



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

**DRAFT**

Date Introduced:	<b>02/27/09</b>	Bill No:	<b><a href="#">SB 600</a></b>
Tax:	<b>Cigarette and Tobacco Products</b>	Author:	<b>Padilla</b>
Related Bills:	<b>AB 89 (Torlakson)</b>		

**BILL SUMMARY**

This measure would impose an additional excise tax on cigarettes of seventy-five mills per cigarette (\$0.075), or \$1.50 per package of 20 and indirectly increase the tax on other tobacco products. In addition, this measure would impose an equivalent compensating cigarette and other tobacco products floor stock tax.<sup>1</sup> The revenue from the cigarette tax increase would be shared between the Tobacco Tax and Health Protection Fund, which this measure would create, and the General Fund.

**ANALYSIS**

**CURRENT LAW**

The current excise tax on cigarettes is 87 cents per package of 20 (43 ½ mills per cigarette). The different components of the cigarette taxes and the disposition of the revenues are as follows:

- 10 cents per pack (5 mills per cigarette) is allocated to the General Fund (Sections 30101 and 30462 of the Revenue and Taxation Code);
- 2 cents per pack (1 mil per cigarette) is allocated to the Breast Cancer Fund (Sections 30101 and 30461.6);
- 25 cents per pack (12 ½ mills per cigarette) is allocated to the Cigarette and Tobacco Products Surtax Fund (Sections 30122 and 30123); and
- 50 cents per pack (25 mills per cigarette) is allocated to the California Children and Families (CCF) Trust Fund (Sections 30131.2 and 30131.3).

For other tobacco products (which are defined in Section 30121 and 30131.1 to include cigars, smoking tobacco, chewing tobacco, snuff, and other products containing at least 50 percent tobacco), Section 30123 (Proposition 99) imposes a tax on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 (Proposition 10) imposes an additional tax on tobacco products based on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the 50-cent per pack tax on cigarettes also imposed by Section 30131.2. The tobacco products tax rate is determined annually by the Board and based on the March 1 wholesale cost of cigarettes. Currently, the surcharge rate for fiscal year 2008-09 is 45.13 percent.

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<sup>1</sup> A floor stock tax is a one-time tax on all tax-paid (stamped) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette and tobacco products tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate.

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The other tobacco products surtax imposed under Section 30123 (Proposition 99) is deposited into the Cigarette and Tobacco Products Surtax Fund (including any revenues that result from an indirect increase in the other tobacco products tax triggered by a cigarette tax increase), while the surtax imposed under Section 30131.2 (Proposition 10) is deposited into the CCF Trust Fund.

**Proposition 10 Backfill.** Health and Safety Code Section 130105 (added by Proposition 10) requires the Board to determine the revenue reductions to any Proposition 99 state health-related education and research programs and the Breast Cancer Fund that are a direct result of the additional taxes imposed by Proposition 10's additional taxes, and annually backfill these amounts from the tax revenues received from Proposition 10.

#### PROPOSED LAW

**Cigarette Tax and Indirect Other Tobacco Products Tax Increases.** This measure would add Article 4 (commencing with Section 30135) to Chapter 2 of Part 13 of Division 2 of the Revenue and Taxation Code to impose an additional tax of \$1.50 per package of 20 cigarettes (and, as discussed in Comment 2 below, indirectly increase the tax on other tobacco products). The additional cigarette tax would be imposed on or after the first day of the first calendar quarter commencing more than 90 days on and after the effective date of the bill.

**Cigarette Tax Rate Adjusted Annually.** This bill would require that the additional cigarette tax imposed be adjusted annually and indexed to the California Consumer Price Index (CPI), as determined by the Department of Industrial Relations. On or before March 1 of each year, the Board would calculate the percentage increase in the CPI of December of the prior calendar year over the December of the preceding calendar year. If there was an increase in the CPI then the Board would adjust the cigarette tax rate imposed by this bill by June 30, and each successive fiscal year, with the rate taking effect in the following state fiscal year.

**Floor Stock Tax.** This measure would also impose upon every dealer and wholesaler a compensating floor stock tax for each cigarette or tobacco product in his or her possession or control at 12:01 a.m. on the first day of the first calendar quarter commencing more than 90 days after the effective date of the bill at the rate of seventy-five mills per cigarette (\$0.075) or the equivalent rate of tax for each cigarette or the equivalent rate of tax for each tobacco product, as determined by the Board.

**Backfill Provisions.** This measure would require the Board to determine, within one year of passage and then annually thereafter, the effect that the additional tax imposed on cigarettes and the resulting increase in the tax on tobacco products required by subdivision (b) of Section 30123 (Prop. 99) has on the consumption of cigarettes and other tobacco products in this state. To the extent that a decrease in consumption is determined by the Board to be the direct result of the additional cigarette and other tobacco products tax, the Board shall determine the fiscal effect the decrease in consumption has on the California Children and Families Trust Fund (Prop. 10), the Hospital Services Account, the Physician Services Account, the Unallocated Account of the Cigarette and Tobacco Products Surtax Fund (Prop. 99), and the Breast Cancer Fund created by Section 30461.6.

Funds would be transferred from the Tobacco Tax and Health Protection Fund to the California Children and Families Trust Fund (Prop. 10), the Hospital Services Account, the Physician Services Account, the Unallocated Account of the Cigarette and Tobacco Products Surtax Fund (Prop. 99), and the Breast Cancer Fund as necessary to offset the revenue decrease directly resulting from the imposition of the additional cigarette and indirect tobacco products tax.

**Fiscal Provisions.** Fifteen percent (15%) of the proceeds from the cigarette tax increase would be transferred to the Tobacco Tax and Health Protection Fund, which this measure would create, and eighty-five percent (85%) to the General Fund. Upon appropriation by the Legislature, the moneys in the Tobacco Tax and Health Protection Fund would be allocated for each fiscal year to fund the following:

- 65% to the State Department of Public Health Tobacco Control Program for carrying out tobacco prevention and control programs.
- 15% to the State Department of Education to be used solely to prevent or reduce the use of tobacco products.
- 10% to the University of California to supplement the Cigarette and Tobacco Products Surtax Medical Research Program.
- 10% to the University of California for the establishment and administration of a Lung Cancer Early Detection and Treatment Research Program.

The bill would become operative on or after the first day of the first calendar quarter commencing more than 90 days on and after the effective date of the bill.

#### BACKGROUND

Proposition 99, approved by voters in November 1988 and effective January 1, 1989, imposed a surtax of 25 cents per package of 20 cigarettes, and also created an equivalent tax on other tobacco products. Proceeds from the taxes provide funding for health education, disease research, hospital care, fire prevention, and environmental conservation.

Assembly Bill 478 (Ch. 660, 1993) and Assembly Bill 2055 (Ch. 661, 1993), effective January 1, 1994, added an excise tax of 2 cents per package of 20 cigarettes for breast cancer research and early detection services.

Proposition 10, approved by voters in November 1998 and effective January 1, 1999, imposed an additional surtax of 50 cents per package of 20 cigarettes. Additionally, the measure imposed an additional excise tax on the distribution of other tobacco products equivalent to the additional cigarette tax and imposed an equivalent compensating floor stock tax. The revenues from the additional tax are deposited into the CCF Trust Fund and are used to fund early childhood development programs, and to offset any revenue losses to certain Proposition 99 programs as a result of the additional tax imposed by Proposition 10.

#### COMMENT

1. **Sponsor and purpose.** This measure is sponsored jointly by the American Cancer Society, American Heart Association, and the American Lung Association, and is intended to curb tobacco use in California and continue funding the state's cancer research and tobacco prevention and enforcement efforts.

2. **Indirect other tobacco products rate increase.** This measure does not contain a direct tax increase on other tobacco products, however, the \$1.50 cigarette tax increase would indirectly increase the other tobacco products tax rate as a result of Proposition 99. Section 30123(b) (Proposition 99) generally provides that the other tobacco products tax rate, which is required to be determined annually by the Board, *must be equivalent to the combined rate of all taxes imposed on cigarettes*. As such, a tax increase on other tobacco products is automatically triggered whenever the tax imposed on cigarettes is increased.

It should be noted that the proceeds from the resulting other tobacco products tax increase would not be deposited into the Tobacco Tax and Health Protection Fund, which this bill would create. The proceeds would be deposited into the Cigarette and Tobacco Products Surtax Fund (Proposition 99) to fund health education, disease research, hospital care, fire prevention, and environmental conservation.

3. **Effective date of the indirect increase on other tobacco products.** Existing law requires the Board to annually determine the other tobacco products tax rate. As discussed in Comment 2, the \$1.50 cigarette tax increase would indirectly increase the other tobacco products tax rate as a result of Proposition 99. Existing law does not, however, specify when the Board is required to determine the other tobacco products tax rate, only that it is based on the wholesale cost of tobacco products as of March 1 and must be determined annually for the state's next fiscal year. As such, the rate must be determined no earlier than March 1, but no later than June 30, each year to be effective for the next fiscal year.
4. **Floor stock tax provisions need to be clarified.** In general, a floor stock tax is a one-time tax on all tax-paid (fixed stamp) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate. A floor stock tax is imposed to equalize the excise tax paid by cigarette dealers, wholesalers, or distributors on their inventory and those cigarettes purchased after the effective date of a tax increase.

Having a large cigarette inventory before a tax rate increase takes effect can result in a windfall profit to a cigarette seller. The selling price of cigarettes purchased before the increase, but sold after, can be raised and attributed to the rate increase.

These additional funds would represent a windfall profit rather than excise taxes paid to the state. A floor stock tax mitigates this windfall profit.

This bill proposes to add Section 30135.4, which contains language to impose a floor stock tax on the cigarette or tobacco products inventory of every dealer and wholesaler. The floor stock tax would apply to each cigarette or tobacco product in the dealer or wholesaler's possession at 12:01am on the first day of the first calendar quarter commencing more than 90 days after the effective date of this section. The rate of the floor stock tax is at seventy-five mills (\$0.075) for each cigarette or the equivalent rate of tax for each cigarette or the equivalent rate of tax for each tobacco product, as determined by the Board. This bill contains a direct cigarette tax increase, and as explained previously, the indirect tobacco product tax rate would also be affected, but as determined by the Board and according to the

applicable timeframe. As such, the floor stock tax proposed by this measure would not apply to the indirect increase in the tobacco products rate and the language referencing tobacco products throughout Section 30135.4 should be deleted.

Furthermore, the proposed floor stock tax provision only applies to dealers and wholesalers; not distributors. It is suggested that the bill be amended to impose the floor stock tax on a distributor's inventory of affixed and unaffixed stamps to prevent a potential stockpiling of stamps, windfall profit and lost tax revenues.

And lastly, the bill should be amended to add provisions specifying the due date of the floor stock tax and return, which Board staff is available to work with the author on.

- 5. The proposal should contain an appropriation/reimbursement and refund language.** This bill may require the Board to begin collecting the tax effective January 1, 2010, which is in the middle of the state's fiscal year. In order to be able to administer and collect the tax, the bill should be amended to provide an appropriation to the Board. Without an appropriation, consideration should be given to changing the operative date of the cigarette tax increase to January 1, 2011 to become effective at the beginning of the fiscal year and to coincide with the budget development process.

Additionally, in order for the Board to be adequately compensated for the cost of administering this proposal in subsequent fiscal years, language should be added to authorize reimbursements from the funds collected before the tax is deposited in the Tobacco Tax and Health Protection Fund and General Fund. Language should also be added to authorize the payment of refunds for overpayments from moneys collected.

Board staff also notes the need for additional future funding for greater compliance efforts for additional billings and delinquencies and increased investigative staff presence due to increased tax evasion.

- 6. Cigarette and tobacco products tax evasion.** Tax evasion is one of the major areas that can reduce state revenues generated from cigarettes and other tobacco products taxes. Board staff recently estimated that cigarette tax evasion in California was running at a rate of approximately \$182 million, along with \$94 million in tax on other tobacco products.<sup>2</sup>

During the mid-1990's, the Board's cigarette tax evasion estimates changed little since there was little change to cigarette prices and excise taxes during that time. However, two major events that occurred since November 1998 dramatically increased California excise taxes as well as cigarette prices (excluding taxes): Proposition 10 and the Tobacco Master Settlement Agreement between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, coincided with an increase in the average prices of cigarettes to California consumers by about 50 percent in relation to early November 1998 prices. It is estimated that the impacts of

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<sup>2</sup> <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>

Proposition 10 and the tobacco settlement more than doubled the dollar amount of cigarette tax evasion in California.

Since the 1998 experience, many new measures have been implemented to reduce cigarette and other tobacco products tax evasion. These include the Cigarette and Tobacco Products Licensing Act, an encrypted cigarette tax stamp, and various Internet restrictions (such as agreements with UPS, DHL, and FedEx under which those companies have agreed to stop transporting cigarettes directly to individual consumers nationwide and credit card companies adopting policies to prohibit the use of credit cards for the illegal sale of cigarettes over the Internet).

This measure would increase the cigarette tax substantially, which would result in an increase in the retail price, to the extent that the tax increase is passed along to consumers. Based on previous experience related to Proposition 10 and the tobacco settlement, along with research of experiences in other states, Board staff believes the proposed cigarette tax increase and resulting increase in the other tobacco products tax could result in both a decrease in actual consumption and an increase in cigarette and other tobacco products tax evasion. The exact magnitude of these responses is uncertain since the proposed excise tax increases are significantly greater than previously experienced.

- 7. This bill could result in an annual adjustment of the cigarette tax.** On or before March 1 of each year, the Board would be required to calculate the percentage increase in the California Consumer Price Index (CPI) of December of the prior calendar year over the December of the preceding<sup>3</sup> calendar year. If there was an increase in the CPI then the Board would adjust the cigarette tax rate imposed by this bill by the percentage increase, with the rate taking effect in the following fiscal year.

It should be noted that the tobacco products tax rate is currently determined each fiscal year pursuant to existing law. Since that determination is not part of this measure (it is an indirect increase as a result of Proposition 99 as explained in Comment 2) and the bill does not impose a direct increase on tobacco products, the reference to tobacco products in Section 30135.5 should be removed. The tobacco products rate calculation would include any adjustment in the cigarette tax proposed by this measure. It may also be necessary to specify that any adjustment to the cigarette excise tax rate pursuant to this measure coincide with the effective date of the tobacco products tax rate adjustment. Additionally, it may be necessary for an equalizing floor stock tax, dependent on the CPI increase, and it may need to be done annually, or at another specified period of time. The author may also want to consider changing the “trigger” for the adjustment, for example, changing the cigarette tax rate when the annual CPI increase is 5% or more, or when the CPI increase is below 5% to make the cigarette tax rate change effective when the cumulative annual CPI increase is 5% or more. The DIR website indicated that the California CPI rate increase from December 2007 to December 2008 was only .182 ( $219.775 - 219.593 = .182$ ), while the CPI rate increase from December 2006 to December 2007 was 8.539 ( $219.593 - 211 = 8.593$ ). (<http://www.dir.ca.gov/dlsr/CPI/EntireCCPI.PDF>) The Board would experience costs

<sup>3</sup> The language referring to prior and preceding year may need to be clarified.

related to a floor stock tax, but these costs could be offset by the revenues collected from a floor stock tax resulting from a substantial change in the cigarette excise tax rate. For the reasons explained previously, without a floor stock tax an expected substantial increase in the cigarette excise tax rate could result in a windfall profit for distributors, wholesalers, and dealers.

8. **Increase in state and local sales and use tax revenues.** Under current Sales and Use Tax Law, the total amount of the retail sale is subject to sales or use tax unless specifically exempted or excluded by law. Because the excise tax on cigarettes and other tobacco products is not specifically exempted or excluded, the excise tax is included in the total amount of the sale and subject to sales or use tax.

This measure would increase the excise tax on cigarettes and result in an other tobacco products tax rate increase, which may be passed on to the ultimate consumer through an increase in the retail-selling price of cigarettes and other tobacco products. Any increase in the amount of the retail-selling price of cigarettes as a result of this measure would be included in the amount on which sales or use tax is computed.

9. **Suggested amendments.** This measure should be amended to add conforming and necessary code section references to the Cigarette and Tobacco Products Tax Law in order for the Board to properly administer the additional tax in a manner consistent with the other excise taxes imposed on cigarettes and tobacco products. For example, Section 30104 and 30108, which both reference the cigarette and tobacco tax imposed by Sections 30101, 30123, and 30131.2, would need to be amended to also reference the proposed additional tax in Section 30135.3.

10. **Distributor discount.** Under existing law, Section 30166 of the Revenue and Taxation Code provides that stamps and meter impression settings shall be sold at their denominated values less 0.85 percent to licensed distributors. The discount is intended to help defray the cost (leasing of equipment/labor cost) to the distributor for affixing the stamps.

Currently, distributors receive a discount of \$221.85 [(30,000 stamps x \$0.87 tax per package of cigarettes) x 0.85 percent discount = \$221.85 discount] per roll of 30,000 cigarette tax stamps. By increasing the excise tax on a package of 20 cigarettes to \$2.37, this measure would increase the distributor's discount to \$604.35 [(30,000 stamps x \$2.37 tax per package of cigarettes) x 0.85 percent discount = \$604.35 discount] per roll of 30,000 stamps.

11. **Related legislation.** AB 89 (Torlakson) imposes an additional excise tax on cigarettes of \$2.10 per package of 20. The proceeds would fund various education, health, and research programs.

## **COST ESTIMATE**

A detailed cost estimate is pending. However, the Board would incur significant costs related to the administration and collection of the additional cigarette tax proposed by this measure. These costs would be related to notifying taxpayers, developing returns, programming computers, developing and carrying out compliance and audit efforts to ensure proper reporting, and administering a floor stock tax. Additionally, the proposed

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tax increase would require enhanced Board efforts to ensure the floor stock tax is properly reported and collected, greater compliance efforts for additional billings and delinquencies, and increased investigative staff presence due to increased tax evasion.

## REVENUE ESTIMATE

### BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

**Cigarette Tax.** Tax-paid cigarette distributions were about 1,107 million packs in fiscal year 2007-08. Since 1980 tax paid distributions have averaged a decline of about 3 percent per year. We believe this is a reasonable estimate of the underlying trend for future years, so we project a 3 percent decline for 2008-09 and future years without any federal or state law changes.

In early February H.R. 2 was signed into law by the President. This bill funds the federal Children's Health Insurance Program (CHIP) with revenues from increases in federal excise tax rates on cigarettes and tobacco products.<sup>4</sup> Under the law the federal cigarette tax rate will increase from \$0.39 per pack to \$1.01 per pack on April 1, 2009. Federal tax rates for tobacco products will also increase substantially; the increases vary greatly depending on the type of product. We assume that all of these increases in federal taxes will be passed on to cigarette and tobacco products consumers as higher prices. We reviewed a description of the federal revenue estimates for H.R. 2 as well as many other studies that analyzed consumer responses to cigarette price increases. Using economic analyses based on these studies we believe that California consumers will respond to the higher prices in fiscal year 2009-10 resulting from this federal legislation by purchasing about 8 percent fewer cigarettes than they would have if the federal tax rate had not changed. This estimate uses a price elasticity of demand of -0.60 calculated by the arc price elasticity formula, applied to an average estimated November 1, 2008 price of approximately \$4.29 per pack.<sup>5</sup>

Based on previous tax increases, many academic studies, and research of experiences in other states, we believe an increase in the tax rate as large as the one proposed by this bill is likely to cause both a decrease in actual consumption and an increase in tax evasion. Although the exact magnitude of the split between evasion and consumption is uncertain, we estimate a decrease of 15 percent in tax paid distributions. This estimate uses a price elasticity of demand of -0.60 calculated by the arc price elasticity formula, applied to an average estimated April 1, 2009 price of approximately \$4.91 per pack.

There is a corresponding floor stock tax imposed on inventories on January 1, 2010, our projected implementation date. We assume a three weeks supply of cigarettes would be subject to the floor stock tax, based on a combination of expected sales rates before and after the tax takes effect.

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<sup>4</sup> As used here, the term "tobacco products" refers to all tobacco products except cigarettes. Examples of such products include chewing tobacco, snuff, cigars, pipe tobacco, and roll-your-own cigarette tobacco.

<sup>5</sup> The general price elasticity of demand formula is:  $e_p = (Q_1 - Q_2) / ((Q_1 + Q_2) / 2) / (P_1 - P_2) / ((P_1 + P_2) / 2)$ , where P = price, and Q = sales.

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*Tobacco Products Tax.* Pursuant to Proposition 99, this measure would result in an additional tax on tobacco products at a rate equivalent to the new \$2.10 per pack that this measure would impose on cigarettes. The Board of Equalization sets the tobacco tax rate prior to the start of each fiscal year using wholesale cost data available as of March 1. In recent years the Board has set the rate in April or May, and we assume that the fiscal year 2009-10 rate would be set by the Board in April or May of 2009.

The tobacco products tax is based on the wholesale costs of these products at a tax rate that is equivalent to the rate of tax imposed on cigarettes. The rate is determined by dividing the tax rate per cigarette by the average wholesale cost per cigarette. For rate setting purposes, the average cost per cigarette for the 2008-09 fiscal year was \$0.1518. The current-law tax rate on cigarettes is \$0.0685 per cigarette.<sup>6</sup> The tobacco tax rate for 2008-09 is 45.13 percent ( $\$0.0685 / \$0.1518 = 0.4513$ ).

As mentioned previously, federal legislation will increase the tax rates for cigarettes and tobacco products. The federal taxes affect tobacco products revenues in three ways. First, assuming that the federal taxes are passed on to consumers, wholesale costs of tobacco products will increase. Second, consumers will respond to these higher costs by purchasing fewer tobacco products. Third, the wholesale costs of cigarettes will increase, again under the assumption that the federal taxes are passed on to consumers. When the current-law California cigarette tax rate (which does not change) is divided by the post-April 1, 2009 wholesale costs of cigarettes (which increases by the amount of the federal tax), the result is that the calculated tobacco products tax rate declines. If we assume no other changes in wholesale costs from the figure used to calculate the fiscal year 2008-09 tobacco products tax rate, the rate would decline from 45.13 percent to 37.10 percent.

At this point in time the Board is in the process of determining a new data source for the wholesale cost of cigarettes to calculate the 2009-10 tobacco products tax rate. Since the 2009-10 rate is unknown, for revenue estimation purposes we will estimate 2010-11 tobacco revenues under this bill using the 2008-09 rate of 45.13 percent.

Under this measure, the tobacco products tax rate would rise from 45.13 percent to 94.53 percent in fiscal year 2010-11. This rate assumes no other changes in the average wholesale price of cigarettes in 2009 or 2010.

The wholesale cost (or wholesale sales) of tobacco products was about \$160 million in fiscal year 2007-08. With the federal tax increases for tobacco products passed on from manufactures to wholesalers, we estimate that wholesale costs will increase to \$168 million after taking into account expected declines in consumption and assuming no other changes in wholesale costs. We will assume wholesale costs to stay at approximately this level over the next few years under current law.

Based on previous tax increases, an increase in the tax rate as large as the one proposed by this legislation is likely to cause both a decrease in actual consumption and

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<sup>6</sup> The current tobacco products tax rate is the equivalent of \$1.37 per pack, \$0.87 per pack for Proposition 99 funds and \$0.50 per pack for Proposition 10 funds.

an increase in tax evasion of tobacco products. We estimate the percentage declines in sales of tobacco products would be similar to the percentage decline in cigarette sales.

*Backfill Provisions.* This bill requires the Board to annually determine the effects of its provisions on the consumption of cigarettes and tobacco products and determine the extent to which there has been a decrease in consumption as a direct result of the additional tax imposed. Its provisions require a transfer of funds be made to the California Children and Families First Trust Fund (Proposition 10), the Breast Cancer Fund and certain specified accounts in the Cigarette and Tobacco Products Surtax Fund (Proposition 99). The specific accounts of the Cigarette and Tobacco Products Surtax Fund to be “backfilled” include the Hospital Services Account, the Physician Services Account, and the Unallocated Account. These accounts comprise 70 percent of the Cigarette and Tobacco Products Surtax Fund.

*Sales and Use Tax Impacts.* We expect that all of the cigarette and tobacco products tax increases are passed on to consumers. For both cigarettes and tobacco products we added sales taxes on the excise tax increases and subtracted sales taxes resulting from projected declines in sales to determine net sales tax gains. Sales taxes are calculated assuming average estimated April 1, 2009 retail prices. The state and local sales and use tax rates reflect the temporary 1 percent increase in the state rate as specified in ABX3 3 (Ch. 18) which took effect on April 1, 2009.

#### REVENUE SUMMARY

The revenue impacts of this bill are shown in the table on the next page. Under our assumption of when the bill is signed, the first complete year that all the provisions of the proposal are in effect will be fiscal year 2010-11. For fiscal year 2010-11 cigarette excise tax revenues increase by a total of \$1,179.3 million from the new tax rate. Of these new revenues, 85 percent are to be deposited in the General Fund, and 15 percent are to be deposited in the Tobacco Tax and Health Protection Fund, as shown in the table. In fiscal year 2010-11 these amounts are \$1,002.4 million for the General Fund and \$176.9 million for the Tobacco Tax and Health Protection Fund.

The impacts on tobacco products tax revenues and sales tax revenues are also shown in the bottom part of the table. Proposition 99 tobacco products revenues increase by \$61.9 million, while Proposition 10 tobacco revenues decrease by \$4.4 million because of reduced sales of tobacco products, resulting in a net increase of \$57.5 million for all tobacco products revenues. State and local sales and use tax revenues from both the increase in cigarette and tobacco products tax rates rise by a combined \$50.1 million.

<b>Revenue Impacts Summary</b>	<b>Fiscal Year 2009-10 (\$ Millions)</b>	<b>Fiscal Year 2010-11 (\$ Millions)</b>
Cigarette Excise Tax Revenue Impacts by Fund		
Impacts on Existing Funds:		
Breast Cancer	-1.4	-2.7
Proposition 99	-17.7	-34.3
Proposition 10	-35.4	-68.7
<b>New Revenues:</b>	<b>602.8</b>	<b>1,179.3</b>
General Fund (85 Percent)	512.4	1,002.4
Tobacco Tax and Health Protection Fund (15 Percent)	90.4	176.9
<b>Floor Stocks Tax</b>	<b>71.0</b>	<b>0.0</b>
Total Cigarette Excise Tax Revenues	619.3	1,073.5
Tobacco Tax Revenue Increase	0.0	57.5
Total Net Excise Tax Increase (Cigarettes Plus Tobacco Taxes)	619.3	1,131.0
State Sales and Use Tax (at 6.25%)	16.7	34.9
General Fund (6.00%)	16.0	33.5
Fiscal Recovery Fund (0.25%)	0.7	1.4
Local Sales & Use Tax (at 2.0%)	5.3	11.2
Transit Tax (at 0.71%)	1.9	4.0
Total	643.2	1,181.1
Total (Excluding Floor Stock Revenues)	572.3	1,181.1

<b>Associated Revenue Impacts on Other Tobacco Tax Revenues</b> <i>(Change from revenues under current law, millions of dollars)</i>	
Proposition 99	61.9
Proposition 10	-4.4
Total Impact	57.5

As a result of this increase in the tax, existing cigarette excise funds will lose a combined total of \$105.7 million because fewer packs would be sold. A large portion of this revenue will be backfilled by transfers of funds from the Tobacco Tax and Health Protection Fund. The backfill amounts for fiscal year 2010-11 (to be made in fiscal year 2011-12) include \$2.7 million for the Breast Cancer Fund, \$68.7 million for the California Children and Families First Trust Fund (Proposition 10), and \$24.0 million for the specified accounts in the Cigarette and Tobacco Products Surtax Fund (70 percent of the \$34.3 million shown in the table under "Proposition 99").

The total backfill for all these funds and accounts will reduce the \$1,179.3 million of new cigarette excise tax revenue by \$95.4 million, leaving net new revenues in of \$1,083.9 million. The \$95.4 million all comes out of the \$176.9 million in the Tobacco Tax and Health Protection Fund. Therefore, the backfill provisions reduce revenues in the Tobacco Tax and Health Protection Fund by more than more than half.

We expect tax-paid cigarette distributions to decline in fiscal year 2011-12 and future years because we assume that tax paid distributions will continue to decrease at the long-term average of 3 percent per year. However, this bill increases the tax rate based on the California consumer price index (CPI). Over the past ten years the California

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CPI has increased an average of about 3 percent per year. Therefore, we expect revenues to stay at approximately the same level for many years.

Analysis prepared by:	John Cortez	445-6662	04/03/09
Revenue estimate by:	Joe Fitz	323-3802	
Contact:	Margaret S. Shedd	322-2376	
Is			0600-1jc.doc

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