

[Senate Bill 1400](#) (Wieckowski)

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Program: Cigarette & Tobacco Products Licensing Act (Licensing Act) Joe Fitz (Revenue) 916-445-0840

Sponsor: Author

Business and Professions Code (BPC) Section 22971

Effective January 1, 2017

Summary: Revises the Licensing Act to redefine “retail location” to reduce the number of locations that sell cigarettes and tobacco products.

Purpose: According to the author, the bill’s purpose is to reduce exposure of minors to cigarettes and tobacco products and streamline the BOE’s Licensing Act enforcement as it relates to retail licensees.

Fiscal Impact Summary: Total annual revenue loss of \$84.6 million.

Existing Law: Cigarette and Tobacco Products Licensing Act of 2003.¹ The Licensing Act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers, and retailers.

BPC Section 22972 requires a retailer to have a license to sell cigarettes and tobacco products in this state. Section 22972 further requires a retailer to obtain a separate license for each retail location that sells cigarettes and tobacco products.

Section 22971 defines “retail location” to mean:

- Any building from which cigarettes or tobacco products are sold at retail.
- A vending machine.

BPC Section 22973 requires a one-time \$100 license fee to be paid with each retailer license application. A retailer must obtain a separate license (and pay \$100) for each retail location, but may submit one application for those licenses. A retailer must annually renew the license, but no fee is charged.

Cigarette and Tobacco Products Tax Law² (CTPTL). 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 annually determines the tobacco products tax rate based on the March 1 wholesale cost of cigarettes. The tobacco products tax rate is 28.13% for fiscal year 2015-16. 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.

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

¹ Division 8.6 (commencing with Section 22970) of the BPC.

² Part 13 (commencing with Section 30001) of Division 2 of the Revenue and Taxation Code (RTC).

- 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.

BPC Section 22962 makes it unlawful for 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. A violation of this provision subjects the person to a specified schedule of civil penalties. The self-service display prohibition does not apply to tobacco store's display of cigars, pipe tobacco, snuff, chewing tobacco, or dipping tobacco, unless provided. Section 22962 defines a "tobacco store" to mean a retail business that meets all of the following requirements:

- Primarily sells tobacco products.
- Generates more than 60 percent of its gross revenues annually from the sale of tobacco products and tobacco paraphernalia.
- Does not permit any person under 18 years of age to be present or enter the premises at any time, unless accompanied by the person's parent or legal guardian, as defined in [Family Code Section 6903](#).
- Does not sell alcoholic beverages or food for consumption on the premises.

Proposed Law: This bill amends BPC Section 22971 to redefine "retail location" to mean a "tobacco store" as defined in [BPC Section 22962](#).

The bill becomes operative January 1, 2017.

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. As of February 2016, the BOE licenses approximately 33,381 retailers and 844 distributors and wholesalers to engage in the sale of cigarettes and tobacco products in California.

As AB 71 was developed and made its way through the Legislature, it was determined that the licensure fees would not permanently sustain the Licensing Act program. Since the Licensing Act enforces the CTPTL and directly benefits the funds established pursuant to that program, the funding for the Licensing Act would eventually shift to the cigarette and tobacco products tax funds: General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Prop. 99) and California Children and Families Trust Fund (Prop. 10). However, there was concern about the Licensing Act program and the impact it would have on the cigarette and tobacco products tax funds if the Licensing Act expenses exceeded the revenues generated. To address this concern, a sunset date of January 1, 2010, was incorporated into the Licensing Act to make sure the Licensing Act would not harm the cigarette and tobacco products tax funds. Furthermore, AB 71 included uncodified language to clarify that all revenues and expenses generated by the Licensing Act are to be allocated in the same manner as those revenues and expenses are allocated under the Cigarette and Tobacco Products Tax Law to make sure no one cigarette and tobacco product fund benefited or was burdened when the funding shift took place. In 2006, Assembly Bill 1749 (J. Horton, Ch. 501) repealed the sunset date for the Licensing Act due to the amount of additional excise tax revenues generated. The BOE has estimated that the Licensing Act and enhanced cigarette tax stamp generates an additional \$66.8 million in cigarette excise tax annually. The Licensing Act generates an additional \$24.5 million in additional tobacco products tax. The resulting additional sales and use tax revenue is estimated to be \$44.4 million annually.³

³ <http://www.boe.ca.gov/legdiv/pdf/CigaretteEvasion.pdf>.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Commentary:

1. **Effect of this bill.** The bill redefines “retail location” to have the same meaning as that term is defined within the STAKE Act. The proposed definition change reduces the number of businesses that may hold a retailer license from 33, 000 to 10,000, as of January 1, 2017. (*See Revenue Estimate*)
2. **Effect 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 funds⁴ to make up the difference.

This bill limits the types of businesses that may obtain a retail license and engage in the sale of cigarettes and tobacco products. While the bill results in a one-time license fee increase, ongoing fee revenues will decrease (*See Revenue Estimate*). As a result, the Cigarette and Tobacco Products Compliance Fund shortfall will increase, as well as the corresponding amount needed from the cigarette and tobacco products funds to cover that shortfall.

3. **Mobile vendors.** On May 19, 2003, AB 71 was amended to redefine “retail location” to prohibit a mobile vendor from engaging in the sale of cigarettes and tobacco products. Specifically, the definition was revised to allow only a location that is a “building” to be licensed. The amendment was intended to prevent cigarette and tobacco products access to minors and to make tax enforcement, including retail inspections, feasible and more effective.

This bill does not include any restrictions that prohibit a mobile vendor from obtaining a license to engage in the sale of cigarettes and tobacco products. Accordingly, catering trucks, lunch wagons, and other mobile facilities may be licensed if they meet the “tobacco store” requirements. This appears to undermine the bill’s intent to prevent access to minors and complicates retail license enforcement.

4. **Cigarette and tobacco products tax evasion.** Tax evasion can significantly reduce state revenues generated from cigarettes and other tobacco products taxes. BOE staff estimates that cigarette tax evasion in California was running at a rate of approximately \$126.2 million, plus \$87.8 million in tax on other tobacco products.⁵

Since 1988, many new measures have reduced cigarette and other tobacco products tax evasion. These include the Licensing Act, an encrypted cigarette tax stamp, and the Prevent All Cigarette Trafficking Act (PACT Act).

This bill significantly reduces the number of retail locations that sell cigarettes and tobacco products, thereby making such products much less convenient to buy. Will reducing consumer convenience alter consumers’ purchase behavior to instead purchase from non- or lower-taxed sources? If so, the bill may result in increased consumer tax evasion and decrease consumption.

5. **Administrative start-up cost funding is essential.** With a January 1, 2017 operative date, the BOE must implement the bill in fiscal year 2016-17. Implementation includes, but is not limited to, identifying and closing out the licenses of licensed retailers that do not qualify as retail locations under this bill. The BOE’s 2016-17 budget does not include funding to implement the bill. Consequently, the BOE requires an adequate appropriation to cover administrative implementation costs.

⁴ Comprised of payments made to the state for the excise taxes on the distribution of cigarettes and tobacco products.

⁵ <http://www.boe.ca.gov/legdiv/pdf/CigaretteEvasion.pdf>.

Administrative Costs: The bill results in additional BOE administrative costs to notify retailers, rewrite computer programs, close out non-qualifying retail licenses, revise applications and publications, verify new applicants qualify as a retail location, and answer inquiries from licensees. A detailed cost estimate is pending.

Revenue Impact:

Background, Methodology, and Assumptions. Identifying changes in the numbers of retail licenses and taxable distributions of cigarettes and tobacco products resulting from such a drastic change in retailer characteristics is challenging; however, BOE staff estimated these values by making assumptions and combining data from the following sources:

1. Board of Equalization data from the Business Tax and Fee Department on numbers of retail cigarette and tobacco licenses.
2. U.S. Census Bureau, *County Business Patterns*, California, Retail Trade, 2013.
3. *Reducing the Availability of Tobacco Products at Retail: Policy Analysis*, Non-Smokers' Rights Association, 2011.
4. *The Fiscal and Social Effects of State Alcohol Control Systems*, Roland Zullo and others, Institute for Research on Labor, Employment and the Economy, University of Michigan, 2013.

License Numbers. BOE data indicates that 33,381 retailers had licenses that allowed them to sell cigarette and tobacco products in February 2016. The North American Industry Classification System (NAICS) shows that the largest numbers of licensees were grocery stores, gas stations, convenience stores, liquor stores, and tobacco stores. Of the total licenses, 2,276 were tobacco stores. These tobacco stores are unlikely to be affected by this bill, but all the others will likely no longer meet the requirements to be licensed. However as discussed further below, staff believes that under this bill, 7,238 new store locations will begin operations with a structure required to be licensed, totaling about 10,000 (2,276 + 7,238) locations. Staff reached this conclusion after reviewing several studies and data. A total of 10,000 locations are similar in magnitude to the 7,364 gas stations (*California County Business Patterns*), which potentially would not be permitted to sell tobacco products

Sales Impacts. BOE staff could not find any definitive studies quantifying the relationship between the number of outlets and cigarette and tobacco consumption due to such a large change as specified in the bill. However, staff did find studies for alcohol consumption. A low-impact estimate is that a 10% decrease in retailer outlets is associated with a 1% decrease in hard liquor sales.⁶ Staff assumed this same relationship would apply to cigarettes and tobacco products.

Cigarette Revenues. Staff assumes a 70% reduction from the 33,381 licenses currently valid, or 10,000 licenses. Consequently, using the relationship described above, this implies a reduction in tax-paid cigarette sales of 7%. The table below quantifies the associated excise tax and sales and use tax revenue losses.

⁶ *Reducing the Availability of Tobacco Products at Retail: Policy Analysis*, Non-Smokers' Rights Association, 2011. This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Cigarette Excise Tax and Sales and Use Tax Impacts	
Cigarette Distributions (Packs) , FY 2014-15	867,000,000
Cigarette and Tobacco Licenses, February 2016	33,381
Projected Number of Licenses (70% Decline)	10,014
Projected Decrease in Distributions (7% Decline)	60,690,000
Excise Tax Rate	\$0.87
Excise Tax Revenues (\$ Millions)	\$52.8
Average Price per Pack (2014)	\$5.51
Cigarette Sales (Million Dollars)	\$334.4
Average Statewide Sales and Use Tax Rate, 2017	8.21%
Sales and Use Tax Revenues (\$ Millions)	\$27.5

Tobacco Products Revenues. Staff estimates that about 50% of sales of tobacco products are made by tobacco stores.⁷ The remaining 50% of retailers would have a 7% reduction under this bill. The table below quantifies the associated excise tax and sales and use tax revenue losses for tobacco products.

Tobacco Products Excise Tax and Sales and Use Tax Impacts	
Wholesales Sales of Tobacco Products, Fiscal Year 2014-15 (\$ Millions)	\$282.7
Estimated Percentage of Tobacco Products sold in Tobacco Stores	50%
Wholesales Sales of Tobacco Products Impacted (\$ Millions)	\$141.8
Projected Decline (7%, \$ Millions)	\$9.9
Tobacco Products Rate, Fiscal Year 2015-16	28.13%
Estimated Excise Tax Revenue Loss	\$2.8
Wholesales to Retail margin Factor	1.28
Estimated Retail Sales Decline	\$12.7
Taxable Sales Rate	8.21%
Estimated Sales Tax Decline	\$1.0

License Fees. There are two kinds of impacts on retailer license fees. The first assumption is that 7,238 new retailers will become licensed and qualify under the new criterion of the bill. This is a one-time impact, with fee revenues estimated to increase by \$0.7 million. Second, with fewer licenses, annual fee revenues from changes in ownership for existing locations will decline by about \$0.5 million. When cigarette and tobacco retail businesses are sold, the associated license is not transferable. A new \$100 license is required. Historically turnover averages about 20% of these retail businesses. The calculations showing the derivation of these estimates are shown in the table below.

Licensing Impacts	
<i>One-Time New Licenses</i>	
Current Law Tobacco Store Licensees	2,776
Proposed Law Tobacco Stores	10,014
Difference	7,238
License Fee Rate	\$100
One-time Revenue Gain	\$723,830
<i>Annual Turnover of Licenses</i>	
Current Law Turnover (20% of Total Licenses)	6,676
Proposed Law Turnover (20% of Total Licenses)	2,003
Difference	4,673
License Fee Rate	\$100
Ongoing Annual Revenue Loss From Reduced Turnover	\$467,334

⁷ BOE, *Cigarette and Tobacco Products Tax Evasion*, Table 2, <http://www.boe.ca.gov/legdiv/pdf/CigaretteEvasion.pdf>
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Revenue Summary. Cigarette and tobacco products excise taxes will decline by about \$55.6 million, sales and use taxes by \$28.5 million, and licensing fees by \$0.5 million. The total annual revenue loss is \$84.6 million. There would also be a one-time License Fee revenue increase of \$700,000.

Summary of Revenue Impacts	Millions of Dollars
Cigarette and Tobacco Excise Taxes (\$52.8M + \$2.8M)	\$55.6
Cigarette and Tobacco Sales and Use Taxes (\$27.5M + \$1.0M)	\$28.5
Cigarette and Tobacco Retailer License Fees (Ongoing Losses)	\$0.5
Total Ongoing Revenue Losses	\$84.6
One-Time License Fee Increase	\$0.7

Qualifying Remarks. The BOE Research and Statistics Section estimated changes in retail outlets and sales using professional judgment and the most accurate information available at the time. Staff is continuing to research cigarette and tobacco sales, and may modify the estimates if more definitive information becomes available.

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