end systems for processing. Additionally, TRD expects \$10 thousand will be needed to set up the payments for processing. Recurring costs would include four new FTE required for processing returns at a cost of \$30-45 thousand per FTE. Additional FTE would be needed to collect samples and forward them DOH and to recording results.

TECHNICAL ISSUES

This bill does not contain an effective date. As such, it is unclear when nicotine products become taxable, and by when the TRD and DOH compliance systems need to be implemented. The LFC recommends adding an effective date, whether it be July 1, 2015, or January 1, 2016.

TRD adds it would need clarification on the collection of the samples would be needed, stating that retail shops mix the nicotine with the liquid at the time of sale, per the customer’s request.

Finally, TRD adds a definition of manufacturer would assist with administration to clarify whether a retailer who combines the nicotine product with a liquid made for the electronic cigarette, is considered a manufacturer.

OTHER SUBSTANTIVE ISSUES

According to the U.S. Food and Drug Administration (FDA), e-cigarettes have not been fully studied, so consumers currently don't know the potential risks when used as intended, how much nicotine or other potential harmful chemicals are being inhaled during use, and whether there are any benefits associated with using these products. The FDA adds it is unknown whether e-cigarettes may lead young people to try other tobacco products, including conventional cigarettes, which are known to cause disease and lead to premature death.

Only e-cigarettes that are marketed for therapeutic purposes are currently regulated by the FDA Center for Drug Evaluation and Research. Currently, the FDA Center for Tobacco Products (CTP) regulates cigarettes, cigarette tobacco, and smokeless tobacco. FDA has issued a proposed rule that would extend the agency's tobacco authority to cover additional products that meet the legal definition of a tobacco product, such as e-cigarettes. The proposed rule would empower FDA to issue restrictions to individuals under the age of 18, require the display of health warnings on tobacco product packages and advertisements. It would also allow the agency to evaluate claims of new tobacco products to reduce tobacco-related disease and death, through rigorous scientific review and to prohibit the sale of e-cigarettes through vending machines, unless in a facility that never admits youth.

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

PvM/aml/bb