



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

Draft

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| Date Amended | 05/22/02 | Bill No: | SB 1700 |
| Tax: | Cigarette and Tobacco Products | Author: | Peace |
| Board Position: | | Related Bills: | SB 1701 (Peace) SB 1702 (Peace) AB 1768 (Wayne) AB 2205 (Koretz) |

BILL SUMMARY

Among other things, this bill would:

- Provide for the licensure by the State Board of Equalization (Board) of manufacturers, distributors, wholesalers, and retailers of cigarette and tobacco products;
- Impose a fee upon manufacturers not to exceed two-cent (\$0.02) per pack of cigarettes;
- Impose penalties for violations of the licensure program, as specified;
- Reimburse licensed distributors for the actual cost of labor for applying cigarette tax stamps; and
- Allow a distributor or wholesaler a bad debt deduction on uncollectable accounts.

ANALYSIS

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.

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

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.

Proposed Law

LICENSURE PROGRAM

Business and Profession Code Provisions

Licensing Provisions. This bill would add Division 8.6 (commencing with Section 22970) to the Business and Professions Code to require, commencing January 1, 2004, a retailer who sells cigarette and tobacco products in this state to obtain from the Board a valid license to sell cigarette and tobacco products.

Every person who owns or, if the owner is not the operator, then any person who operates one or more vending machines through which cigarettes or tobacco products are sold in this state, regardless of whether located on the premises of the vending machine owner or, if the owner is not the operator, then the premises of the operator or the premises of any person, would be required to register each such vending machine with the Board. On or after January 1, 2004, a vending machine registration certificate, in such form as may be prescribed by the Board, would be required to be affixed to each machine through which cigarettes or tobacco products are sold in this state.

Commencing January 1, 2003, a manufacturer that provides cigarette and tobacco products to a distributor or wholesaler or to a distributor functioning as a wholesaler, for distribution and sale in this state would be required to obtain and maintain a valid tobacco manufacturer's license from the Board.

This bill would also require a distributor or wholesaler, or a distributor functioning as a wholesaler, that provides cigarette and tobacco products for distribution and sale in this state to obtain and maintain a valid distributor's license or a valid wholesaler's license from the Board.

Retailer Licensure Requirements. 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, but could submit a single application for those licenses. The license would be required to be conspicuously displayed at the place of business for which it was issued. A licensee who has no regular place of business would be required to conspicuously display such certificate on each of its carts, stands, trucks or other merchandising devices through which it sells cigarettes or tobacco products in this state.

A retailer would be qualified and issued a non-transferable license when the Board receives a completed application, unless the retailer has previously been issued a license and is currently serving a suspension of the previously issued license. A retailer

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applying for a license after completing a suspension pursuant to the Cigarette and Tobacco Products Tax Law pursuant to the provisions of this bill would not be issued a license until any unpaid taxes and fees are paid.

A retailer would be required to retain purchase invoices 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 premises for which the license was issued and thereafter be made available for a period of three years.

This bill would provide that the retailer's license to sell cigarette and tobacco products is subject to the licensee requiring each employee making retail sales of cigarette and tobacco products to successfully complete a training program, developed by the Department of Health Services (DHS), on tobacco control every 12 months.

Manufacturer, Distributor, and Wholesaler Licensing Requirements. This bill would prohibit a manufacturer, distributor or wholesaler from selling cigarette and tobacco products to an unlicensed distributor, wholesaler, or retailer. Each separate sale to an unlicensed retailer would constitute a separate violation. This bill would also prohibit a distributor or wholesaler from selling cigarette and tobacco products to any retailer whose license has been suspended or revoked unless all existing cigarette or tobacco tax debts of the retailer for the purchase of cigarette and tobacco products have been cleared. The Board would be required to determine the debt status of a suspended retailer licensee 25 days prior to the reinstatement of the tobacco retailer's license.

Additional Board responsibilities. The Board would have the authorization to revoke the registration of a person or refuse to register an application for a license for a location that is the same premises as that of a person whose registration is revoked or revocation is pending, unless the person applying provides the Board with adequate documentation demonstrating that the person acquiring the premises or business in an arms length transaction. An "arms length transaction" would be defined as a sale in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction. A sale between relatives, related companies or partners or a sale for the primary purpose of avoiding the effect of the violations on the premises would be presumed not to be "arm's length". Any person or licensee convicted of a felony pursuant to Cigarette and Tobacco Products Tax Law Section 30480 would not be granted a license, or if a person holds a license, that license would be revoked.

This bill would require the Board to notify all licensed distributors and wholesalers by fax and e-mail within 48 hours upon suspending or revoking the license of a retailer.

MANUFACTURER PER PACK FEE

On or before March 1, 2003, a manufacturer would be required to pay a fee of not to exceed two cents (\$0.02), as determined by the Board, to the Board for each pack of cigarettes that was sold to a distributor or wholesaler for distribution or sale in this state in 1998. The fee would only apply to manufacturers who signed the tobacco master settlement agreement.

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Beginning January 1, 2004, a manufacturer would be required to pay a fee not to exceed two cents (\$0.02), as determined by the Board, for each pack of cigarettes that was sold to a distributor or wholesaler for distribution or sale in this state in the prior calendar year. This would apply to both signatories and non-signatories of the tobacco master settlement agreement.

PENALTIES

Sales of cigarette and tobacco products to minors. The Board would be required to take action against any retailer convicted of a violation of the Stop Tobacco Access to Kids Enforcement (STAKE) Act (Division 8.5 (commencing with Section 22950)), or Section 308 of the Penal Code, or other violation pursuant to the provisions of this bill, as follows:

- 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 be suspended and the amount of time the license may be suspended. The retailer and its employees would receive training on tobacco control laws from the DHS upon a first conviction.
- Upon the second conviction of a violation within five years, the retailer would be subject to a fine of five hundred dollars (\$500) and a 30-day suspension of the license to sell cigarette and tobacco products.
- Upon the third conviction of a violation within five years, the retailer would be subject to a fine of one thousand dollars (\$1,000) and a 90-day suspension of the license to sell cigarette and tobacco products.
- Upon the fourth conviction of a violation within five years, the licensee would be subject to a fine of one thousand dollars (\$1,000) and a one year suspension of the license to sell cigarette and tobacco products.
- Upon the fifth conviction of a violation within five years, the Board would revoke the retailer's license to sell cigarette and tobacco products.

Violations by a retailer at one retail location would not be accumulated against other locations of that same retailer. Violations accumulated against a prior retail owner at a licensed location would not be accumulated against a new retail owner at the same licensed location. Prior to suspending or revoking a retailer's license to sell cigarette and tobacco products, the Board would be required to notify the retailer and to provide the retailer instructions for appealing the license suspension or revocation.

The final decision of a local regulatory authority to suspend or revoke the retailer's license would be appealed to the Board within 30 days after the local regulatory authority's action becomes final. All appeals would be required to be submitted in writing. The timely filing of an appeal to the Board would hold in abeyance any license suspension or revocation and the payment of any administrative fine until the appeal is heard and decided. Once the appeal is heard and decided, any license suspension or revocation upheld by the Board on appeal would be effective on the date of the Board's decision and any administrative fine upheld by the Board would be paid within ten (10)

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days of the Board's decision. In the absence of an appeal to the Board, any license suspension or revocation would be effective and any administrative fine paid on the day 31 days after notice from the Board or after the local regulatory authority's action becomes final.

Sales of counterfeit cigarettes and unstamped packages of cigarettes. This bill would define "counterfeit cigarette and tobacco products" to include cigarette and tobacco products that have false manufacturing labels or cigarette packs without tax stamps or with counterfeit tax stamps, or a combination thereof.

The sale, possession, storage, or ownership of counterfeit cigarettes or unstamped packages of cigarette or other tobacco products by a retailer would result in the seizure of the product by the Board or any law enforcement agency and would constitute a misdemeanor punishable by the following actions:

- A first violation with a total quantity of less than 10 cartons of cigarettes would be misdemeanor punishable by a fine of one thousand dollars (\$1,000) or imprisonment not to exceed one year in county jail, or both the fine and imprisonment.
- A second violation within 5 years with a quantity of less than 10 cartons of cigarettes would be a misdemeanor punishable by a fine of not less than two thousand dollars (\$2,000) but not to exceed five thousand dollars (\$5,000) or imprisonment not to exceed one year in county jail, or both the fine and imprisonment, and would also result in the revocation of the retailer's license.
- A first violation with a total quantity of more than 10 cartons of cigarettes would be a misdemeanor punishable by a fine of two thousand dollars or imprisonment not to exceed one year in county jail, or both the fine and imprisonment
- A second violation within 5 years with a quantity of 10 cartons of cigarettes or more would be a misdemeanor punishable by a fine of not less than five thousand dollars (\$5,000) but not to exceed fifty thousand dollars (\$50,000) or imprisonment not to exceed one year in county jail, or both the fine and imprisonment, and would also result in the revocation of the retailer's license.

These actions would also apply to the sale of counterfeit cigarettes and tobacco products by a manufacturer, distributor, or wholesaler.

With respect to the retail license only, these actions would apply to the holder of the license and not to an employee of the licensee. In addition, the retailer would not be subject to the provisions of this section if an employee of the retailer is selling counterfeit cigarette and tobacco products without the retailer's knowledge.

This bill would also add a presumption that all tobacco products in the possession of a retailer are "untaxed tobacco product" until the contrary is established by a purchase invoice. The burden of proof that tax has been paid on "untaxed tobacco products" would be upon the person in possession thereof.

Violation of licensure provisions. This bill would provide that any violation of the licensure provisions by any person, except as otherwise provided, would be a misdemeanor. Each offense would be punished by a fine of not less than one thousand

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dollars (\$1,000) and not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

Retailer failure to maintain records. Any licensee found in violation of maintaining records would be subject to a misdemeanor and a fine of not less than one thousand dollars (\$1,000) and not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

Unlicensed persons. A person who engages in 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, would be guilty of a misdemeanor. Each day that a retailer offers cigarette and tobacco products for sale or exchange without a valid retailer license for the location from which they are sold would constitute a separate violation.

General. Any prosecution for violation of any criminal provisions of the licensure program would be required to be instituted within five years after the commission of the offense or within two years after the violation is discovered, whichever is later.

DISTRIBUTOR REIMBURSEMENT FOR AFFIXING STAMPS AND IMPRESSIONS

All moneys collected pursuant to the provisions of this bill would be deposited in the Cigarette and Tobacco Products Control Fund (Fund), which this bill creates in the State Treasury. All monies in the Fund would be available for expenditure, upon appropriation by the Legislature, for the following purposes:

- To the Board for the administration and investigation of the programs relating to the issuance and use of cigarette tax stamps, cigarette and tobacco products retailer's licenses, cigarette and tobacco products wholesaler's licenses, cigarette and tobacco products distributor's licenses, and cigarette and tobacco manufacturer's licenses. **Included in those costs would be reimbursement to licensed distributors and wholesalers for the actual cost of labor for applying indicia or impressions, bonding cost, warehouse space, and stamping equipment lease, including case cutters and packers. The Board would adjust reimbursement to the distributor or wholesaler to reflect those actual costs when renewing its contract for cigarette indicia or impressions.**
- To the DHS for costs related to controlling youth access to cigarette and tobacco products.
- To the Bureau of Investigation of the Department of Justice for criminal investigative activities associated with criminal activity in the sale of cigarette or tobacco products or counterfeit cigarette or tobacco products.

BAD DEBTS

A distributor or wholesaler would be relieved from liability for cigarette and tobacco products taxes that became due and payable if the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes, or in accordance with generally accepted accounting principles. If the

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distributor or wholesaler has previously paid the tax, the distributor or wholesaler would be allowed to take as a deduction the amount found worthless and charged off. If any of those accounts are thereafter in whole or in part collected by the distributor or wholesaler, the amount so collected would have to be included in the first return filed after the collection.

This bill would require each distributor and wholesaler to include specified information on each invoice for the sale of cigarette and tobacco products. Each distributor and wholesaler of cigarette and tobacco products subject to licensing pursuant to this bill would be required to maintain accurate and complete records relating to the sale of those products. Failure to comply with the record keeping requirements would be a misdemeanor and result in a fine of not less than one thousand dollars (\$1,000) and not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

Other Revenue and Taxation Code Provisions

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 of not less than two thousand dollars (\$2,000) and not to exceed five thousand dollars (\$5,000) or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

Any person who, with intent to defeat or evade or with the intent to aid another to defeat or evade the taxes imposed by this part, possesses, sells, or offers to sell, buys or offers to buy, any false or fraudulent stamps or meter impressions provided for or authorized under this part in a quantity of 2000 or greater, would be guilty of a misdemeanor, punishable by a fine of not less ten-thousand dollars (\$10,000) but not to exceed fifty thousand dollars (\$50,000) or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment.

In General

Revenue and Taxation Provisions

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

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amounted to \$31,320, \$60,030 and \$127,132, respectively. Again, only misdemeanor charges apply since current law does not contain a felony provision.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by Senator Peace and is intended to provide comprehensive regulation of cigarette and tobacco products sales.
2. **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 for the distribution and sale of cigarette and tobacco products in this state, as well as retailers for the privilege of selling such 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.
3. **This bill would add felony provisions for the possession of fraudulent tax stamps or meter impressions with intent to evade the taxes.** These provisions are similar to a proposal adopted by the Board at the November 28, 2001, Legislative Committee Meeting. The Board's proposal, however, did not provide that the misdemeanor would be punishable by a fine or imprisonment.
4. **This bill would add bad debt provisions for distributors and wholesalers similar to those contained in the sales and use tax law.** Under current sales and use tax law, a sales tax is imposed on the gross receipts from the sale of tangible personal property, unless specifically exempted by statute. A retailer is relieved from liability for sales tax that became due and payable insofar as the measure of the tax is represented by accounts that have been found worthless and charged off. Unlike the sales and use tax, the cigarette and tobacco products tax is based on a per-item distribution of such products. In other words, the cigarette and tobacco products tax is imposed upon the action of the distributor, not the gross receipts. For example, since the sales tax is based on the amount received (gross receipts) by the retailer, no sales tax is due if the retailer receives no payment (7.5 percent tax x no gross receipts = no tax due). However, the cigarette and tobacco products tax is imposed upon the act of distribution whether or not payment is collected.

Further, taxpayers who have a responsibility to report and pay taxes based on a per-item rate of tax on the distribution or sale of a commodity, such as gasoline and alcoholic beverages, would likely seek a bad debt deduction. These other excise tax programs administered by the Board require a taxpayer to pay the tax regardless of the taxpayer's collection of tax reimbursement from their customer.

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And as a technical note, the proposed bad debt provisions specifically relate to excise taxes imposed upon distributors for their distribution of cigarette and tobacco products pursuant to Part 13 (commencing with Section 3001) of Division 2 of the Revenue and Taxation Code (Cigarette and Tobacco Products Tax Law). As such, it is recommended that this bill be amended to delete the bad debt provisions from the Business and Professions Code, and add them to the Revenue and Taxation Code.

5. **Distributor's discount.** This bill would reimburse licensed distributors and wholesalers for the actual cost of labor for applying indicia or impressions, bonding cost, warehouse space, and stamping equipment lease, including case cutters and packers. However, wholesalers do not apply cigarette tax stamps or impressions. As such, the reference to wholesaler in Section 22990 should be deleted.

In addition, it should be noted that Section 30166 of the Cigarette and Tobacco Products Tax Law provides that stamps and meter register settings are to be sold to licensed distributors at their denominated values less 0.85 percent. That discount is intended to help defray the cost (leasing of equipment/labor cost) to the distributor for affixing the stamps. Accordingly, if this bill were chaptered in its current form, distributors would receive 1) reimbursement for their actual cost of affixing indicia and 2) a discount on their purchase of tax indicia and impressions as provided in current law.

6. **Suggested technical amendments.** Board staff is working with the author's office in drafting appropriate amendments to address the following concerns:

- Require persons importing cigarettes and tobacco products into this state to be licensed and require such persons to pay the per-pack fee imposed upon manufacturers pursuant to the provisions of this bill.
- Proposed Section 22987(c) would prohibit a distributor or wholesaler from selling cigarette and tobacco products to any retailer whose license has been suspended or revoked unless all existing cigarette or tobacco tax debts of the retailer for the purchase of cigarette and tobacco products have been cleared. However, the excise tax on cigarette and tobacco products is imposed on the distributor upon distribution of such products – not a retailer. Therefore, retailers would not have cigarette or tobacco tax debts.
- This bill would require the Board to determine the per-pack fee on cigarettes, not to exceed two cents (\$0.02) per pack. However, the bill is not specific as to what the determination of the fee is to be based upon. Accordingly, this bill should be amended to provide a basis for setting the fee.

7. **Related legislation.** Three additional measures have been introduced this legislative session to address cigarette tax evasion: AB 2205 (Koretz), SB 1701 (Peace), and SB 1702 (Peace). Assembly Bill 2205 would increase the penalty for possessing, selling, or offering for sale unstamped cigarettes from one hundred dollars (\$100) to two hundred dollars (\$200) for each carton of 200 cigarettes. The Board voted to support that measure.

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Senate Bill 1701 would, as of January 1, 2005, require the Board to replace the stamps and meter impressions, currently required to be affixed to a package of cigarettes, with stamps and meter impressions generated by a technology capable of being read by a scanning or similar device. The Board voted to support SB 1701 at the April 17, 2002, Legislative Committee Meeting. And Senate Bill 1702, a Board-sponsored measure, would authorize persons employed by the Board's Investigations Division, 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.

Also this Legislative Session, Assembly Member Wayne introduced a measure that would reduce the discount provided to distributors. Assembly Bill 1768 would provide that the 0.85 percent cigarette distributor discount only applies to the first \$0.10 of the value of the stamp or meter impression. The Board voted to support that measure.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a new licensure program. These costs would include 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. A cost estimate is pending.

REVENUE ESTIMATE

Manufacturer Per Pack Fee

Fiscal Year 2002-03. The Board of Equalization annual report shows tax-paid distributions of 1,668 million packs of cigarettes in fiscal year 1997-98. We will assume this figure held for calendar year 1998 as well. The U.S. market share of signatories to the Master Settlement Agreement (MSA) was approximately 97 percent in 1997. We will assume this market share for California for 1998. At a rate of \$0.02 per pack, fiscal year 2002-03 revenues are estimated to be \$32.4 million ($1,668 \times 0.02 \times 0.97 = 32.36$).

Fiscal Year 2003-04. Tax-paid cigarette distributions were 1,288 million packs in fiscal year 2000-01. According to the 2002-03 *Governor's Budget Summary*, total cigarette consumption is estimated to decline in the range of 3 percent annually in the next few years. (Alternatively stated, a 3 percent annual decline is 97 percent of prior year consumption.) In fiscal year 2002-03, two years from FY 2000-01, consumption is estimated to be 1,212 million packs ($1,288 \text{ million packs} \times 0.97 \times 0.97 = 1,212 \text{ million packs}$). Consumption is estimated to be 1,176 million packs in fiscal year 2003-04, ($1,212 \text{ million packs} \times 0.97 = 1,176 \text{ million packs}$). Average tax-paid distributions for the two fiscal years is 1,194 million packs. We will assume this figure as an estimate for calendar year 2003 sales. We also will assume the fee is to be paid before the end of the fiscal year. At a rate of \$0.02 per pack, fiscal year 2003-04 revenues are estimated to be \$23.9 million ($1,194 \times 0.02 = 23.88$).

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Bad Debt Costs. Under this bill, wholesalers or distributors would be allowed to deduct paid cigarette and tobacco products excise taxes from accounts found worthless and charged off. An examination of Board sales and use tax returns for a number of large retailers indicated that bad debt deductions averaged approximately 2 percent of total taxable sales. We have no specific bad debt information for cigarette and tobacco products excise taxes. We will assume bad debt deductions would also average 2 percent of tobacco excise tax revenues.

Assuming calendar year 2003 sales of 1,194 million packs (see earlier discussion), cigarette excise taxes would be approximately \$1,039 million [1,194 packs x \$0.87 (excise taxes per pack) = 1,038.8]. In 2000-01 tobacco products surtax revenues were nearly \$53 million. If we assume no change in tobacco products surtax revenues, a reasonable estimate of total cigarette and tobacco products excise taxes would be approximately \$1,092 million. Two percent of this figure is \$22 million. We will assume bad debt deductions of \$22 million each fiscal year.

Cigarette Distributor Discount. An industry estimate of the fiscal impacts of reimbursement of distributors' actual costs of applying stamps and storing product is \$20 million per year. We have no information to either verify or negate this estimate. However, it seems reasonable given our understanding of the fixed and variable costs of cigarette stamping.

Sales and Use Tax Impacts. We will assume the two-cent per pack fee would be passed on to consumers and subject to the sales and use tax. However, we do not believe the stamping and storage reimbursement would be likely to be passed on to consumers. Sales and use taxes should not be affected by the bad debt deductions.

If the two-cent per pack fee is passed on to the ultimate consumer, there would be an increase in state and local sales and use tax revenue as follows:

| | <u>Increased Revenue</u> | |
|--------------------------|--------------------------|----------------|
| | <u>2002-03</u> | <u>2003-04</u> |
| State (5%) | 1.6 | 1.2 |
| Local (2.25%) | 0.7 | 0.5 |
| Special District (0.67%) | <u>0.2</u> | <u>0.2</u> |
| Total | \$2.5 Million | \$1.9 Million |

Revenue Summary

The multiple provisions affecting revenues, as the bill is currently written, would result in the revenue impacts shown in the following table. Fiscal year 2002-03 revenue impacts are one-time effects, since the manufacturer per pack fees received are based on 1998 sales. In fiscal year 2003-04, this bill would generate \$24 million in fees, but these are more than offset by bad debt deductions of \$22 million and cigarette distributor discounts of \$20 million, for a net decrease of \$18 million.

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2002-032003-04Manufacturer per Pack Fee Impacts:

| | | |
|--------------------------------|----------------------|----------------------|
| Fee Revenue Generated | \$32 million | \$24 million |
| Bad Debt Deductions | -\$22 million | -\$22 million |
| Cigarette Distributor Discount | <u>-\$20 million</u> | <u>-\$20 million</u> |
| Net Revenue Impacts | -\$10 million | -\$18 million |

Sales and Use Tax Impacts

| | | |
|----------------------------------|----------------------|----------------------|
| State Sales & Use Tax (at 5%) | \$1.6 million | \$1.2 million |
| Local Sales & Use Tax (at 2.25%) | \$0.7 million | \$0.5 million |
| Transit Tax (at 0.67%) | <u>\$0.2 million</u> | <u>\$0.2 million</u> |
| Total Sales and Use Tax Impacts | \$2.5 million | \$1.9 million |

Qualifying Remarks

The two-cent per pack fee revenue estimate assumes that manufacturers do not ship to neighboring states for distribution in California to avoid paying the tax.

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