STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended	**Enrolled**	Bill No:	**AB 71**
Tax:	**Cigarette and Tobacco Products**	Author:	**J. Horton**
Board Position:		Related Bills:	**AB 1276 (J. Horton)**

BILL SUMMARY

This bill would:

- Establish a statewide licensure program to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products to be administered by the State Board of Equalization (Board); *(BPC §§22970; RTC §30019)*
- Require the Board to take action, as specified, against a retailer convicted of a violation of either the Stop Tobacco Access to Kids Enforcement (STAKE) Act (Division 8.5 (commencing with Section 22950) of the Business and Professions Code) or Section 308 of the Penal Code; *(BPC §22974.8)*
- Require the Board to determine the debt status, as specified, of a suspended retailer licensee 25 days prior to the reinstatement of the license; *(BPC §22980.1 and 22980.3)*
- Authorize the Board's Investigative Division staff to receive engraved pictures or photographs from the Department of Motor Vehicles (DMV); *(GC §15618.5)*
- Authorize the Board's Investigations Division staff, whose primary duty is the enforcement of laws administered by the Board, to exercise the powers of arrest of a peace officer and the power to serve warrants, as specified; *(PC §830.11)*
- Among other things, this bill would prohibit any cigarette tax stamp or meter impression to be affixed to a package of cigarettes, or tax be paid on a tobacco product defined as a cigarette, unless the tobacco manufacturer and brand family is included on the Master Settlement Agreement compliance list posted by the Attorney General, as specified; *(RTC §§30165.1, 30177.5, 30435, 30436, 30449, and 30471; H&SC §104557)*
- Require the Board to submit a report to the Legislature that, among other things, evaluates the average actual costs for applying cigarette tax indicia or impressions, bonding, warehousing, and leasing stamping equipment; *(RTC §30166.1)*
- Require the tax, interest and penalties to become immediately due and payable on all unlicensed cigarette and tobacco products distributors, and to facilitate the seizure and sale of assets to satisfy liens, as specified; *(RTC §§30210 and 30355)*

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- Increase penalties for the possession of fraudulent tax stamps or meter impressions with intent to evade the taxes; *(RTC §30473.5)*
- Clarify that penalties relating to the possession of unstamped cigarettes do not apply to licensed distributors; *(RTC §30474)*
- Revamp the penalty for any person who possesses, sells, or offers to sell, or buys or offers to buy, any false or fraudulent stamps or meter impressions; *(RTC §30474.1)*
- Extend the time in which the prosecution for violating the penal provisions may be instituted; *(RTC §30481)* and
- Allow for the recoupment of costs incurred in criminal investigations. *(RTC §30482)*

ANALYSIS

Licensure Program

Business and Professions Code Division 8.6 (commencing with Section 22970)
Revenue and Taxation Code Section 30019

Current Law

Section 30140 of the Cigarette and Tobacco Products Tax Law generally provides that every person desiring to engage in the sale of cigarettes or tobacco products as a distributor shall file with the Board an application, in such a form as the Board may prescribe, for a distributor's license. A distributor shall apply and obtain a license for each place of business at which he or she engages in the business of distributing cigarettes or tobacco products.

Section 30155 of the Cigarette and Tobacco Products Tax Law requires that every person desiring to engage in the sale of cigarettes or tobacco products as a wholesaler shall file with the Board an application, in that form as the Board may prescribe, for a wholesaler's license. A wholesaler shall apply for and obtain a license for each place of business at which he or she engages in the business of selling cigarettes or tobacco products as a wholesaler.

Currently, the Cigarette and Tobacco Products Tax Law does not require manufacturers and retailers of cigarettes and tobacco products to be licensed with the Board.

Proposed Law

This bill would add Division 8.6 (commencing with Section 22970) to the Business and Professions Code as the Cigarette and Tobacco Products Licensing Act of 2003. Among its principal provisions, this bill would require the Board to administer a statewide cigarette and tobacco products license program to regulate the sale of cigarettes and tobacco products in the state.

RETAILERS

Commencing June 30, 2004, a retailer who sells cigarette and tobacco products in this state would be required to have in place a license to engage in the sale of cigarettes and tobacco products and conspicuously display the license at each retail location in a manner visible to the public. A retailer that owns or controls more than one retail

location where cigarette and tobacco products are sold would be required to obtain a separate license for each retail location. A "retail location" would be defined to mean any building, including a residence, from which cigarettes or tobacco products are sold at retail or a vending machine.

A license would not be assignable or transferable. A person who obtains a license as a retailer who ceases to do business as specified in the license, or who never commenced business, or whose license is suspended or revoked, would be required to immediately surrender the license to the Board.

A retailer of cigarette or tobacco products would be required to file an application to obtain a license on or before April 15, 2004. The Board would be authorized to investigate the truthfulness and completeness of the information provided in the application. The Board would be authorized to issue a license to an applicant for a retail location if that applicant holds a valid license from the Department of Alcoholic Beverage Control (ABC) for that same location. A license would be valid for a 12-month period, and would be renewed annually.

This bill would require each retailer to submit a one-time license fee of one hundred dollars ($100) with each application. An applicant which owns or controls more than one location where cigarette or tobacco products are sold would be required to obtain a separate license for each location, but may submit a single application for those licenses with a license fee of one hundred dollars ($100) per location. However, the one-time license fee would not apply to an application for renewal of a license for a retail location for which the one-time license fee has already been paid.

The Board would be required to issue a license to a retailer upon receipt of a completed application and payment of the fees, unless otherwise specified. Any person or retailer convicted of a felony under the Cigarette and Tobacco Products Tax Law would not be issued a license, or if that person holds a license, that license would be revoked. Any retailer who is denied a license may petition for a redetermination of the Board's denial within 30 days after service upon that retailer of the notice of the denial.

A retailer would be required to retain purchase invoices, as specified, for all cigarette and tobacco products for a period of four years. A retailer would be 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

This bill would also require, commencing June 30, 2004, every distributor and every wholesaler to annually obtain and maintain a license to engage in the sale of cigarettes or tobacco products. The license would be valid for a calendar year period upon payment of the fee, unless surrendered, suspended, or revoked prior to the end of the calendar year, and could be renewed each year upon payment of such fee. A license would not be assignable or transferable. A person who obtains a license as a distributor or wholesaler who ceases to do business as specified in the license, or who never commenced business, or whose license is suspended or revoked, would be required to immediately surrender the license to the Board.

A distributor or wholesaler of cigarette or tobacco products would be required to file an application to obtain a license on or before April 15, 2004, unless otherwise specified. Each application would have to be accompanied by a fee of one thousand dollars

($1,000) for each location. The fee would be for a calendar year and would not be prorated.

For calendar years beginning on and after January 1, 2005, every distributor and every wholesaler would be required to file an application for renewal of the license, accompanied with a fee of one thousand dollars ($1,000) for each location where cigarettes and tobacco products are sold.

The Board would be required to issue a license to a distributor or wholesaler upon receipt of a completed application and payment of the fees, unless otherwise specified. The Board may issue a license without further investigation if a distributor or wholesaler, at the time of application, holds a valid license by the Board issued pursuant to the Cigarette and Tobacco Products Tax Law. Any person or licensee convicted of a felony under the Cigarette and Tobacco Products Tax Law would not be issued a license, or if that person holds a license, that license would be revoked. Any distributor or wholesaler who is denied a license may petition for a redetermination of the Board's denial within 30 days after service upon that distributor or wholesaler of the notice of the denial.

All distributors and all wholesalers would be required to retain purchase records, as specified, for all cigarette and tobacco products purchased. The records would be required 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 would have to be made available for inspection by the Board or a law enforcement agency for a period of four years.

MANUFACTURERS AND IMPORTERS

Commencing January 1, 2004, every manufacturer and every importer would be required to obtain and maintain a license to engage in the sale of cigarettes. In order to be eligible for obtaining and maintaining a license, a manufacturer or importer would be required to do all of the following:

- Submit to the Board a list of all brand families that they manufacture or import.
- Update the list of all brand families 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.

In order to be eligible to obtain and maintain a license, 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), would be required to do all of the following in the manner specified by the Board:

- Certify to the Board that it is a "participating manufacturer" as defined in subsection II(jj) of the "Master Settlement Agreement" (MSA), or is in full compliance with paragraph (2) of subdivision (a) of Section 104557 of the Health and Safety Code.

- Submit to the Board a list of all brand families that fit under the category applicable to the manufacturer or importer, as specified.

A license would not be granted, or be permitted to be maintained, by any manufacturer or importer of cigarettes that does not affirmatively certify, both at the time the license is granted and annually thereafter, that all packages of cigarettes manufactured or imported by that person and distributed in this state fully comply with subdivision (b) of Section 30163 of the Revenue and Taxation Code, and that the cigarettes contained in those packages are the subject of filed reports that fully comply with all requirements of the federal Cigarette Labeling and Advertising Act (15 U.S.C. Sec. 13355a et seq.) for the reporting of ingredients added to cigarettes.

Any manufacturer or any importer who is denied a license may petition for a redetermination of the Board's denial within 30 days after service upon that manufacturer or that importer of the notice of the denial.

Every manufacturer and every importer would be required to pay to the Board an administration fee on or before January 1, 2004. The amount of the administration fee would be one cent ($0.01) per package of cigarettes:

- Manufactured or imported by the manufacturer or the importer, and
- Shipped into this state during the 2001 calendar year as reported to the Board.

The Board would be required to notify each manufacturer and each importer of the amount due. All manufacturers and all importers that become eligible for licensure on or after December 1, 2003, would be required to pay that fee within 90 days of notification.

All manufacturers and all importers that begin operations in the state after enactment of the Cigarette and Tobacco Products Licensing Act of 2003 would be charged an administrative fee, as specified, commensurate with their respective marketshare of:

- Cigarettes manufactured or imported by the manufacturer, and
- Sold in this state during the next calendar year as estimated by the Board.

The Board would administer this fee in accordance with the Fee Collection Procedures Law, Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code.

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

Each manufacturer and each importer of cigarette and tobacco products subject to licensing would also be 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, and

would be required to make these records available upon request by a representative of the Board or a law enforcement agency.

ADDITIONAL BOARD RESPONSIBILITIES

The Board would be required to, upon request, provide to the State Department of Health Services, the office of the Attorney General, a law enforcement agency, and any agency authorized to enforce local tobacco control ordinances, access to the Board's database of licenses issued for locations within the jurisdiction of that agency or law enforcement agency. The agencies authorized to access the Board's database would be authorized to only access and use the database for purposes of enforcing tobacco control laws and would be required to adhere to all state laws, policies, and regulations pertaining to the protection of personal information and individual privacy.

In addition, the Board would be required to provide electronic means for applicants to download and submit applications and to notify all licensed distributors, wholesalers, manufacturers, and importers by fax and e-mail within 48 hours upon suspending or revoking the license of a retailer.

PENALTIES

This bill would create a misdemeanor subjecting violators to, among other things, a fine of not to exceed five thousand dollars ($5,000), or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment for any of the following:

- Possession, storing, owning, or has made sales of an unstamped package of cigarettes bearing a counterfeit California tax stamp.
- Possession, storing, owning, or has made sales of tobacco products on which tax is due but has not been paid.
- Sales of cigarettes to any distributor, wholesaler, importer, retailer, or any other person who is not licensed or whose license has been suspended or revoked.
- Sales of tobacco products to any retailer, wholesaler, distributor, or any other person who is not licensed or whose license has been suspended or revoked.
- Purchases of cigarette and/or tobacco products from a manufacturer or any other person not required to be 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, and each officer of any corporation which so engages in business. Each day after notification by a law enforcement agency that a manufacturer, wholesaler, distributor, importer, retailer, or any other person required to be licensed offers cigarettes and tobacco products for sale or exchange without a valid license for the location from which they are offered for sale would constitute a separate violation.
- Failure to allow an inspection.

Any cigarettes or tobacco products forfeited to the state pursuant to the Cigarette and Tobacco Products Licensing Act of 2003 would be destroyed.

This bill also provides that any person who signs a statement that asserts the truth of any material matter that he or she knows to be false would be guilty of a misdemeanor punishable by imprisonment of up to one year in the county jail, or a fine of not more than one thousand dollars ($1,000), or both the imprisonment and the fine.

SUSPENSIONS AND REVOCATIONS

The Board would be authorized to revoke or suspend the license or licenses of a retailer, wholesaler, distributor, importer or manufacturer, as specified, upon a finding that the licensee has violated any provision of the California Cigarette and Tobacco Products Licensing Act of 2003.

The Board would be required to revoke a license for a second violation within five years involving seizure of unstamped packages of cigarettes. The Board would also be required to revoke the license of any licensee convicted of a felony pursuant to the Cigarette and Tobacco Products Tax Law, or had any permit or license revoked under any provision of the Revenue and Taxation Code.

MISCELLANEOUS

All moneys collected pursuant to the provisions of this bill would be deposited in the Cigarette and Tobacco Products Compliance Fund (Fund), which this bill creates in the State Treasury. All moneys in the Fund would be available for expenditure, upon appropriation by the Legislature, solely for the purpose of implementing, enforcing, and administering the California Cigarette and Tobacco Products Licensing Act of 2003.

An amount of eleven million dollars ($11,000,000) would be appropriated from the Cigarette and Tobacco Products Compliance Fund during the 2003-04 fiscal year to the Board for the purpose of implementing, enforcing, and administering the California Cigarette and Tobacco Products Licensing Act of 2003, subject to the following provisions:

- Spending under the appropriation made by this subdivision would be limited solely to revenues in the fund that are derived from fees imposed on cigarette and tobacco product manufacturers, wholesalers, distributors, importers, and retailers.
- Of the total amount appropriated, five million four hundred thousand dollars ($5,400,000) would be available for reimbursement to the Department of Justice through an interagency agreement with the Board for investigation and enforcement assistance.
- The expenditure of any funds from the appropriation would require the prior approval of the Director of Finance. The amounts appropriated would be approved for expenditure on an allotment basis and limited to the amounts necessary to carry out the operating and staffing plans for the implementation of the California Cigarette and Tobacco Products Licensing Act of 2003 as approved by the Department of Finance. The Department of Finance would be required to notify the Joint Legislative Budget Committee of its approval of any expenditure authorization within 30 days prior to that approval.

The Cigarette and Tobacco Products Licensing Act of 2003 would remain in effect until January 1, 2010, and as of that date is repealed.

In General

During the 2001-02 Legislative Session, three measures would have established a statewide licensure program to be administered by the Board. Those bills include SB 1700 (Peace), AB 1666 (Horton), and SB 1843 (Committee on Budget and Fiscal Review). Senate Bill 1700 died in the Assembly Committee on Governmental Organization, Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments, and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. These provisions of the bill are intended to provide comprehensive regulation of cigarette and tobacco product sales.
2. **Key amendments.** The **September 8, 2003**, amendments deleted the provision that would have declared that the bill take effect immediately as an urgency statute.

   The **September 4, 2003**, amendments provided that a retailer license is valid for a 12-month period and must be renewed annually, clarify the retailer license fee is a one-time fee and does not apply to an application for renewal, clarify that a distributor and wholesaler license must be renewed each calendar year and must be accompanied with a $1,000 fee for each location, revise the date by which manufacturers and importers are to obtain a license and pay the administration fee, and make technical corrections.

   The September 4, 2003, amendments also added a definitive sunset date of January 1, 2010 and require the Department of Finance to notify the Joint Legislative Budget Committee of its approval of any expenditure authorization 30 days prior to that approval.

   The **July 24, 2003, amendments** revised the date by which retailers, wholesalers, distributors, manufacturers and importers must have a license in place, appropriate $11 million to the Board for the purposes of implementing, enforcing, and administering the licensing act subject to specified provisions, and made other technical corrections. In addition, the amendments repeal the licensing program, unlicensed persons and seizure and sale, inspection, and limited peace officer status provisions if the net tax revenues generated as a result of the enactment of the licensing act is less than $10 million during the 2005-06 fiscal year.

   The **July 14, 2003,** amendments deleted all references requiring statements to be signed under penalty of perjury. Instead, the amendments provide that any person who signs a statement that asserts the truth of any material matter that he or she knows to be false is guilty of a misdemeanor punishable by imprisonment of up to one year in the county jail, or a fine of not more than one thousand dollars ($1,000), or both the imprisonment and the fine.

The June 19, 2003, amendments closed the loophole that would allow unlicensed "mobile vendors" to purchase and sell cigarettes and tobacco products, and make other technical corrections. In addition, the amendments require that any cigarettes or tobacco products forfeited to the state pursuant to the Cigarette and Tobacco Products Licensing Act of 2003, or any cigarettes forfeited to the state that are not contained in packages to which are affixed a tax stamp, shall be destroyed.

The **May 19, 2003**, amendments 1) revised the definition of "retail location," 2) revised the date by which a retailer must have a license in place from July 1 to February 1, 2004, 3) authorized a law enforcement agency to destroy seized unstamped packages of cigarettes, 4) revised the provisions related to outstanding debts owed to a distributor or wholesaler, 5) deleted language that would have transferred revenues, as specified, from the General Fund to the Cigarette and Tobacco Products Compliance Fund, and 6) deleted the $11 million appropriation to the Board from the Cigarette and Tobacco Products Compliance Fund during the 2003-04 fiscal year.

The **April 10, 2003**, amendments that would affect the Board are technical in nature.

3. **This measure would require the Board to administer a new cigarette and tobacco products licensure program.** The Board currently licenses distributor and wholesalers of cigarette and tobacco products for purposes of collecting, and ensuring the collection of, the excise tax pursuant to the Cigarette and Tobacco Products Tax Law. As such, this bill would require a distributor and wholesaler to hold an additional license with the Board for the distribution and sale of cigarette and tobacco products in this state pursuant to the provisions of this bill. The Board would also license manufacturers and importers engaged in the sale of cigarettes, as well as retailers engaged in the sale of cigarettes and tobacco products. The Board would also be required to enforce the licensure program through actions such as license suspension and revocation, verifying the licensure of persons selling or distributing cigarettes and tobacco products in this state, and verifying that licensees are selling or distributing such products to licensed persons.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a new licensure program. These costs would include enforcement, licensing manufacturers, distributors, wholesalers and retailers of cigarette and tobacco products, developing computer programs, processing license fee payments, conducting audits, investigating the criminal provisions/violations, developing regulations, training staff, and answering inquiries from the public. These costs are estimated to be $5,600,000 for fiscal year 2003-04, $7,429,000 for fiscal year 2004-05, and $7,371,000 for fiscal year 2005-06, and each fiscal year thereafter.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

One-Time Retailer Application Fees

Fiscal Year 2003-04. While estimates vary, we believe cigarettes and tobacco products are sold by retailers in approximately 85,000 locations (including licensees with multiple locations). At $100 per location, total one-time retailer license application fees would be approximately $8.5 million (85,000 x $100 = $8,500,000) in fiscal year 2003-04.

Fiscal Year 2004-05 and Future Years. Changes in ownership and the addition of new accounts would imply some ongoing revenues from these fees in future fiscal years. According to the Board Sales and Use Department staff, the turnover rate for all sales and use tax accounts is approximately 20 percent per year. We do not have readily available data specific to cigarette and tobacco retailers, so we will assume that the turnover rate for retailers selling cigarettes or tobacco products is also 20 percent per year. At this rate, and assuming no net growth in accounts, turnover would imply annual ongoing revenues of approximately $1.7 million per year (85,000 x 0.20 x 100 = $1,700,000).

Annual Wholesaler, Distributor and Importer License Fees

There are approximately 1,000 cigarette and tobacco distributor and wholesaler locations in California. At $1,000 each, license fees would total $1.0 million per year.

Per Pack Fee Increases

Under AB 71, manufacturers and importers would be required to pay fees based on calendar year 2001 shipments. Board data show that tax-paid cigarette distributions were 1,257 million packs in calendar year 2001. At a fee of $0.01 per pack, revenues are estimated to be $12.6 million. Based on our interpretation of the language of the bill, this is a one-time payment.

Sales and Use Tax Impacts

We believe the impacts of the AB 71 on sales and use taxes would be minimal. The application fee and the per-pack fee are one-time in nature, and not likely to be passed on to consumers directly. The ongoing annual components of these fees are relatively small: $1.0 million from wholesalers and distributors paying annual fees of $1,000, and $1.7 million from turnover from new retailers or new owners paying their $100 license application fees. The combined value of these ongoing components is approximately $2.7 million. We think it is unlikely that these revenues would be passed on to consumers directly in higher prices. Even if they were, at a statewide average sales and use tax rate of 7.92 percent, revenues would be relatively small, $0.2 million (0.0792 x 2.7 = 0.214).

Revenue Summary

The multiple provisions affecting revenues of AB 71, as the bill is currently written, would result in the revenue impacts shown in the table below. Fees going to the Cigarette and Tobacco Products Compliance Fund would be $22.1 million in fiscal year 2003-04. In 2004-05, fees paid would decline sharply to $2.7 million since retailer license application fees and the one cent per pack fees paid by manufacturers and importers are one-time fees. The decline in fees from fiscal year 2003-04 to fiscal year 2004-05 would be $19.4 million.

	2003-04	2004-05
License Application Fee (Retailers, $100)	$ 8.5 million	$ 1.7 million
License Fee (Wholesalers and Distributors, $1000)	$ 1.0 million	$ 1.0 million
Per Pack Fee (One Cent Per Pack)	$12.6 million	$ 0
Total	$22.1 million	$ 2.7 million

Qualifying Remarks

We assume current-law taxes of $0.87 per pack are in place; we do not presume higher cigarette taxes.

As a result of this proposal, cigarette tax evasion should decline, depending on the extent to which this bill fosters improved compliance by retailers. The Board's current cigarette excise tax evasion estimate for retailers is $238 million, associated with 274 million packs of cigarettes. (See letter from Joe Fitz, Board Chief Economist, to Mr. Alva Johnson, Chief Consultant, Assembly Governmental Organization Committee, February 27, 2003 for documentation of the methodology used to derive this estimate.) With the compliance improvement measures of the bill, Board staff believes it would be reasonable to expect this proposal to result in a 20 percent decrease in evasion figures. This assumption is based on reviewing information and analyses for the state of New York (the only state we are aware of that licensed retailers since the early 1990s), and making some assumptions to apply the New York experience to California.[1] With a 20 percent decrease in cigarette tax evasion, we could expect improved compliance resulting in revenues of $48 million (238 x 0.20 = 48).

In addition to cigarette tax evasion, Board staff has recently estimated evasion for tobacco products. According to data from the Board Investigations Division, tobacco investigation cases average about $10 million per year in tobacco tax revenues. Based on data from these cases, Board staff believes that tobacco products excise tax evasion is equal to annual tobacco products revenues of approximately $50 million per year. Board staff believes that it would be reasonable to assume that the compliance improvement provisions of AB 71 would, like those for cigarettes, improve compliance by at least 20 percent. Therefore, excise tax revenues from compliance improvements for tobacco products would add about $10 million (50 x .20 = 10) to the $48 million

[1] The sources we examined include various documents from the New York State Department of Taxation and Finance. We also reviewed an estimate of cigarette tax evasion, *New Cigarette Tax Revenue Sources for New York State,* Prepared for the FACT Alliance for the Fair Application of Cigarette Taxes, by Ridgewood Economic Associates, Ltd. The study was released January 14, 2003. For a description of the methodology we used to apply this information to our analyses, please contact Joe Fitz, Chief Economist, Board of Equalization, at (916) 323-3802.

estimated for cigarettes. Total excise tax revenues from compliance improvements for both cigarettes and tobacco products would thus be approximately $58 million.

For a variety of reasons, Board staff believes that assuming compliance improvement of 20 percent of evasion revenues from AB 71 is a very conservative estimate. As mentioned, this 20 percent estimate is based on data for New York. Unlike California, New York has Native American tribes that sell large volumes of untaxed cigarettes to residents. Relative proximity to states such as Virginia with low cigarette taxes and large portions of state population living near borders of other states are other demographic characteristics unique to New York, but not to California. Licensing retailers would have little impact on much of the cigarette evasion associated with Native American tribes and low-tax states nearby. In addition, New York has had a much more active enforcement presence than California even before it began licensing retailers. Current data indicate that New York has three times more investigations staff than California, even though New York has only about half of the population of California. The benefits of licensing in New York probably would have been greater if they had an enforcement staff the relative size of California's prior to licensing. For these reasons, Board staff believes that compliance improvements can easily range as high as 30 percent rather than 20 percent. If we assume compliance improvement revenues are 30 percent of cigarette and tobacco products evasion, AB 71 would increase revenues by $87 million instead of $58 million ((30/20) x 58 = 87).

In summary, we believe that compliance improvement excise tax revenues of passing AB 71 could reduce cigarette and tobacco products evasion by $58 to $87 million. These figures assume full-year impacts. Because of the time lags involved in training, staffing, and compliance, the partial year impacts for 2003-04 are likely to be about half of the full-year impacts*.

Board staff is uncertain as to whether significant amounts of additional sales taxes would be collected on the $58 to $87 million of compliance improvement excise tax revenues. The amount that could potentially be collected depends to a large extent on retailer margins for untaxed cigarettes and tobacco products and volumes of sales from unregistered retailers. Both retailer margins for untaxed cigarettes and tobacco products and volumes of sales from unregistered retailers are unknown. If registered retailers charge too low of a price for untaxed product, they risk discovery by Board staff. We believe that retail prices for untaxed cigarettes and tobacco products are not much lower than they are for legal products, and consequently, little additional sales tax would be remitted by registered retailers as a result of AB 71 provisions.

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ANALYSIS

Sales to Minors
Business and Professions Code Section 22974.8

Current Law

STAKE ACT

The STAKE Act (Division 8.5 (commencing with Section 22950)) of the Business and Professions Code established a statewide enforcement program to take action against businesses that illegally sell tobacco to minors. In general, the Act requires the Department of Health Services (DHS) to:

- Implement an enforcement program to reduce the illegal sale of tobacco products to minors and to conduct sting operations using 15 and 16 year old minors granted immunity;
- Operate a toll-free number for the public to report illegal tobacco sales to minors;
- Assure that tobacco retailers post warning signs which include the toll-free number to report violations;
- Assure clerks check the identification of youthful-appearing persons prior to a sale;
- Assess civil penalties ranging from $200 to $6,000 against the store owner for violations; and
- Comply with the Synar Amendment (Section 1926 of Title XIX of the federal Public Health Service Act) and prepare an annual report regarding enforcement activities and their effectiveness for the federal government, Legislature, and Governor.

Furthermore, the STAKE Act:

- Requires all persons engaging in the retail sale of tobacco products to check the identification of tobacco purchasers if the purchaser reasonably appears to be under 18 years of age.
- Prohibits any person, firm, or corporation from selling, giving, or in any way furnishing to another person who is under the age of 18 years any tobacco, cigarette, or cigarette papers, or any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or any controlled substance.
- Prohibits the selling, offering for sale, or distributing tobacco products from a cigarette or tobacco products vending machine unless such vending machines or appliances are located at least 15 feet away from the entrance of a premise issued an on-sale public premise license, as defined.
- Prohibits advertising of any tobacco product on any outdoor billboard, as specified.
- Prohibits the distributing or selling of tobacco products directly or indirectly to any person under the age of 18 years through the United State Postal Service or through any other public or private postal or package delivery service, as described.

Penal Code Section 308

Penal Code Section 308 prohibits every person, firm, or corporation which knowingly or under circumstances in which it has knowledge, or should otherwise have grounds for knowledge, from selling, giving, or in any way furnishing to another person who is under the age of 18 years:

- Any tobacco, cigarette, or cigarette papers, or
- Any other preparation of tobacco, or
- Any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or
- Any controlled substance.

Any person failing to comply is subject to criminal action for a misdemeanor or to a civil action brought by a city attorney, a county counsel, or a district attorney, punishable by a fine of two hundred dollars ($200) for the first offense, five hundred dollars ($500) for the second offense, and one thousand dollars ($1,000) for the third offense.

Section 308 also requires every person, firm, or corporation which sells, or deals in tobacco or any preparation thereof, to post conspicuously and keep posted at each point of purchase a notice that states, in part, selling tobacco products to anyone under 18 years of age is illegal. Any person failing to do so is punished, upon conviction, by a fine of ten dollars ($10) for the first offense and fifty dollars ($50) for each succeeding violation, or by imprisonment for not more than 30 days.

Proposed Law

This provision would require the Board to take action against a retailer convicted of a violation of either the STAKE Act or Section 308 of the Penal Code, according to the following schedule:

- Upon the first conviction of a violation, the retailer would receive a warning letter from the Board that delineates the circumstances under which a retailer's license may by suspended or revoked and the amount of time the license may be suspended or revoked. The retailer and its employees would be required to receive training on tobacco control laws from the Department of Health Services upon a first conviction.
- Upon the second conviction of a violation within 12 months, the retailer would be subject to a fine of five hundred dollars ($500).
- Upon the third conviction of a violation within 12 months, the retailer would be subject to a fine of one thousand dollars ($1,000).
- Upon the fourth to the seventh conviction of a violation within 12 months, the Board would be required to suspend the retailer's license to sell cigarette and tobacco products for 90 days.
- Upon the eighth conviction of a violation within 24 months, the Board would be required to revoke the retailer's license to sell cigarette and tobacco products.

Convictions of violations by a retailer at one retail location would not be accumulated against other locations of that same retailer. Furthermore, convictions of violations accumulated against a prior retail owner at a licensed location would not be accumulated against a new retail owner at the same retail location.

This provision would become operative on the date results from the Youth Tobacco Survey are released if the survey finds that 13 percent or more of youth were able to purchase cigarettes. The Board's authority to take action under this provision would become inoperative on or after the date of the subsequent release of the results from the survey showing that less than 13 percent of youth were able to purchase cigarettes.

Background

In 1992, Congress passed Section 1926 of Title XIX of the federal Public Health Service Act, commonly called the "Synar Amendment." The Synar Amendment requires each state to:

- Have in effect a law prohibiting any manufacturer, retailer or distributor of tobacco products from selling or distributing such products to any individual under the age of 18.
- Enforce such laws in a manner that can reasonably be expected to reduce the extent to which tobacco products are available to individuals under the age of 18.
- Conduct annual random, unannounced inspections to ensure compliance with the law. These inspections are to be conducted in such a way as to provide a valid sample of outlets accessible to youth.
- Develop a strategy and timeframe for achieving an inspection failure rate of less than 20% of outlets accessible to youth.

Failure to meet the terms and conditions of the Synar Amendment could result in reductions (up to 40 percent) in the amount of Substance Abuse Prevention and Treatment (SAPT) block grant funds allocated to California for alcohol and other drug prevention and treatment programs.

To comply with the Synar Amendment, the Legislature passed Senate Bill 1927 (Stats. 1994, Ch. 1009) which established the Stop Tobacco Access to Kids Enforcement (STAKE) Act. The STAKE Act created a new statewide enforcement program to take regulating action against businesses that illegally sell tobacco products to minors. Authority for enforcement and responsibility for implementation of the program was delegated to the DHS, Food and Drug Branch.

COMMENTS

1. **Purpose.** This provision is intended to link violations of underage sales prohibitions to a retailer's license to engage in the sale of cigarettes or tobacco products.
2. **Summary of amendments.** The **August 25, 2003**, amendments incorporated the provision that would require the Board take action against a retailer convicted of a violation of either the STAKE Act or Section 308 of the Penal Code, as provided.
3. **STAKE Act and Penal Code Section 308 violations.** This provision would impose specified actions against a retailer based on the number of convictions of a violation

of either the STAKE Act or Penal Code Section 308. However, it is not clear whether violation convictions would accumulate while this provision is inoperative. For example, ABC retailer is convicted of four violations during the period of December 2003 and July 2004. A Youth Tobacco Survey is released in August 2004 that shows that 16 percent of youth were able to purchase cigarettes. As such, this provision would become operative on the date of the release of the results of the survey. Would ABC retailer's license be immediately suspended based on violation convictions that accumulated while the provision was inoperative? Or would only violation convictions that occur while this provision is operative determine the action the Board is required to take?

4. **What retailers does this provision affect?** This provision would become operative or inoperative based on the results of the Youth Tobacco Survey, which measures the percentage of youth that were able to purchase cigarettes. A sale of cigarettes to a minor constitutes violation of the STAKE Act and/or Penal Code 308, however such violation may not be against a retailer.

   Typically, retailers hire clerks to make sales of products, such as in retail grocery stores. In such a case, it would be the clerk subject to the violation conviction, not the retailer, for making a sale of cigarettes to a minor. Violation convictions against a clerk would not be considered "a retailer" convicted of either the STAKE Act or Penal Code Section 308 for purposes of Board authorized actions pursuant to proposed Section 22974.8.

5. **How would the Board be notified of a conviction?** This provision does not provide how or when the Board would receive information regarding a retailer conviction of either the STAKE Act or Penal Code Section 308 violations. As such, it is suggested that this provision be amended to specify the agency responsible for notifying the Board of retailer convictions and to specify the number of days after a conviction that the agency is required to notify the Board.

COST ESTIMATE

The Board would incur some costs related to this provision for notifying affected retailers upon conviction of a violation of either the STAKE Act or Penal Code Section 308, collecting fines, and suspending or revoking retailer licenses. These costs are expected to be absorbable.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Outstanding debt to cigarette distributor

Business and Professions Code Section 22980.1 and 22980.3

Current Law

Existing law imposes an excise tax upon every distributor for his or her distributions of cigarettes. A surcharge is also imposed upon every distributor upon the distribution of tobacco products. The term "distribution" includes:

- The sale of untaxed cigarettes or tobacco products in this state
- The use or consumption of untaxed cigarettes or tobacco products in this state
- The placing in this state of untaxed cigarettes or tobacco products in a vending machine or in retail stock for the purpose of selling the cigarettes or tobacco products to consumers.

Proposed Law

As part of the proposed Cigarette and Tobacco Products Licensing Act of 2003, this bill would add Section 22980.1(f) to the Business and Professions Code to provide that no manufacturer, distributor, wholesaler, or importer sell cigarette or tobacco products to any retailer or wholesaler whose license has been suspended or revoked unless:

- All outstanding debts of that retailer or wholesaler owed to a wholesaler or distributor for cigarette or tobacco products are paid, and
- The license of that retailer or wholesaler has been reinstated by the Board.

Any payment received from a retailer or wholesaler would be credited first to the outstanding debt for cigarettes or tobacco products and must be immediately reported to the Board. The Board would be required to determine the debt status of a suspended retailer licensee 25 days prior to the reinstatement of the license.

This bill would also add Section 22980.3(d) to provide that upon completion of a suspension period, a license would be reinstated by the Board upon certification that all existing cigarette or tobacco tax debts of the retailer for the purchase of cigarette and tobacco products have been cleared, and all outstanding debts owed to a manufacturer, wholesaler, or distributor for cigarette products are paid.

In General

During the 2001-02 Legislative Session, two measures would have required the Board to determine the debt status of a suspended retailer licensee prior to the reinstatement of the license. Those bills include AB 1666 (Horton) and SB 1843 (Committee on Budget and Fiscal Review). Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to keep retailers who do not pay their cigarette and tobacco products debt from being in the business of selling such products.

2. **Summary of amendments.** The amendments to the **September 4, 2003**, version of the bill made Board suggested technical corrections.

   The amendments to the **May 19, 2003**, version of the bill made clarifying and technical corrections to the outstanding cigarette and tobacco products debt provisions.

3. **Should the Board be in the position of a collection agent for the distributors, wholesalers and manufacturers?** Section 22980.3(d) generally provides that a suspended license would be reinstated by the Board "upon certification that all existing cigarette or tobacco tax debts of the retailer for the purchase of cigarette and tobacco products have been cleared, and all outstanding debts owned to a manufacturer, wholesaler, or distributor for cigarette products are paid." Board staff is concerned that this provision puts the Board, a taxing agency, into the position of a collection agent for the distributors, wholesalers and manufacturers. In addition, staff is concerned that if there is a legal dispute between the retailer and the distributor, wholesaler, or manufacturer over an account, who would decide whether or not these accounts are paid in full?

4. **This provision could set precedent.** Reinstating a license based on a condition that all debts between third parties have been cleared would complicate administration and could set a precedent for other programs administered by the Board. This would result in increasing administrative costs to the Board.

COST ESTIMATE

The Board would incur costs related to this provision for determining that all outstanding debts of the retailer or wholesaler that are owed to a wholesaler or distributor for the purchase of cigarette and tobacco products are paid. These costs are included in the Licensure Program Cost Estimate on page 10 of this analysis.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Engraved Pictures or Photographs from DMV

Government Code Section 15618.5

Current Law

Under existing law, Section 15604 of the Government Code requires the Board to enforce the tax laws of the State of California. Specific tax law enforcement authority is contained throughout the Revenue and Taxation Code, including but not limited to, the Cigarette and Tobacco Products Tax Law, the Diesel Fuel Tax Law, and the Sales and Use Tax Law.

Currently, all criminal tax fraud investigations are conducted by investigators in the Board's Investigations Division (ID). ID staff investigate suspected criminal violations in all the tax programs administered by the Board and identify criminal suspects for prosecution.

ID fraud investigators are not peace officers and therefore have limitations as to what they can do. To help overcome these limitations, the Board contracts with the Department of Justice (DOJ) for four full time peace officers. The DOJ contract provides the Board with a multitude of services including moving surveillance, obtaining background criminal history information, and the execution of search warrants. All services are procured to assist Board tax fraud investigators in the performance of their duties.

Proposed Law

This provision would grant Board tax fraud investigators the statutory authority to obtain engraved pictures or photographs directly from the DMV in order to more effectively and efficiently conduct their investigative duties.

Background

In 1997, the Board contracted with the Commission on Peace Officer Standards and Training (POST) to conduct a management review of its investigative programs. The purpose of the study was to assess the organizational structure and operations of the Board's investigative functions to ensure their ability to perform high-quality and effective investigations in the most efficient manner possible.

The POST report concluded that dedicated employees were trying to do a good job but lacked the tools to do the job correctly. The review also found that the current investigation system was inadequate to meet the needs of a proper investigative staff. One tool instrumental in affording Board tax fraud investigators the ability to conduct investigations is the ability to obtain drivers license photographs directly from DMV, thereby limiting the need for outside agency assistance.

The DMV photograph is one of the most pertinent pieces of information to the criminal tax fraud investigator in charge of a case. While felony tax evasion is still considered a white-collar crime, today's perpetrators include individuals who operate anonymously in the underground economy, and traditional organized crime. There are several operational needs that justify the use of DMV photographs. Assisting law enforcement agencies and district attorneys to describe suspects with particular specificity, substantiating and/or collaborating residential address locations, as well as identifying

and qualifying witnesses as the state's affiant for felony search warrants all necessitate the use of DMV photographs. While the aforementioned issues are significant, the most important need is to provide Board tax fraud investigators with an essential tool necessary to protect themselves in a potentially hostile environment – the ability to visually identify the person they are investigating.

The Board previously did enjoy the privilege of receiving drivers license photographs from the DMV. However, the DMV reviewed their practices and determined, based on the 1986 California Supreme Court decision, *Perkey v. Department of Motor Vehicles* (1986) 42 Cal. 3d. 185, that the Board could no longer have access to the photographs as it did not have specific authority under the law. Currently, Board staff must request the photographs from the DOJ, who obtains them from the DMV. Inability to obtain the information directly from the DMV can delay a Board tax fraud investigation for up to two weeks, contingent on DOJ's workload. Obtaining the information directly from the DMV can take one day. This delay in obtaining necessary information reduces the ID's effectiveness.

The annual cost associated with DOJ providing the driver's license photograph on behalf of the ID is estimated to be $23,231 for approximately 620 requests. This amount will increase over time as a result of an increase in the number of ID investigations and contract cost increases. This cost is equivalent to losing one DOJ agent for two months every year. The money could be better spent on law enforcement services Board investigators cannot currently do.

In General

During the 2001-02 Legislative Session, SB 1843 (Committee on Budget and Fiscal Review) would have granted the Board tax fraud investigators the statutory authority to obtain engraved pictures or photographs directly from the DMV. SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to provide Board tax fraud investigators with an essential tool necessary to protect themselves in a potentially hostile environment – the ability to visually identify the person they are investigating.
2. **This provision is identical to a 2002 Board proposal.** As part of its 2001-02 Legislative package, the Board voted to adopt a proposal identical to this provision.
3. **Is the Board's current practice of obtaining photographs authorized?** The DOJ has expressed concern about providing DMV photographs to the Board since the Board does not have specific authority under the law to have DMV photographs. This matter is currently under review.

COST ESTIMATE

The state could possibly realize an annual cost avoidance of $23,231, depending on the number of Board DMV photograph requests. However, this amount could be offset by any contract costs associated with obtaining the photographs directly from the DMV.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Limited Peace Officer Status

Penal Code Section 830.11

Current Law

Under existing law, Section 15604 of the Government Code requires the Board to enforce the tax laws of the State of California. Specific tax law enforcement authority is contained throughout the Revenue and Taxation Code, including, but not limited to, the Sales and Use Tax Law, Cigarette and Tobacco Products Tax Law, Alcoholic Beverage Tax Law, and the Diesel Fuel Tax Law. Existing law provides criminal and civil penalties, including fines and incarceration, for violations of the laws administered by the Board.

Existing law provides limited peace officer authority to specified persons employed by various departments of state government. Such persons may exercise the powers of arrest of a peace officer and the power to serve warrants during the course and within the scope of their employment if they receive a course in the exercise of those powers. Current law includes those employed and authorized by the Department of Financial Institutions, Department of Real Estate, State Lands Commission, Public Utilities Commission and Department of Insurance. Notwithstanding any other provision of law, persons designated with limited peace officer status are prohibited from carrying firearms altogether. (Penal Code Section 830.11)

Proposed Law

This bill would amend Section 830.11 of the Penal Code to allow persons employed by the Board's Investigations Division, who are designated by the executive director, provided that the primary duty of these persons is the enforcement of laws administered by the Board, to exercise the powers of arrest of a peace officer as specified in Section 836, and the power to serve warrants as specified in Sections 1523 and 1530 during the course and within the scope of their employment, if they receive a course in the exercise of those powers pursuant to Section 832. The authority and powers of the persons employed as investigators by the Board would be extended to any place in the state.

This bill specifically provides that persons employed by the Board's Investigation Division designated with limited peace officer status would not be entitled to peace officer retirement benefits.

This provision would remain in effect until January 1, 2010, and as of that date is repealed.

Background

The Investigations Division administers the Board's criminal investigations program. The Investigations Division plans, organizes, directs, and controls all criminal investigative activities for the various tax programs administered by the Board. The goal of the Board's Investigations Division is to identify tax evasion problems, identify new fraud schemes, and actively investigate and assist in the prosecution of crimes committed by individuals who are violating the laws administered by the Board.

The nature of these criminal cases requires investigation by specialized law enforcement personnel, specifically trained in these types of crimes. However, when investigating these crimes, investigators are often denied access to criminal history information because they are not peace officers. Also, due to a lack of peace officer powers, Board investigators have no authority to issue misdemeanor citations or to access Department of Motor Vehicles information. To overcome such restrictions, the Board contracts with the Department of Justice and the California Highway Patrol for law enforcement services.

Under existing law, any person desiring new peace officer status after January 1, 1990, is required to request the Commission on Peace Officer Standards and Training (POST) to undertake a feasibility study regarding designating that person or persons as peace officers. Any such study must include, but is not limited to, the current and proposed duties and responsibilities of the proposed peace officers employed in the category seeking the designation change, their field law enforcement duties and responsibilities, their supervisory and management structure, and their proposed training methods and funding sources.

In 1997, the Board contracted with POST to conduct a management review of its four investigative programs; sales tax, cigarette tax, alcoholic beverage tax, and diesel fuel tax. The study assessed the organizational structure and operations of the Board's investigative functions to ensure their ability to perform high-quality and effective investigations in the most efficient manner possible. The study included interviews with Board personnel from the various investigative units, in addition to personnel from the Department of Justice, other state agencies, district attorney's offices, and local law enforcement agencies. Investigators were questioned about their current caseload and status of their cases. Questions also included job responsibilities, training they received, and knowledge of basic investigative process. Additionally, investigators were asked for input regarding potential changes to improve investigative functions of the Board and their respective jobs.

The POST report issued May 22, 1998 concluded, among other things, that the Board seek limited peace officer status pursuant to Section 830.11 of the Penal Code for Board investigators involved in criminal tax fraud cases. POST believes limited peace officer status will allow Board investigators to conduct complete investigations without the necessity to regularly use outside agency support for basic investigative procedures. POST concluded that this would lead to increased efficiency and effectiveness in conducting criminal tax fraud investigations and reduce the potential for liability. POST further recommended that the Board adopt an operating policy that requires uniformed peace officer presence in situations requiring a peace officer, such as arrests and search warrants.

In General

During the 2001-02 Legislative Session, AB 1666 (Horton), SB 1702 (Peace), and SB 1843 (Committee on Budget and Fiscal Review) would have granted limited peace officer status to specified staff in the Board's Investigations Division. Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments, SB 1702 died in Assembly Appropriations without being heard, and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to grant limited peace officer status to specified staff in the Board's Investigations Division in accordance with POST's recommendation.
2. **Key amendments.** The **September 4, 2003**, amendments deleted the provision that would have repealed the seizure and sale provisions, effective July 1, 2007, if the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 was less than ten million dollars ($10,000,000) during the 2005-06 fiscal year and replaced it with a definite sunset date of January 1, 2010.

   The **July 24, 2003**, amendments specifically provide that persons employed by the Board's Investigation Division designated with limited peace officer status are not entitled to peace officer retirement benefits. The amendments also repeal the Board's authority and powers to designate persons employed by the Board's Investigations Division with limited peace officer status, effective July 1, 2007, if the Bureau of State Audits determines that the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 is less than ten million dollars ($10,000,000) during the 2005-06 fiscal year.
3. **This measure would empower the Board's Investigations Division investigators with the ability to:**
   - seize plain-view evidence encountered in responding to crime or search scenes;
   - withhold from release, document requests made under the Information Practices Act, which relate to an active criminal tax evasion investigation;
   - issue misdemeanor citations;
   - obtain criminal history information from the California Law Enforcement Telecommunications System on suspects and obtain other criminal history information from allied law enforcement agencies when conducting joint criminal investigations;
   - require participation in basic, intermediate, and advanced investigative training courses and retain available space on an as-needed basis;
   - gain credibility with law enforcement personnel; and
   - promote a reciprocal exchange of information with law enforcement.

As such, Board investigators would have the ability to conduct complete investigations without the necessity to regularly use outside agency support for basic investigative procedures. In addition, such authority would lead to increased efficiency and effectiveness in conducting criminal tax fraud investigations and reduce the potential for liability.

4. **Limited peace officer authority is a vital component of the Board's Investigations Division.** In accordance with POST recommendations, the new division within the Board is responsible for all criminal investigations of non-Board personnel. As recognized by POST, the new division has made strides to increase the effectiveness and efficiency of Board investigative functions and has placed a new focus on team building, the fostering of teamwork, and improved investigative relationships. The Investigations Division has also been responsible for developing and implementing policies and procedures regarding evidence collection and storage.

5. **This measure does not seek the full peace officer status granted to Franchise Tax Board in 1997 (Senate Bill 951 (Johnson) Chapter 670).** This bill would not provide Board investigators the authority to carry firearms or enhance retirement benefits. Although the need for outside law enforcement would diminish, the Board would specifically adopt a policy in which a person with full peace officer status would be involved in cases involving staff safety.

6. **This bill would not lead to unnecessary and intrusive investigations of ordinary taxpayers.** Though the Investigations Division would review and revise the current policy concerning case screening and supervision of criminal cases under investigation, the Board would continue to use the current high standards for determining if reasonable and probable cause exists to investigate whether or not a crime is being committed or has been committed. This measure would in no way weaken any taxpayer rights contained in current law.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

The provisions of this bill should have a positive impact on the state excise taxes collected due to decreased evasion. However, the Board has no way of measuring the potential impact these provisions may have, and therefore, cannot provide an estimate at this time.

ANALYSIS

Master Settlement Agreement Compliance

Revenue and Taxation Code Section 30165.1, 30177.5, 30435, 30436, 30449 and 30471; Health and Safety Code Section 104557

Current Law

Under existing law, the Board administers the Cigarette and Tobacco Products Tax Law. An excise tax of $0.87 per package of 20 cigarettes is imposed on the distribution of cigarettes in this state. Distributors pay the excise tax by purchasing cigarette stamps, which they affix to each package of cigarettes to indicate that the tax has been paid to the state. Distributors are also required to file monthly reports with the Board indicating their distribution of cigarettes and purchase of stamps during the preceding month.

Proposed Law

This bill would add Section 30165.1 to the Revenue and Taxation Code to prohibit persons from affixing, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied pursuant to Sections 30123 and 30131.2 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.

This bill would also prohibit 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 this bill's stamping prohibitions or are not included in the Attorney General's directory.

DIRECTORY OF CIGARETTES APPROVED FOR STAMPING AND SALE

This bill would require the Attorney General to develop and publish on its Internet web site a directory listing the following:

1. 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 that has made all required escrow payments.
2. All brand families that are listed in the certifications, except as specified.

PENALTIES

This bill would authorize the Board, upon a finding that a distributor has violated this bill's prohibitions or reporting requirements, to revoke of suspend the license or licenses of the distributor in the case of a first offense. In the case of a second or subsequent offense, the Board, in addition to revoking or suspending the distributor's license or

licenses, would be authorized to impose a civil penalty not to exceed the greater of either of the following:

- Five times the retail value of the cigarettes or tobacco products, as defined.
- Five thousand dollars ($5,000).

A distributor would be allowed a defense for a violation provided that:

1. At the time of the violation, the cigarettes or tobacco products claimed to be the subject of the alleged violation belonged to a brand family that was included on the list, as provided.
2. At the time of the violation, the distributor possessed a copy of the Attorney General's most recent written acknowledgment of receipt of the certifications and other information required as a condition of including the brand family on the list, as provided.

However, a defense would not be available to the distributor if, at the time of the violation, the Attorney General had provided the distributor with written notice that the brand family had been excluded or removed from the list, or the distributor had failed to provide the Attorney General with a current address for the receipt of written notice through electronic mail.

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 this bill's provisions, would be subject to seizure and forfeiture pursuant to the Cigarette and Tobacco Products Tax Law, regardless of whether the violation is subject to a defense, as provided. The cigarettes or tobacco products seized and forfeited would be destroyed.

This bill also provides that any person who signs a statement that asserts the truth of any material matter that he or she knows would be false is guilty of a misdemeanor punishable by imprisonment of up to one year in the county jail, or a fine of not more than one thousand dollars ($1,000), or both the imprisonment and the fine.

DISTRIBUTOR CREDIT FOR CIGARETTE AND TOBACCO TAXES PAID

If a distributor affixes a stamp or meter impression to a package of cigarettes, or pays the tax on a tobacco product defined as a cigarette, during the period between the date on which the brand family of the cigarettes or tobacco product was excluded or removed from the list and the date on which the distributor received notice of the exclusion or removal, then both of the following would apply:

- The distributor would be entitled to a credit for the tax paid by the distributor with respect to the cigarette or tobacco product to which the stamp or meter impression was affixed or the tax paid during that period. The distributor would be required to comply with regulations prescribed by the Board regarding refunds and credits that are adopted pursuant to Section 30177.5, which this bill would add to the Revenue and Taxation Code. If the distributor has sold the cigarette or tobacco product to a wholesaler or retailer, and has received payment from the wholesaler or retailer, the distributor would be required to provide the credit to the wholesaler or retailer.
- The brand family would not be included on or restored to the list until the tobacco product manufacturer has reimbursed the distributor for the cost to the distributor of

the cigarettes or tobacco product to which the stamp or meter impression was affixed or the tax paid during that period.

REPORTING OF INFORMATION

This bill would require, not later than 25 days after the end of each calendar quarter or more frequently if so directed, each distributor to submit any information as the Board or Attorney General requires to facilitate compliance of this bill's provisions. The distributor would also be required to maintain, and make available to the Board and the Attorney General, all invoices and documentation of sales of all non-participating manufacturer cigarettes and any other information relied upon in reporting to the Board and the Attorney General for a period of five years.

The Board would be authorized to disclose to the Attorney General any information requested by the Attorney General for purposes of determining compliance with and enforcing the provisions of this bill. The Board and Attorney General would be authorized to share with each other, and may share with other federal, state or local agencies, information for purposes of enforcing this bill's provisions and the Model Statute.

MISCELLANEOUS

This bill would not permit persons to be issued a license or granted a renewal of a distributor's license unless that person has certified in writing that the person will comply fully with this bill's provisions.

This bill would authorize the Attorney General to adopt rules and regulations to, among other things, establish procedures for the seizure and destruction of cigarettes forfeited to the state, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes.

This bill would add Section 30435 to the Revenue and Taxation Code to clarify that an employee of the Board, upon presentation of the appropriate identification and credentials, is authorized to enter into, and conduct an inspection of any building, facility, site, or place, as described. Any person that refuses to allow an inspection would be guilty of a misdemeanor and subject to a fine, not to exceed $1,000 for each offense. However, this provision would be repealed, effective July 1, 2007, if the Bureau of State Audits determines that the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 is less than ten million dollars ($10,000,000) during the 2005-06 fiscal year.

Background

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.

In order to safeguard themselves against unfair competition from tobacco products manufacturers who do not participate in the MSA, the MSA contains provisions which would reduce the payments made to states that do not enact a "Model Statute" to require nonparticipating manufacturers to put funds into escrow accounts. The money in the escrow accounts is intended to be available to pay judgements or settlements on any claims brought by the state against any nonparticipating tobacco manufacturers.

In 1999, California enacted a "Model Statute" pursuant to Senate Bill 822 (Escutia, Chapter 780). That bill, among other things, authorized the Board 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, approximately fifteen States have enacted Complementary Legislation to make state enforcement of Model Statutes more effective and thereby promote the purposes for which the Model Statutes were enacted. Complementary Legislation has been effective in promoting compliance with the Model Statutes, which led to the development of draft Complementary Legislation that could be recommended as a model to all of the Settling States.

The National Association of Attorneys General (NAAG) Tobacco Committee has recommended that the Attorneys General of the Settling States give serious consideration to the legislation and designate its enactment a priority. The Committee believes that enactment of such legislation by all Settling States will promote the purposes the Model Statutes were designed to serve and safeguard payments to the Settling States that might otherwise be imperiled.

In General

Similar provisions were contained in last year's AB 2906 (Horton), AB 1666 (Horton), and SB 1843 (Committee on Budget and Fiscal Review). Assembly Bill 2906 died on the Senate inactive file, Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments, and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to protect California's settlement payments under the MSA, which are directly threatened by manufacturers that do not either join the MSA or make the escrow payments required by the Model Statute. The provisions of this bill are very similar to the Model Complementary Legislation developed under the purview of the NAAG's Tobacco Project Committee.

   According to the author, California's MSA settlement payments have been significantly less than projected because of declining sales by the four original participating manufacturers. The decline (possibly in the millions of dollars) is partially attributable to increased sales by some non-participating manufacturers who have created an artificial price advantage over participating manufacturers by not making the escrow payments as required by law.

2. **Key amendments.** The **September 4, 2003**, amendments deleted the provisions that would have provided, upon appropriation by the Legislature, all funds in the Tobacco Control Special Fund be available for expenditure for the purposes of enforcing the MSA provisions of this bill. The amendments also relate to the "Model Statute" and do not impact the Board.

   The **June 24, 2003**, amendments would repeal Section 30177.5, which this bill would add to the Revenue and Taxation Code to clarify that an employee of the Board is authorized to enter into and conduct an inspection of any building, facility, site, or place, effective July 1, 2007, if the Bureau of State Audits determines that the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 is less than ten million dollars ($10,000,000) during the 2005-06 fiscal year.

   The **July 14, 2003**, amendments deleted all references requiring statements to be signed under penalty of perjury. Instead, the amendments provide that any person who signs a statement that asserts the truth of any material matter that he or she knows to be false is guilty of a misdemeanor punishable by imprisonment of up to one year in the county jail, or a fine of not more than one thousand dollars ($1,000), or both the imprisonment and the fine.

   The **July 14, 2003** amendments also deleted the requirement for a court to order any profits, gain, gross receipts, or other benefit from a person's violation of proposed Section 30165.1 to be disgorged in restitution to distributors, wholesalers, retailers, or tobacco product manufacturers who filed the action for restitution or unfair competition or became a party to an action filed by the Attorney General or other pubic official or agency. The amendment also deleted the language that would have created the Tobacco Control Special Fund.

The **May 19, 2003**, amendments authorize a distributor having a defense for a violation to recoup taxes paid with respect to tobacco products defined as a "cigarette" under the Health and Safety Code. The amendments also clarify the Board's inspection authority and make other non-substantive corrections.

The **April 10, 2003**, amendments authorize the Attorney General to adopt rules and regulations to, among other things, establish procedures for the seizure and destruction of cigarettes forfeited to the state, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes.

3. **The Board would not know the date a distributor affixes a stamp.** Under specified circumstances, this bill would entitle a distributor to recoup excise taxes paid for a cigarette tax stamp that was unlawfully affixed during a specified period. In order to determine whether a distributor is entitled to recoup the excise taxes paid, the Board would need to know the exact date a stamp is affixed. However, the Board has no way of knowing that date.

   Beginning January 1, 2005, however, this concern will be addressed by SB 1701 (Ch. 881, Stats. 2002) which requires that the stamps and meter impressions be encrypted with the date the stamp or meter impression was affixed.

4. **Suggested technical amendments.** It is suggested that the language that would repeal Section 30435, as of January 1, 2010, be removed. Proposed Section 30435 is intended to address an ambiguity in current law that could affect the Board's ability to verify that tax stamps have been affixed to a package of cigarettes, or the tax paid on a tobacco product defined as a cigarette, in accordance with this provision.

5. **Does the Attorney General have the statutory authority to promulgate regulations under the Cigarette and Tobacco Products Tax Law?** This bill would authorize the Attorney General to adopt rules and regulations establishing procedures for seizure and the destruction of cigarettes forfeited to the state pursuant to Section 30436 or Section 30449, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes. However, it is not clear whether the Attorney General would have the statutory authority to adopt regulations pursuant to the Cigarette and Tobacco Products Tax Law. An exception would be those regulations adopted pursuant to proposed Section 30165.1 since that section would specifically grant the Attorney General such authority.

6. **This bill should contain a specific appropriation to cover the Board's start-up costs associated with the MSA provisions.** This bill would require the Board to enforce the MSA Model Statute, as provided, effective January 1, 2004, which would occur in the middle of the state's fiscal year. In order to begin to hire appropriate staff to handle the compliance and enforcement responsibilities to properly administer the MSA Model Statute provisions, an adequate appropriation would be required to cover the Board's administrative start-up costs that would not already be identified in the Board's 2003-04 budget.

7. **Related legislation.** Similar provisions are contained in AB 1276 by the same author. As of the date of this analysis, this bill is in the inactive file in the Assembly.

COST ESTIMATE

The Board would incur additional costs to 1) revoke or suspend the license or licenses of the distributor for stamping or paying taxes on brands that are in violation of this bill's requirements, 2) impose additional penalties for violations, 3) provide credit for taxes paid, as specified, 4) prepare reports and answer the requests from the Office of the Attorney General, 5) seize cigarettes, and 6) warehouse and destroy product seized. The start-up costs for fiscal year 2003-04 are estimated to be $261,000, and $409,000 in fiscal year 2004-05 and annually thereafter.

REVENUE ESTIMATE

It is not possible to estimate actual revenue that could be realized by enactment of this bill. It is intended to protect California's settlement payments under the MSA, which are directly threatened by manufacturers that do not either join the MSA or make the escrow payments required by the Model Statute.

However, the following chart shows the difference between the revenues estimated in 1998 from the MSA and the actual payments made.

Year	State		Local*		Total		
	Projected In 1998	Actual	Projected In 1998	Actual	Projected In 1998	Actual	Difference
1999 & 2000 Initial Payment 2000 Annual Payment	$562	$515	$562	$515	$1,124	$1,030	($94 million)
2001 Initial payment, Annual Payment and Additional Annual Payments	$442	$383	$442	$383	$884	$766	($118 million)
2002 Initial Payment, Additional Initial Payment, Annual Payment and Additional Annual Payment	$531	$478	$531	$478	$1,062	$956	($106 million)

*Includes payments to all 58 counties and the cities of Los Angeles, San Diego, San Francisco, and San Jose.

ANALYSIS

Report to the Legislature evaluating average actual costs to apply cigarette tax indicia or impressions

Revenue and Taxation Code Section 30166.1

Current Law

Pursuant to Revenue and Taxation Code Section 30101 (Cigarette and Tobacco Products Tax Law), an excise tax of 6 mills (or 12 cents per package of 20) is imposed on each cigarette distributed. In addition, Sections 30123 and 30131.2 impose a surtax of 12 1/2 mills (25 cents per package of 20) and 25 mills (50 cents per package of 20), respectively, on each cigarette distributed. The current total tax on cigarettes is 43 1/2 mills per cigarette (87 cents per package of 20).

Section 30161 of the Cigarette and Tobacco Products Law generally provides that the cigarette tax imposed with respect to the distribution of cigarettes shall be paid by distributors through the use of stamps or meter impressions. Section 30163 requires that an appropriate stamp or meter impression be affixed to, or made on, each package of cigarettes prior to distribution of the cigarettes, except as otherwise provided.

Currently, Section 30166 of the Cigarette and Tobacco Products Tax Law provides that stamps and meter register settings be sold to licensed distributors at their denominated values less 0.85 percent. The discount is intended to help defray the cost (leasing of equipment/labor cost) to the distributor for affixing the stamps.

Of the 87 cent excise taxes imposed on a package of 20 cigarettes, 2 cents go to the Breast Cancer Fund, 10 cents to the General Fund, 25 cents to the Cigarette and Tobacco Products Surtax Fund, and 50 cents to the California Children and Families Trust Fund.

Proposed Law

This bill would add Section 30166.1 to the Revenue and Taxation Code to require the Board to submit, no later than July 1, 2005, a report to the Legislature that evaluates the average actual costs, including labor for applying indicia or impressions, bonding, warehousing, and leasing stamp equipment, including case cutters and packers, associated with applying stamps or meter impressions to cigarette packages. The report would be required to be updated every two years.

Background

The distributor discount per roll of stamps (30,000 stamps) since August 1, 1967 is as follows:

Period	Tax Increase Pursuant To:	Stamp Value*	Roll Value**	Licensed DistributorsDiscount	Discount Amount Per Roll
08/01/67-09/30/67	SB 556	$0.07	$2,100	.85 percent	$17.85
10/01/67-12/31/88	SB 556	$0.10	$3,000	.85 percent	$25.50
01/01/89-12/31/93	Proposition 99	$0.35	$10,500	.85 percent	$89.25
01/01/94-12/31/98	AB 3601	$0.37	$11,100	.85 percent	$94.35
1/1/99-Current	Proposition 10	$0.87	$26,100	.85 percent	$221.85

*Per package of 20 cigarettes
**One roll is equivalent to 30,000 stamps

COMMENTS

1. **Purpose.** This provision is intended to provide the Legislature with information regarding the average actual costs to apply cigarette tax indicia and impressions to packages of cigarettes.
2. **This provision could be problematic to administer.** This provision would require the Board to evaluate the average actual costs, including labor for applying indicia or impressions, bonding, warehousing, and leasing stamping equipment, including case cutters and packers, associated with applying stamps or meter impressions to cigarette packages. In order to evaluate such costs, the Board would need the cooperation of, among others, all cigarette distributors and any company that leases stamping equipment (currently Meyercord Company) to distributors. Currently, this provision does not require persons having information necessary for the Board to complete the required report to provide such information to the Board. As such, the Board would have to base the report on information available, which may not accurately represent the average actual costs associated with applying stamps or meter impressions to cigarette packages.
3. **Bonding costs.** It is unclear why a distributor's bonding costs are part of the average actual cost associated with applying stamps or meter impressions to packages of cigarettes. Bonding is essentially an "insurance" policy that is purchased by distributors that elect to make payment of stamps and meter impressions on a deferred payment basis. The bond, which is equal to not less than 70 percent of the amount and no more than twice the amount of deferred purchases that can be made, is a mechanism to protect the state's interest for non-payment of stamps. Currently, 48 of the 242 distributors licensed with the Board purchase cigarette tax stamps on a deferred basis.

COST ESTIMATE

The administrative costs associated with this provision would be absorbable.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Tax, interest and penalties immediately due and payable on all unlicensed persons *(Article 2.5 (commencing with Section 30210))* and seizure and sale of assets to satisfy liens *(Article 5 (commencing with Section 30355))*

Current Law

Under existing Cigarette and Tobacco Products Tax Law, an excise tax of 6 mills (or 12 cents per package of 20) is imposed on each cigarette distributed. Proposition 99 imposes an additional surtax of 12 1/2 mills per cigarette (25 cents per package of 20) effective January 1, 1989. Beginning January 1, 1999, Proposition 10 imposes an additional surtax of 25 mills per cigarette (50 cents per package of 20) for a current total tax of 43 1/2 mills per cigarette (87 cents per package of 20).

For tobacco products (which are defined to include cigars, smoking tobacco, chewing tobacco, snuff, and other products containing at least 50 percent tobacco), a tax is imposed on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the combined rate of tax imposed on cigarettes. An additional tax, pursuant to 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 additional 50-cent per pack tax on cigarettes. The tobacco products tax rate is determined annually by the Board. As of November 8, 2001, the tax rate on tobacco products ranges from 52.65 percent to 490 percent of the wholesale cost (depending on the tobacco product) for the period July 1, 2001 through June 30, 2002.

Existing law provides that if any person fails to make a report or return, the Board shall make an estimate of the number of cigarettes or the wholesale cost of tobacco products distributed by him or her. Upon the basis of this estimate, the Board shall compute and determine the amount required to be paid to the state, adding a penalty of 10 percent. Any person against whom a determination is made, as specified, may petition for a redetermination within 30 days after service upon the person of notice thereof. If a petition for redetermination is not filed within the 30-day period, the determination becomes final at the expiration of the period.

Proposed Law

This provision would provide that the tax, and applicable penalties and interest become immediately due and payable on account of all products distributed if a person becomes a distributor without first securing a license. In addition, this provision would also add seizure and sale provisions to the Cigarette and Tobacco Products Tax Law to facilitate the administration of the sections providing for the immediate liability for the tax.

This provision would remain in effect until January 1, 2010, and as of that date is repealed.

Background

A jeopardy determination may be issued if the Board believes that the collection of any amount of tax required to be paid by any person will be jeopardized by delay. If the amount that is due is not paid within 10 days after service upon the person of notice of the determination, the determination becomes final, unless a petition for redetermination is filed within the 10 days. Determinations are due and payable at the time they become final. The collection of the amounts due and payable generally can not take place until the determination becomes final.

Prior to Proposition 99, tobacco products were not taxed and the tax on cigarettes was paid by the sale of tax stamps. Proposition 99 commenced the taxing of tobacco products, which is based on the wholesale cost of the product at a rate determined annually. The Tobacco Products surtax is imposed on the distributor and is paid on a monthly return. Proposition 99 did not change the manner in which the taxes on cigarettes are paid.

Subsequent to the passage of Proposition 99, unlicensed transient and other distributors were importing tobacco products into the state and distributing them without reporting and paying the tax due. After the passage of Proposition 10 in November 1998, the Investigations Division discovered a counterfeit tax stamp problem with unlicensed distributors importing cigarettes from out-of-state.

The Board's Investigations Division has encountered a large number of cigarettes and tobacco product distributors who are unlicensed. The purpose for being unlicensed is to conceal the nature of their business and to evade the tax. These unlicensed distributors normally maintain minimal assets and are typically transient, which hinders the Board's ability to collect the taxes due and payable. The Board's difficulty in collecting amounts due from these unlicensed distributors is best evidenced by the Cigarette and Tobacco Products Taxes receivables, which consists of 198 accounts. Of these 198 accounts, 23 are directly related to work done by the Investigations Division and account for 94 percent of the accounts receivable balance.

Prior to a search warrant, the Investigations Division has been able to determine in advance that a liability is due by using third party sources. Five recent cases where search warrants were served, large sums of cash in the amounts of $125,000, $48,000, $200,000, $59,000 and $58,000, for a total $490,000, were not seized for lack of authority to issue immediate billings. Subsequent collection efforts based on current law have been unsuccessful, as that cash is no longer available. In each of these cases, Investigations Division was aware that the subject would owe a large liability to the state.

In General

A similar provision was contained in last year's SB 1843 (Committee on Budget and Fiscal Review), which passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to provide for the efficient and effective administration of the Cigarette and Tobacco Products Tax Law. Allowing the Board to recover cash and assets available at the time of the billing, as specified, would be a tremendous aid in the Board's collection effort as these assets are typically not accessible at a later date. This provision mirrors similar provisions currently in the Diesel Fuel Tax Law.

2. **Key amendments.** The **September 4, 2003**, amendments deleted the provision that would have repealed the seizure and sale provisions, effective July 1, 2007, if the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 was less than ten million dollars ($10,000,000) during the 2005-06 fiscal year and replaced it with a definite sunset date of January 1, 2010.

   The **July 24, 2003**, amendments would repeal the unlicensed distributor and seizure and sale provisions, effective July 1, 2007, if the Bureau of State Audits determines that the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 is less than ten million dollars ($10,000,000) during the 2005-06 fiscal year.

3. **This provision is identical to a 2002 Board proposal.** As part of its 2001-02 Legislative package, the Board voted to adopt a proposal identical to this provision.

4. **Seizure and sale.** This provision would simply extend the seizure and sale provisions from other programs administered by the Board, such as the Sales and Use Tax Law, to the Cigarette and Tobacco Products Tax Law. Seizure and sale language was not necessary for the Cigarette and Tobacco Products Tax Law prior to the passage of Proposition 99 in November 1998. Prior to the passage of Proposition 99, the tobacco products surtax did not exist, collection issues with the cigarette tax was minimal due to the cigarette tax being paid at the time a tax stamp was purchased, and cigarette tax evasion was virtually non-existent. Since the passage of Proposition 99 and Proposition 10, the seizure and sale provision has become a necessary tool to facilitate compliance and to protect the interest of the state.

5. **Due process.** This bill would add Article 5 (commencing with Section 30355) to the Revenue and Taxation Code to allow the Board to seize any property, real or personal, subject to the lien of the tax whenever any person is delinquent in the payment of the obligations imposed under the Cigarette and Tobacco Products Tax Law. The property seized, or a sufficient part of it, would be sold at public auction to pay the tax due together with any interest and penalties imposed for the delinquency and any costs incurred on account of the seizure and sale. Persons whose property would be subject to seizure and sale would already have received due process because at the time of the seizure, the persons would have either:

   - Exhausted the Board's administrative appeals process available to contest a liability for taxes, including a hearing before the elected Members of the Board, and the amount owed would have become a final tax liability that was delinquent, or

- Elected not to participate in the Board's appeals process, but the amount owed would have become a final tax liability that was delinquent.

Furthermore, the person would be entitled to notice of the sale at least twenty days in advance of any sale.

As such, a person whose property is subject to seizure and sale would have received due process prior to any seizure and again, prior to any sale.

This bill would also add Article 2.5 (commencing with Section 30210) to the Revenue and Taxation Code to make the tax, and applicable penalties and interest immediately due and payable on account of all products distributed if a person becomes a distributor without first securing a license. These unlicensed distributors would have same administrative appeals procedure rights as licensed distributors to contest the liability for taxes, subject to the jeopardy determination process.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision would aid in the collection of cigarette and tobacco products taxes due and payable to the state that, after subsequent collection efforts, are deemed uncollectible. However, the Board has no way of measuring the potential impact this provision may have, and therefore, cannot provide an estimate at this time.

ANALYSIS

Possession of Fraudulent Tax Stamps or Meter Impressions

Revenue and Taxation Code Section 30473.5

Current Law

Under current law, any person who possesses, sells, or offers to sell, buys or offers to buy, any false or fraudulent stamps or meter impressions with a tax value greater than seven hundred fifty dollars ($750) is guilty of a misdemeanor. Current law does not contain corresponding felony provisions for this violation.

All amounts paid to the Board under the Cigarette and Tobacco Products Law are to be transmit to the Treasurer to be deposited in the State Treasury to the credit of the Cigarette Tax Fund, unless otherwise specified.

Proposed Law

This bill would amend Section 30473.5 of the Revenue and Taxation Code to make any person who possesses, sells, or offers to sell, buys or offers to buy, any false or fraudulent stamps or meter impressions in a quantity of less than 2000 guilty of a misdemeanor, punishable by a fine not to exceed five thousand dollars ($5,000) or imprisonment not exceeding one year in the county jail, or both by fine and imprisonment.

Any person who possesses, sells, or offers to sell, buys or offers to buy, any false or fraudulent stamps or meter impressions provided for or authorized under the Cigarette and Tobacco Products Tax Law in a quantity of 2000 or greater, would be guilty of a misdemeanor, punishable by a fine not to exceed five thousand dollars ($5,000) or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

The court would be required to order in fines assessed to be deposited in the Cigarette and Tobacco Products Compliance Fund.

Background

With the passage of Proposition 10 in November 1998, which increased the tax from $0.37 to $0.87 per pack of twenty, the incentive to evade the taxes has escalated. Prior to this time, the Board had no evidence of counterfeit stamps in California. However, recent information has indicated this is changing. The most recent case involved approximately one million dollars ($1,000,000) in counterfeit California stamps on their way to Los Angeles from out of state. Possession of this quantity of stamps under current law is only a misdemeanor, which is not a very effective deterrent against flagrant offenders.

Unaffixed stamps are generally found and seized during the search warrant process. Three recent cases where search warrants were served led to the seizure of unaffixed stamps in amounts of 36,000, 69,000 and 146,129, for a total 251,129 counterfeit stamps. If these stamps had been affixed, the amount of tax evaded would have amounted to $31,320, $60,030 and $127,132, respectively.

In General

Similar provisions were contained in last year's SB 1843 (Committee on Budget and Fiscal Review), which passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to provide an effective deterrent against flagrant offenders.
2. **These provisions are similar to a Board proposal adopted in 2001.** That proposal would have:
   - Generally provided that any person who, with the intent to defeat or evade the taxes imposed, possessed or sold false or fraudulent stamps would be guilty of a felony. This bill provides that such a person would be guilty of a misdemeanor.
   - Not provided that the misdemeanor would be punishable by a fine or imprisonment.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision could potentially reduce tax evasion. However, the Board has no way of measuring the potential impact this provision may have, and therefore, cannot provide an estimate at this time.

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.

ANALYSIS

Sales of Untaxed Cigarettes

Revenue and Taxation Code Section 30474

Current Law

Section 30474 of the Revenue and Taxation Code provides that any person who knowingly possesses, keeps, stores, or retains for the purpose of sale, or sells or offers to sell, any unstamped package of cigarettes is guilty of a misdemeanor punishable by a fine of not more than one-thousand dollars ($1,000), imprisonment for not more than one year in a county jail, or both. The guilty person must also pay one hundred dollars ($100) for each carton of 200 cigarettes possessed, sold or offered for sale, as determined by the court. The court must direct that 50 percent of the penalty assessed be transmitted to the local prosecuting jurisdiction, to be allocated for costs of prosecution, and 50 percent of the penalty assessed be transmitted to the Board.

Proposed Law

This bill would amend Section 30474 to clarify that the penalty for possessing, selling or offering to sell unstamped cigarettes does not apply to a licensed distributor.

Background

The cigarette tax is paid by distributors, who purchase tax stamps from banks and affix them to each package of cigarettes before distribution. As such, licensed distributor's inventory consists of unstamped packages of cigarettes.

In General

Similar provisions were contained in last year's SB 1700 (Peace), AB 1666 (Horton) and SB 1843 (Committee on Budget and Fiscal Review). Senate Bill 1700 died in the Assembly Governmental Committee, Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments, and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to clarify that penalties related to unstamped cigarettes do not apply to licensed distributors who affix stamps to packages of cigarettes.
2. **Summary of amendments.** The **May 19, 2003**, amendments made a non-substantive change.
3. **The Board staff does not foresee any administrative problems with this provision.** This provision would simply clarify existing law. Accordingly, enactment of this provision would not affect the Board's administration of the Cigarette and Tobacco Products Tax Law.

COST ESTIMATE
Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Sale or Possession for Sale of Counterfeit Cigarettes or Tobacco Products

Revenue and Taxation Code Section 30474.1

Current Law

Section 30474 of the Revenue and Taxation Code provides that any person who knowingly possesses, keeps, stores, or retains for the purpose of sale, or sells or offers to sell, any unstamped package of cigarettes is guilty of a misdemeanor punishable by a fine of not more than one-thousand dollars ($1,000), imprisonment for not more than one year in a county jail, or both. The guilty person must also pay one hundred dollars ($100) for each carton of 200 cigarettes possessed, sold or offered for sale, as determined by the court. The court must direct that 50 percent of the penalty assessed be transmitted to the local prosecuting jurisdiction, to be allocated for costs of prosecution, and 50 percent of the penalty assessed be transmitted to the Board.

Section 30474.5 imposes an additional penalty for possessing, selling or offering to sell unstamped cigarettes in an amount of one hundred dollars ($100) for each carton of 200 cigarettes, as determined by the court. The court will direct the additional penalty assessed to be transmitted to the Controller for deposit in the Unlawful Sales Reduction Fund, which this bill creates. Upon appropriation by the Legislature, the moneys in the fund will be allocated to the Office of Criminal Justice Planning (OCJP) for the funding of a competitive grant program.

Proposed Law

This bill would add Section 30474.1 to the Revenue and Taxation Code to provide that the sale or possession for sale of counterfeit tobacco products, or the sale or possession for sale of counterfeit cigarettes by a manufacturer, importer, distributor, wholesaler, or retailer would result in the seizure of the product by the Board or any law enforcement agency. In addition, the possession or possession for sale of counterfeit product would constitute a misdemeanor punishable as follows:

- A violation with a total quantity of less than two cartons of cigarettes would be a misdemeanor punishable by a fine not to exceed five thousand dollars ($5,000), or imprisonment not to exceed one year in a county jail, or both the fine and the imprisonment, and would also result in the revocation by the Board of the manufacturer, distributor, or wholesaler license.
- A violation with a quantity of two cartons of cigarettes or more would be a misdemeanor punishable by a fine not to exceed fifty thousand dollars ($50,000) or imprisonment not to exceed one year in a county jail, or both the fine and imprisonment, and would also result in the revocation by the Board of the manufacturer, distributor, or wholesaler license.

A court would be required to consider a defendant's ability to pay when imposing fines pursuant to this provision. Also, for the purposes of this provision, counterfeit cigarette and tobacco products would include cigarette and tobacco products that have false manufacturing labels, false or fraudulent stamps or meter impressions, or a combination thereof. The Board would be required to seize and destroy any cigarettes or other tobacco products forfeited to the state under this provision.

This provision would remain in effect until January 1, 2010, and as of that date is repealed.

Background

Philip Morris USA has filed lawsuits against retailers engaged in the illegal sale of counterfeit versions of the Company's cigarettes, according to a March 3, 2003 press release. Fifteen suits were filed against 325 retailers in federal courts in seven states, including California. The lawsuits are aimed at stopping the retail sale of counterfeit cigarettes and their illegal use of Philip Morris USA's trademarks, including the MARLBORO® mark, and identifying suppliers of counterfeit cigarettes. Through these lawsuits, Philip Morris states that they are able to gather information about where this product is coming from so that they, working together with government agencies, legislators and tobacco retailers, wholesalers and suppliers, can take further actions to stop the sale of counterfeit cigarettes.

These suits are the result of periodic audits conducted by the company during which cigarettes were purchased in the marketplace. Philip Morris USA shares the results of these audits and other information with law enforcement at the federal, state and local level.

In General

Similar provisions were contained in last year's AB 1666 (Horton) and SB 1843 (Committee on Budget and Fiscal Review). Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to deter manufacturers, importers, distributors, wholesalers, or retailers from selling or possessing counterfeit cigarettes or tobacco products.

2. **Summary of amendments.** The **September 4, 2003**, amendments deleted the provision that would have repealed the seizure and sale provisions, effective July 1, 2007, if the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 was less than ten million dollars ($10,000,000) during the 2005-06 fiscal year and replaced it with a definite sunset date of January 1, 2010.

   The **July 24, 2003**, amendments would repeal Section 30474.1, effective July 1, 2007, if the Bureau of State Audits determines that the net tax revenues generated as a result of the enactment of the Cigarette and Tobacco Products Licensing Act of 2003 is less than ten million dollars ($10,000,000) during the 2005-06 fiscal year.

   The **May 19, 2003**, amendments revised the definition of counterfeit cigarette and tobacco products to include cigarette and tobacco products that have false or fraudulent stamps or meter impressions. The previous version of the bill included cigarette and tobacco products with *counterfeit tax stamps* within the definition of counterfeit cigarette and tobacco products.

3. **Revocation of the manufacturer, distributor, or wholesaler license.** This provision would, in part, require the Board to revoke the manufacturer, distributor, or wholesaler license for selling or possessing counterfeit cigarettes or tobacco products. This would also result in an automatic revocation of distributor's or wholesaler's cigarette and tobacco products license pursuant to proposed Section 22978.6.
4. **False manufacturing labels.** This provision would define counterfeit cigarettes and tobacco products to include, in part, products that have false manufacturing labels. Board staff is not trained to detect false manufacturing labels and would not be able to determine with certainty whether or not product seized has a false label. However, cigarette and tobacco product manufacturers, such as Philip Morris, do provide Board staff information to aid in the detection of false manufacturing labels. In addition, such companies are willing to provide experts who can analyze suspect seizures.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision could have a positive impact on the state excise tax collected on sales of cigarettes and tobacco products. However, the Board has no way of measuring the potential impact these provisions may have, and therefore, cannot provide an estimate at this time.

ANALYSIS

Extension of the Time in which the Prosecution for Violating the Penal Provisions may be Instituted

Revenue and Taxation Code Section 30481

Current Law

Under existing Cigarette and Tobacco Products Law, Section 30481 provides that the prosecution for violation of any of the criminal provisions shall be instituted within three years after the commission of the offense, or within two years after the violation is discovered, whichever is later. These sections do not conform to the federal law (Section 6531(4)) which has a six year statue of limitation for fraud, California income tax law (Revenue and Taxation Code 19704) which mirrors federal law, or Section 801.5 of the California Penal Code which states that the statute is four years after discovery, or within four years after completion of the offense, whichever is later.

Title 26, Subtitle F, Chapter 66, Subchapter D Section 6531 of the federal law provides that:

> "No person shall be prosecuted, tried, or punished for any of various offenses arising under the internal revenue laws unless the indictment is found or the information instituted within 3 years next after commission of the offense, except that the period of limitations shall be 6 years
>
> . . .
>
> (2) for the offense of willfully attempting in any manner to evade or defeat any tax or the payment thereof.
>
> . . ."

Under current state law, California Penal Code Section 801.5 provides that:

> Notwithstanding Section 801 or any other provision of the law, prosecution for any offense described in subdivision (c) of Section 803 shall be commenced within four years after discovery of the commission of the offense, or within four years after the completion of the offense, whichever is later.

Under Revenue and Taxation Code Section 19704, relating to the state income tax laws administered by the Franchise Tax Board, any action for prosecution must be instituted within six years after the commission of the offense.

Proposed Law

The bill would amend Section 30481 of the Revenue and Taxation Code to extend the current three years statute to six years for filing a criminal prosecution in a state court and conform this law to the Federal Law and state income tax laws and be more in line with California Penal Code statute of limitations for felonies that involve fraud.

Background

Revenue and Taxation Code Section 7154 (Sales and Use Tax Law) was amended in 1992 to five years instead of three years because of a court case (*People v. Zamora*, 116 Cal.3d 538). The judge in the case ruled that an auditor who discovers an underreporting on the returns or other information may trigger the discovery date of a fraud violation. The judge held that "discovery" for statute of limitations purposes occurs after the authorities have notice of circumstances sufficient to make them suspicious of fraud thereby leading them to make inquiries, which might reveal fraud. Since most audits are done on a three-year cycle, the then existing three year statute would have run on the first year under audit before fraud was discovered and the criminal case was developed. A successful prosecution at this time would be difficult due to the limited time remaining under the statute. Since a normal prosecution may take two to three years, the statute would have run.

In one fuel tax case, after working jointly with federal and state agencies, the Assistant United States Attorney (AUSA) declined to file federal charges. Even though federal statutes had not expired, due to the length of the investigation and legal proceedings, the state statute of limitations had expired. Subsequently, a potential criminal fraud prosecution became a civil billing. Currently, two other federal and state joint fuel investigations are pending in which the state statute of limitations has run while the state has waited for the AUSA to file charges. If the AUSA decides to drop the federal charges, no charges can be prosecuted by the state. Further, with the increasing number of counterfeit cigarette stamps found in California, the Investigations Division is working jointly on many of its cigarette cases with the federal Bureau of Alcohol, Tobacco and Firearms Bureau (ATF). These joint efforts increase the possibility of additional statute problems arising.

In General

Similar provisions were contained in last year's SB 1843 (Committee on Budget and Fiscal Review), which passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to allow the state sufficient time to file criminal fraud charges in state court when the AUSA declines to file charges in federal court and prevent criminal fraud cases from being treated solely as civil liabilities.
2. **This provision is identical to a 2002 Board proposal.** As part of its 2001-02 Legislative package, the Board voted to adopt a proposal identical to this provision. However, the Board's proposal would have also extended the time in which the prosecution for violating the penal provisions may be instituted under various other programs administered by the Board, including the sales and use tax law.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

ANALYSIS

Allows for Recoupment of Costs Incurred in Criminal Investigations

Revenue and Taxation Code Section 30482

Current Law

Other tax agencies (Franchise Tax Board and Employment Development Division) currently have such recoupment authority. However, statutory authority does not exist for the State to seek recoupment of the costs that are incurred during criminal investigations conducted by the Board. The State of California's costs to conduct various criminal investigations result in thousands of dollars being expended annually.

Proposed Law

The bill would add Section 30482 to the Cigarette and Tobacco Products Tax to allow the Board to seek recoupment of costs incurred during criminal investigations. All reimbursed monies would be deposited into the appropriate State funds.

Background

The Franchise Tax Board (FTB) indicated that cost recoupment is ordered on approximately 50 percent of their cases. The FTB also provided the following data on cost recoupment orders:

Period	Number of cases	Amount ordered	Amount collected
2000	18	$124,817	$71,841
Jan 2001 – Oct 2001	27	$174,937	$47,095

It is the Board's Investigations Division's understanding from some district attorneys that judges are hesitant to order recoupment absent a statute clearly giving that authority. In a recent Board case (*People v. Elias Chaghouri*), the judge refused to include the Board's investigation costs in the restitution order. He based his ruling in large part on the proposition that the costs of investigations are a normal part of the State's costs and since there are no statutes authorizing recovery, none was allowed. Accordingly, the district attorneys argue that this ruling fails to recognize the simple fact that investigation costs would not be a normal operating cost of a business or a government agency if it were not for the existence of the crimes in the first place. It also does not recognize the fact that certain crimes incur costs that are specific to the particular crime. Such costs cannot reasonably be viewed as normal operating expenses.

In General

Similar provisions were contained in last year's SB 1843 (Committee on Budget and Fiscal Review), which passed the Assembly with no further action.

COMMENTS

1. **Purpose.** This provision is intended to conform the Cigarette and Tobacco Products Tax Law with authority already granted to other California tax agencies, and to make the intent clear and concise to avoid various interpretations by the courts.
2. **The July 14, 2003, amendments.** The amendments make a non-substantive change by revising that any person convicted of a "crime", rather than a "misdemeanor or felony", may be charged with the costs of investigation and prosecution at the discretion of the court.
3. **This provision is identical to a 2002 Board proposal.** As part of its 2001-02 Legislative package, the Board voted to adopt a proposal identical to this provision. However, the Board's proposal would have also allowed the Board to seek recoupment of costs incurred during criminal investigations under various other programs administered by the Board, including the sales and use tax law.

COST ESTIMATE

Enactment of this provision would not impact the Board's administrative costs.

REVENUE ESTIMATE

This provision would not affect the state's revenues.

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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 Board's formal position.