

[Senate Bill 24](#) (Hill)

Date: 04/21/15

Program: Cigarette & Tobacco Products Licensing Act

Sponsor: Author

Code: BPC 22958, 22970.2, 22971, 22972, 22973, 22974, 22974.7, 22980, 22980.1, 22980.2, 22980.3, 22980.4

Effective: January 1, 2016

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This analysis only addresses the provisions that impact the Board of Equalization (BOE).

Summary: Among other things, this bill:

- Revises the Cigarette and Tobacco Products Licensing Act of 2003¹ (Licensing Act) to require the licensure of electronic cigarette (e-cigarette) retailers, and
- Requires the BOE to assess a civil penalty and suspend or revoke a retailer license for specified e-cigarette violations of the Stop Tobacco Access to Kids Enforcement (STAKE) Act².

Summary of Amendments: The amendments that impact the BOE since the last analysis extend the STAKE Act prohibitions to persons under 21 years of age.

Purpose: To prevent minors from acquiring e-cigarettes and reduce liquid nicotine overdoses.

Fiscal Impact Summary: Does not impact state cigarette and tobacco product tax revenues.

Existing Law:

Cigarette and Tobacco Products Tax Law³ (CTPTL). Revenue and Taxation Code (RTC) Section 30451 specifically provides that the BOE shall enforce the provisions of the CTPTL and may prescribe, adopt, and enforce rules and regulations relating to its administration and enforcement.

Existing law imposes an 87-cent per package of 20 (43 ½ mills per cigarette) cigarette tax. The CTPTL requires tax payment through the use of stamps or meter impressions that a distributor affixes on each cigarette package prior to the distribution.

RTC Section 30123 imposes a tax upon the distribution of tobacco products, based on the wholesale cost of these products at a tax rate that is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 imposes an additional tobacco products tax at a rate equivalent to the \$0.50 per pack cigarette tax. The BOE determines the tobacco products tax rate annually based on the March 1 wholesale cost of cigarettes. The 2014-15 tobacco products rate is 28.95%. Distributors pay the tobacco products tax through the use of a tax return that reports the wholesale cost of the tobacco products distributed and calculates the tax due.

Licensing Act. The Licensing Act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers, and retailers. Business and Professions Code (BPC) Section 22970.1 includes legislative findings and declarations that state “tax revenues have declined by hundreds of millions of dollars per year due, in part, to unlawful distributions and untaxed sales of cigarettes and tobacco products conducted by organized crime syndicates, street gangs, and international terrorist groups.” Section 22970.1 further provides that “the licensing of manufacturers, importers, wholesalers, distributors, and retailers will help stem the tide of untaxed distributions and illegal sales of cigarette and tobacco products.”

¹ Division 8.6 (commencing with Section 22970) of the Business and Professions Code (BPC).

² Division 8.5 (commencing with Section 22950) of the BPC.

³ Part 13 (commencing with Section 30001) of Division 2 of the RTC.

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The law requires a retailer to have a license to sell cigarettes and tobacco products in this state. BPC Section 22972 requires a retailer to obtain a separate license for each retail location that sells cigarettes and tobacco products and also designates a 12-month validation period for a license with an annual renewal.

Section 22973 requires a retailer to file a license application on a BOE-prescribed form. In addition, it authorizes the BOE to (1) investigate the truthfulness and completeness of the retailer's application, and (2) issue a license without further investigation if that applicant holds a valid Department of Alcoholic Beverage Control license for that same location.

Section 22973.1 requires the BOE to issue a retailer license upon receipt of a completed application and fee payment, unless any of the following apply:

- The retailer has previously been issued a licensed that is suspended or revoked for a violation of the Licensing Act;
- The application is for a retail location that is the same retail location as that of a retailer whose license was revoked or is subject to revocation proceedings for a violation of the Licensing Act, as specified;
- The retailer has been convicted of a felony pursuant to specified sections of the CTPL;
- The retailer does not possess all required permits or licenses required under the RTC.

Any retailer denied a license is allowed to appeal that denial within 30 days after service of the denial notice under Section 22973.1.

Section 22974 requires a retailer to retain for four years cigarette and tobacco products purchase invoices that meet certain requirements. The retailer must maintain the records at the retail location for at least one year after purchase.

The BOE is authorized under Section 22974.7 to revoke or suspend a retailer's license for a first offense, and revoke or suspend a retailer's license and impose a civil penalty for a second or subsequent offense.

Section 22974.8 requires the BOE to suspend or revoke a retailer's license upon notification by the CDPH for certain STAKE Act violations.

Chapter 5 authorizes any peace officer or BOE employee granted limited peace officer status to enter a place that sells cigarettes and tobacco products to conduct an inspection.

Sections 22980.1 and 22980.2 encompass sale and purchase prohibitions between certain persons, such as a licensed distributor and any unlicensed person.

Section 22980.3 mandates the BOE to take certain actions against a licensee for conviction of a Licensing Act violation. It also contains other miscellaneous provisions that relate to license suspension and revocation.

STAKE Act. The STAKE Act established a statewide enforcement program to take action against businesses that illegally sell tobacco to minors. In general, the STAKE Act requires the CDPH to:

- Implement an enforcement program to reduce the availability of tobacco products to minors and conduct sting operations using 15 and 16 year old minors granted immunity;
- Establish requirements for tobacco product retailers to conspicuously post a notice stating that selling tobacco products to a person under 18 years of age is illegal and subject to penalties;
- Assess civil penalties ranging from \$200 to \$6,000 against the store owner for violations; and
- Comply with the Synar Amendment (Section 1926 of Title XIX of the federal Public Health Service Act) and prepare an annual report regarding enforcement activities and their effectiveness for the federal government, Legislature, and Governor.

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Furthermore, the STAKE Act:

- Requires all persons engaging in the retail sale of tobacco products to check the identification of tobacco purchasers if the purchaser reasonably appears to be under 18 years of age.
- Prohibits any person, firm, or corporation from selling, giving, or in any way furnishing to another person who is under the age of 18 years any tobacco, cigarette, cigarette papers, any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or any controlled substance.
- Prohibits the selling, offering for sale, or distributing tobacco products from a cigarette or tobacco products vending machine unless such vending machines or appliances are located at least 15 feet away from the entrance of a premises issued an on-sale public premises license, as defined.
- Prohibits advertising of any tobacco product on any outdoor billboard, as specified.
- Prohibits a person engaged in the retail sale of tobacco products to sell, offer for sale, or display for sale any tobacco product or tobacco paraphernalia by self-service display, except as permitted. Retailers of blunt wraps cannot place or maintain, or cause to be placed or maintained, any blunt wraps advertising display within two feet of candy, snack, or nonalcoholic beverage displayed inside any store or business or that is less than four feet above the floor.
- Prohibits the distributing or selling of tobacco products directly or indirectly to any person under the age of 18 years through the United State Postal Service or through any other public or private postal or package delivery service, as described.

Upon CDPH notification, BPC Section 22958 requires the BOE to suspend or revoke a retailer's Licensing Act license upon a civil penalty assessment for third, fourth, or fifth sales to minors violation, in accordance with the following schedule:

- A 45-day suspension of the license for a third violation at the same location within a five-year period.
- A 90-day suspension of a license for a fourth violation at the same location within a five-year period.
- Revocation of the license for a fifth violation at the same location within a five-year period.

Section 22958 also requires the BOE to assess an additional \$250 civil penalty. The BOE deposits the additional penalty amounts collected into Cigarette and Tobacco Products Compliance Fund (Compliance Fund).

Health and Safety Code (HSC). To the extent not preempted by federal law, HSC Section 119405 makes it unlawful for a person to sell or furnish an e-cigarette to a person under 18 years of age. The section defines "e-cigarette" to mean a device that provides an inhalable dose of nicotine by delivering a vaporized solution.

Proposed Law: Among other things, this bill amends BPC Section 22958 to allow an enforcing agency to assess civil penalties against any person, firm, or corporation that sells, gives, or in any way furnishes to another person under 21 years of age e-cigarettes, cigarette, tobacco, or specified related product. The bill requires the CDPH to notify the BOE upon a civil penalty assessment for a third, fourth, or fifth violation that includes any e-cigarette, as well as any cigarette, tobacco, or specified related product. Existing law requires the BOE to take action in accordance with the specified schedule, which includes the suspension or revocation of a retailer's Licensing Act license.

The bill also amends the Licensing Act to require, as of September 30, 2016, e-cigarette retailers to obtain a retailer license. The bill also incorporates correlated e-cigarette references to Chapters 2 and 5, the licensing and inspection provisions, respectively. Amendments to BPC Section 22980.1 include technical, housekeeping changes.

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This bill becomes effective January 1, 2016; however, Sections 22972 (the license requirement) and 22973 (the license application) become operative September 30, 2016 and July 1, 2016, respectively.

In General: In 1992, Congress passed Section 1926 of Title XIX of the federal Public Health Service Act, commonly called the "Synar Amendment," which requires each state to:

- Have in effect a law prohibiting any manufacturer, retailer or distributor of tobacco products from selling or distributing such products to any individual under the age of 18.
- Enforce such laws in a manner that can reasonably be expected to reduce the extent to which tobacco products are available to individuals under the age of 18.
- Conduct annual random, unannounced inspections to ensure compliance with the law. These inspections are to be conducted in such a way as to provide a valid sample of outlets accessible to youth.
- Develop a strategy and timeframe for achieving an inspection failure rate of less than 20% of outlets accessible to youth.
- Failure to meet the terms and conditions of the Synar Amendment could result in reductions (up to 40%) in the amount of Substance Abuse Prevention and Treatment (SAPT) block grant funds allocated to California for alcohol and other drug prevention and treatment programs.

To comply with the Synar Amendment, the Legislature passed Senate Bill 1927 (Stats. 1994, Ch. 1009) which established the STAKE Act. The STAKE Act created a new statewide enforcement program to take regulating action against businesses that illegally sell tobacco products to minors. Enforcement authority and implementation responsibility was delegated to the Department of Health Services⁴.

E-Cigarettes. The California's Attorney General's Office's Tobacco Highlights includes e-cigarette information:

"Electronic cigarettes are battery powered devices designed to look and feel like regular cigarettes, but they emit water vapor rather than smoke. The cartridges contain liquid nicotine and various flavors. Known as e-cigarettes or e-cigs, the products have become popular in the past couple of years. The U.S. Food and Drug Administration consider e-cigarettes "drugs or devices" and claims the products must be approved by the FDA before they can be sold in the U.S. To date, no e-cigarettes have been approved by the FDA. Preliminary tests by the FDA found that e-cigarettes contain many impurities and some contain dangerous chemicals. FDA's jurisdiction to regulate e-cigarettes is in litigation, however. E-cigarettes are not governed by the Master Settlement Agreement or by many of California's tobacco laws.

The California Attorney General's Office is concerned that e-cigarettes are being sold in the state without appropriate quality control and with many false or misleading claims about their safety or effectiveness. Many are also in violation of California's Proposition 65 which requires health warnings about dangerous chemicals.

California passed a statute prohibiting the sale of electronic cigarettes to minors. (Health & Safety Code §119405). The office is investigating a number of electronic cigarette companies selling e-cigarette products on the Internet to ensure compliance with the statute as well as other consumer protection provisions. Many companies are coming into compliance voluntarily."

Background: In 2003, Assembly Bill 71 (J. Horton, Ch. 890) enacted the Licensing Act, which established a statewide licensure program administered by the BOE to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Currently, the BOE licenses 35,000 retailers and 900 distributors and wholesalers to engage in the sale of cigarettes and tobacco products in California.

⁴ The CDPH, Food and Drug Branch, now enforces the STAKE Act program.

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In 2012, Assembly Bill 1301 (Hill, Ch. 335) amended the STAKE and Licensing Acts to require the BOE to suspend or revoke a retailer license for certain cigarette and tobacco products sales to minors violations.

Commentary:

1. **The April 21, 2015 amendments** extend the STAKE Act prohibitions to persons under 21 years of age and make other technical corrections to the Licensing Act. The **April 6, 2015 amendments** incorporated BOE-suggested changes to make the Licensing Act provisions appropriately apply to e-cigarette retailers and to delay the e-cigarette retailer licensure operative dates by three months.
2. **BOE's mission and tasks.** The BOE's mission "is to serve the public through fair, effective, and efficient tax administration." This bill amends the BOE-administered Licensing Act to require e-cigarette retailer licensure. As a result, the bill requires the BOE to suspend or revoke a retailer's Licensing Act license for a third, fourth, or fifth violation of selling e-cigarettes to minors. This represents a departure from the BOE's traditional "tax collection and enforcement" functions. In general, the BOE requires a license, permit, or registration for the various tax and fee programs administered. The licensing/registration/permit requirement ensures vital tax revenue collection for the state.

Furthermore, the Licensing Act's declarations and findings state, in part, that manufacturer, importer, wholesaler, distributor, and retailer licensing will help stem the tide of untaxed distributions. However, this bill's e-cigarette retailer licensing requirements relate to health, public safety, or other non-tax purposes.

Additionally, this bill incorporates e-cigarettes into the Licensing Act, which enforces the CTPTL. The CTPTL's "cigarette" and "tobacco product" definition omit e-cigarettes, a non-tobacco nicotine-delivery device. As such, should this bill amend the Licensing Act to incorporate e-cigarettes, a non-cigarette and non-tobacco product?

3. **What effect would this bill have on the Compliance Fund?** Currently, the BOE's Licensing Act enforcement costs exceed licensing fee revenues. The Licensing Act authorizes the various cigarette and tobacco products tax funds⁵ to make up the difference.

As Assembly Bill 71 made its way through the Legislature, revenue projections indicated that revenue beyond the licensure fees would be needed to sustain the Licensing Act program. Since the Licensing Act enforces the CTPTL and directly benefits the funds established pursuant to that program, the bill was amended to require that the cigarette and tobacco products tax funds⁶ cover the difference between the amount received in licensure fees and the funds needed for the program.

The Licensing Act makes available Compliance Fund moneys to implement, enforce, and administer the Licensing Act, including any provisions this bill adds to the Licensing Act. Thus, the Licensing Act administrative costs related to this bill increases the Compliance Fund shortfall and increases the amount needed from the cigarette and tobacco products tax funds, including the General Fund.

Staff also notes that this bill allows cigarette and tobacco products tax funds, which existing law provides for cigarette and tobacco products taxes⁷ collection and administration, to fund youth e-cigarette enforcement.

4. **Related legislation.** [Senate Bill 151](#) (Hernandez) extends the tobacco sales to minors prohibitions with the STAKE Act to persons under 21 years of age.

⁵ Comprised of payments made to the state for the excise taxes on the distribution of cigarettes and tobacco products.

⁶ General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Prop. 99) and California Children and Families Trust Fund (Prop. 10).

⁷ RTC §§30124, 30125, 30131.3 and 30131.4.

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Administrative Costs: The bill results in additional BOE administrative costs to identify, notice, and license e-cigarette retailers and to suspend or revoke retailer licenses for e-cigarette sales to minors violations. These costs include: e-cigarette identification, notification, and registration; publication and form revisions; compliance, inspection and enforcement tasks; public inquiry responses; and related computer programming. A detailed cost estimate is pending.

Revenue Impact: With respect to e-cigarette retailer licensing, this measure does not impact state cigarette and tobacco product tax revenues except to the extent that such tax revenues may be necessary to cover administrative costs (see Comment 2).

This measure also extends the minimum legal age to purchase e-cigarettes from 18 to 21 years of age.

Background, Methodology, and Assumptions: While minors under age 18 are currently prohibited from purchasing e-cigarettes in California and many other states, data from the Center for Disease Control (CDC) indicate that use of e-cigarettes by high school students is widespread. A recent CDC survey shows that 13.4 percent of U.S. high school students used e-cigarettes within the last 30 days of 2014.⁸ This prevalence rate is at least as high as rates for adults cited in various studies.⁹

This estimate excludes sales made for the portion of the population who will no longer be able to legally purchase e-cigarettes. Although already prohibited from purchasing e-cigarettes, staff also included ages 15 through 18 since studies indicate prevalent use by high school students. The estimate assumes significantly improved compliance with age restrictions by retailers.

Data from the California Department of Finance Demographic Research Unit indicate that about 10 percent of the age 15 and over population of California are in the 15 to 20 age group. Review of the literature indicates that it is likely that e-cigarette sales will decline in proportion to this percentage if this bill is enacted. This measure will have a half-year revenue impact in fiscal year (FY) 2015-16.

Industry data indicate that U.S. e-cigarette sales were about \$2 billion in 2014 and are likely to grow about 24 percent per year over the next several years.¹⁰ Staff assumes that the 12 percent California share of U.S. population provides an accurate estimate of California's e-cigarettes sales.

Revenue Summary. For FY 2016-17, the first full year of the restriction, sales and use tax losses from changing the age limit approximate \$3.1 million. Details are shown in the table below.

This revenue estimate does not account for any further changes in economic activity that may or may not result from enactment of the proposed law.

⁸ Source: "Tobacco Use Among Middle and High School Students — United States, 2011–2014," *Morbidity and Mortality Weekly Report*, April 17, 2015, <http://www.cdc.gov/mmwr/publications/index.html>

⁹ For other studies, see page 752 of *The Health Consequences of Smoking—50 Years of Progress A Report of the Surgeon General*, 2014, U.S. Department of Health and Human Services, <http://www.surgeongeneral.gov/library/reports/50-years-of-progress>

¹⁰ *Tobacco Talk: Vapors/Tanks Driving Next Wave Of E-Vapor Growth*, Wells Fargo, March 2014. *U.S. e-cigarette sales seen rising 24.2% per year through 2018*, 6/10/14, Fortune.com.

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		FY 2015-16 <i>(Half-Year Impacts)</i>	FY 2016-17
	Rates	Millions, Unless Indicated Otherwise	
-			
Estimated CA E-Cigarette Sales	N.A.	\$298	\$369
Percentage of Total Population Age 15 - 20	N.A.	10.2%	10.0%
Estimated Sales, Age 15-20	N.A.	\$15	\$37
Total Taxable Sales and Use Revenues	8.42%	\$1.3	\$3.1
State General Fund	4.19%	\$0.6	\$1.6
State Education Protection *	0.25%	\$0.0	\$0.0
Local	3.06%	\$0.5	\$1.1
Special Districts	0.92%	\$0.1	\$0.3
* Half-year revenue impact. The added rate for the State Education Protection Fund ends 12/31/2016.			