

[Assembly Bill 2770](#) (Nazarian)

Date: 06/16/16

Program: Cigarette & Tobacco Products Licensing Act (Licensing Act)

Sponsor: Author

Business and Professions Code (BPC) Sections 22973, 22977.1, 22990.5, and 22990.7

Effective January 1, 2017

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Summary: This bill:

- Prohibits cigarette and tobacco products revenues from being appropriated to the BOE for Licensing Act administration and enforcement, and
- Requires the BOE's report to the Legislature regarding the funding adequacy of the Licensing Act to include information on the State Auditor's recommendation to eliminate the excess fund balance in the Cigarette and Tobacco Products Compliance Fund (Compliance Fund).

Summary of Amendments: The amendments since the previous analysis prohibit cigarette and tobacco products revenues from being appropriated to the BOE for Licensing Act administration and enforcement and revise the due date of the funding adequacy report, from January 1, 2018 to January 1, 2019, and annually thereafter.

Purpose: To provide additional funding for cigarette and tobacco products tax compliance enforcement.

Fiscal Impact Summary: None.

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. Similar license requirements are imposed on distributors and wholesalers under Section 22977.

BPC Section 22973 requires a \$265 license fee to be paid with each retailer license application. A retailer must obtain a separate license for each retail location, but may submit one application for those licenses. A retailer must annually renew their license, but until December 31, 2016, no fee is charged. Operative January 1, 2017, a \$265 per retail location renewal fee will be imposed.

BPC Section 22977.1 requires distributors and wholesalers to pay a \$1,000 fee with each license application or renewal application submitted, as required under Section 22977. A license is also required for each location. Operative January 1, 2017, the distributor and wholesaler license fee increases to \$1,200 per location.

BPC Sections 22973 and 22977.1 requires the BOE to report back to the Legislature, no later than January 1, 2019, regarding the adequacy of funding for the Licensing Act. The report shall include data and recommendations about whether the annual licensing fee funding levels are set at an appropriate level to maintain an effective enforcement program.

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.

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).

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 rate is 27.30% for fiscal year 2016-17. 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.

Proposed Law: This bill amends BPC Sections 22973 and 22977.1 to relocate to BPC Section 22990.7 the requirement for the BOE to submit a report to the Legislature on or before January 1, 2019, and on or before January 1 annually thereafter, regarding the adequacy of funding for the Licensing Act. The report shall contain data and recommendations about whether the annual retailer, distributor, and wholesaler licensing fees are set at an adequate level to maintain an effective enforcement program. Additionally, the report shall include information on the BOE compliance with the recommendation in the [State Auditor's March 2016 report](#) to eliminate the excess fund balance in the Compliance Fund.

This bill adds BPC Section 22990.5 to prohibit, on or after January 1, 2017, cigarette and tobacco products revenues from being appropriated to the BOE for the purpose of implementing, enforcing, or administering the Licensing Act.

Background: In 2003, Assembly Bill (AB) 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 approximately 37,000 retailers and 921 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 were more than 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

This year [ABx2 11](#) (Ch. 6, Stats. 2016, Nazarian) revised the Licensing Act to change a retailer's license fee from a one-time \$100 fee to an annual \$265 fee and increased the distributor/wholesaler license fee from \$1,000 to \$1,200, operative January 1, 2017. For new retail and distributor/wholesaler licenses, the license fee increase becomes effective June 9, 2016, and removed the retailer reinstatement fee. That bill also requires the BOE to report back to the Legislature no later than January 1, 2019, regarding the adequacy of funding for the Licensing Act.

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.

In General: The State Auditor’s March 2016 report states that although it is legally permissible to use cigarette and tobacco products revenues to fund the Licensing Act, options exist to make the program self-supporting. The options include, among other things, retailer, wholesaler, and distributor license fee changes and increases, which the report includes as a recommendation. ABx2 11 increased the retailer, wholesaler, and distributor license fees.

The state audit also found that the Compliance Fund accumulated more than \$9 million in license fee revenues even though the Licensing Act has a continuing funding shortfall. The report notes that these funds could be used to offset the Licensing Act costs and reduce the Compliance Fund shortfall. The audit report recommends that “unless the Legislature directs the board to eliminate the compliance fund’s excess fund balance within a time frame of more than a year, the board should eliminated the excess fund balance by June 30, 2017 by using it to offset the licensing program’s annual funding shortfall.”

Commentary:

- The June 16, 2016 amendments** prohibit cigarette and tobacco products revenues from being appropriated to the BOE for Licensing Act administration and enforcement and revise the due date of the funding adequacy report, from January 1, 2018 to January 1, 2019, and then annually thereafter. The **May 12, 2016 amendments** revised the date by which the BOE must report to the Legislature the funding adequacy for the Licensing Act, from January 1, 2020 to July 1, 2018. The amendments also required the report to include information on the BOE’s compliance with the State Auditor’s recommendation to eliminate the excess fund balance in the Compliance Fund.
- Licensing Act funding.** The BOE’s costs to enforce and administer the Licensing Act are funded with revenues deposited into the Compliance Fund, which includes license fee revenues, penalties and fines. The Compliance Fund fully reimbursed those costs through fiscal year 2005-06. In 2006-07, the BOE’s administrative costs were partially offset with cigarette and tobacco products tax revenues. As of 2007-08, substantially all of the BOE’s costs will be funded in this manner in order to cover the difference between Compliance Fund revenues and expenses. Below is a funding summary for the Licensing Act program (in thousands):

Fund	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Taxes from License Fees, Fines and Penalties									
Cigarette and Tobacco Products Compliance Fund	\$6,716	\$1,198	\$1,130	\$648	\$777	\$846	\$1,189	\$1,557	\$1,912
Cigarette and Tobacco Products Tax									
General Fund	\$378	\$928	\$970	\$883	\$884	\$933	\$1,313	\$925	\$913
Breast Cancer Fund	57	186	193	176	176	155	155	188	182
Cigarette and Tobacco Products Surtax Fund	687	2,319	2,423	2,201	2,208	1,944	1,945	2,312	2,280
CA Children and Families First Trust Fund	1,375	4,641	4,848	4,384	4,417	3,887	3,888	4,622	4,561
Total Cigarette and Tobacco Products Funds	\$2,497	\$8,074	\$8,434	\$7,644	\$7,685	\$6,919	\$7,301	\$8,047	\$7,936
Total	\$9,213	\$9,272	\$9,564	\$8,292	\$8,462	\$7,765	\$8,490	\$9,604	\$9,848

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.

3. **Will the license fees fully fund the Licensing Act?** The BOE estimates the license fees established pursuant to [ABx2 11](#) will generate approximately \$9.8 million annually, beginning January 1, 2017. Additionally, BOE staff estimates \$1.908 million in total annual revenues for [SBx2 5](#). Accordingly, half-year revenues (1/1/17-6/30/17) for these two bills are estimated at \$5.854 million, plus any retail license fees for new retail locations from July 1 to December 2016. Adding the estimated \$5.854 license fee revenue to the proposed reserve of \$2.8 million results in \$8.654 million in license fees for Fiscal Year (FY) 2016-17.

The 2016-17 California State Budget (Budget) estimates current Licensing Act program expenditures at \$10.688 million. Also, the BOE staff estimates SBx2 5 and ABx2 11 administrative costs at \$0.4 million, respectively. Based on these figures, the BOE will incur approximately \$11.1 million in administrative costs.

The estimated \$8.654 in license fee revenues does not sufficiently cover the proposed Licensing Act program expenditures of \$11.1 million for FY 2016-17. *To address the shortfall*, \$3.2 million of cigarette and tobacco products revenues, as allocated to the Licensing Act program in the Budget, will be used first to support the Licensing Act program prior to the bill's January 1, 2017, effective date.

Currently at fiscal year-end, adjustments are made first to ensure that all available Compliance Fund revenues are used to support the Licensing Act program, and second, backfill any shortfall with cigarette and tobacco products revenues. Since this bill prohibits any backfill from the cigarette and tobacco products revenues as of January 1, 2017, before actual revenues and expenses are known for the fiscal year, the BOE will first use cigarette and tobacco products revenues, as allocated in the Budget, to support the Licensing Act program, and second, supplement any shortfall with Compliance Fund revenues. Reversing the order of the funds used to support the Licensing Act program would likely increase the Compliance Fund backfill from cigarette and tobacco products tax revenues. In contrast, waiting to determine the backfill until fiscal year-end, when revenues and expenses are known, would ensure that no more than the essential cigarette and tobacco products tax revenues are used to backfill the Compliance Fund. It should be noted that the BOE staff would make fiscal-year end adjustments to refund any unneeded cigarette and tobacco products revenues once the final costs are known; however, the BOE would hold those funds until those adjustments are made.

To avoid any inadvertent impact to the cigarette and tobacco products funds and allow the BOE to use Compliance Fund revenues first to support the Licensing Act program, **the BOE staff suggests an amendment to delay the bill's operative date to July 1, 2017.**

Further, the estimated license fee revenues and expenditures for FYs 2017-18 and 2018-19 pursuant to ABx2 11 and SBx2 5 could change. The BOE will not have a full year of revenue and expenditure data until early 2018. Without this historical data, it is uncertain whether or not the Licensing Act program will generate sufficient revenues to support its costs. **The author may wish to consider a further delay in the bill's operative date to July 1, 2018, to provide the BOE at least a full year of revenue and expenditure data to ensure the license fees are set at an appropriate level to maintain an effective enforcement program.** The bill requires the BOE to report to the Legislature on or before January 1, 2019, the adequacy of funding for the Licensing Act program.

Costs: None.

Revenue Impact: None.