



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

Date Introduced	<b>02/25/99</b>	Bill No:	<b>AB 1143</b>
Tax:	<b>Tobacco Products</b>	Author:	<b>Floyd</b>
Board Position:		Related Bills:	

**BILL SUMMARY:**

This bill would limit the annual determination of the tobacco products tax rate required by Proposition 99 to the cigarette tax rate in effect prior to the passage of Proposition 10 in November 1998.

**ANALYSIS:**

Current Law:

Under existing law, Section 30101 of the Cigarette and Tobacco Products Tax Law imposes an excise tax of 6 mills (or 12 cents per package of 20) on each cigarette distributed. In addition, Section 30123 imposes a surtax of 12 1/2 mills (25 cents per package of 20). Beginning January 1, 1999, Section 30131.2 imposes an additional surtax of 25 mills (50 cents per package of 20) for a current total tax on cigarettes of 43 1/2 mills per cigarette (87 cents per package of 20).

As for tobacco products such as cigars, smoking tobacco, chewing tobacco, and snuff, Section 30123 imposes a tax on the wholesale cost at a rate to be annually determined by the Board. The tobacco products tax rate is equivalent to the combined rate of tax on cigarettes and based on the March 1 wholesale cost of tobacco products. The tax rate on tobacco products required by this section of law was set by the Board at 26.17% for the period July 1, 1998 through June 30, 1999.

Beginning January 1, 1999, Section 30131.2 imposed an additional tax on tobacco products at a rate to be annually determined by the Board equivalent to the 50 cent per pack tax on cigarettes also imposed by this section. The rate for the period January 1, 1999 through June 30, 1999 is 35.36%. The Board must also annually set this second tobacco products tax rate to be in effect for each fiscal year. Combined, the total tobacco products tax rate for the first six months of calendar year 1999 is 61.53% (26.17% + 35.36%).

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The following chart summarizes the cigarette and tobacco products tax rates that are scheduled to be in effect on and after July 1, 1999.

Cigarette Taxes		
Code Section	Rate per pack of 20	Disposition of Funds
30101	10 cents	General Fund
30101	2 cents	Breast Cancer Awareness
30123	25 cents	Cigarette and Tobacco Products Surtax Fund
30131.2	50 cents	California Children and Families First Trust Fund
Total Tax	87 cents	

Tobacco Products Taxes		
Code Section	Rate on wholesale costs (effective 7-1-99)	Disposition of Funds
30123	Percentage equivalent to Total Cigarette Taxes of 87 cents	Cigarette and Tobacco Products Surtax Fund
30131.2	Percentage equivalent to 50 cents	California Children and Families First Trust Fund
Total Tax	Percentage equivalent to \$1.37	

Proposed Law:

This bill would amend Section 30123 of the Revenue and Taxation Code to limit the factors included in the annual determination of the Proposition 99 tobacco products tax rate to the cigarette tax imposed by Proposition 99 of 1989 (25 cents per pack) and the cigarette tax rate contained in Article 1 (commencing with Section 30101), currently imposed at 12 cents per pack. If enacted before July 1, 1999, this change would make the total tobacco products tax rate equivalent to the total cigarette tax rate of 87 cents per pack of 20, instead of the \$1.37 equivalent rate scheduled to be imposed on July 1, 1999.

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Background:

Beginning in September 1992 (Ch. 699, Stats. 1992), all cigarette tax revenue from the total 10 cent per pack rate in effect at that time was deposited into the General Fund. Prior to 1992, a portion of these revenues were allocated to cities and counties.

Proposition 99, passed on the November 1988 ballot, effective January 1, 1989, imposed a surtax of 25 cents per package of 20 cigarettes, and also created an equivalent tax on tobacco products. Proceeds from the taxes fund tobacco-related health education, tobacco-related disease research, low-income hospital care, and programs for fire prevention, environmental conservation, and maintenance of wildlife habitats and parks.

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

Most recently, Proposition 10 adopted by the voters on the November 3, 1998 ballot added Article 3 (commencing with Section 30131) to Chapter 2 of Part 13 of Division 2 of the Revenue and Taxation Code to impose an additional tax of 50 cents per package of 20 cigarettes, in addition to an equivalent tax on tobacco products. The tax was imposed beginning January 1, 1999. Those funds are deposited in the California Children and Families First Trust Fund.

In General:

A result of the language contained in Proposition 10 is to disproportionately increase the Proposition 99 tobacco product tax rate to be equivalent with not only the current 37 cent per pack cigarette tax but also the 50 cent per pack cigarette tax increase imposed by Proposition 10. Because current Section 30123 requires the Proposition 99 tobacco products tax rate to include the Proposition 99 cigarette tax rate and any other cigarette taxes imposed under Part 13 of the Revenue and Taxation Code, in which the Proposition 10 tax increase was included, that measure resulted in overlapping tax increases on tobacco products.

**COMMENTS:**

1. Sponsor and purpose. According to the author's office, this bill is sponsored by the California Distributors Association, a trade group representing cigarette and tobacco products wholesalers. The sponsor believes the Board's interpretation of the current statutes imposes an unfair and disproportionate excise tax on tobacco products contrary to the intent of Proposition 99 and Proposition 10. This bill is intended to clarify that the total excise tax rate on tobacco products be equivalent to the excise tax rate on cigarettes.

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2. The Board voted in December 1998 to apply a strict interpretation of Section 30131.5. At the Board of Equalization's December 7, 1998 Business Taxes Committee Meeting, the Board Members discussed the issue of whether the tobacco products tax rate should include the 50 cent per pack tax imposed by Proposition 10 in the calculation of the Proposition 99 tobacco products tax rate for the fiscal year beginning July 1, 1999. The committee determined that Propositions 10 and 99 require the staff's calculation of the Proposition 99 tobacco products tax rate, effective July 1, 1999, to include a rate component equivalent to the 50 cent per pack tax imposed by Proposition 10, in addition to a similar tax increase on tobacco products collected directly under Proposition 10.
3. This bill is necessary to allow a truly equivalent tax rate on tobacco products. In a paper prepared by the Board's Excise Taxes Division for the December 7, 1998 Business Taxes Committee Meeting, the Board staff argued that the rules of statutory interpretation apply equally to initiatives, and the cardinal or fundamental rule of statutory interpretation is that the court should ascertain the intent of the legislature (in this case the voters) so as to carry out the purpose of the law. Where the meaning of the language of a statute is clear and unambiguous, a "plain meaning", there is no uncertainty or doubt of the legislative intent and there is no need for statutory interpretation. Board staff believes a review of Proposition 10 provides no room for interpretation and does not believe the current statute allows an alternative interpretation. The language of the initiative pertaining to the tax on cigarettes and tobacco products is clear and unambiguous. There is no language in the initiative which prohibits the resulting "unequivalent tax rate on tobacco products," nor is there any acknowledgment of the "unequivalent tax rate" result. The summary and analysis provided in the voter Ballot Pamphlet, however, reference the resulting "unequivalent tax rate". Given that an enacted initiative must be interpreted and applied in a manner consistent with the voters' intention, the language in the Ballot Pamphlet would support a strong argument that the will of the people is the resulting "unequivalent tax rate" on tobacco products. Based on these conclusions, this bill is necessary to make the total tobacco products tax rate equivalent to the total cigarette tax rate.

**COST ESTIMATE:**

The administrative costs associated with this bill would be absorbable. These costs would include advising and answering inquires from the public, and informing Board staff.

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**REVENUE ESTIMATE:**

**Background, Methodology, and Assumptions**

The passage of Proposition 10 at the November 3, 1998 General Election imposed a \$0.50 per pack tax on cigarettes and a tax rate equivalent to a \$0.50 per pack rate on other tobacco products.

Proposition 99 also imposes a tax on tobacco products. Currently, that tax is at a rate “equivalent” to the combined tax rate on cigarettes. This combined rate consists of the \$0.10 per pack rate imposed by the Cigarettes Tax Law, \$0.02 per pack imposed for the Breast Cancer Fund, and the \$0.25 per pack imposed by Proposition 99. This combined rate is equal to \$0.0185 per cigarette.

Proposition 99 calls for a recalculation of the Tobacco Tax rate every year. On July 1, 1999, the tax rate for tobacco products will be changed. The Board of Equalization has determined that the “equivalent” Proposition 99 tax rate on tobacco products should include the \$0.50 per pack increase in the cigarette tax imposed by Proposition 10. AB 1143 would amend the provisions of Proposition 99 to exclude the increase in the cigarette tax imposed by Proposition 10 from the calculation of that rate.

The tobacco products tax is based on the wholesale cost of these products at a tax rate that is “equivalent” to the rate of tax imposed on cigarettes. The rate is determined by dividing the tax rate per cigarette by the average wholesale cost per cigarette. The wholesale price of cigarettes has increased substantially in the past few months. The Excise Tax Division has determined that the average wholesale cost per cigarette to be used to set the 1999-00 Tobacco Tax rate is \$0.1030. The Proposition 10 tax rate on cigarettes as of January 1, 1999 is \$0.0250 per cigarette.

The total cigarette tax rate, including the Proposition 10 rate, is \$0.0435 per cigarette. (\$0.0185 + \$0.0250 = \$0.0435.) This is the rate that will be used to calculate the Proposition 99 Tobacco Tax rate. Based on this information the Tobacco Tax rate for 1999-00 would be as follows:

	Wholesale Cost Per Cigarette (A)	Equivalent Cigarette Tax Rate (B)	Tobacco Tax Rate (B / A)
Prop 10	\$0.1030	\$0.0250	24.27%
Prop 99	\$0.1030	\$0.0435	42.23%
Combined Rate			66.50%

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AB 1143 would revise the calculation of the Proposition 99 Tobacco Tax rate. The Proposition 10 tax on cigarettes would not be included in the “equivalent” cigarette tax rate. Under this proposal, the Proposition 99 “equivalent” cigarette tax rate would remain \$0.37 per pack or \$0.0185 per cigarette. Based on this proposal, the tobacco tax rate for 1999-00 would be as follows:

	Wholesale Cost Per Cigarette (A)	Equivalent Cigarette Tax Rate (B)	Tobacco Tax Rate (B / A)
Prop 10	\$0.1030	\$0.0250	24.27%
Prop 99	\$0.1030	\$0.0185	17.96%
Combined Rate			42.23%

Total wholesale sales of tobacco products in California amounted to \$134.9 million during the 1997-98 fiscal year. According to the 1998-99 Governor’s Budget Summary, wholesale sales of tobacco products was estimated to remain flat for 1998-99 and 1999-00. However, an increase in the tax rate as large as the one imposed by Proposition 10 would surely cause both a decrease in actual consumption and an increase in tax evasion. Tax evasion is a larger problem with tobacco products than with cigarettes. Tax indicia, which is one disincentive to evaders, are not required for tobacco products. Although the exact magnitude of the effects is uncertain, we have assumed that the tobacco products tax imposed by Proposition 10 would cause a decrease in apparent consumption of 25%. Therefore, the estimated wholesale sales of tobacco products for the 1999-00 fiscal year would be \$101.2 million. ( $\$134.9 \text{ million} \times .75 = \$101.2 \text{ million}$ )

Using the Proposition 10 cigarette tax increase to determine the “equivalent” tax rate for the Proposition 99 tobacco products tax would cause a further decline in apparent consumption. We estimate that imposing this higher tax will cause apparent consumption to decline to \$80.9 million.

This proposal will impact the revenues for both the Proposition 99 funds and for the Proposition 10 funds. Proposition 99 revenues will decline due to this change, as the Proposition 99 tax rate on tobacco products will be reduced. Proposition 10 revenues will increase, as lowering the tax rate will result in a smaller decline in apparent consumption.

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The revenue impact for fiscal year 1999-00 will be as follows:

**1999-00 – Proposition 99 Revenues:**

	Wholesale Cost <u>(millions)</u>	<u>Rate</u>	Revenue <u>(millions)</u>
Without Prop. 10 increase	\$101.2	17.96%	\$18.2
With Prop. 10 increase	\$ 80.9	42.23%	<u>\$34.2</u>
Revenue Change			<u>-\$16.0</u>

**1999-00 – Proposition 10 Revenues:**

	Wholesale Cost <u>(millions)</u>	<u>Rate</u>	Revenue <u>(millions)</u>
Without Prop. 10 increase	\$101.2	24.27%	\$24.6
With Prop. 10 increase	\$ 80.9	24.27%	<u>\$19.6</u>
Revenue Change			<u>\$ 5.0</u>

**Revenue Summary**

The revenue impact in revising the provisions of the Tobacco Tax and Health Protection Act of 1988 (Proposition 99) to provide that the combined rate of tax imposed on cigarettes for use in calculating the tax rate for the Tobacco Products Tax does not include the tax imposed by the Children and Families First Act of 1998 (Proposition 10) would be as follows:

Revenue loss to Proposition 99 funds	\$16 million
Revenue gain for Proposition 10 funds	\$ 5 million

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