



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/14/10	Bill No:	AB 2496
Tax:	Cigarette and Tobacco Products Tax Cigarette and Tobacco Products Licensing Act	Author:	Nava
Related Bills:			

This analysis will only address the bill's provisions which impact the State Board of Equalization (BOE).

BILL SUMMARY

Among other things, this bill would make the following BOE-related changes:

- Impose additional licensing requirements upon every manufacturer and every importer for the purpose of enforcement of the Model Statute¹ and Tobacco Directory Law in order to be eligible to obtain and maintain a license under the Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act);
- Expand the BOE's inspection authority under the Licensing Act to any site where evidence of activities involve violations of the Tobacco Directory Law;
- Prohibit for purposes of the Licensing Act an importer, distributor, wholesaler, distributor functioning as a wholesaler, or retailer from purchasing, obtaining, or otherwise acquiring any package of cigarettes to which a stamp is affixed in violation of the Tobacco Directory Law;
- Allow retailers a 60-day period to sell cigarettes removed from the Tobacco Directory before such products become subject to seizure and destruction; and
- Expand the BOE's seizure authority to include cigarettes or tobacco products of a tobacco product manufacturer or its brand families not appearing on the Tobacco Directory.

SUMMARY OF AMENDMENTS

Since the previous analysis, this bill was amended to, among other things, (1) add additional manufacturer and importer requirements to obtain and maintain a Licensing Act license, (2) delete the requirement for an appropriate stamp or meter impression to be made upon any rolls of tobacco described as a little cigar, (3) require the BOE to file a lien for a tax penalty in the same amount as the unpaid refund against, and to revoke the Licensing Act license of, a manufacturer, importer, distributor or wholesaler that fails to provide a refund of all moneys paid for product removed from the Tobacco Directory, (4) incorporate delivery seller provisions, and (5) expand the cigarettes subject to seizure by the BOE and forfeiture to the state.

¹ Article 3 (commencing with Section 104555), Chapter 1, Part 3, Division 103 of the Health and Safety Code.

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ANALYSIS**CURRENT LAW**

Cigarette and Tobacco Products Tax Law (Tax Law). Under existing law, the BOE administers the Tax Law (Part 13 commencing with Section 30001) of Division 2 of the Revenue and Taxation Code). Revenue and Taxation Code Section 30451 specifically provides that the BOE shall enforce the provisions of the Tax Law and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement.

The current excise tax on cigarettes is 87 cents per package of 20 (43 ½ mills per cigarette). The cigarette tax is paid through the use of stamps or meter impressions. An appropriate stamp is affixed to, or an appropriate meter impression is made on, each package of cigarettes prior to the distribution of the cigarettes.

The tobacco products tax rate is determined annually by the BOE and based on the March 1 wholesale cost of cigarettes. Currently, the surcharge rate for fiscal year 2009-10 is 41.11 percent. The tobacco products tax is paid through the use of a return on which the distributor reports the wholesale cost of the tobacco products distributed and calculates the tax due.

Also incorporated in the Tax Law is the **Tobacco Directory Law**, which more effectively enforces and promotes the purpose of the Model Statute. The Tobacco Directory Law, which can be found in Section 30165.1, requires, in part, the Attorney General to develop and publish on its Internet web site a directory listing the following:

- All tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a participating manufacturer under the Master Settlement Agreement (MSA), or is a non-participating manufacturer (NPM) that has made all required escrow payments.
- All brand families that are listed in the certifications, except as specified.

No person may affix, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied on a tobacco product defined under Section 30165.1 as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.

The Tobacco Directory Law also prohibits a person from:

- Selling, offering, or possessing for sale in this state, or importing for personal consumption in this state, cigarettes of a tobacco product manufacturer or brand family not included in the Attorney General's directory, and
- Selling, distributing, acquiring, holding, owning, possessing, transporting, importing, or causing to be imported cigarettes that the person knows or should know are intended to be distributed in violation of the Tobacco Directory's stamping prohibitions or are not included in the Attorney General's directory.

Section 30435 authorizes an employee of the BOE, upon presentation of the appropriate identification and credentials, to enter into, and conduct an inspection of any place for which there is evidence of failure to comply with the requirements of the MSA, including, but not limited to, the Tobacco Directory Law. Any cigarette or tobacco products that are stamped or to which a meter impression is affixed, or for which tax is paid, in violation of the Tobacco Directory Law, is subject to seizure and forfeiture,

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pursuant to Section 30436 regardless of whether the violation is subject to a defense, as provided. The seized cigarettes or tobacco products are forfeited to the state and must be destroyed.

Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act). Division 8.6 of the Business and Professions Code established the Licensing Act, which created a statewide licensure program for the sales of cigarettes and tobacco products to address the unlawful distribution and untaxed sales of cigarettes and tobacco products.

In part, Sections 22979 and 22979.21 require every manufacturer and every importer to obtain and maintain a license to engage in the sale of cigarettes or tobacco products. In order to be eligible for a license, a manufacturer or importer is required to meet specified requirements, such as consenting to jurisdiction of the California courts for the purpose of enforcement of the Licensing Act, appoint a registered agent for service of process in this state, and identify the registered agent to the BOE.

The Licensing Act also authorizes, pursuant to Section 22980, any peace officer or BOE employee granted limited peace officer status to enter any place, as described, and conduct inspections. In part, inspections may be at any place at which cigarettes or tobacco products are sold, produced, or stored, or at any site where evidence of activities involving evasion of cigarette or tobacco products may be discovered.

The Licensing Act also imposes specified prohibitions and penalties in Business and Professions Code Sections 22980.1 through 22982. Among the prohibitions, subdivision (g) of Section 22980.1 provides that no importer, distributor, or wholesaler, or distributor functioning as a wholesaler, or retailer, shall purchase, obtain, or otherwise acquire any package of cigarettes to which a stamp or meter impression may not be affixed in accordance with the Tax Law, or any cigarette obtained from a manufacturer or importer that cannot demonstrate full compliance with all requirements of the federal Cigarette Labeling and Advertising Act (15 U.S.C. Sec. 13335a et seq.) for the reporting of ingredients added to cigarettes. Section 22981 provides that any violation of the Licensing Act by any person, except as otherwise provided, is a misdemeanor. Each offense is punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment.

PROPOSED LAW

Among other things, this bill makes changes to the Licensing Act and Tax Law to enhance enforcement of the MSA and subsequent legislation (Model Statute and Tobacco Directory Law).

Licensing Act. This bill would amend Business and Professions Code Section 22979 to require a manufacturer or importer to consent to the jurisdiction of the California courts and waive any sovereign immunity defense for the purpose of enforcement of the Model Statute and the Tobacco Directory Law and regulations adopted pursuant thereto. A manufacturer or importer would also be required to provide to the BOE a copy of any valid, corresponding federal permit issued by the United States Treasury, Alcohol, and Tobacco Tax and Trade Bureau.

This bill would also amend Section 22980 to allow any peace officer or BOE employee granted limited peace officer status, upon presentation of appropriate credentials, to enter any site where evidence of activities involving violations of the Tobacco Directory

Law may be discovered. Such inspections must be performed in a reasonable manner and at times that are reasonable under the circumstances, taking into consideration the normal business hours of the place to be entered.

And lastly, this bill would amend Section 22980.1 to prohibit an importer, distributor, wholesaler, distributor functioning as a wholesaler, or retailer from purchasing, obtaining, or otherwise acquiring any package of cigarettes to which a stamp or meter impression may not be affixed in accordance with the Tobacco Directory Law.

Tax Law. This bill would make numerous amendments to Section 30165.1, the Tobacco Directory Law. Those amendments impacting the BOE's administration of the Tax Law are as follows:

- Requires a distributor, within seven days of receiving a notice of removal of any tobacco product manufacturer or brand family from the Tobacco Directory, to provide a copy of the removal notice to each of their customers that have purchased product removed from the directory. The customer would be provided a 60 day sell-off period from the effective date of the removal notice to sell the affected cigarettes purchased prior to removal from the tobacco directory. On and after the 61st day, the cigarettes are contraband and become subject to seizure and destruction by the BOE.
- Entitles a licensed distributor or wholesaler to a refund from a tobacco product manufacturer or the importer of cigarettes or tobacco products, as described, of any money paid by the licensed distributor for any cigarettes of the tobacco product manufacturer in the possession of the licensed distributor or wholesaler on the effective date of removal from the directory. Also entitles a licensed retailer to a refund from a licensed distributor or wholesaler for any cigarettes or tobacco products in the possession of the retailer on the effective date of removal from the directory. Requires the BOE to revoke the Licensing Act license of any person for which the BOE is provided a certified copy of a final judgment issued by a state or federal court ordering the person to make a refund of such amounts. Requires the BOE to file a lien against the person failing to provide the refund for a tax penalty in the same amount as the unpaid refund.
- Expands the prohibition for any person selling, offering, or possessing for sale in this state or import for personal consumption in this state, to also include shipping or otherwise distributing into or within this state, cigarettes of a tobacco product manufacturer or brand family not included in the directory.
- Requires each manufacturer and its importers to report in the manner, including electronically, as required by the Attorney General and the BOE, all cigarettes and tobacco products, including, but not limited to, the quantity of each brand family, and make all escrow deposits and pay state taxes due before the importer or manufacturer releases the cigarettes and tobacco products for transport to or sale in California. Any manufacturer or importer that fails to file the report as required is liable for a civil penalty in an amount not to exceed the greater of five times the retail value of the cigarettes, as defined, that were not reported prior to release for shipment to or sale in California, or five thousand dollars (\$5,000).
- Authorizes the BOE or Attorney General to require an importer to submit any additional information, including, but not limited to, samples of the packaging or labeling of each brand family, as is necessary to enable the Attorney General to

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determine whether a tobacco product importer has complied, is in compliance, and will continue in compliance with the Tobacco Directory Law, the Model Statute, and any regulations promulgated pursuant thereto.

- Expands from a distributor to any person the imposition of penalties for violating the Tobacco Directory Law. In the case of the first offense, the BOE would be authorized to revoke or suspend the license or licenses issued to the person by the BOE. In addition to distributors, this amendment would now subject wholesalers and retailers to license revocation and suspension. And the licenses subject to suspension and revocation would be expanded from licenses issued to distributors and wholesalers under the Tax Law to also include a retailer, distributor and wholesaler licenses issued under the Licensing Act. In the case of a second or any subsequent offense, the BOE would be authorized to impose civil penalty in an amount not to exceed the greater of five times the retail value of the cigarettes, as defined, or five thousand dollars (\$5,000).

This bill would also add Section 30165.2 to the Revenue and Taxation Code to require as a condition of selling cigarettes in the state, every tobacco product manufacturer, as defined in the Tobacco Directory Law, whose cigarettes are to be sold in the state whether directly or through a distributor, importer, retailer, or similar intermediary or intermediaries to, at the election of the tobacco product manufacturer, either:

- Submit to the Attorney General a true and correct copy of each and every applicable return of tobacco product manufacturer.
- Submit to the United States Treasury a request or consent under Internal Revenue Code Section 6103(c) authorizing the Alcohol and Tobacco Tax and Trade Bureau to disclose the applicable returns of manufacturer to the Attorney General. A foreign tobacco product manufacturer whose cigarettes are imported into the United States by an importer or importers would be required to submit, or cause each of its importers to submit, to the Attorney General each and every applicable return that includes any information about cigarettes of that foreign tobacco product manufacturer imported into the United States. The Attorney General would be prohibited from disclosing any applicable returns or any information contained therein, except as necessary to carry out the functions and duties of the Department of Justice or BOE, or as otherwise provided.

A tobacco product manufacturer who does not comply with the above requirements would, after 30 days notice by the state to the tobacco product manufacturer of the failure to comply, be removed, along with its brand families, from the tobacco directory unless the tobacco product manufacturer has brought itself into compliance by the end of the 30-day period.

Any tobacco manufacturer or importer that intentionally provides any applicable return containing materially false information shall be liable for a civil penalty in an amount not to exceed the greater of either of the following:

- Five times the retail value of the cigarettes or tobacco products defined as cigarettes under this section and about which false information was provided.
- Five thousand dollars (\$5,000).

The Attorney General would be authorized to promulgate regulations to implement and carry out proposed Section 30165.2.

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The bill would also add Section 30165.3 to the Tax Law to require every person selling or taking a delivery sale order, as defined, or engaging in any other non-face-to-face sale of cigarettes, or distributing or engaging in the sale or non-sale distribution of tobacco products to:

- Obtain and maintain a Licensing Act license, and sell only through other importers, wholesalers, distributors, and retailers so licensed.
- Comply with the escrow obligations pursuant to the Model Statute.
- Comply with all marking, labeling, and stamping requirements.
- Comply with the Tobacco Directory Law and proposed Section 30165.2.
- Comply with all state laws applicable to sales and distribution of tobacco products that occur in this state.

Each delivery seller would be required to report specified information to the BOE and Attorney General regarding its sales of cigarettes or tobacco products to persons in this state. A seller would be defined to mean any person, within or outside the state, who agrees to sell tobacco products to a customer in this state. A district attorney, city attorney, the Attorney General, or the BOE may assess specified civil penalties against any person that violates Section 30165.3.

And lastly, this bill would amend Section 30436 to provide that (1) cigarettes or tobacco products of a tobacco product manufacturer or its brand families that do not appear on the tobacco directory maintained by the Attorney General, and (2) cigarettes contained in packages that fail to meet the marking, labeling, and stamping requirements, or provide or affix the information specified by the BOE or Attorney General, are forfeited to the state upon seizure by the BOE.

This bill would become effective January 1, 2011.

IN GENERAL

Under the November 1998 MSA between the State of California, other states, and tobacco product manufacturers, each tobacco company must make annual payments to the participating states in perpetuity, totaling an estimated \$206 billion through 2025. California's share of the revenue is projected to be \$25 billion over the next 25 years, based on receiving approximately 12.8% of the total payments. The payments will be split 50/50 between state and local governments under a Memorandum of Understanding negotiated by the Attorney General and various local jurisdictions (cities and counties) which had also sued the tobacco companies.

The payment provisions of the MSA apply to "participating manufacturers" which include both original signatories to the MSA, as well as other companies which subsequently agree to be bound by the MSA. In return for these payments, the states have agreed to release the cigarette manufacturers from all claims for damages, penalties, and fines. In addition, the participating manufacturers have agreed to certain non-economic terms that restrict their advertising and marketing practices and control their corporate behavior. The primary purpose of these restrictions is to prevent marketing of cigarettes to minors and thereby reduce smoking by minors.

The MSA prompted states to enact the Model Statute by creating a significant financial incentive: Settling States that enact and "diligently enforce" the Model Statute would not

be subject to severe reductions to their MSA payments. All Settling States have enacted Model Statutes requiring NPM reserve (escrow) funds, including California. California's "Model Statute" was enacted in 1999 pursuant to Senate Bill 822 (Escutia, Chapter 780). That bill, among other things, authorized the BOE to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by tobacco products manufacturers who do not participate in the MSA.

While the Settling States, such as California, have been aggressively enforcing the provisions of the Model Statutes, enforcement has proved costly and cumbersome. Accordingly, almost every state has enacted Complementary Legislation to make state enforcement of the Model Statutes more effective and thereby promote the purposes for which the Model Statutes were enacted.

In 2003, California enacted Complementary Legislation (Tobacco Directory Law) pursuant to Assembly Bill 71 (Horton, Chapter 890). Generally, these statutes:

- Require the Attorney General to develop and publish on its Internet web site a directory of all tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a participating manufacturer under the MSA, or is a NPM that has made all required escrow payments, and all brand families that are listed in the certifications, except as specified.
- Prohibit a person from affixing, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.
- Subject violators, principally manufacturers and distributors, to civil and criminal penalties and license suspension or revocation.

COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the Attorney General and is intended to allow for better enforcement of Internet and other delivery sales of cigarettes and tobacco products in this state, strengthen the Attorney General's and BOE's ability to diligently enforce the Model Statute and Tobacco Directory Law, and to provide retailers relief of any financial hardship resulting from cigarettes and tobacco product inventory that immediately becomes illegal to sell upon removal from the Tobacco Directory.
2. **The April 14, 2010 amendments,** among other things, (1) add additional manufacturer and importer requirements to obtain and maintain a Licensing Act license, (2) delete the requirement for an appropriate stamp or meter impression to be made upon any rolls of tobacco described as a little cigar, (3) require the BOE to file a lien for a tax penalty in the same amount as the unpaid refund against, and to revoke the Licensing Act license of, a manufacturer, importer, distributor or wholesaler that fails to provide a refund of all moneys paid for product removed from the Tobacco Directory, (4) incorporate delivery seller provisions for specified non-face-to-face sales of cigarettes or tobacco products to a consumer, and (5) expand the cigarettes subject to seizure by the BOE and forfeiture to the state to include

packages that fail to meet the marking, labeling, and stamping requirements or provide or affix the information in the manner specified.

3. **What is the BOE's enforcement role for the Model Statute?** The BOE has several responsibilities with respect to "diligent enforcement" of the Model Statute, which protects the state's approximately \$900 million annual revenue payment stream from the MSA. The BOE's enforcement role, which coincides with administration of the Tax Law, is as follows:

- The Model Statute requires NPMs to place into a qualified escrow fund by every April 15 an amount, as specified, based on units sold during the previous year. "Units sold" is generally defined to mean the number of individual cigarettes sold in the state by the applicable tobacco product manufacturer as measured by excise taxes collected by the state on packs bearing the excise tax stamp of the state. The BOE is authorized to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by NPMs.

As a result of this provision, the BOE provides the Attorney General with annual statistics of cigarettes sold in California by NPMs. The BOE compiles this information measured by the excise tax reported to the BOE, which is adjusted by BOE staff to remove brands that are considered a "cigarette" for tax purposes, but not for purposes of the Model Statute.

- The Tobacco Directory Law prohibits a distributor from affixing a tax stamp to a package of cigarettes, or paying the tax on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on Tobacco Directory². A violation of this prohibition could result in the revocation or suspension of the license or licenses of the distributor and/or a civil penalty and subject such products to seizure and forfeiture by the BOE.
- The Licensing Act requires every manufacturer or importer required to obtain and maintain a license to engage in the sale of cigarettes. In order to be eligible to obtain and maintain a license, a manufacturer or importer that is a "tobacco products manufacturer" pursuant to the Model Statute must 1) certify to the BOE that it is a "participating manufacturer" or is in compliance with the Model Statute, and 2) submit to the BOE a list of all its brand families. AB 71 also gave the authority to the BOE to revoke or suspend the license of a distributor for selling product not listed on the California Tobacco Directory.

Finally, Licensing Act allows an employee of the BOE, upon presentation of the appropriate identification and credentials, is authorized to enter into, and conduct an inspection of, any building, facility, site, or place, for which there is evidence of the failure to comply with the requirements of the Model Statute or the Tobacco Directory Law.

² Tobacco products commonly known as "little cigars" currently do not have to be listed in the tobacco directory in order to be lawfully sold in California. The AG may decide in the future to require that certain brands of little cigars be listed in this Directory.

4. **Should the Tobacco Directory Law and related enforcement provisions be in the Tax Law?** Revenue and Taxation Code Section 30451 requires the BOE to enforce the provisions of the Tax Law. The Tobacco Directory Law was added to the Tax Law in 2003 pursuant to AB 71 (Ch. 890, J. Horton). Although the Tobacco Directory Law contains mostly non-tax provisions enforced by the Attorney General, it also includes provisions that appropriately tie-in with the Tax Law enforced by the BOE.

However, this bill proposes to expand the Tobacco Directory Law, much of it unrelated to the BOE's enforcement and administration of the Tax Law. The bill also proposes to add Section 30165.2 to the Tax Law, which has no direct relationship to the cigarette or tobacco products tax. Since the Tobacco Directory Law and proposed Section 30165.2 are primarily related to enforcement of the Model Statute, it is suggested that the bill be amended to place the Tobacco Directory Law and proposed Section 30165.2 in the Health and Safety Code along with the Model Statute, which is located in Article 3 (commencing with Section 104555), Chapter 1, Part 3, Division 103 of the Health and Safety Code. It is further suggested that the current BOE Tobacco Directory Law responsibilities, which are tax-related, remain in the Tax Law.

In addition to maintaining only tax-related provisions within the Tax Law, these suggested amendments would more clearly define the BOE's and Attorney General's role for enforcement of the Model Statute and funding for those costs. Funding under the Tax Law is provided by the cigarette and tobacco products tax funds, specifically, the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Proposition 99), and the California Children and Families Trust Fund (Proposition 10).

Provisions within the Tobacco Directory, as proposed by this bill, that don't clearly specify administrative enforcement responsibility, include, but are not limited to, the following:

- **Section 30165.1(c)(3)(B):** Requires each distributor to provide a copy of a notice of removal from the Tobacco Directory to each customer.
- **Section 30165.1(c)(3)(D) and (E):** Entitles distributors, wholesalers, and retailers to a refund from the seller of cigarettes removed from the Tobacco Directory of any money paid by such persons.
- **Section 30165.1(e)(2) and (3):** Prohibits persons from selling, offering, or possessing for sale in this state, ship or otherwise distribute into or within this state or import for personal consumption in this state, cigarettes not included in the Tobacco Directory. Also prohibits persons from selling, distributing, acquiring, holding, owning, possessing, transporting, or importing cigarettes that the person knows or should know are intended to be distributed in violation of the Tobacco Directory Law.
- **Section 30165.2(e):** Imposition of civil penalty for any tobacco manufacturer or importer that intentionally provides any applicable return to the Attorney General containing materially false information.

Each of the examples provided do not involve administration or enforcement of the cigarette or tobacco tax; however, without specifying the agency required to enforce

these provisions, the responsibility would lie with the BOE pursuant to Revenue and Taxation Code Section 30451. Enforcement of these provisions would be outside the BOE's purview of tax administration.

Staff from the Attorney General's Office has indicated a willingness to pursue future legislation to move the Tobacco Directory Law and related provisions to the Health and Safety Code; however, until this happens, BOE staff requests that language be added to both Sections 30165.1 and 30165.2 providing that the Attorney General shall enforce the provisions of each section, unless otherwise specified.

5. **Notification of brand family or manufacturer removal from the Tobacco Directory.** Under current law, cigarettes or tobacco products to which a tax stamp is affixed, or for which tax is paid, is subject to seizure and forfeiture by the BOE at the time the manufacturer or any of its brand families are removed from the tobacco directory. When a manufacturer or brand family is removed from the Tobacco Directory, only distributors are notified of the removal by e-mail. Wholesalers and retailers must check the Tobacco Directory, which is located on the Attorney General's website, for recent changes to the directory, such as removals. As such, wholesalers and retailers are typically not aware that a manufacturer or a brand family has been removed from the directory when found by BOE inspectors to be selling, offering, or possessing for sale removed product.

To provide better notification of manufacturers or brand families removed from the tobacco directory, this bill would require each distributor, within seven days of receiving a removal notice from the Attorney General, to provide each customer with a copy of the removal notice. To clarify any ambiguity of the sponsor's intent, BOE staff suggests amending the bill to: (1) substitute the term "retailer" for "customer," (2) require the Attorney General to directly notify wholesalers of removals, and (3) require both a distributor and a wholesaler to provide a copy of the removal notice to every customer who is a retailer, distributor or wholesaler who has purchased the removed product within the previous two years.

In addition, a distributor should be given more than seven days, which is the same amount of time they are required to provide a copy of the removal notice to customers, to provide the BOE a list of the customers to whom the removal notices were sent. Furthermore, it is unclear to BOE staff what the purpose is for the BOE to receive a list of the customers to whom the removal notices were sent. The amendments don't provide a defense for those retailers not receiving a copy of the notice who are found selling, offering or possession for sale product after the 61st day from the effective date of the removal notice. While the reference to the BOE for purposes of list of customers should be removed, should the list of customers be sent to the Attorney General instead to document compliance with the requirements of customer notification? In addition, there is no specific penalty for failing to provide the BOE the list of customers to whom removal notices were sent.

6. **Retailer sell-off period for product removed from the Tobacco Directory.** Currently, cigarettes or tobacco products of a manufacturer or its brand families become illegal to sell, offer, or possess for sale upon removal from the Tobacco Directory. Even with proper notice of such removal, it is a financial hardship on retailers who have an inventory of the removed products that they can no longer sell. To address this hardship, this bill would provide a distributor's customer (retailer) 60 days from the effective date of the removal notice to sell the affected product only if

it was purchased prior to being removed from the Tobacco Directory. This provision would provide a retailer an opportunity to sell their existing inventory of removed product thereby limiting or eliminating any financial hardship imposed under current law.

BOE staff is continuing to work with staff from the Attorney General's office to develop appropriate amendments intended to properly notify wholesalers and retailers of product removal and to provide clear and concise sell-off period language.

7. **Additional cigarette and tobacco products subject to seizure by the BOE.** With respect to Tobacco Directory Law violations, only cigarettes or tobacco products not appearing on the Tobacco Directory to which a cigarette stamp is affixed, or for which the tax is paid, after such products are removed from the Tobacco Directory are currently forfeited to the state upon the BOE's seizure. This bill would expand the BOE's seizure authority for Tobacco Directory violations to include untaxed cigarettes and tobacco products. These additional seizures could be from manufacturers, importers and distributors of cigarettes or tobacco products that have not been distributed, which is the incidence of tax. Such seizures could be strictly related to Tobacco Directory violations with no relationship to cigarette and tobacco products tax enforcement. For example, a distributor could have an inventory of unstamped cigarettes that do not appear on the Tobacco Directory intended to be shipped to a customer outside California. This bill would subject those products to seizure and forfeiture to the state.

On the other hand, the additional seizure authority would allow the BOE to seize cigarettes or tobacco products that are in violation of the Tobacco Directory where a taxable distribution has occurred, but the tax has not been remitted to the BOE. These seizures would also involve a violation of the Tax Law and Licensing Act, and are currently subject to seizure and forfeiture to the state.

8. **Tobacco Directory refunds problematic.** In addition to no clear line of administrative responsibility, the refund provisions found in Section 30165.1(c)(3)(D) and (E) are not workable in their current form. Among other things, the bill would entitle a wholesaler to a refund from a tobacco product manufacturer or importer for any money paid by the licensed distributor to the manufacturer or importer; however, how would a wholesaler know the distributor's purchase price from the manufacturer or importer? The refund provisions also entitle a retailer to a refund from a wholesaler, but the wholesaler is not afforded reimbursement for that refund from manufacturer or importer. The refund provisions also require the BOE to revoke any license issued under the Licensing Act for failing to provide a refund, as described. In addition, the BOE would be required to file a lien against the manufacturer, importer, distributor or wholesaler for a tax penalty in the same amount as the unpaid refund.

For purposes of the Tax Law, a distributor is the taxpayer. Since current law already authorizes tax refunds to distributors, the BOE should not have any role overseeing the proposed refunds of non-tax amounts paid for cigarettes removed from the directory and returned to the seller, nor should the BOE be required to file a non-tax lien for any money paid by the purchaser for the removed products.

9. **Penalty expanded beyond distributor for violations.** Under existing law, the Tobacco Directory, pursuant to Section 30165.1(i), imposes civil or criminal penalties upon a distributor for violations of the Tobacco Directory and authorizes the BOE to suspend or revoke the distributor's license. This bill would expand those penalties to all license holders (manufacturer, importer, distributor, wholesaler, and retailer) for violations of the Tobacco Directory. A distributor would be in violation of the Tobacco Directory if a stamp is affixed, or the tax paid, on cigarettes not appearing on the directory. Other licensee Tobacco Directory violations would involve selling, offering, or possessing for sale cigarettes not included on the directory, which do not have a direct tie to tax reporting. As such, is the BOE the correct agency to be collecting these penalties?

10. **Delivery seller requirements not consistent with federal law.** On March 31, 2010, Senate Bill 1147, known as the Prevent All Cigarette Trafficking Act of 2009 or PACT Act, became Public Law 111-154 and will go into effect July 1, 2010. Among other things, the PACT Act amends the Jenkins Act to require persons who sell, transfer, or ship for profit cigarettes or smokeless tobacco in interstate commerce to file with the tobacco tax administrator of the State into which the shipment is made a memorandum or copy of the invoice, containing specified information, of each shipment. Previously, this requirement was only imposed upon sellers of cigarettes.

The PACT Act also added provisions related to "delivery sales," which the PACT Act generally defines as any sale of cigarettes or smokeless tobacco to a consumer where the order was made by telephone or the Internet, and the cigarettes or tobacco products are delivered to the buyer by common carrier, private delivery service, or other method of remote delivery. The addition of Section 30165.3 to the Revenue and Taxation Code appears to be modeled after the PACT Act; however, it imposes additional reporting requirements upon out-of-state sellers and limits sales to only importers, wholesalers, distributors, and retailers so licensed.

In its current form, Section 30165.3 is not compatible with the Licensing Act or the Tax Law with respect to requirements, definitions, and administration. BOE staff has been working with Attorney General staff to formulate language that is workable within the existing structure of the Tax Law.

In addition, the intent of the PACT Act and its delivery seller provisions is to allow shipments directly to consumers as long as certain criteria is met, including, but not limited to, paying the applicable excise taxes to the BOE. As such, delivery sellers should not be limited to selling only to importers, wholesalers, distributors, and retailers.

COST ESTIMATE

The BOE would incur administrative costs related to revising Licensing Act application forms for manufacturers and importers, issuing citations to licensees for purchasing, obtaining or otherwise acquiring cigarettes stamped in violation of the Tobacco Directory law, and for additional cigarette and tobacco products seizures. These costs are estimated to be minor (over \$10,000 and under \$50,000); however a detailed cost estimate is pending.

REVENUE ESTIMATE

The delivery sale provisions of this bill may have a positive impact on the state excise tax collected on sales of cigarettes and tobacco products and also on use tax collected on cigarettes and tobacco products purchased from out-of-state retailers. However, the BOE has no way of measuring the potential impact these provisions may have, and therefore, cannot provide an estimate at this time.

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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.