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FISCAL IMPACT REPORT

ORIGINAL DATE 2/6/18

SPONSOR Thompson LAST UPDATED _____ HB 232

SHORT TITLE Cigarette Tax Raise & Distribution SB _____

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
\$0.0	\$335.0	\$323.0	\$311.0	\$300.0	Recurring	General Fund (Cigarette)
\$0.0	\$2,869.0	\$3,357.0	\$3,939.0	\$4,633.0	Recurring	General Fund (TPT)
\$0.0	\$15.0	\$14.0	\$14.0	\$13.0	Recurring	Credit Enhancement Acct
\$0.0	\$15.0	\$15.0	\$14.0	\$14.0	Recurring	UNM Cancer Center
\$0.0	\$24.0	\$23.0	\$23.0	\$22.0	Recurring	NM Finance Auth./UNM Health Sciences
\$0.0	\$10,891.0	\$10,498.0	\$10,115.0	\$9,728.0	Recurring	NM Finance Auth./DOH
\$0.0	\$21.0	\$20.0	\$19.0	\$19.0	Recurring	Rural County Cancer Treatment
\$0.0	\$27,635.0	\$26,637.0	\$25,665.0	\$24,683.0	Recurring	NEW Public School Fund (Cigarette)
\$0.0	\$8,743.0	\$9,367.0	\$10,077.0	\$10,873.0	Recurring	NEW Public School Fund (TPT)
\$0.0	\$27,635.0	\$26,637.0	\$25,665.0	\$24,683.0	Recurring	NEW Medicaid Trust Fund (Cigarette)
\$0.0	\$8,743.0	\$9,367.0	\$10,077.0	\$10,873.0	Recurring	NEW Medicaid Trust Fund (TPT)
\$0.0	\$3,219.0	\$3,694.0	\$4,264.0	\$4,946.0	Recurring	Subtotal (General Fund)
\$0.0	\$36,378.0	\$36,004.0	\$35,742.0	\$35,556.0	Recurring	Subtotal (Medicaid Trust Fund)
\$0.0	\$36,378.0	\$36,004.0	\$35,742.0	\$35,556.0	Recurring	Subtotal (Public School Fund)
\$0.0	\$86,948.0	\$86,279.0	\$85,939.0	\$85,861.0	Recurring	TOTAL

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
\$50.0	\$100.0	\$100.0	\$250.0	Recurring	TRD/General Fund

Parenthesis () indicate expenditure decreases

Conflicts with SB25

SOURCES OF INFORMATION

LFC Files

Responses Received From

New Mexico Finance Authority (NMFA)

Responses Not Received From

Taxation and Revenue Department (TRD)

Human Services Department (HSD)

Department of Health (DOH)

Public Education Department (PED)

SUMMARY

House Bill 232 amends the Cigarette Tax Act to increase the excise tax on cigarettes, amends the Tobacco Products Act to include e-cigarettes and other vapor products, taxes tobacco products at an increased rate, and creates the Medicaid trust fund. Specifically, the bill:

- Increases the excise tax by \$1.88 on packs of 25 cigarettes and by \$1.50 on packs of 20 and removes unnecessary language on excise taxes for packs of less than 20 as such were banned under the federal Family Smoking Prevention and Tobacco Control Act of 2009.
- Increases the tobacco products tax from 25 percent to 76 percent of the product value of the tobacco products;
- Revises the cigarette tax distributions with the intent of new revenues from the tax increase to be distributed to the public school fund for the state equalization guarantee, to the new Medicaid trust fund, and to the Department of Health (DOH) for tobacco prevention and cessation programs;
- Creates the Medicaid trust fund, which can be appropriated by the legislature to support the state Medicaid program. The bill specifies money appropriated from the fund shall be supplemental to any general fund appropriations; and
- Expands the definition of “tobacco product” significantly to include:
 - A product that is made of or derived from tobacco or nicotine and that is intended for human consumption, whether smoked, heated, chewed, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means;
 - An electronic device that delivers nicotine or other substances to the person inhaling from the device;
 - A component, part, or accessory of a tobacco product; and,
 - A cigar, chewing tobacco, pipe tobacco, snuff, electronic cigarette, electronic cigar, or electronic pipe.

The effective date of this bill is July 1, 2018.

FISCAL IMPLICATIONS

The fiscal impact estimate uses the Consensus Revenue Estimating Group’s (CREG) December 2017 forecast of cigarette and tobacco products revenues for FY19-FY22 as a starting point. Based on historical changes in consumer demand after a cigarette tax increase in New Mexico,

the estimate assumes the price increases would result in a 3 percent decrease in consumption of cigarettes and a 13 percent decrease in consumption of tobacco products (excluding e-cigarettes). Additionally, the estimate assumes a 12 percent reduction in e-cigarette consumption. Even with the decrease in consumption, total revenues from the two taxes are expected to reach around \$170 annually. New revenues from the tax increases are expected to total about \$85 million annually. Revenues in the fiscal impact table are rounded to the nearest \$1 thousand.

Based on the continued trend of declines of cigarette consumption seen since FY07, the estimate also incorporates the consensus forecasted declines in cigarette tax revenues for FY19-FY22. The bill amends cigarette tax distributions with the intent of distributing all new revenues to the public school fund and holding other accounts virtually harmless despite anticipated declines in cigarette consumption due to the tax increase. The adjusted distributions given the projected impact on consumption, are expected to generate a slight revenue increase for cigarette tax beneficiaries. These estimates assume all consumption for cigarettes come from packs of 20, which is how the large majority of cigarettes are sold.

Unlike cigarette consumption, revenues from tobacco products consumption have continued to grow, and the estimate continues this trend for the forecast period. The effect of incorporating e-cigarettes in the tobacco products tax is estimated using data on U.S. sales for e-cigarettes, adjusted for the New Mexico population, and then adds yearly growth estimates for the U.S. market, which are relatively strong (about 20 percent). When factoring in adjustments for consumer price responses, it is expected that taxing e-cigarettes will add \$6 million to \$10 million in revenues between FY19-FY22.

NMFA issues cigarette tax revenue bonds (as set forth below) and structures those bonds to withstand an annual 3 percent decline in revenue as a result of declined cigarette consumption over time. For the last several years, cigarette tax revenue generation has been volatile, with certain years declining beyond the bond structured decline. Despite declines in consumption due to the bill, the adjusted distributions intended to hold cigarette tax beneficiaries harmless are estimated to result in about a 1.5 percent increase to these accounts, on average. Therefore, it is assumed the changes contemplated in this bill will not impair outstanding NMFA cigarette tax revenue bonds.

In response to similar legislation (2018 SB25), PED noted that historically, increased distributions to the public school fund from various sources intended to grow the SEG have been used by legislative budgeters to supplant existing general fund appropriations to education and have not been used to increase funding to the total education funding pot. This increase would only occur if the existing SEG commitment remained flat and the new revenue source was not offset or supplanted by redirecting existing SEG appropriation amounts to other needs. If existing appropriation commitments to the SEG distribution from the General Fund are both reduced and increased by approximately \$80+ million, the impact on SEG distributions may be flat or non-consequential.

While the bill does not specify that increased funding for the SEG should be supplemental to general fund appropriations, it does specify that appropriations from the newly created Medicaid trust fund “shall be supplemental to any general fund appropriations to the state Medicaid program.”

SIGNIFICANT ISSUES

Currently, New Mexico imposes an excise tax for each cigarette sold, given or consumed at the rates below, through section 7-12-3 NMSA 1978 of the Cigarette Tax Act:

- \$.083 if the cigarettes are packaged in lots of 20 or 25 (\$1.66 and \$2.08 per pack, respectively);
- \$.166 if the cigarettes are packaged in lots of 10 (\$1.66 per pack); or
- \$.332 if the cigarettes are packaged in lots of five (\$1.66 per pack).

This bill raises the per pack tax of cigarettes to \$3.95 for lots of twenty-five and to \$3.16 for lots of 20. The bill also removes unnecessary language on excise taxes for packs of less than 20 since the sale of smaller packs were banned under the federal Family Smoking Prevention and Tobacco Control Act of 2009.

The increased tax results in a 16 percent price increase on cigarettes, a 51 percent price increase on tobacco products (excluding e-cigarettes), and a 76 percent price increase on e-cigarettes. TRD has previously indicated increasing cigarette stamp taxes may further promote internet sales and use of counterfeit stamps.

While the estimated fiscal impact only considers consumers' direct price responses (e.g. reducing consumption based price increases), it does not consider the potential for consumers to seek out lower-taxed cigarettes and tobacco products (e.g. purchases on tribal lands or online). If taxable volumes of cigarette and tobacco products decrease by an additional 5-10 percent as a result of such lower-price-seeking behavior, then total new revenues could be reduced by \$10 million to \$20 million.

The proposed tax rate of \$3.16 per pack of 20 cigarettes would exceed the tax rate of surrounding states and would make New Mexico cigarette taxes 6th in the nation (see Appendix A). About half of all states have proposed some form of vapor excise tax, although only eight states had enacted a vapor excise tax as of January 2017. Inclusion of e-cigarettes in the tobacco products tax would make New Mexico an outlier among surrounding states, although Arizona has proposed similar legislation to impose an excise tax on e-cigarettes (see Appendix B). A report published by the Tax Foundation, a non-partisan tax policy research organization, states New Mexico currently ranks 3rd in the nation for inbound cigarette smuggling activity, with an estimated 46.2 percent of cigarettes consumed in the state derived from smuggled sources in 2014 (see Appendix C).¹ Raising tax rates substantially higher than surrounding areas may exacerbate the issue.

Education. In response to similar legislation (2018 SB25), PED stated the additional revenues from the bill could impact the state level of maintenance of effort (MOE) under the provisions of the Individuals with Disabilities Education Act (IDEA). Increased revenue to the SEG will have the effect of growing the level of funding associated with the special education lines of the SEG thus increasing the MOE level.

¹ Tax Foundation, *Cigarette Taxes and Cigarette Smuggling by State, 2014*, <https://taxfoundation.org/cigarette-taxes-and-cigarette-smuggling-state-2014/>. According to this report, New York and Arizona rank 1st and 2nd in cigarette smuggling activity, respectively, and New Mexico ranks 3rd. This report includes both legal and illegal sales in their definition of smuggling, with "casual smuggling" identified as military and tribal sales.

Medicaid. No response has been received from the Human Services Department (HSD) regarding the need for or plan to utilize the additional funding this bill generates for the Medicaid trust fund. According to Medicaid.gov, cigarette smoking is one of the greatest drivers of adverse health outcomes and costs for state Medicaid programs.²

ADMINISTRATIVE IMPLICATIONS

This bill would likely have a minimal administrative impact to PED; the agency would distribute any additional revenues through the SEG distribution.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with SB25, which increases the tax rates for cigarettes and tobacco products, includes e-cigarettes in the definition for tobacco products, and distributes the new revenue to the public school fund for the state equalization guarantee.

In response to similar legislation (2018 SB25), TRD indicates provisions of this bill would have a high impact on the Information Technology Division, requiring over 6 months to implement. Thus, the effective date of July 1, 2018 is likely not feasible and instead an effective date of July 1, 2019 is recommended. TRD has also stated similar bills (2018 SB25) will have a moderate impact on the Audit and Compliance Division, requiring two new full time employees to increase compliance efforts. Additionally, TRD expects similar bills to have a moderate impact to the Revenue Processing Division, such that implementing the changes by the effective date will be difficult.

OTHER SUBSTANTIVE ISSUES

The New Mexico Department of Health (DOH) has previously indicated in reviews of similar legislation that significantly higher hookah use is seen among youth who earn mostly D's and F's (29 percent) and lesbian, gay, or bisexual youth (25 percent), compared to the general youth population (11 percent). E-cigarette use is also especially high among youth earning D's and F's (43 percent) and lesbian, gay, or bisexual youth (36 percent), compared to the general youth population (24 percent).

The Human Services Department has previously indicated in reviews of similar legislation cigarette use among New Mexico high school youth declined to a historic low of 11.4 percent in 2015. Declines in cigarette use have been offset by increased use of other tobacco products such as e-cigarettes and hookah. In 2015, 24 percent of NM high school youth used e-cigarettes and 11.4 percent used hookah. Altogether, one-third of NM youth still use at least one form of tobacco (cigarettes, cigars, spit/chew, hookah, or e-cigarettes), and about half of youth tobacco users use more than one tobacco product. Factors that may be influencing these trends in youth tobacco product use include pricing differences among tobacco products (i.e., higher taxes on cigarettes compared to other tobacco products), availability of products in flavors that appeal to youth, and increased marketing of e-cigarettes.³

² <https://www.medicaid.gov/medicaid/quality-of-care/improvement-initiatives/tobacco/index.html>

³ Youth Risk & Resiliency Survey. Available at <http://youthrisk.org/>

Among adults in the state, DOH previously noted cigarette smoking remains disproportionately high among African Americans (24 percent), lesbian, gay, and bisexual people (29 percent), and people experiencing poverty (25 percent), compared to 17.5 percent of all adults (2015 Behavioral Risk Factor Surveillance System).⁴ Groups at increased risk for e-cigarette use include cigarette smokers (18 percent) and young adults ages 18-29 (12 percent), compared to only 5 percent of all adults. There are also higher rates of spit tobacco use among men (8 percent) and American Indians (8 percent) than the general population (4 percent). Hookah use among adults is concentrated among young adults, 18-29 year olds (9 percent).

According to the 2014 Surgeon General’s Report on The Health Consequences of Smoking, there is evidence to conclude “increases in the prices of tobacco products, including those resulting from excise tax increases, prevent initiation of tobacco use, promote cessation, and reduce the prevalence and intensity of tobacco use among youth and adults.”⁵

According to the U.S. Food and Drug Administration (FDA), e-cigarettes have not been fully studied, so consumers currently do not 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.

A 2016 Tax Foundation report titled Vapor Products and Tax Policy, states “vapor products are generally found to have a much lower risk profile than traditional incinerated cigarettes” and “punitive taxes on vapor products could inadvertently close out options for cigarette users looking to quit.” This report notes that the Public Health England, a subset of the British Department of Health, “issued findings that vapor products are 95 percent less harmful than cigarettes and can serve as an effective tobacco-cessation method.”⁶ Lawmakers who wish to tax vapor products while encouraging the use of these products as means of quitting traditional cigarette smoking may consider taxing vapor products at a lower rate. Although, it is noted this bill exempts from the tobacco products tax “any product that has been approved by the United States food and drug administration (FDA) for sale as a tobacco cessation product or for other therapeutic purposes where such product is marketed and sold solely for such an approved use.” If vapor products were to become officially approved by the FDA as a tobacco cessation product, then they would not be subject to the excise tax.

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

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⁴ <https://www.cdc.gov/brfss/index.html>

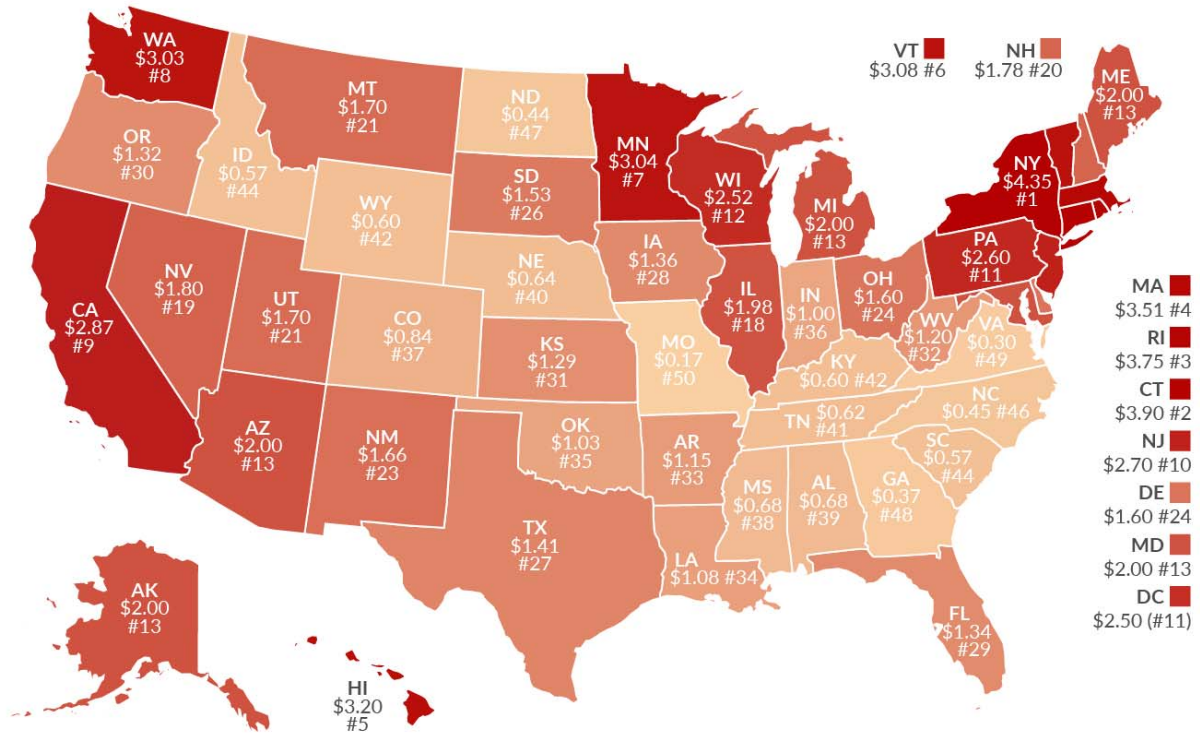
⁵ www.surgeongeneral.gov/library/reports/50-years-of-progress/exec-summary.pdf

⁶ <https://taxfoundation.org/vapor-products-and-tax-policy/>

APPENDIX A

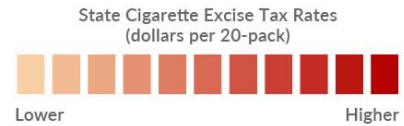
How High Are Cigarette Taxes in Your State?

State Cigarette Excise Tax Rates as of April 1, 2017 (dollars per 20-pack)



Note: Local taxes are not included and can be substantial. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.

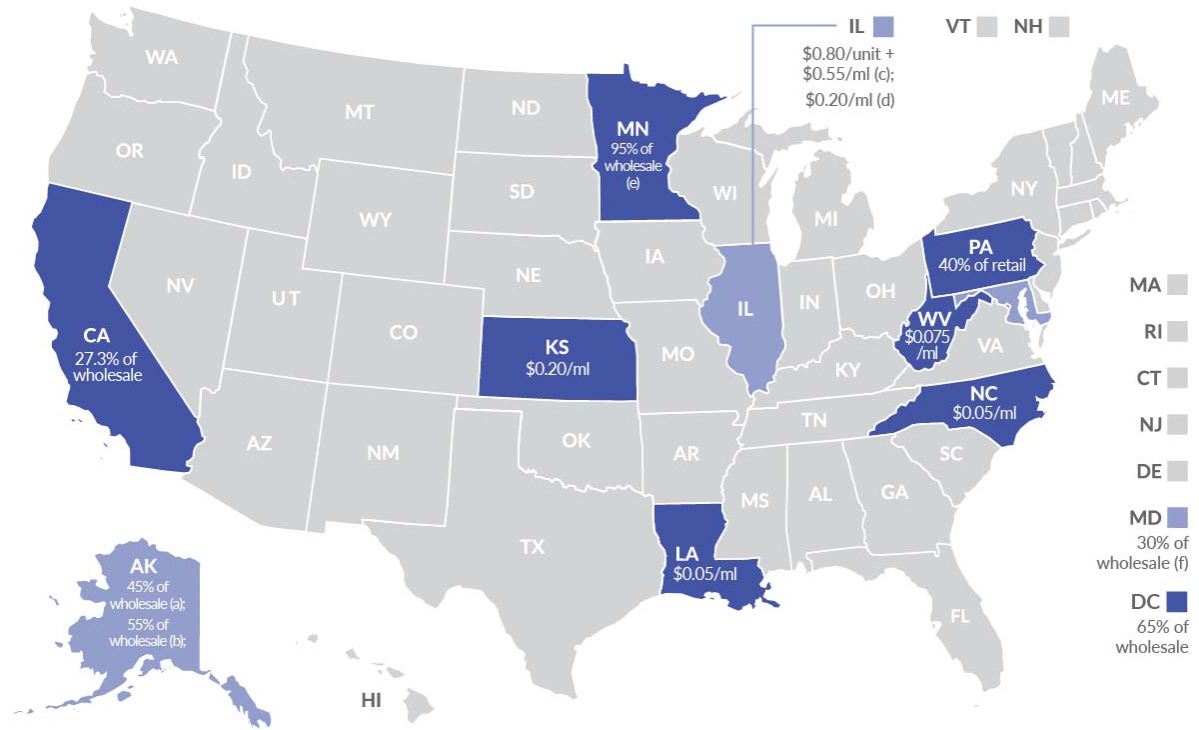
Source: Tax Foundation; RJ Reynolds; state revenue departments.



APPENDIX B

How High Are Vapor Excise Taxes in Your State?

State & Local Vapor Excise Tax Rates, as of January 2017



Note: (a) Tax is only applicable in Juneau, NW Arctic Borough, and Petersburg. (b) Tax is only applicable in Mat-Su Valley. (c) Tax is only applicable in the city of Chicago. (d) Tax is only applicable in Cook County. (e) Tax is on the wholesale cost of any product containing or derived from tobacco. The tax on an e-cigarette starter kit is calculated on the total cost unless the nicotine cartridges are sold separately and then the tax is levied only on the value of the nicotine cartridge. (f) Tax is only applicable in Montgomery County.

Source: State statutes; Bloomberg BNA.

Statewide Vapor Excise Tax
 Municipal Vapor Excise Tax

APPENDIX C

Cigarette Smuggling by State

Smuggled cigarettes consumed as a percentage of total cigarettes consumed, 2014

