



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced	02/21/02	Bill No:	SB 1701
Tax:	Cigarette and Tobacco Products	Author:	Peace
Board Position:		Related Bills:	

BILL SUMMARY

This bill would, on or before January 1, 2005, require the State Board of Equalization (Board) to replace the stamps and meter impressions, currently required to be affixed to tobacco products, with a two-dimensional (2-D) bar code stamp that can be read with an existing scanning device.

ANALYSIS

Current Law

Revenue and Taxation Code Section 30161 (Cigarette and Tobacco Products Tax 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. Stamps and meter impressions, pursuant to Section 30162, shall be of such designs, specifications and denominations as may be prescribed by the Board.

Proposed Law

This bill would add Section 30162.1 to require the Board, on or after January 1, 2005, to replace the stamps and meter impressions, currently required to be affixed to tobacco products prior to distribution as evidenced of payment of the tax imposed, with a 2-D bar code stamp that can be read with existing scanning devices and capable of recording and storing the following information:

- The name and address of the wholesaler or distributor affixing the 2-D bar code.
- The date the 2-D bar code stamp was affixed.
- The amount of tax represented by the 2-D bar code stamp.

Background

The Board currently contracts with The Meyercord Company (Meyercord) for cigarette tax stamps and application machinery. Among other things, the contract provides the denominations and configurations of stamps, design of stamps, performance of stamps,

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security, inventory system, and requirements for application machinery, ancillary equipment, service and training. The cigarette tax stamp contract is for the three-year period commencing January 1, 2002 and ending December 31, 2004. With respect to counterfeit stamps, the contract provides the following:

- Stamps shall be designed so that the state of issuance and denomination can quickly be determined upon unaided visual inspection of stamps affixed to packages of cigarettes.
- Stamps shall contain hidden security features that will allow staff of both the Board and the bidder to determine their authenticity.
- Bidder shall provide specifications using the most effective technology that would contain security features to prevent counterfeit or reproduction of stamps.
- Stamps shall be constructed in layers consisting of at least five impressions, including safety-tint letter, applied to a release type carrier using a gravure process.
- Each stamp shall contain not less than three different distinctive colors.
- All stamps on rolls shall be numbered to provide a means to trace both affixed and unaffixed stamps in the case of fraud, theft, or loss.

Stamps ordered by the Board are furnished by Meyercord to Bank of America. The Board contracts with Bank of America to sell cigarette tax stamps to licensed distributors and to remit the tax collected to the Board. The Board's current contract with Bank of America is for the three-year period commencing July 1, 2001 and ending June 30, 2004.

Licensed cigarette distributors affix the cigarette stamps to packages of cigarettes with machinery purchased or leased from Meyercord. The packages of cigarettes are generally distributed by cigarette distributors to retailers and wholesalers in this state.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by Senator Peace and is intended to require the Board to use a "smart" cigarette tax stamp capable of storing a unique, encrypted digital signature. The author believes that a smart cigarette tax stamp would address the counterfeit tax stamp issue where stamps are reproduced and appear identical to legitimate indicia. The authenticity of the tax stamp could be verified visually and with a hand held scanning device.
2. **Two-dimensional code.** Two-dimensional code or 2-D code really is generic to this entire class. There are several terms now being used to describe this new class of keyless data entry symbologies. The terms *stacked symbology* or *multi-row code* are more accurately applied to those symbologies made up of a series of one-dimensional bar codes. The data is coded in a series of bars and spaces of varying width.

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The term Matrix code applies to 2-D codes that code the data based on the position of black spots within a matrix. Each black element is the same dimension and it is the position of the element that codes the data.

Ordinary bar code is "vertically redundant", meaning that the same information is repeated vertically. It is in fact a one-dimensional code. A two-dimensional code stores information along the height as well as the length of the symbol. Two-dimensional code systems have become more feasible with the increased use of moving beam laser scanners, and Charge Coupled Device (CCD) scanners. The 2-D symbol can be read with hand held moving beam scanners by sweeping the horizontal beam down the symbol.

- 3. This measure would provide investigators a method of instantly verifying the authenticity of a stamp.** The Board's Investigations Division has identified several evasion schemes involving counterfeit cigarette stamps. Production methods of such stamps include, in part, offset printing, silkscreen, lithography, flexo printing, laser printing and personal computer. Currently, counterfeit stamps are typically of such good quality that they appear identical to an authentic stamp therefore making it virtually impossible to identify counterfeit stamps by visual inspection.

This bill would address the identification of counterfeit stamps by requiring the use of a 2-D bar code stamp that is capable of being read by a scanning device. Each stamp would be a unique, encrypted digital signature. An on-site decryption of a 2-D bar code stamp with a scanning device would instantly reveal the unique digital signature, which would verify the authenticity of the stamp. A duplicate or wrong message would indicate a counterfeit stamp.

- 4. New process would eliminate the need for bank contract.** The purchase process of 2-D bar code stamps, as Board staff understands, would begin with the distributor placing an order for stamps with the Board. The Board would subsequently notify the 2-D bar code stamp vendor of the order. The 2-D bar code vendor would create the stamp and deliver it electronically to the distributor's digital stamping equipment. As a result of this measure, Bank of America's role of selling stamps to licensed distributors would no longer be necessary since the 2-D bar code stamp would be delivered directly from the vendor to the distributor electronically. The Board's contract with Bank of America currently costs California approximately \$586,000 per year. This would also address the Department of Finance's interest in reducing or eliminate these contract costs.
- 5. Suggested technical amendments.** This bill would, on or before January 1, 2005, require the Board to replace the current tax stamps with a 2-D bar code stamp. By limiting the Board to the 2-D barcode stamp, the Board would be required to utilize a stamp that is not necessarily the optimum choice considering security, general specifications and cost. Accordingly, it is suggested that the bill be amended to allow for the use of other computer generated stamping methods rather than limiting the Board to a specific type of technology. Board staff is willing to work with the author's office in drafting appropriate amendments to address this concern.

In addition, this bill provides that stamps and meter impressions are currently required to be affixed to "tobacco products" prior to distribution as evidence of the

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payment of tax. Stamps and meter impressions, however, are required to be affixed to cigarettes, not tobacco products, as evidence of the payment of tax. Accordingly, this bill should be amended to replace the term "tobacco products" with "cigarettes" on page 1, line 5.

COST ESTIMATE

The Board would incur costs related to new workload associated with notifying licensed distributors, developing returns, computer programming, and contracting with a vendor capable of producing a 2-D cigarette tax stamp. The related costs are unknown. However, these costs may be offset by the cost avoidance associated with eliminating the Board's existing contracts with Bank of America and Meyercord Company for services related to the current stamp method. A cost estimate of the new workload and offsetting cost avoidance is pending.

REVENUE ESTIMATE

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

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