



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/18/11	Bill No:	<a href="#">Assembly Bill 1030</a>
Tax Program:	Cigarette and Tobacco Products	Author:	Achadjian
Sponsor:	California Distributors Association	Code Sections:	RTC 30133
Related Bills:		Effective Date:	01/01/12

## BILL SUMMARY

This bill would subject a person who fails to pay a cigarette or tobacco products tax liability, as specified, to suspension of their distributor's license and seizure of any assets of the person related to the distribution of cigarettes or tobacco products.

## ANALYSIS

### CURRENT LAW

**In General.** Under existing Cigarette and Tobacco Products Tax Law (Tax Law), every distributor is required to pay a tax upon his or her distributions of cigarettes or tobacco products. A distribution includes: (1) the sale of untaxed cigarettes or tobacco products in this state, (2) the use or consumption of untaxed cigarettes or tobacco products in this state, or (3) the placing in this state of untaxed cigarettes or tobacco products in a vending machine or in retail stock for the purpose of selling to consumers. Every person desiring to engage in the sale of cigarettes or tobacco products as a distributor is required to apply and obtain a license for each place of business at which he or she engages in the business of distributing cigarettes and tobacco products.

Existing law imposes an excise tax of 6 mills (or 12 cents per package of 20) on each cigarette distributed. Proposition 99 imposes an additional surtax of 12 1/2 mills per cigarette (25 cents per package of 20) effective January 1, 1989. Beginning January 1, 1999, Proposition 10 imposed an additional surtax of 25 mills per cigarette (50 cents per package of 20) for a current total tax of 43 1/2 mills per cigarette (87 cents per package of 20).

For tobacco products (which are defined to include cigars, smoking tobacco, chewing tobacco, snuff, and other products containing at least 50 percent tobacco), a tax is imposed on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the combined rate of tax imposed on cigarettes. An additional tax, pursuant to Proposition 10, imposes an additional tax on tobacco products based on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the additional 50-cent per pack tax on cigarettes. The tobacco products tax rate is determined annually by the Board of Equalization (BOE). Currently, the surcharge rate for fiscal year 2010 - 2011 is 33.02 percent.

**Underreporting.** Existing law provides that if any person fails to make a report or return, the BOE shall make an estimate of the number of cigarettes or the wholesale cost of tobacco products distributed by him or her. Upon the basis of this estimate, the

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BOE shall compute and determine the amount required to be paid to the state, adding a penalty of 10 percent. In addition, if the BOE is dissatisfied with a report or return filed, it may compute and determine the amount to be paid upon the basis of any information available. Any person against whom a determination is made, as specified, may petition for a redetermination within 30 days after service upon the person of notice thereof. If a petition for redetermination is not filed within the 30-day period, the determination becomes final at the expiration of the period.

**Unlicensed Distributors.** With respect to persons that become a distributor without first securing a license, existing law provides that the tax, and applicable penalties and interest, become immediately due and payable on account of all cigarette and tobacco products distributed. The BOE would establish as best it may the amount of cigarettes or tobacco products distributed and determine the tax on that amount, adding to the tax a penalty of 25 percent of the amount of the tax or five hundred dollars (\$500), whichever is greater, and give the unlicensed person notice of that determination. The BOE could then immediately collect that tax, penalty and interest due from the unlicensed person by seizure and sale of property in the manner prescribed for the collection of delinquent monthly tax.

The Tax Law also contains seizure and sale provisions to facilitate the administration for the immediate liability for the tax from an unlicensed person. These provisions, in part, specify the persons authorized to seize the property, requirements pertaining to the notice and conduct of sale of the property, and the disposition of proceeds.

**Licensing Act.** The Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act) also requires manufacturers, importers, distributors, wholesalers, and retailers to be licensed in order to engage in the sale of cigarette and tobacco products. Licensing Act licenses are subject to suspension or revocation for violations of the Tax Law, and subject to revocation if any permit or license is revoked under the Revenue and Taxation Code (including a seller's permit for sales and use tax and a cigarette and tobacco products distributor's license).

#### PROPOSED LAW

This bill would add Article 3.5 (commencing with Section 30133) to Chapter 2 of Part 13 of Division 2 of the Revenue and Taxation Code to subject a distributor's license to suspension and any assets related to distribution of cigarettes or tobacco products to seizure if that distributor fails to pay a cigarette and tobacco products tax liability.

The BOE would be required to hold a hearing to confirm or dismiss the failure to pay a tax liability within 30 days of a license suspension or seizure of assets. If a willful failure to pay taxes is confirmed, the BOE would be authorized to sell the assets seized and revoke the distributor's license. Proceeds from the sale of the assets would be deposited in the following priority:

- The amount of unpaid tax liability owed under this part by the person under this chapter shall be deposited into the fund to which it is owed. Notwithstanding any other provision of law, monies deposited pursuant to this paragraph shall not be continuously appropriated, and shall only be available upon appropriation by the Legislature.
- Any remaining moneys shall be deposited into the General Fund.

The bill would also require the BOE to adopt regulations to implement its provisions.

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The bill would become effective on January 1, 2012.

### **BACKGROUND**

In 2003, Assembly Bill 71 (Horton, Ch. 890) enacted the Licensing Act along with other tools to facilitate the enforcement of the Tax Law. Among other things, that bill added Article 2.5 (commencing with Section 30210) to Chapter 4 of, and Article 5 (commencing with Section 30355) to Chapter 5, of the Tax Law known as *Payment by Unlicensed Persons* and *Seizure and Sale*, respectively.

The intent of these provisions was to provide for the efficient and effective administration of the Tax Law. Allowing the BOE to recover cash and assets available from unlicensed distributors at the time of the billing, as specified, has been a tremendous aid in the BOE's collection effort as these assets are typically not accessible at a later date.

The BOE's Investigations Division had encountered a large number of cigarettes and tobacco product distributors who were unlicensed. The purpose for being unlicensed is to conceal the nature of their business and to evade the tax. These unlicensed distributors normally maintain minimal assets and are typically transient, which hinders the BOE's ability to collect the taxes due and payable.

Although the Investigations Division was able to determine in advance of serving a search warrant that a liability is due by using third party sources, large sums of cash were not seized for lack of authority to issue immediate billings and subsequent collection efforts (based on prior law) were unsuccessful, as that cash was no longer available.

While the provisions for unlicensed persons has proven to be effective enforcement tool, persons that are licensed and violate the Tax Law with the intent to defeat or evade the cigarette and tobacco products tax are not subject to the same provisions that make the tax, interest, and penalties immediately due and payable or subject assets to seizure and sale. Becoming a licensed distributor with the intent to evade or defeat the tax is advantageous in the sense that a licensed distributor can easily purchase cigarettes and tobacco products without the payment of tax and is not subject to the same collection tools as unlicensed distributors.

### **COMMENTS**

- 1. Sponsor and Purpose.** This bill is sponsored by the California Distributors Association and is intended to help the BOE crack down on the illegal sale of untaxed tobacco products, by subjecting distributors who illegally distribute untaxed tobacco products, to suspension of their distributor's license and seizure of any assets related to tobacco distribution.
- 2. This bill is targeting licensed distributors.** Typically, licensed distributors pay their tax liability as required by the Tax Law through the purchase of tax stamps that are affixed to packages of cigarettes and by reporting and paying the tax on the distribution of tobacco products. However, some persons may obtain a license and legally purchase cigarettes and tobacco products without the payment of tax from licensed manufacturers, but not pay the tax by affixing a tax stamps to packages of cigarettes, or by reporting tobacco products distributed. A person who violates the Tax Law with intent to defeat or evade the determination of any amount due is guilty

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of a felony when the amount of tax liability aggregates twenty-five thousand dollars (\$25,000) or more in any 12-consecutive-month period. In addition, any person who fraudulently counterfeits cigarette tax stamps, tampers with any metering machine, or procures counterfeit tax stamps, for the purpose of evading the tax, is also guilty of a felony.

As previously discussed under Current Law, the Tax Law makes the tax, and applicable penalties and interest, immediately due and payable on account of all product distributed if a person becomes a distributor without first securing a license. The BOE is also authorized to immediately collect the tax, penalty, and interest due from the unlicensed person by seizure and sale of property. This provision was added to the Tax Law to specifically address those situations in which immediate collection action is imperative to protect the interest of the state and applies only in those criminal cases where a search warrant is served and the BOE has been able to determine in advance the liability due using third party sources.

BOE staff understands that this measure is intended to add similar seizure provisions for licensed distributors when the BOE's criminal investigation has sufficient evidence to support probable cause for a search warrant. BOE staff is providing technical assistance in drafting amendments in order to achieve this intent.

- 3. Licensed persons continue to operate.** Under the Tax Law, a distributor's license may be suspended if the distributor fails to pay any amounts due, and a license revoked if the distributor fails to comply with any provision of the Tax Law or BOE adopted regulations. Under the Licensing Act, a distributor's license may be suspended, in part, for a false statement on a license application, refusal to allow inspection, and seizures of untaxed product, or a second violation of other provisions, such as failure to retain purchase invoices or purchases from an unlicensed person. A license may be revoked under the Licensing Act if any person has: (1) been convicted of a second violation within four years of a previous violation, (2) convicted of a felony under the Tax Law, or (3) had a license or permit revoked under the Revenue and Taxation Code.

Licensed distributors found to be violating the Tax Law and the Licensing Act, where the BOE is pursuing the distributor criminally for felony tax evasion, are allowed to continue to engage in the sale of cigarettes and tobacco products during criminal prosecution, and until the BOE's administrative appeals process is exhausted. This process could take several years to conclude, after which the BOE could then revoke the license if the distributor was convicted of either a second Licensing Act violation within four years or a felony tax evasion.

This measure would require the BOE to suspend a distributor's license pending a hearing to confirm or dismiss the violation of failing to pay a tax liability. If willful failure to pay taxes is confirmed, the BOE would be authorized to sell the seized assets and revoke the license of the person. BOE staff suggests amending this provision to define the term "willful failure to pay taxes," align the seizure and sale provisions with existing law (Article 5 (commencing with Section 30355) of Chapter 5 of the Tax Law), which specifies the disposition of proceeds from a sale to pay the tax due, together with any interest and penalties, with any excess returned to the tax payer, and to clarify the conditions under which the BOE would be required to uphold a distributor's license suspension or to revoke the license. In addition to the distributor's license, the author may also wish to consider requiring the BOE to

suspend all Licensing Act licenses held by the distributor, such as retailer and wholesaler licenses, deem all untaxed cigarette and tobacco products inventory “distributed,” and to suspend the distributor’s Licensing Act license upon suspension of the distributor’s license under the Tax Law.

- 4. Due process.** The BOE currently has seizure and sale authority under several tax and fee programs, including the Tax Law. The BOE’s current collection of tax and fee amounts due by seizure and sale is used only after careful consideration and as the last action for collection purposes. The same would be true if similar authority is granted to the BOE as proposed under this measure.

It should be emphasized that the BOE’s seizure and sale authority under the Tax Law does not prevent a person’s right to due process. With respect to this measure, the BOE staff’s suggested amendments would provide the same due process rights provided to any licensed distributor through the BOE’s administrative appeals process to contest the liability for taxes, subject to the jeopardy determination process. This administrative appeals process allows any person to petition for the redetermination of the amount of tax due with the BOE within 10 days after service upon him or her of a notice of determination. If the petition for redetermination is filed within the required timeframe, the BOE must reconsider the determination and grant the person an oral hearing. The BOE is authorized to decrease or increase the amount of the determination before it becomes final, as specified.

This bill would allow the BOE to sell the assets seized if a willful failure to pay taxes is confirmed pursuant to the manner prescribed for the collection of a delinquent monthly tax (Article 5 (commencing with Section 30355) of Chapter 5 of the Tax Law). These provisions also provide that the person would be entitled to notice of the sale at least twenty days in advance of any sale. As previously noted, the bill should define the term “willful failure to pay taxes,” and conform the seizure and sale provisions of this bill to those under existing law for unlicensed distributors.

## **COST ESTIMATE**

Enactment of this bill would not impact the BOE’s administrative costs.

## **REVENUE ESTIMATE**

This bill would aid in the collection of cigarette and tobacco products taxes due and payable to the state. However, the BOE has no way of measuring the potential impact this bill may have, and therefore, cannot provide an estimate at this time.

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