



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

|                 |                                       |                |                |
|-----------------|---------------------------------------|----------------|----------------|
| Date Amended    | <b>04/18/02</b>                       | Bill No:       | <b>AB 2906</b> |
| Tax:            | <b>Cigarette and Tobacco Products</b> | Author:        | <b>Horton</b>  |
| Board Position: |                                       | Related Bills: |                |

### BILL SUMMARY

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 in question is:

- A participating manufacturer under the Master Settlement Agreement (MSA), or
- A non-participating manufacturer that has made all required escrow payments.

### ANALYSIS

#### Current Law

Under existing law, the State Board of Equalization (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 respecting their distribution of cigarettes and purchase of stamps during the preceding month.

#### Proposed Law

This bill would add Section 30163.1 to the Revenue and Taxation Code to require that no person affix, 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 cigarette or tobacco product, are included on a list posted by the Attorney General.

The Attorney General's list would be annually posted on the Attorney General's web site and include the following:

1. All tobacco product manufacturers that are participating manufacturers under the MSA.

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2. All non-participating tobacco product manufacturers in the MSA that have been determined by the Attorney General to have made all escrow payments required by law.
3. All brand families of such participating and non-participating manufacturers.

### **VIOLATIONS**

This bill would authorize the Board to revoke or suspend the license or licenses of a distributor for stamping or paying taxes on brands that are in violation of this bill's requirements. The Board would also be authorized to impose a penalty not to exceed the greater of either of the following:

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

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 deemed "contraband" and subject to seizure and forfeiture pursuant to the Cigarette and Tobacco Products Tax Law. The cigarettes or tobacco products seized and forfeited would be destroyed.

### **MISCELLANEOUS**

This bill would authorize the Board to require those distributors that affix stamps or meter impressions to packages of cigarettes, or that pay the tax on a tobacco product defined as a cigarette, to submit all information necessary to enable the Attorney General to determine whether a tobacco product manufacturer has made all escrow payments.

The Board and the Attorney General would be authorized to exchange information as is reasonably necessary for the enforcement and administration of this bill.

### **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.

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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. The Board was neutral on Senate Bill 822.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by R.J. Reynolds Tobacco Company and 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.

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. **This bill would require that contraband product be seized and forfeited to the state.** This bill would deem as "contraband" any cigarettes, or tobacco products defined as cigarettes, that are stamped, or for which tax has been paid, but that are in violation of this bill's requirements, and subject those cigarettes and tobacco products to seizure and forfeiture.

Under existing Cigarette and Tobacco Products Tax Law, the seizure and forfeiture provisions are contained in Chapter 7.5 (commencing with Section 30436). In part, Section 30436 specifically provides what property, upon seizure by the Board, is forfeited to the state. Since cigarette and tobacco products violating this bill's provisions are not listed as property that would be forfeited to the state upon seizure by the Board, it is suggested that Section 30436 be amended to add such products. This amendment would make the remaining provisions of proposed Section 30163.1(g) unnecessary since the Board would be authorized to enforce the restriction on stamping cigarettes products prohibited by this bill in a manner consistent with the seizure provisions on all other illegally stamped cigarettes in California. As such, the following language is suggested:

~~30163.1. (g) Any cigarettes or tobacco products defined as cigarettes under this section that are stamped or to which a meter impression is affixed, or for which tax is paid as required by Sections 30123 and 30131.2, in violation of subdivision (b) shall be deemed contraband and shall be subject to seizure and~~

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~~forfeiture as provided in Chapter 7.5 (commencing with Section 30436), and the cigarettes or tobacco products seized and forfeited shall be destroyed. The cigarettes or tobacco products shall be deemed contraband regardless of whether the violation of subdivision (b) is knowing.~~

30436. The following property, upon seizure by the board, is hereby forfeited to the State of California:

(e) Any cigarettes or tobacco products to which are affixed California cigarette tax stamps or meter impressions, or for which tax is paid as required by Sections 30123 and 30131.2, in violation of Section 30163.1.

3. **Would this bill authorize the Board to request additional information from distributors?** This bill would authorize the Board to require those distributors that affix stamps to packages of cigarettes to submit all information necessary to enable the Attorney General to determine whether a tobacco product manufacturer has made all escrow payments, as required. The Board currently requires those distributors to provide information allowing staff to calculate the number of tax paid units sold in California by each participating manufacturer pursuant to Section 30454. Section 30454 provides, in general, that in addition to any other reports required, the Board may require additional, other, or supplemental reports from licensed distributors. As such, it appears this provision would not create a new responsibility for the Board.
4. **Suggested technical amendment.** This bill would prohibit a person from affixing a stamp to a package of cigarettes pursuant to Section 30163 of the Cigarette and Tobacco Products Tax Law unless the tobacco product manufacturer that makes or sells the cigarettes or tobacco products has made all escrow payments pursuant to the MSA. In its current form, it appears that a tobacco product manufacturer in compliance with the MSA would be authorized to stamp any package of cigarettes – including those cigarettes prohibited from being stamped pursuant to Section 30163(b). To make it clear that no stamp shall be affixed to any package of cigarettes pursuant to Section 30163(b) and proposed Section 30163.1(b), the following amendment is suggested:

30163.1. (b) No person shall affix, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes pursuant to Section 30163(a), or pay the tax levied pursuant to Sections 30123 and 30131.2 on a tobacco product defined as a cigarette under this section, unless the brand family of the cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on the list posted by the Attorney General pursuant to subdivision (c).

In addition, this bill provides in Section 30163.1(h)(2) that the Attorney General would be authorized to require tobacco product manufacturers to submit all information to enable the Attorney General to determine whether a manufacturer has made all escrow payments. In addition, Section 30163.1(i) provides that the

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Attorney General would be authorized to require each tobacco product manufacturer, as specified, to make all escrow payments, as provided, and to appoint a registered agent for service of process in the state and identify the agent to the Attorney General. It appears that these provisions would be more appropriately placed within the MSA provisions in the Health and Safety Code since they are not related to the Cigarette and Tobacco Products Tax.

### **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, and 3) seize cigarettes. A detailed cost estimate is pending.

### **REVENUE ESTIMATE**

The following chart shows the estimated annual tobacco settlement payments to California as compiled by the Legislative Analyst's Office, the actual payments for 1998, 2000 and 2001, and projected payments as of July 31, 2001, compiled by the Attorney General's Office. As previously indicated, California's MSA settlement payments have been significantly less than projected because of declining sales by the four original participating manufacturers.

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| Estimated Annual Tobacco Settlement Payments to California<br>1998 through 2025 (in millions) |                   |                   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Year  | State             |                   | Local*            |                   | Total             |                   |
|   | Projected In 1998 | Actual            | Projected In 1998 | Actual            | Projected In 1998 | Actual            |
| 1998 & 2000 Initial Payment<br>2000 Annual Payment  | \$562             | \$515             | \$562             | \$515             | \$1,124           | \$1,030           |
| 2001  | \$442             | \$383             | \$442             | \$383             | \$884             | \$766             |
|   | Projected in 1998 | Projected in 2001 | Projected in 1998 | Projected in 2001 | Projected in 1998 | Projected in 2001 |
| 2002  | \$531             | \$445             | \$531             | \$445             | \$1,062           | \$891             |
| 2003  | \$536             | \$445             | \$536             | \$445             | \$1,072           | \$891             |
| 2004 thru 2007 (each year)  | \$447             | \$386             | \$447             | \$386             | \$894             | \$771             |
| 2008 thru 2017 (each year)  | \$456             | \$367**           | \$456             | \$367**           | \$912             | \$773             |
| 2018 thru 2025 (each year)  | \$511             | \$441             | \$511             | \$441             | \$1,022           | \$881             |
| <b>Totals</b>   | <b>\$12,503</b>   | <b>\$10,531</b>   | <b>\$12,503</b>   | <b>\$10,531</b>   | <b>\$25,007</b>   | <b>\$21,445</b>   |

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

\*\* Less \$38,232 Strategic Contribution Fund Allocation

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