

Memorandum

To : Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Board Member
Honorable Bill Leonard
Honorable Steve Westly

Date: October 13, 2005

From : Kristine Cazadd
Chief Counsel *K Cazadd*

Subject: **AB 71, The Cigarette and Tobacco Products Licensing Act of 2003 - Proposed Clarification of Penalties and Request to Draft Regulations.**

Introduction:

At its November 4, 2004 meeting, the Board considered civil penalties (including fines, suspensions and revocations) and appeals procedures to be implemented in addressing violations of AB 71, the California Cigarette and Tobacco Products Licensing Act of 2003 ("the Act"), proposed by the staff in an Informal Issue Paper. On November 4, 2004, the Board adopted the AB 71 Penalty Table attached to the Informal Issue Paper, which were subsequently revisited by the Board in May, 2005. During the past several months, the Excise Taxes and Fees Division (ETFD) and the Appeals Division have been handling appeals from taxpayers cited for AB 71 violations. Staff now recognizes the need for delegation of authority to apply the penalties with the flexibility permitted by statute,¹ but not addressed in the Issue Paper.

The purpose of this memorandum is as follows: First, to request delegation from the Board to allow the staff discretion² to be flexible in imposing 0- to 30-day suspensions for violations of Business and Professions Code (BPC) section 22974.3, involving sale or possession of unstamped cigarette packages. Second, to request authorization for staff to draft proposed regulations setting forth the appeals procedures to be followed and penalties to be imposed in implementing the Act.

¹ The applicable statutory provision is Business and Professions Code § 22974.7, which states that "[i]n addition to any other civil or criminal penalty provided by law, upon a finding that a retailer has violated any provision of this [Act], the board may take the following actions: (a) [i]n the case of the first offense, the board may revoke or suspend the license or licenses of the retailer..."

² This authority would be extended to the ETFD, and the Appeals Division.

Discretion as to Suspension Period:

First, the Informal Issue Paper sets forth the following penalties for retailers' first violations under the Act:

- (1) BPC § 22973 (false statements on application) --- 10- or 30-Day Suspension or a Revocation.
- (2) BPC § 22974 (retention of purchase invoices) --- Warning Notice.
- (3) BPC § 22974.3 (sale or possession of unstamped cigarettes) --- 30-Day Suspension.
- (4) BPC § 22974.5 (failure to display license) --- \$500 Fine (mandatory).
- (5) BPC § 22980(b) (failure to allow inspection) --- 30-Day Suspension.
- (6) BPC § 22980.1(c), (d) (purchases from unlicensed, suspended or revoked manufacturer/person) --- Warning Notice.
- (7) BPC § 22980.1(g) (acquiring cigarettes in violation of RTC § 30163) – Warning Notice to retailers and 10-Day Suspension for wholesalers and distributors.
- (8) BPC § 22980.2(a) (unlicensed sales of cigarettes & tobacco products) – Warning Notice.

When ETFD receives a copy of a citation from the Investigations Division, ETFD mails the licensee a Warning Notice or a Notice of Violation, depending on the statutes violated, which references the citation issued and the violation(s) observed. The Notice of Violation indicates the penalties to which the licensee is subject. Both notices provide information regarding appeal rights. The Notice of Violation specifies a date 60 days from the date of the notice when the license may be suspended or revoked. This meets the statutory requirements of notice before actual suspension or revocation.

Under the AB 71 Penalty Table for Retailers submitted by staff for Board approval at its November 4, 2004 meeting, an automatic 30-day suspension was intended to be imposed for a violation of BPC § 22974.3, for sale or possession of unstamped cigarette packages. (Unstamped cigarette packages include those that are affixed with a counterfeit tax stamp.) Even though the statute states that the Board “may” suspend the license because the staff believed at that time that strict liability was the appropriate penalty standard.

When the staff previously addressed the Board on the types of punitive action that should be taken against first and second offenders in possession of contraband cigarettes, we did not have the benefit of knowledge of the licensees' side of the story, or of the types of mitigating circumstances that might arguably lead a retailer to accidentally come into possession of cigarettes with counterfeit stamps. Now, after having held a number of Appeals conferences, the staff has concluded that, in some cases, an initial 30-day suspension period might be too severe. According to the licensees, a 30-day suspension will result in significant financial consequences to them, and may even put some of them out of business, particularly, as many of these businesses depend heavily on repeat customers. Furthermore, until March of this year, licensees had no possible way of identifying the more skillfully counterfeited stamps because the scanners did not become available for sale to retailers until March 10, 2005.

Due to the above circumstances, a majority of the staff who have reviewed these cases are now requesting the discretion to impose a 10-day initial suspension period in lieu of the present mandated 30-day suspension period. Examples of mitigating circumstances that staff find compelling are set forth below:

1. The cigarettes with counterfeit stamps were very small in number or constituted only a very small percentage of total inventory.
2. The retailer argues that he purchased the cigarettes with the counterfeit stamps from a licensed distributor and had no way of telling that the stamps were fake (because they were purchased prior to January 1, 2005 or otherwise before the retail scanners were available).
3. The retailer argues that he or she only recently purchased the store and that the contraband was present in the existing inventory and there was no way of identifying the counterfeit stamps for the reasons stated in #2 above.
4. The contraband cigarettes were received in an exchange from a customer or from a licensed vendor who had taken them in exchange.
5. The very small number of contraband cigarettes found on the retail premises were obtained outside the state for personal use only.

Of course, some of these representations may merely have been presented by the charged licensees to provide an alternative innocent explanation for their possession of the contraband. Nonetheless, given the minor nature of some of the violations and the likelihood that some retailers may be telling the truth, and the fact that this is their first offense, the staff believes that some retailers who have been found to violate BCP § 22974.3 (possession or sale of unstamped cigarette packages) should have their licenses suspended for less than 30 days, possibly for only 10 days in some cases. Therefore, the staff requests that it be given the option of imposing a 0- to 30- day suspension for the first offense under appropriate circumstances, in their discretion.

Regulations:

Second, now that the administration of the Act including appeals by violators is in place, formalizing the process discussed in the Issue Paper into formal Board regulations is advised. Therefore, we request approval to draft proposed regulations setting forth the applicable appeals procedures and civil penalties. We expect to propose these draft regulations as part of the newly revised Board Rules of Practice for California Tax Administration and Review in the next several months. We believe that formalizing the procedures and penalties will be beneficial to licensees and the Board for a number of reasons, including clarifying how the Board will be addressing any violations of the Act, as well as documenting the appeals process available to licensees, and the applicable penalties that will be imposed against licensees in cases where violations are found to exist.

Requested Board Action:

Staff is requesting the following: (1) the discretion to impose license suspensions from 0- to 30- day for unstamped cigarette packages, and (2) authorization to draft proposed regulations regarding civil penalties and the appeals procedures related to the Act.

If there are any questions, please contact Supervising Tax Counsel Robert W. Lambert at (916) 324-6593.

KEC:kc

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