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## FISCAL IMPACT REPORT

**SPONSOR** Lujan/Chandler/ Ferrary/Montoya, RE      **ORIGINAL DATE** 02/06/21      **LAST UPDATED** 03/01/21      **HB** 167  
**SHORT TITLE** Increase Cigarette & Tobacco Product Taxes      **SB** \_\_\_\_\_  
**ANALYST** Iglesias/Torres

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
	\$60.0	\$60.0	\$60.0	\$55.0	Recurring	Credit Enhancement Account
	\$30.0	\$30.0	\$30.0	\$30.0	Recurring	Rural Cancer Treatment
	\$45.0	\$45.0	\$40.0	\$40.0	Recurring	DOH Facilities
	\$65.0	\$65.0	\$65.0	\$60.0	Recurring	UNM Health Sciences Center
	\$20.0	\$20.0	\$20.0	\$15.0	Recurring	UNM Cancer Center
	\$69,385.0	\$67,775.0	\$66,060.0	\$63,975.0	Recurring	General Fund – Cigarette Tax
	\$20,500.0	\$20,100.0	\$19,200.0	\$19,300.0	Recurring	General Fund – Tobacco Products Taxes

Parenthesis ( ) indicate revenue decreases

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	\$21.6		\$21.6	Nonrecurring	TRD - ITD

Parenthesis ( ) indicate expenditure decreases

**Relates to HB97 and SB95**  
**Duplicates SB197**

#### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

New Mexico Attorney General (NMAG)  
 Department of Health (DOH)  
 Taxation and Revenue Department (TRD)

New Mexico Finance Authority (NMFA)

## **SUMMARY**

### Synopsis of Bill

House Bill 167 (HB167) increases the excise tax rate for cigarettes, tobacco products, and e-liquids and closed system cartridges for electronic cigarettes. HB167 also decreases discounts for tax stamps sold in larger quantities during a calendar month. Lastly, HB167 adjusts the percentages of the cigarette tax revenue distributed to the related healthcare entities to maintain current funding levels.

Section 1 changes the distributions from the cigarette tax to the Comprehensive Cancer Center at the New Mexico Health Sciences Center and to the New Mexico Finance Authority (on behalf of and for the benefit of the University of New Mexico Health Sciences Center, DOH facilities, the credit enhancement account, and the rural county cancer fund).

Section 2 increases excise taxes for cigarettes sold, given, or consumed in the state from 10 cents to 20 cents.

Section 3 decreases the discounts for tax stamps sold at face value.

Section 4 increases the tobacco products tax for products distributed for consumption from 25 percent to 83 percent, for e-liquids from 12.5 percent to 83 percent, and for closed system cartridges from 50 cents to \$3.32 per closed system cartridge.

The effective date of this bill is July 1, 2021.

## **FISCAL IMPLICATIONS**

The fiscal impact table represents analysis using the December 2020 consensus revenue forecast for cigarettes and tobacco products. The estimates assume price increases will have an inverse effect on consumption (higher prices will reduce consumption) of cigarettes, tobacco products, and e-cigarettes. These estimates assume all consumption for cigarettes come from packs of 20, which is how the most cigarettes are sold. New revenues from the tax increases are expected to total about \$90 million annually.<sup>1</sup> 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 FY22-FY25.

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). The Tax Foundation finds that if taxable volumes of cigarette and tobacco products decrease by an

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<sup>1</sup> The analysis provided by the Taxation and Revenue Department (TRD) assumes the tax increase will result in larger declines in consumption than the LFC analysis. Combined with differing assumptions for revenues from e-cigarettes, this results in TRD's estimate being almost \$16 million lower than the LFC estimate.

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 increases under the Tobacco Products Tax Act applies to all but one of the categories, cigars. Different demand elasticities were applied to the remaining products: little cigars, e-liquid (for use in e-cigarettes), closed system cartridges (single-use e-liquid containers for e-cigarette), and all other tobacco products. Based on a recent study of the impact of e-cigarette taxes on e-cigarette and other tobacco consumption by Cotti et al.<sup>2</sup>, an average elasticity impact for different varieties of e-cigarettes (flavored, non-flavored, etc.) was applied. The study notes that cigarettes and e-cigarettes represent substitutable products. Due to the bill increasing both cigarette and e-cigarette taxes, the fiscal impact does not assume any substitution impacts to consumption between the two products. In addition, the tax increase proposed in the bill for e-cigarette products is substantial at 564 percent, representing around \$3 to \$4 in tax increases for various e-cigarette products depending on product values. The elasticity assumption from empirical work looked at a \$1 increase in taxes. Given the large increase in taxes, the drop in consumption could be higher than what is modeled. Also, if consumption moves to the black market (see policy issues below), then the assumed drop in consumption could also be higher.

The Cotti et al. study noted that for other tobacco products, such as chewing tobacco and loose tobacco, there was no significant impact to consumption with an increase in price. This appears logical given that users of these products are most likely older established users. The tax increase to the other tobacco products is substantial at 232 percent. TRD applied an elasticity for smokers from the Franz study assuming that such a large increase in the tax rate may elicit a lower consumption rate among this population.

The Covid-19 pandemic and economic recession have altered consumption patterns for tobacco products. There was evidence of hoarding purchasing prior to the spring 2020 stay-at-home order. The continued economic impacts and stress associated with the pandemic and financial concerns could further alter the consumption of these products both upwardly and downwardly.

**Related Healthcare Entities.** HB167 adjusts the distribution percentages in existing law to effectively send all new revenue generated from the tax increases to the general fund. NMFA has fully utilized cigarette tax revenue distributed to it for the intended purposes. To the extent that increased cigarette tax rates offset decreased cigarette tax distributions to NMFA, NMFA's cigarette tax lending capacity will not change. However, increased net distributions would increase NMFA's cigarette tax lending capacity.

## **SIGNIFICANT ISSUES**

According to the Federation of Tax Administrators, as of January 1, 2020, the median tax on cigarettes in the United States was \$1.70 per pack. The lowest rate was 17 cents per pack in Missouri, while the highest was \$4.50 in the District of Columbia. New Mexico's current cigarette tax was tied with six other states for 17th highest rate in the nation at that time.

This bill's proposed tax rate would make New Mexico's rate the 5<sup>th</sup> highest in the nation and

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<sup>2</sup> 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>

would substantially exceed the tax rate of surrounding states (see Attachment A). 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 36 percent of cigarettes consumed in the state derived from smuggled sources in 2018 (see Attachment B).<sup>3</sup> The Tax Foundation states one notable consequence of high state cigarette excise tax rates has been increased smuggling as people procure discounted packs from low-tax states and sell them in high-tax states. Raising tax rates substantially higher than surrounding areas may exacerbate the issue.

According to the Centers for Disease Control and Prevention, 28 states and territories currently tax e-cigarettes on a percentage of price. Price subject to tax varies by retail or wholesale price. New Mexico's e-cigarette tax of 12.5 percent of wholesale price is among the lowest of any state or territory that taxes e-cigarettes. Wholesale tax rates in other states include 15 percent in Illinois and Wyoming, 30 percent in Nevada, 56 percent in Utah, 59 percent in California, 92 percent in Vermont, and 95 percent in Minnesota.

The bill proposes to increase the tax rate on cigarettes and other tobacco-derived products, presumably to discourage their consumption to both reduce negative health outcomes associated with consumption of such products and increase revenue. By increasing the rate on cigarettes and e-cigarettes, the bill presumably negates substitution effects noted in studies between these products. By raising taxes on most tobacco products, the bill would presumably encourage overall lower consumption of the various products. It is notable then, that cigar tax rates are not raised, and consumers could increase consumption of cigars if seen as a potential substitute.

The following significant issues were raised by the Department of Health:

HB167 would likely have a significant impact on youth, as nearly 4 in 10 (38 percent) of NM high school youth use some form of tobacco, and most (90 percent) of that tobacco use is in the form of e-cigarettes. HB167 would not only increase the tax on cigarettes and other tobacco products, but more importantly, bring about tax equity across all tobacco products. With reduced availability of lower-priced products such as flavored spit/chew and e-cigarettes, we would expect dramatic declines in the use of e-cigarettes. Reduced e-cigarette use among NM youth would translate into fewer youth, and eventually adults, who are addicted to nicotine and experience the negative health consequences.

Tobacco use among adults, especially young adults, would also be expected to decline from across-the-board tobacco tax increases ([2012 & 2014 Surgeon General Reports Highlights](#)), eventually reducing the annual number of smoking-related deaths among New Mexicans (2,800) and the number of adults suffering from related diseases (84,000).

## ADMINISTRATIVE IMPLICATIONS

TRD would conduct staff training and update forms, instructions, and publications. Changes

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<sup>3</sup> Tax Foundation, *Cigarette Taxes and Cigarette Smuggling by State*, November 2020, <https://taxfoundation.org/cigarette-taxes-cigarette-smuggling-2020/>. 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.

would be made to TRD’s GenTax system to update tax rates, discount rates, and revenue distribution per the new percentages, requiring development and testing of TRD’s GenTax system. TRD’s Information Technology Division (ITD) estimates the changes would incur approximately 320 hours of development. This involves multiple updates to existing distributions, document, and configuration changes.

**CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Relates to HB97 and SB95, which both would clarify that municipalities and counties may enact ordinances, charter amendments or regulations pertaining to the sales of tobacco products that are stricter than, but not in conflict with, the provisions of the Tobacco Products Act.

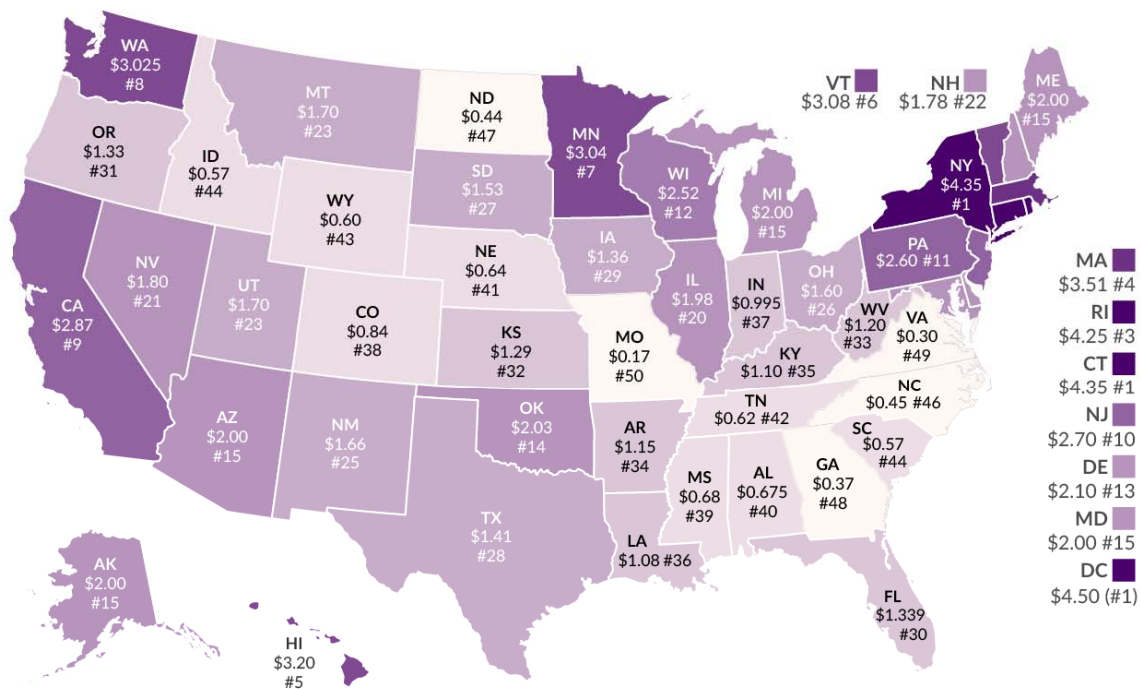
Duplicates SB197

IT/DI/sb/al

ATTACHMENT A

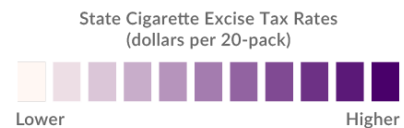
**How High Are Cigarette Taxes in Your State?**

State Cigarette Excise Tax Rates (dollars per 20-pack), January 2019



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.

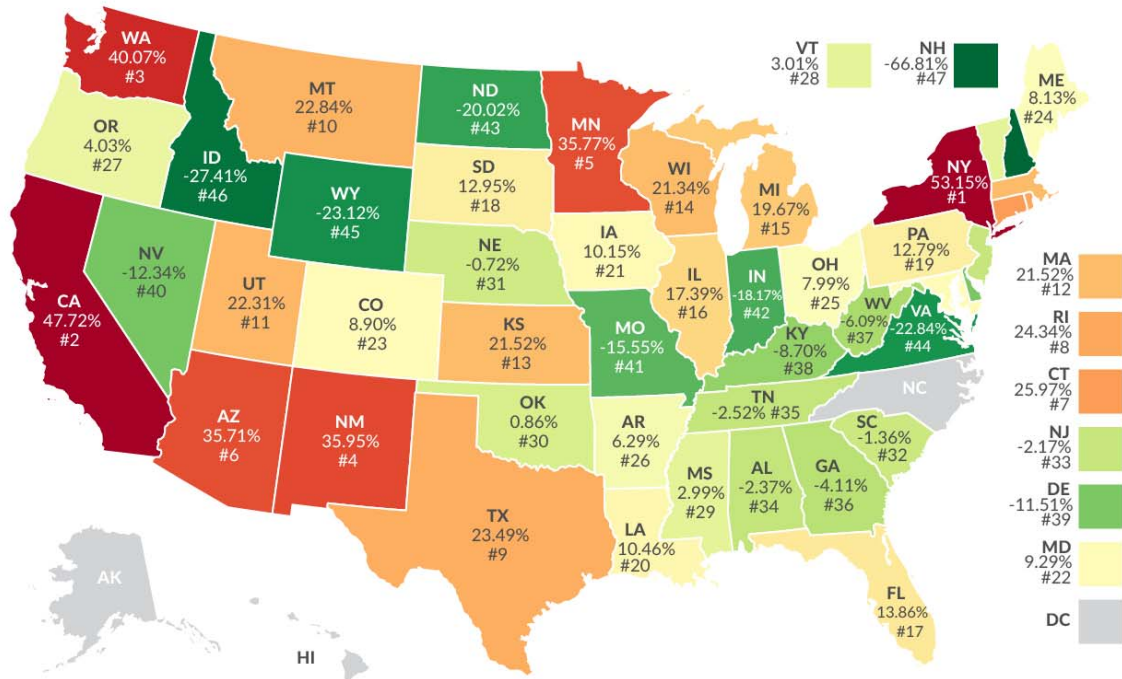
Source: Bloomberg Tax; state statutes.



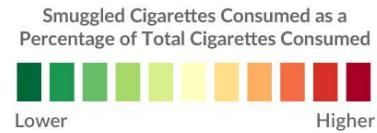
ATTACHMENT B

**Cigarette Smuggling by State**

*Smuggled Cigarettes Consumed as a Percentage of Total Cigarettes Consumed, 2018*



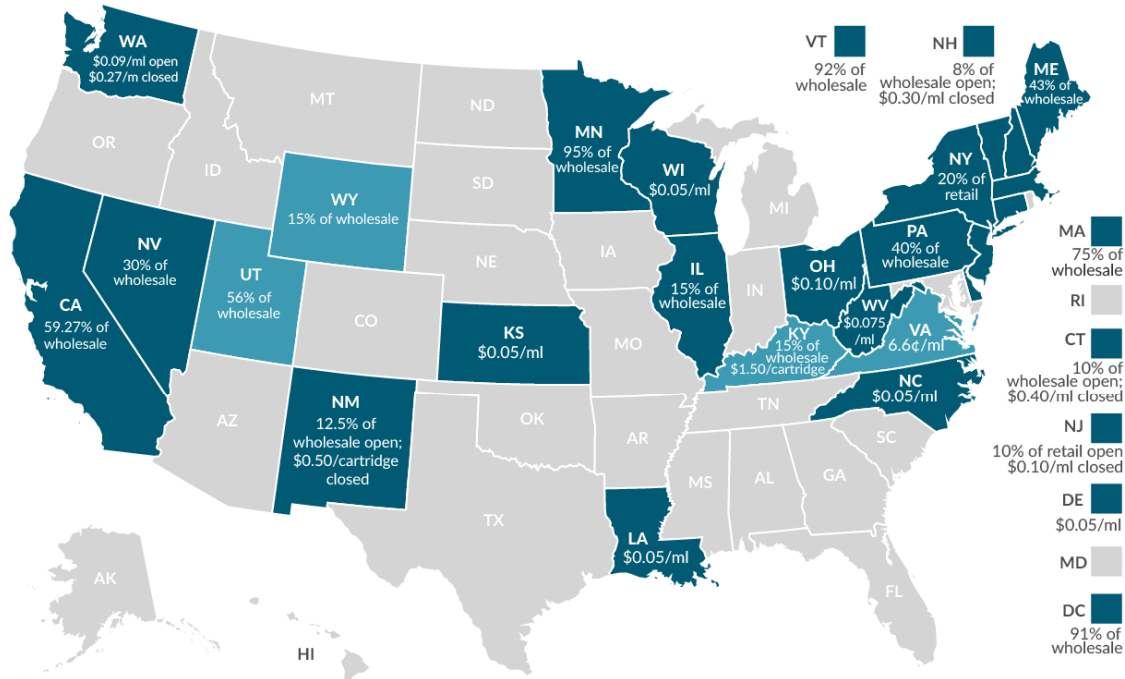
Note: Alaska, Hawaii, North Carolina, and DC are not included in the study.  
 Data used is from 2018 and is most recently available data.  
 Source: Mackinac Center for Public Policy; Tax Foundation.



ATTACHMENT  
C

## How High are Vapor Taxes in Your State?

State Vapor Excise Tax Rates, as of June 2020



Note: Several states levy general sales taxes in addition to the excise tax. Those are not included on the map. CA's rate will change to 56.93% on July 1. Vapor taxes in UT, VA, and WY take effect on July 1. KY's tax goes into effect on August 1.

Open: An open tank allows the consumer to refill the liquid and allows more freedom in voltage and nicotine levels.

Closed: Normally sold as pods or cartridges. Closed systems typically have higher nicotine levels to allow for consumption of the desired amount of nicotine in shorter sessions.

Source: State Statutes & Bloomberg Tax

- Has a Statewide Vapor Excise Tax
- Planned Statewide Vapor Excise Tax
- No Vapor Excise Tax

## ATTACHMENT D

<b>Current E-Cigarette Prevalence (%), NM High School Youth</b>				
<b>County</b>	<b>2015</b>	<b>2017</b>	<b>2019</b>	<b>% change 2015-2019</b>
Bernalillo	22.7	27.6	32.1	41%
Chaves	22.5	25.4	28.8	28%
Cibola	30.6	27.4	38.6	26%
Colfax	30.5	23.2	23.6	-23%
Curry	13.3	21.5	31.2	135%
DeBaca	10.8	-	23.0	113%
Dona Ana	16.6	22.5	31.7	91%
Eddy	23.3	32.1	44.2	90%
Grant	32.9	15.3	36.9	12%
Guadalupe	30.3	35.4	46.5	53%
Hidalgo	24.9	18.7	27.6	11%
Lea	25.2	21.1	28.9	15%
Lincoln	23.3	29.3	35.1	51%
Los Alamos	26.0	22.8	26.9	3%
Luna	23.6	28.2	26.7	13%
McKinley	18.0	22.5	27.6	53%
Mora	20.3	20.7	23.1	14%
<b>New Mexico</b>	<b>24.0</b>	<b>24.7</b>	<b>34.0</b>	<b>42%</b>
Otero	23.2	22.2	33.7	45%
Quay	24.9	22.2	24.5	-2%
Rio Arriba	35.7	48.0	41.3	16%
Roosevelt	25.6	18.7	31.1	21%
Sandoval	25.4	30.1	34.1	34%
San Juan	22.2	18.9	31.9	44%
San Miguel	24.1	24.3	41.0	70%
Santa Fe	28.3	31.8	37.0	31%
Sierra	23.9	24.4	27.3	14%
Socorro	24.0	34.1	38.7	61%
Taos	44.0	53.8	57.5	31%
Torrance	30.8	36.2	39.3	28%
Union	23.9	16.1	39.2	64%
Valencia	29.7	34.2	47.1	59%

Source: NM Youth Risk & Resiliency Survey, NM Dept of Health & NM Public Education Department. Sample sizes insufficient to report out data for Catron and Harding counties.

