



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	06/23/09	Bill No:	SB 400
Tax:	Cigarette and Tobacco Products Licensing Act	Author:	Corbett
Related Bills:	SB 601 (Padilla) SB 602 (Padilla) SB 603 (Padilla)		

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

BILL SUMMARY

This bill would require any person selling a tobacco substitute, as defined, to be licensed under the Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act) in order to engage in the sale of such products.

CURRENT LAW

The Licensing Act requires the Board to administer a statewide cigarette and tobacco products license program to regulate the sale of cigarettes and tobacco products in the state. The Licensing Act requires every retailer, distributor, wholesaler, manufacturer and importer to obtain and maintain a license to engage in the sale of cigarettes or tobacco products.

Retailers. A retailer is required to have in place and maintain a license to engage in the sale of cigarettes or tobacco products for each retail location. A retailer that owns or controls more than one location is required to have a separate license for each retail location. A retailer license is valid for a 12-month period and must be renewed annually. In order to obtain a license, a retailer must file a license application accompanied by a one-time license fee of \$100 for each retail location.

A retailer is required to retain purchase invoices, as specified, for all cigarette and tobacco products for a period of four years. The records must be kept at the retail location for at least one year after the purchase. A retailer is required to make invoices available upon request during normal business hours for review, inspection and copying by the Board or by a law enforcement agency.

Distributors and Wholesalers. A distributor and wholesaler license is valid for a calendar year upon payment of a fee of \$1,000 per location, unless surrendered, suspended, or revoked prior to the end of the calendar year, and may be renewed each year upon payment of such fee.

All distributors and all wholesalers are required to retain purchase records, as specified, for all cigarette and tobacco products purchased. The records have to be maintained for a period of one year from the date of purchase on the distributor's or the wholesaler's premises identified in the license, and thereafter, the records have to be made available for inspection by the Board or a law enforcement agency for a period of four years.

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 Board's formal position

Distributor and wholesaler sales invoices for the sale of cigarettes or tobacco products are required to include specified information, which includes, but is not limited to, the distributor or wholesaler license number and the amount of excise taxes due to the Board by the distributor on the sale of cigarettes and tobacco products.

Manufacturers and Importers. In order to be eligible for a license, a manufacturer or importer is required to do all of the following:

- Submit to the Board a list of all cigarette brand families and all tobacco products that they manufacture or import.
- Update the list of all cigarette brand families and tobacco products that they manufacture or import whenever a new or additional brand is manufactured or imported, or a listed brand is no longer manufactured or imported.
- Consent to jurisdiction of the California courts for the purpose of enforcement of this division and appoint a registered agent for service of process in this state and identify the registered agent to the Board.

Furthermore, a manufacturer or importer that is a "tobacco product manufacturer" as defined in the Model Statute (Article 3 (commencing with Section 104555) of Chapter 1 of Part 3 of Division 103 of the Health and Safety Code), must meet additional criteria.

Every manufacturer and every importer would be required to pay to the Board an administration fee, which differs for cigarettes and tobacco products. With respect to tobacco products, the one-time fee is \$10,000 for every manufacturer or importer of chewing tobacco or snuff and \$2,000 for every manufacturer or importer of all other tobacco products. The total amount of the fees cannot exceed \$10,000.

Every tobacco products manufacturer or importer is required to file a monthly report to the Board, which includes, but is not limited to, a list of all distributors to which the manufacturer or importer shipped its tobacco products or caused its tobacco products to be shipped, and the total wholesale cost of the products.

Each manufacturer and each importer of cigarette and tobacco products is also required to maintain accurate and complete records relating to the sale of those products, including, but not limited to, receipts, invoices, and other records as may be required by the Board, during the past four years with invoices for the past year to be maintained on the premises for which the license was issued. The records must be made available upon request by a representative of the Board or a law enforcement agency.

Violations. Violations of the Licensing Act include, in part, the following:

- Possession, storing, owning, or has made sales of an unstamped package of cigarettes bearing a counterfeit California tax stamp or tobacco products on which tax is due but has not been paid.
- Sales of cigarettes or tobacco products to any distributor, wholesaler, importer, retailer, or any other person who is not licensed or whose license has been suspended or revoked.
- Retailer and wholesaler purchases of cigarette or tobacco products from any person who is not licensed or whose license has been suspended or revoked.

- Distributor purchases of cigarettes or tobacco products from any person who is required to be licensed pursuant to the Licensing Act but who is not licensed or whose license has been suspended or revoked.
- Failure to maintain records or make such records available to the Board and law enforcement agency, as specified.
- A person or entity that engages in the business of selling cigarettes or tobacco products in this state without a license or after a license has been suspended or revoked,
- Failure to allow an inspection.
- Retailer's failure to conspicuously display a license.

Funding. All moneys collected pursuant to the Licensing Act are deposited in the Cigarette and Tobacco Products Compliance Fund (Compliance Fund) and are available for expenditure, upon appropriation by the Legislature, solely for the purpose of implementing, enforcing, and administering the Licensing Act.

Definition. The Licensing Act defines "tobacco products" to mean tobacco products as defined in subdivision (b) of Section 30121 and subdivision (b) of Section 30131.1 of the Cigarette and Tobacco Products Tax Law. Those Cigarette and Tobacco Products Tax Law sections define "tobacco products" to include, but not be limited to, all forms of cigars, smoking tobacco, chewing tobacco, snuff, and any other articles or products made of, or containing at least 50 percent, tobacco, but does not include cigarettes.

Several key terms used in the Licensing Act are defined to have the same meaning as those terms are defined under the Cigarette and Tobacco Products Tax Law.

PROPOSED LAW

This bill would revise the definition of "tobacco products" for purposes of the Licensing Act to include a tobacco substitute, defined to mean a battery-powered device that can provide inhaled doses of nicotine by delivering a vaporized solution.

This bill would become effective January 1, 2010.

BACKGROUND

In 2003, Assembly Bill 71 (J. Horton, Ch. 890) enacted the Licensing Act, which established a statewide licensure program administered by the Board to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Currently, the Board has approximately 38,000 retailers and 1,000 distributors and wholesalers licensed 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 Cigarette and Tobacco Products Tax Law 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

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 Board's formal position

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 Board has estimated that the Licensing Act and enhanced cigarette tax stamp generates an additional \$87.7 million in cigarette excise tax annually. The Licensing Act generates an additional \$15.7 million in additional tobacco products tax. The resulting additional sales and use tax revenue is estimated to be \$35.7 million annually.

IN GENERAL

A device that would fall under the definition of "tobacco substitute," and which this bill is intended to address, is an electronic cigarette. An electronic cigarette or "e-cigarette" is advertised as an alternative to cigarettes or other smoked tobacco products, such as cigars and pipes. It is a battery-powered device that provides inhaled doses of nicotine by delivering a vaporized propylene glycol/nicotine solution. The vapor also provides a flavor and physical sensation similar to that of inhaled tobacco smoke. Electronic cigarettes do not contain tobacco, nor is smoke or combustion actually involved in its operation. Many electronic cigarettes resemble cigarettes and other smoked tobacco products. They are reusable devices with replaceable and refillable parts. An electronic cigarette starter kit typically sells for \$60 to \$150 and includes the electronic cigarette device, battery and cartridges. Replacement cartridges cost about \$10 for a package of 5 cartridges with each cartridge normally equivalent to a package of 20 cigarettes. There are also disposable electronic cigarettes, which are sold with a pre-charged battery and sold for about \$20 to \$30 depending on the number of cartridges included.

The U.S. Food and Drug Administration (FDA) considers electronic cigarettes to be both a drug and device under the Federal Food, Drug, and Cosmetic Act, and, therefore, must receive FDA approval before being marketed. The FDA has refused several shipments into the United States of electronic cigarettes, cigars, pipes and their components. Although it has been noted that these products are currently being evaluated on a case-by-case basis, it appears products are already being sold in the United States and are not being seized.

The Wall Street Journal noted in a June 2, 2009, article titled "Controversy Swirls Around E-Cigarettes," that there are three large U.S. companies and dozens of smaller ones selling electronic cigarettes, most of which are made in China. Sales of the products, which barely registered in the United States just two years ago, have more than doubled over the past 12 months to an estimated \$100 million, according to the Washington-based Electronic Cigarette Association, an industry association formed this spring.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to require suppliers and sellers of electronic cigarettes to be in full compliance of established state law relevant to the distribution of tobacco products to minors.

2. **Is this measure consistent with the author's intent?** The Licensing Act was enacted to address cigarette and tobacco products tax evasion. Adding tobacco substitutes to the definition of tobacco products for purposes of the Licensing Act would not address the sale of these products to minors, nor is it consistent with the intent of the Licensing Act. Discussions with Senator Corbett's staff indicated that the bill is also intended to identify and track sellers of electronic cigarettes by requiring their licensure under the Licensing Act.

As currently administered, one license is issued whether cigarettes or tobacco products, or both, are sold. Although an application for a license and an application for renewal asks the applicant to identify whether cigarettes or tobacco products will be sold at each location, it does not ask for any additional detail such as the type of tobacco product (cigar, snuff, chewing tobacco). Furthermore, a licensee who indicates they will be selling cigarettes and not tobacco products at a location could begin selling tobacco products after an application or application for renewal is filed. This would not be a violation of the Licensing Act since the licensee is properly licensed.

In order to achieve the author's intent, the Licensing Act would have to add a new license for sellers of electronic cigarettes. These provisions would require extensive revisions to the Licensing Act, result in substantial administrative costs, and place an additional burden on licensees.

3. **This bill would not subject electronic cigarettes to the excise tax.** The Cigarette and Tobacco Products Tax Law defines "cigarette" to mean any roll for smoking, made wholly or in part of tobacco, irrespective of size or shape and irrespective of whether the tobacco is flavored, adulterated or mixed with any other ingredient, where such roll has a wrapper or cover made of paper or any other material, except where such wrapper is wholly or in the greater part made of tobacco and such roll weighs over three pounds per thousand.

"Tobacco products" includes, but is not limited to, all forms of cigars, smoking tobacco, chewing tobacco, snuff, and any other articles or products made of, or containing at least 50 percent, tobacco, but does not include cigarettes.

Electronic cigarettes do not fall under the Cigarette and Tobacco Products Tax Law definitions of cigarettes or tobacco products since they do not contain tobacco. As such, they are not subject to the cigarette or tobacco products excise tax. Revising the definition of tobacco products to include electronic cigarettes under the Licensing Act would not impact how these products are treated for tax purposes. In other words, this bill would not result in such products being subject to the excise tax.

4. **Is the Licensing Act the appropriate mechanism to track electronic cigarette sellers?** As noted previously, the Licensing Act is a tool to enforce the Cigarette and Tobacco Products Tax Law. As such, many of the Licensing Act's provisions, including definitions, reference the Cigarette and Tobacco Products Tax Law. Adding tobacco substitutes to the definition of tobacco products as proposed by this measure does not perfectly fit within the Licensing Act and is inconsistent with the purpose for which the Licensing Act was enacted. In addition, adding tobacco substitutes to the definition of tobacco products would result in inconsistencies between the tax law and Licensing Act, making the bill more complicated and costly to enforce. For example, the Licensing Act defines wholesaler, distributor and

importer to have the same meaning as those terms are defined under the Cigarette and Tobacco Products Tax Law. In general, distributors, wholesalers and importers under the Cigarette and Tobacco Products Tax Law are persons who distribute, sell or import cigarettes or tobacco products, respectively. Since tobacco products defined under the tax law do not include tobacco substitutes, sales of electronic cigarettes would be limited to distributors, wholesalers and importers as defined under the tax law.

Furthermore, many of the prohibitions and penalties would not apply to electronic cigarettes since they are not subject to the excise tax. Applicable prohibitions related to electronic cigarettes would include sales by an unlicensed person, purchases from an unlicensed person, failure to maintain records, and failure to conspicuously display license (retailer).

5. **How would the Licensing Act provisions of this bill be funded?** Currently, the Board's costs to administer the Licensing Act exceed the amount of revenues from the licensing fees with the shortfall made up by the various cigarette and tobacco products tax funds (Proposition 99 fund, Proposition 10 fund, the Breast Cancer Fund and the General Fund). Since the provisions of this bill are not related to cigarette or tobacco products tax collection and enforcement, it appears that the Proposition funds and the Breast Cancer Fund could not be used to fund administrative costs associated with bill. If this is the case, then the additional workload imposed by this measure would be borne solely by the General Fund.
6. **Internet purchases.** This bill would amend the STAKE Act to include tobacco substitutes (electronic cigarettes) thus making their sale to minors illegal, which could make it more difficult to purchase electronic cigarettes from traditional locations, such as liquor stores and gas station mini-marts. This may lead to minors turning to the Internet as a means of acquiring electronic cigarettes since the retailer is not likely to verify the age of the purchaser. This could lead to additional use tax avoidance.

In addition, this measure would not likely capture out-of-state Internet retailers for purposes of the Licensing Act. Such retailers would not be required to be licensed if they do not have presence in California and sell directly to consumers.

7. **Related legislation.** SB 601 (Padilla) would amend the Licensing Act to prohibit the issuance of a retail license for a location within 600 feet of a school, except in cases of public convenience or necessity, limits retail licenses to "traditional retail locations", authorizes the Department of Public Health to petition the Board to specify other "traditional" retail locations through regulation, and proposes the transfer of a retail license. SB 601 was held under submission by the Senate Appropriations Committee.

SB 602 (Padilla) would amend the Licensing Act to revise the penalty provisions related to illegal sales to minors and changes the reporting requirement related to sales to minors.

SB 603 (Padilla) would amend the Licensing Act to impose an annual retailer fee, limit the total number of retailer licenses issued in an “area of overconcentration,” and prohibit the issuance of a retail license for a location within 600 feet of a school, except in cases of public convenience or necessity.

COST ESTIMATE

In its current form, the Board would incur administrative costs for identifying and registering new licensees (retailers and manufacturers), revising applications and publications, additional enforcement and answering inquires from the public. It is estimated that these costs would be moderate (over \$50,000 and less that \$250,000).

It appears the Board’s administrative costs would be reimbursed by the General Fund.

REVENUE ESTIMATE

It is unknown how many additional retailers and manufacturers would be licensed pursuant to this measure due to insufficient data on electronic cigarette sales. While it is assumed that the number of licensees would increase, Board staff believes the number of additional licensees and related fee revenues would be negligible.

Analysis prepared by:	Cindy Wilson	916-323-7169	07/01/09
Contact:	Margaret S. Shedd	916-322-2376	
ls			0400-1cw.doc

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 Board’s formal position