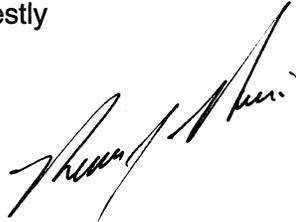


Memorandum

To : Honorable Carole Migden, Chairwoman
Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard
Honorable John Chiang
Honorable Steve Westly

Date : August 13, 2004

From : Ramon J. Hirsig
Executive Director



Subject : **Transmittal of Fiscal Year 2005-06 Budget Change Proposal**

Attached is the Fiscal Year (FY) 2005-06 Budget Change Proposal (BCP) that will be presented at the August 24, 2004 Board Meeting, Administrative Session for your consideration. With your approval, this BCP will be forwarded to the Department of Finance for consideration to be included in the Governor's Proposed FY 2005-06 Budget.

Ms. Raye Zentner and I will contact you next week to respond to any questions you may have. In the interim, should you have any questions or need additional information, please contact me at 327-4975 or Ms. Zentner at 445-4272.

RJH:jg

Attachment

(Budget/05-06 Budget Dev./BCPs/2005-06 BCP/memos/Board transmittal of BCP.doc)

cc: Ms. Betty Yee
Mr. Neil Shah
Ms. Barbara Alby
Ms. Audrey Noda
Ms. Marcy Jo Mandel
Mr. Timothy W. Boyer
Ms. Jerri Dale
Ms. Carol Fieldhouse
Mr. David Gau
Mr. Todd Gilman
Ms. Freda Orendt
Ms. Deborah Pellegrini
Ms. Margaret Shedd
Ms. Raye Zentner

bcc: Ms. Marcia Davey
Mr. Rene Gutierrez
Budget Section Staff

**STATE BOARD OF EQUALIZATION
FISCAL YEAR 2005-06
PROPOSAL 1**

TITLE OF PROPOSED CHANGE:

**PROPOSITION 10 – ONGOING CIGARETTE AND TOBACCO PRODUCTS TAXES INCREASE
WORKLOAD**

SUMMARY OF PROPOSED CHANGES:

This proposal requests \$879,000 (California Children and Families First Trust Fund) and 10.0 Personnel Years/Positions in the budget year to permanently continue the tax administration, enforcement and compliance activities associated with Proposition 10 (California Children and Families First Act of 1998). This proposition increased the excise tax on cigarettes and tobacco products. The Board of Equalization (BOE) is required to enforce the provisions of Proposition 10. Its approval will provide the resources needed to accommodate the continuing workloads related to Proposition 10. It will also protect the estimated \$1.22 billion Cigarette and Tobacco Products Tax annual revenue base and allow the BOE to continue collecting an additional \$14.5 million due to compliance, audit, and enforcement efforts.

FISCAL IMPACT:

	<u>Appropriation No.</u>			<u>Dollars (in Thousands)</u>		
	<u>(Org)</u>	<u>- (Ref)</u>	<u>- (Fund)</u>	<u>Past Year</u>	<u>Current Year</u>	<u>Budget Year</u>
Existing Program:	0860	- 001	- 0001	\$ 5,113	\$ 4,314	\$ 4,130
	0860	- 001	- 0004	\$ 133	\$ 148	\$ 146
	0860	- 001	- 0230	\$ 2,137	\$ 2,387	\$ 1,997
	0860	- 001	- 0623	\$ 1,975	\$ 2,347	\$ 1,703
Reimbursements	0860	- 501	- 0995	\$ ---	\$ ---	\$ ---
	TOTAL			<u>9,358</u>	<u>9,196</u>	<u>7,976</u>
Positions				<u>77.8</u>	<u>69.7</u>	<u>70.1</u>
Personnel Years				<u>74.1</u>	<u>66.4</u>	<u>66.8</u>
Proposed Changes:	0860	- 001	- 0623	\$	\$	\$ 879
(by appropriation)	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
	_____	- _____	- _____	\$ _____	\$ _____	\$ _____
Reimbursements	0860	- 501	- 0995	\$ _____	\$ _____	\$ _____
	TOTAL			\$ _____	\$ _____	\$ 879
Positions				_____	_____	<u>10.0</u>
Personnel Years				_____	_____	<u>10.0</u>

For EDP requests, include date Special Project Report (SPR) or Feasibility Study Report (FSR), approved _____.

STATE BOARD OF EQUALIZATION

CIGARETTE AND TOBACCO PRODUCTS TAX PROGRAM

**PROPOSITION 10 – ONGOING CIGARETTE AND TOBACCO PRODUCTS TAXES
WORKLOAD**

FISCAL YEAR 2005-06

A. Nature of Request

The Board of Equalization (BOE), Cigarette and Tobacco Products Tax Program enforces and ensures all the provisions of Proposition 10 (California Children and Families First Act of 1998). Fiscal Year (FY) 1999-00 BCP No. 13 "Proposition 10 (Cigarette and Tobacco Products Tax Increase)" authorized 12.0 limited-term positions (2.0 positions expired 6-30-01 and 10.0 were to expire 6-30-02). FY 2002-03 BCP No. 5 "Proposition 10 - Ongoing Cigarette and Tobacco Products Taxes Workload" authorized for an additional three years, 10.0 expiring positions (9.5 PYs), blanket funds and related resources for the continuing workload created by Proposition 10. This proposal is to establish permanent funding for the 10.0 expiring positions (10.0 PYs), blanket funds and related resources for the continuing workload created by Proposition 10.

The BOE is required to enforce the provisions of the Cigarette and Tobacco Products Tax Law in accordance with Section 30451 of the Revenue and Taxation (R & T) Code. Denial of this proposal would prevent the BOE from complying with the intent of the law – to administer the tax program. Failure to recover lost cigarette and tobacco products tax would principally impact the California Children and Families First Trust Fund. In addition, cigarette and tobacco products tax evasion encourages further law breaking, which would escalate the crime rate in California. The BOE is the only state entity dedicated to protecting the public from the illegal distribution of cigarettes through a program of detecting and investigating cigarette and tobacco products tax fraud in California.

Establishing the 10.0 positions on a permanent basis would allow the BOE to continue its efforts to comply with the intent of the law. Pursuant to the Department of Finance's Budget Letter 01-23 ("2002-03 Budget Policy"), this proposal recognizes Administration's policy "to strictly limit growth in authorized positions".

The law authorizes the BOE to be reimbursed with revenues from the California Children and Families First Trust Fund for the administration, enforcement, and collection expenses associated with Proposition 10.

B. Background/History

The Cigarette and Tobacco Products Tax imposes an excise tax on the distribution of cigarettes in this state and a tax on the wholesale cost of tobacco products such as cigars, chewing tobacco, pipe tobacco and snuff at a tax rate equivalent to the cigarette tax rate. Proposition 10, effective January 1, 1999, increased the excise tax by \$.50 per pack of cigarettes and an equivalent tax increase for tobacco products. This increased the total tax by 135% or to \$.87 per pack of 20 cigarettes and the tobacco products tax to 61.53% on the wholesale cost of the tobacco products.

Section 30126 of the Revenue and Taxation Code requires the BOE's annual determination of the tobacco products tax rate pursuant to subdivision (b) of Section 30123, Revenue and Taxation Code. The rate is based on the wholesale cost of tobacco products as of March 1, and is effective during the next fiscal year. Effective July 1 2004, through June 30, 2005, the rate is 46.76 percent.

While Proposition 99, enacted by the voters of California on November 8, 1988 which came into effect the following January, established the standard of equivalency between taxes on cigarettes and the taxes on other tobacco products, it is important to note that the BOE was not provided any additional resources to address the audit workload associated with the other tobacco products tax until the passage of Proposition 10 in January 1999.

In short, the increase in the tax rate on cigarette and other tobacco products caused by the combination of Proposition 99 and Proposition 10 resulted in an increase of tobacco products tax revenues for Proposition 99 and Proposition 10, which are allocated at 33.33 percent and 66.67 percent, respectively. This has caused an increase in the illegal consumption and distribution of cigarettes and tobacco products, and an increase in unanticipated workloads related to the administration and enforcement of the cigarette and tobacco products tax laws.

Since January 1999, the BOE Excise Taxes and Fees Division (ETFD) and Investigations Division (ID) have continued to experience increased workloads related to the administration and enforcement of Proposition 10 under the Cigarette and Tobacco Products Tax Law. This workload is in addition to the workload identified in Assembly Bill 71 (AB 71), the California Cigarette and Tobacco Products Licensing Act of 2003, and Senate Bill 1701, Alternative Cigarette Tax Stamp Project (ACTS).

BCP No. 13 "Proposition 10 (Cigarette and Tobacco Products Tax), approved for FY 1999-2000, provided the BOE with limited-term resources to accommodate the start up workload and anticipated audit, compliance, and evasion workloads; however, the implementation of Proposition 10 resulted in new workload that was unforeseen and not in the original request of resource identified in BCP No. 13.

In FY 2002-03 BCP No. 5, "Proposition 10 - On Going Cigarette and Tobacco Products Taxes Workload", ETFD Audit Section was provided with 3.0 limited-term audit positions. Two positions (an Associate Tax Auditor and Tax Auditor) were charged with an anticipated increased audit workload to perform approximately 48 tobacco products audits per year, and the third audit position (an Associate Tax Auditor) was responsible for evasion workload.

B. Background/History (Continued)

The ETFD Compliance Section received 2.5 limited-term positions consisting of 1.5 Tax Technician positions and 1.0 Business Taxes Representative to handle registration, return processing, collection workload, and new workload associated with a ETFD project related to California consumers and retailers purchasing cigarettes and tobacco products through the Internet from unlicensed out-of-state distributors. The positions were also needed to locate and notify unlicensed out-of-state distributors of their reporting requirements under the Federal Jenkins Act (15 U.S.C. 375-377), and to perform billing and collection functions related to collecting taxes when necessary.

In order to help stop the significant growth in evasion primarily in the area of counterfeit tax stamps, ID received 3.0 limited-term positions consisting of 1.0 Business Taxes Representative/Investigator to assist and lead personnel with field investigations, observations, obtaining evidence and executing search warrants, and 2.0 Business Tax Compliance Specialist to conduct criminal fraud investigations and prepare felony complaints in cooperation with Federal, State, and/or local law enforcement agencies.

The BOE Accounting Section also received 0.5 Account Trainee and 1.0 Associate Administrative Analysis Accounting position to accurately maintain the cigarette tax funds, general ledgers, remittance advice, and travel expense claims.

Since 2002, The ETFD and ID have experienced more than the anticipated workloads as suggested in FY 2002-03 BCP No. 5. California consumers and retailers continue to purchase cigarettes and tobacco products from unlicensed out-of-state distributors/sellers over the Internet to avoid paying the excise taxes on cigarettes and tobacco products.

Compliance:

Since the passage of Proposition 10, the ETFD Compliance Section has registered approximately 44,000 taxpayers and collected over \$2.4 million from consumers based on information received from unlicensed out-of-state distributors. Although the BOE has experienced some difficulty with out-of-state distributors complying with the BOE's request for information on consumer purchases under the Federal Jenkins Act, the ETFD Compliance Section continues to experience new and increased workloads related to a number of referrals received from the ID, the Office of the California Attorney General (AGO), U.S. Customs, some California cigarette and tobacco products distributors, and from sharing information with other states (such as New York and Nevada) related to purchases of cigarettes and tobacco products.

For example, upon review of records recently provided to the BOE by two major transporters under subpoena, the ID has identified over 40,600 leads from a review of just one of the transporter's records related to approximately 195,000 parcels of untaxed cigarette and tobacco products shipped to California consumers and retailers. Also, additional leads will be developed from review of other major transporter's records.

B. Background/History (Continued)

Compliance: (Continued)

Additionally, the AGO has taken a more aggressive stance against out-of-state distributors complying with the Jenkins Act. In the past year, ETFD Compliance Section has assisted the AGO in prosecuting four out-of-state distributors. In one case, the AGO and the Bureau of Alcohol, Tobacco, and Firearms seized records from an out-of-state distributor that resulted in over 15,000 invoices related to cigarette purchases by California consumers. The AGO currently has 240,000 documents that will be transferred to the ETFD as soon as it has completed its casework. As the AGO continues to enforce compliance of the Jenkins Act, the workload continues to increase.

Audit:

The ETFD audit goal as a result of Proposition 10 continues to be to perform approximately 48 tobacco product audits per year. In FY 2002-03, fifty field audits and field billing orders were performed by the ETFD for tobacco products tax with 2,607 total hours charged and tax change recommended totaling \$5,393,389. In FY 2003-04, sixty-one field audits and field billing orders were performed by the ETFD for tobacco products tax with 1,982 total hours charged and tax change recommended totaling \$3,642,351.

It should be noted that these workloads are in addition to those assignments recently identified as increased workloads associated with AB 71. The Proposition 10 audit workload performed consists of typical tobacco products tax audit assignments required based on the annual audit selection criteria of established accounts. In addition, the Proposition 10 workload may consist of conducting closeout audit assignments of accounts registered with the BOE having no known understatement of tax liability prior to commencement of the assignment. Referral cases are typically referred to the ETFD by the Board's Investigations Division.

Without permanently establishing the requested staff, beginning in FY 2005-06, the ETFD will not have the resources available to continue auditing these tobacco products accounts (Proposition 10 workloads).

Evasion:

The history of cigarette tax evasion in the United States and Canada conclusively demonstrates that when an excise tax on cigarettes creates a large enough price difference between taxed and untaxed or lower-taxed cigarettes, cigarette tax evasion becomes a problem.

Revenues from Cigarette and Tobacco Products Tax totaled \$888 million in FY 1998-99 and \$1.22 billion in FY 1999-00 (the first full fiscal year in which the tax increases mandated by Proposition 10 were in effect). Of these totals, \$390 million was collected and deposited in the California Children and Families First Trust Fund during FY 1998-99 and \$686 million during FY 1999-00. This revenue provides funding for children's services, health education, and anti-smoking campaigns in local government.

B. Background/History (Continued)

Evasion: (Continued)

Since 1998, taxable distributions have significantly decreased while evasion of taxes has increased. Taxable distributions increased slightly from 1997 to 1998. However, when Proposition 10 went into effect (January 1, 1999) an anomaly occurred. The California Department of Finance population data and the Federal Center for Disease Control smoking prevalence data indicated that the number of smoking individuals in California increased by 73,505, while taxable distributions of cigarettes decreased 26.8%. Therefore, while California's smoking population increased by 73,505 smokers, California's taxable distributions of cigarettes decreased by 469,000,000 packs. This amount of decreased distributions represents a decrease of approximately 1.2 million smokers.

However, as the prevalence rate indicates, the number of smokers in California actually increased rather than decreased over this period (see Exhibit I, page 16, for details). This anomaly could be accounted for as a reduction in individual consumption levels; however, the statistical model used here did not include consumption by minors, which, if factored in, would increase the total smoking population. Since the anomaly does not appear to be a reduction in the number of smokers, nor can it be weighted as a reduction in personal consumption, the anomaly would indicate that California has a significant level of consumption occurring from non-taxed and illegal sources.

If continued funding is not approved, cigarette and tobacco products evasion will continue to increase. A reduction in the level of resources would decrease the effectiveness of this program to deter current and any new evasion as a result of more people evading taxes or new tax increases. This will encourage potential illicit distributors to violate the law because their risk of being apprehended would decrease. Thus, revenue would decline as more people evade the tax.

California's excise tax as well as its geographic, demographic, and transportation structural features together provide ample opportunity for cigarette and tobacco products tax evasion to occur in all forms. A comparative analysis of cigarette tax evasion patterns in the United States and California demonstrated that California meets all preconditions for every known general method of cigarette tax evasion¹. Not unexpectedly, the greatest number of cases occurs where the methods ensure that both state and federal excise taxes are evaded.

The ever-increasing evasion of the cigarette and tobacco products taxes make it imperative that the BOE maintain as large a force of investigators in the field as possible. With the continued resources, the receipt of cigarette and tobacco products tax revenue is expected to continue for three reasons.

¹Source: Advisory Commission of Intergovernmental Relations 1985 report "Cigarette Tax Evasion: A Second Look".

B. Background/History (Continued)

Evasion: (Continued)

First, the resources will allow the BOE to continue its efforts to reduce cigarette and tobacco products tax evasion. Second, investigators will continue to reduce the supply of illicit cigarette and tobacco products from entering the market. This compels some business owners and consumers that illegally purchase untaxed cigarettes to purchase them from legitimate sources. Third, as the risk of illicit distributors being apprehended and required to pay taxes, penalty, and interest on past sales of untaxed cigarettes and tobacco products increases, fewer will participate in this illegal activity. Increased enforcement activities support honest distributors, wholesaler, and retailers who depend on the state to protect their interests and stifles others from getting involved in illegal activities, which includes violence, organized crime, weapons, and/or narcotics.

The ID is responsible for criminal investigations primarily in Sales and Use Tax, Cigarette and Tobacco Products Tax, Alcoholic Beverage Tax, and Fuel Taxes. ID investigators are responsible for all facets of a case once it has been assigned. This includes everything from compliance checks, surveillance, criminal investigations, development of both a criminal audit and a civil audit, and a criminal prosecution package.

Summary:

In summary, California consumers and retailers continue to purchase from out-of-state distributors via the Internet to avoid paying the excise taxes on cigarettes and tobacco products. During the past three years, there has also been a significant growth in tobacco product complaints and criminal cases related to counterfeit stamps and brand name products. Over the last year, cigarette and tobacco products complaints have increase over 500 percent.

The ETFD and ID positions have contributed to the overall tax compliance with the law, the recovery of tax revenues, the closure of civil and criminal cases, and the termination of fraudulent activities. The continuation and permanent establishment of these positions will ensure that auditing the taxpayer base will lead to an increase in voluntary compliance and an increase in tax revenues as a result of the audit activities and investigations disclosing tax liabilities of those who have intentionally or unknowingly understated their tax obligations. These permanent positions are necessary to protect revenue associated with the California Children and Families First Trust Fund. Failure to recover lost cigarette and tobacco products tax would adversely impact state revenues.

C. State Level Considerations

STRATEGIC PLAN CONFORMITY:

This proposal is consistent with the BOE's strategic plan mission statement to serve the public through fair, effective, and efficient tax administration and to identify, analyze areas of noncompliance and to develop approaches to address targeted problem areas (Issue 2, Strategy 3). This proposal also allows the BOE to comply with the administrative mandates of Proposition 10 (California Children and Families First Act of 1998).

D. Justification/Analysis of All Feasible Alternatives

Alternative 1 – Approve funding of 10.0 positions and related resources on a permanent basis.

The BOE requests that 10.0 positions (10.0 PYs) and related resources be continued on a permanent basis to address the continuing workload as a result of the provisions of Proposition 10.

Workload

Compliance Functions:

The establishment of 2.5 positions consisting of 1.5 Tax Technicians II, and 1.0 Business Tax Representative on a permanent basis is requested for the Compliance Section to handle workload related to referrals received from common carriers, the ID, the AGO, U.S. Customs, and other states (such as New York and Nevada). These positions are needed to locate and notify out-of-state distributors of their reporting requirements. In addition, these positions will identify, verify, register accounts, and collect the excise and use tax from California consumers (see Exhibit II, page 17, for workload details).

Audit Functions:

The establishment of 3.0 permanent audit positions is being requested to continue the administration of the tobacco products tax audit program.

Proposition 10 increased the tobacco products tax by approximately 135 percent. Consequently, the cost of taxpayers reporting errors and evasion has also proportionately increased. The three permanent audit positions are needed to continue compliance of the provisions in the Cigarette and Tobacco Products Tax Law as ETD's current staffing levels are fully utilized. The ETD audit staff cannot absorb the additional workload if these three positions are not retained.

Two of the audit positions will continue to audit the 805 (130 large, 54 medium, and 621 small) Tobacco Products accounts. The goal is to audit 50 percent of large volume accounts, 25 percent of medium accounts and 10 percent of small volume accounts over a three-year period. This would equate to 22 large ($130 \times 50\% \div 3$), 5 medium ($54 \times 25\% \div 3$) and 21 small ($621 \times 10\% \div 3$) accounts being audited each year. 115 hours is required for each large audit and 44 hours is required for medium and small audits. The following chart summarizes this workload to justify the one Associate Tax Auditor and one Tax Auditor in the ETFD Audit Section.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1 – (Continued)

Workload (Continued)

Audit Functions: (Continued)

Tobacco Products Tax Audit Workload

Volume	Total Number of Accounts	% of Accounts to Audit Over 3 Years	Accounts to Audit Over 3 Years	Annual Audits Required	Hours per Audit	Total Annual Hours
Large	130	50%	65	22	115	2,530
Medium	54	25%	14	5	44	220
Small	621	10%	62	21	44	924
Total	805		141	48		3,674

In addition, one of the Associate Tax Auditor positions will continue to perform evasion audits. These duties include civil audits, any schedules necessary for an evasion package and subsequent petition and/or appeals hearings. Based on historical data, the audit position can complete 10 fraud cases per year at 160 hours per audit for a total of 1,600 hours which includes workload associated with audits, petitions and appeals.

Cigarette and Tobacco Evasion Audit Workload

Tasks	Occurrences Per Year <u>a/</u>	Hours Per Occurrence	Total Annual Hours
Audit Hours Needed	10	110	1,100
Preparation for Fraud	10	30	300
Petition – Appeals, etc.	10	20	200
Total Annual Hours			1,600

a/ The actual number of cases was derived from Investigations Division historical statistics.

Summary of Audit Workload

Classification	Tobacco Products Tax Audits Hours	Evasion Audits Cigarette and Tobacco Hours	Total Annual Audit Hours	FY 2005-06 Positions (hours/1,600)
Associate Tax Auditor	1,837		1,837	1.0
Tax Auditor	1,837		1,837	1.0
Associate Tax Auditor		1,600	1,600	1.0
Total Hours Required	3,674	1,600	5,274	3.3 <u>a/</u>

a/ Based on 1,600 hours per position. The .3 (474 overtime hours) excess position will be accommodated with requested overtime funds.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1 – (Continued)

Investigations Workload:

Due to the continued increase in cigarette and tobacco products tax evasion, it is necessary that the 3.0 limited term positions authorized by FY 2002-03 BCP No. 5 continue on a permanent basis. These three current positions previously authorized at the (1.0) Business Taxes Representative and (2.0) Business Taxes Compliance Specialist level should be upgraded to the level of Business Taxes Specialist I/ Investigators (BTS I / Investigator) due to the complexity of the workload.

The BTS I/Investigator conducts criminal felony investigations and prepares criminal complaints on felony cases in cooperation with Federal, State and/or local law enforcement agencies. He/she will act as a lead in field investigations, documenting observations, obtaining evidence and executing search warrants. The BTS I/Investigator also prepares subpoenas, search warrants, prosecution packages and any other material needed to successfully pursue a prosecution and or civil audit determination.

BTS I/Investigators also acts as a liaison with other governmental agencies, public entities, and law enforcement agencies and conducts preliminary complaint and background investigations, including identifying suspects and associates; vehicles and assets; and obtaining and verifying documentation from various source databases and agencies.

These 3.0 BTS I/Investigators can annually investigate an average of 9 felony cases per year with an average billable recovery of an estimated \$1 million tax dollars per case.

Summary of Investigations Workload

Classification and Investigations	Total Investigations	Hours per Investigation <u>a/</u>	Total Annual Hours
Business Taxes Specialist I/Investigator			
Complaints	27	13	351
Cases	9	564	5,076
Total Hours			5,427
Total Positions Required <u>b/</u>			3.01

a/ Average hours per investigation are based on historical data.

b/ Based on 1,800 hours per position. The .01 (27.0 overtime hours) excess position will be accommodated with requested overtime funds.

Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1 – (Continued)

Administrative Workload

Accounting Functions:

The Accounting Section maintains the California Children and Families First Trust Fund fund, and the appropriate registers and general ledger accounts. Revenue must be accurately extracted from existing taxes and accounted for separately. In addition, preparing transmittals, remittance advice and checks, as well as processing travel advances and expense claims must be performed continuously in order to appropriately account for the operations of the California Children and Families Trust Fund. To accommodate this workload, 0.5 Accountant Trainee and 1.0 Associate Administrative Analyst, Accounting Systems positions are required. Total Accounting Section continuing need is as follows:

Summary of Accounting Workload

Task Description	Assoc. Admin. Analyst Accounting Systems	Accountant Trainee	Total Year Hours
Reconcile accounts with the State Controller's Office (SCO)	230.0	10.0	240.0
Compile fiscal year-end information and prepare financial statements	110.0		110.0
Post to the general ledger and accounting registers	637.5	25.5	663.0
Processing Controller's journal entries	2.0	46.0	48.0
Process revenue documents and fund adjustments from the Cashier Unit	347.2	13.8	361.0
Process refunds and fund transfer adjustments from the Excise Tax Division	225.2	9.8	235.0
Balance revenue reports received from TSD against EFT transactions reported by State Treasurer's Office (STO)	63.0	60.0	123.0
Reconcile non -EFT and EFT deposits to bank statements	70.0	54.0	124.0
Prepare transmittal, remittance advice, and check	22.0	548.0	570.0
Process Travel advances and expense claims		142.0	142.0
Report revenue to Control Agencies (i.e. DOF, SCO, STO, & BSA) and board units and work with DOF Auditors on annual audits of this program.	117.7	4.3	122.0
Total Hours	1,824.6	913.4	2,738.0
Overtime Hours	24.6	13.4	38.0
Total Positions Required _a/	1.0	0.5	1.5

_a/ based on 1,800 hours per position.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1 – (Continued)

Administrative Workload (Continued)

Data Entry Functions:

The Data Entry Unit will key in data for 15,000 returns anticipated to be filed annually from the registration of accounts generated from taxpayers filing returns on purchases of cigarettes and tobacco products from out-of-state distributors. Total Data Entry overtime requirements are as follows:

<u>Classification</u>	<u>FY 2005-06 and Ongoing OT Hours</u>
Key Data Operator	150
Total Overtime Hours Required _a/	150
_a/ 15,000 returns x 80 keystrokes / 8,000 keystrokes per hours = 150 hours.	

Summary of Positions Required

<u>Classification</u>	<u>FY 2005-06 and Ongoing</u>	<u>FY 2005-06 and Ongoing OT Hours</u>
Accountant Trainee	0.5	13.4
Assoc. Adm. Analyst, Accounting Systems	1.0	24.6
Associate Tax Auditor	2.0	237
Business Taxes Specialist I/ Investigator	3.0	27
Business Taxes Representative	1.0	170
Tax Auditor	1.0	237
Tax Technician II	1.5	263
Key Data Operator		150
Total Positions Required	10.0	1,122

Revenue:

One benefit of continuing the positions is the continued receipt of recoverable revenue. The estimated Compliance Section revenue from assessments issued to consumers purchasing out-of-state tobacco products is \$1,500,000. In addition, the estimated annual assessments for two Tobacco Products Tax Auditors is \$4,518,400 (\$1,412 per hour x 3,200 hours). The estimated annual assessment for one Cigarette and Tobacco Evasion Auditor position is \$2,020,800 (\$1,263 x 1,600). Also, Investigation cases produce an hourly estimate of \$1,263 in initial assessments. Based on this figure, the estimated billable revenue for the three BTS I / Investigators from completion of this workload is currently \$6,410,988 (5,076 x \$1,263) in annual assessments. Total annual assessments are as follows:

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 1 – (Continued)

Revenue: (Continued)

Summary of Annual Assessments

Type of Revenue	Recovery per Hour	Total Audit Hours	Total Assessments
Compliance <u>a/</u>			\$1,500,000
Tobacco Products Tax Audits	\$1,412	3,200	4,518,400
Assessment Revenue			
Evasion Cigarette and Tobacco Tax Audit Assessments	\$1,263	1,600	2,020,800
Investigations, Assessment Revenue	\$1,263	5,076	6,410,988
Total Assessment Revenue			\$14,450,188

a/ Revenue for Compliance is based on billings/returns generated from information received from out-of-state distributors, AGO referrals, other state referrals, and U.S. Customs regarding consumers purchasing out-of-state tobacco products.

Pros:

- Responds to industry concerns.
- Continues the effective administration and enforcement of the provisions associated with Proposition 10.
- Provides the minimum resources to effectively administer the program.
- Protects annual revenue base of \$1.22 billion.
- Continues the audit, evasion and investigation annual assessments of \$14.5 million.
- Requires no General Funds.

Con:

- Requires budget augmentation for the California Children and Families First Trust Fund to provide resources for this purpose.

Alternative 2 – Continue the existing resources and add additional resources to increase the level of compliance.

Pros:

- Responds to industry concerns.
- Continues the effective administration and enforcement of the provisions associated with Proposition 10.
- Provides additional resources to increase annual audit, evasion and investigations assessments.
- Increases the direct collection of additional audit, evasion and investigation assessments.
- Requires no General Funds.

Con:

- Requires additional expenditures of authorized positions and operating equipment.

D. Justification/Analysis of All Feasible Alternatives (Continued)

Alternative 3 – Allow the limited-term positions to expire.

Pros:

- Reduces the level of State Government by allowing resources to expire.
- Does not require any budget augmentation or continued funding.

Cons:

- Staff will not be able to respond to industry's needs in a timely manner.
- Jeopardizes the effective administration and enforcement of the provisions associated with Proposition 10.
- Jeopardizes the annual revenue base of \$1.22 billion as well as the additional \$14.5 million.

E. Timetable

The recommended alternative is proposed to become effective July 1, 2005.

F. Recommendation

Although the BOE believes existing data can justify a need for resources above the existing authorized level, it is recommended that at this time Alternative 1 be approved. This will allow the BOE to continue administering the provisions of Proposition 10 at a minimum level. The cost for the recommended alternative is \$879,000 in the budget year. Approval of this request will allow the BOE to continue its effort in assessing and collecting an additional \$14.5 million of cigarette and other tobacco products tax annually.

G. Fiscal Detail

See attached "Fiscal Detail" schedules.

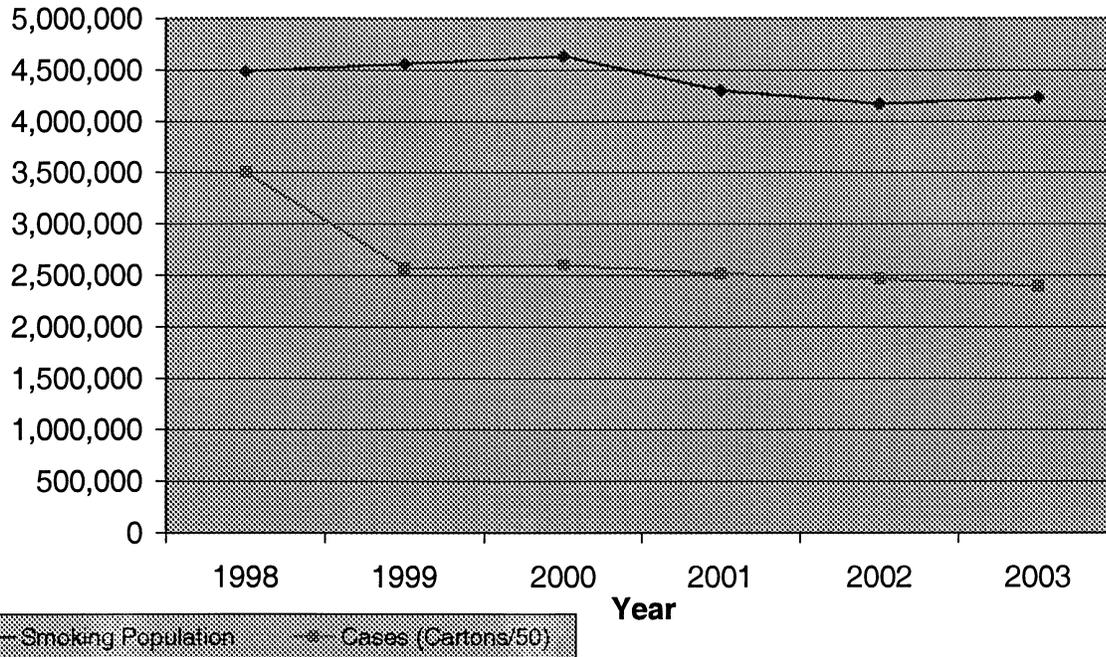
Comparison of California's Smoking Population and Taxable Distribution

Department of Finance, Demographic Data				Centers for Disease		California Taxable		
Year	California Population	Percent Increase/Decrease	Percentage 18 and Over	Eligible Smokers (B x D)	Smoking Prevalence	Smoking Population	Decline/Increase in Taxable Dist.	Decline/Increase in Smokers (H x G)
1998	33,387,000		71.86%	23,991,898	18.70%	4,486,485	2.80%	125,622
1999	33,934,000	1.64%	71.86%	24,384,972	18.70%	4,559,990	-26.80%	(1,222,077)
2000	34,480,000	1.61%	71.85%	24,773,880	18.70%	4,632,716	1.20%	55,593
2001	35,049,000	1.65%	71.37%	25,014,471	17.20%	4,302,489	-3.22%	(138,540)
2002	35,612,000	1.61%	71.37%	25,416,284	16.40%	4,168,271	-2.03%	(84,616)
2003	36,144,000	1.49%	71.37%	25,795,973	16.40%	4,230,540	-2.84%	(120,147)

Taxable Distributions				
Year	Packs	Cartons (Packs/10)	Cases (Cartons/50)	% Change from Prior Yr
1997	1,704,673,000	170,467,300	3,409,346	
1998	1,751,709,000	175,170,900	3,503,418	2.80%
1999	1,282,675,000	128,267,500	2,565,350	-26.80%
2000	1,298,277,000	129,827,700	2,596,554	1.20%
2001	1,256,526,198	125,652,620	2,513,052	-3.22%
2002	1,231,068,146	123,106,815	2,462,136	-2.03%
2003	1,196,110,593	119,611,059	2,392,221	-2.84%

Difference in Packs Dist due to Prop 10

1998 (Pre Prop. 10)	1,751,709,000
2003 (Post Prop. 10)	1,196,110,593
Difference	<u>-555,598,407</u>



Workload Detail for Compliance Section

Classification	Activity	Time Measure		Ongoing Activities	
		M = Minutes = Hours	Time Per Occurrence	Occurrences per Year	Total Hours <i>a/</i>
Tax Technician II					
	Identify and contact out-of-state sellers	M	15	200	50
	Registering affected businesses/taxpayers	M	5	15,000	1,250
	Maintaining accounts	M	5	150	13
	Review/analyze return & schedules	M	5	15,000	1,250
	Issuing billings and delinquency notices	M	5	3,000	250
	Clearing delinquencies	M	5	1,500	125
	Handling claims for refunds	M	10	150	25
	Total Tax Technician II Hours Required				2,963
	Total Positions Requested (1,800 hours per position)				1.5
	Overtime Hours Requested				263
Business Taxes Representative					
	Handling Taxpayer/Feepayer Inquiries	M	10	3,000	500
	Preparing Corresp. and Letters	M	10	300	50
	Research/Clear delinquencies	M	5	1,500	125
	Collecting liabilities below cut-off	M	30	1,470	735
	Collecting liabilities at or above cut-off	H	2	30	60
	Research compliance billings & refunds	M	10	3,000	500
	Total Business Taxes Rep. Hours				1,970
	Total Positions Requested (1,800 hours per position)				1.0
	Overtime Hours Requested				170
	TOTAL COMPLIANCE HOURS REQUIRED				4,933
	TOTAL POSITIONS REQUESTED (1,800 hours per position)				2.5 <i>b/</i>
	TOTAL OVERTIME HOURS REQUESTED				433

Footnotes:

- a/* Total hours if time is measure in minutes = (Time per Occurrence x Occurrences per Year)/60).
 Total hours if time is measure in hours = Time per Occurrence x Occurrences per Year.
- b/* Pursuant to the Department of Finance's Budget Letter 01-23 ("2002-03 Budget Policy"), this proposal recognizes the Administration's policy "to strictly limit growth in authorized positions".

Proposal No. 1
 DATE: September 8, 2004

**BUDGET CHANGE PROPOSAL
 FISCAL DETAIL
 FISCAL YEAR 2005-06
 (\$ in Thousands)**

Title of Proposed Change: PROPOSITION 10 - ONGOING CIGARETTE AND TOBACCO PRODUCTS TAXES WORKLOAD

Program/Element/Component: 45 Cigarette and Tobacco Tax Program (All Elements 45.10 - 45.50)

	<u>Personnel Years</u>		<u>Current Year</u>	<u>Budget Year</u>
	<u>CY</u>	<u>BY</u>		
TOTAL SALARIES AND WAGES_a/		10.0		\$557
Salary Savings				
NET TOTAL SALARIES AND WAGES		10.0		557
Staff Benefits_a/				188
TOTAL PERSONAL SERVICES		10.0		\$745
 OPERATING EXPENSE AND EQUIPMENT				
General Expense				\$22
Printing				
Communications				
Postage				
Travel--In-State				99
Travel--Out-of -State				5
Training				8
Facilities Operations				
Consulting & Professional Services: Interdepartmental				
Consulting & Professional Services: External				
Stephen P. Teale Data Center				
Data Processing				
Equipment				
Other Items of Expense: (Specify Below)				

_a/ See page 20 of 20 for itemized staff benefits and classification detail.

	<u>Current Year</u>	<u>Budget Year</u>
TOTAL OPERATING EXPENSE AND EQUIPMENT	_____	_____ \$134
TOTAL EXPENDITURES (State Operations)	=====	===== \$879

Source of Funds

General Fund	(0001)	
Special Funds:		
Breast Cancer Fund	(0004)	
State Emergency Telephone	(0022)	
Propane Surcharge Fund	(0051)	
Motor Vehicle Fuel	(0061)	
Occupational Lead Prevention Fund	(0070)	
Childhood Lead Poisoning Prev. Fund	(0080)	
Cig. and Tobacco Prod. Surtax Fund	(0230)	
Oil Spill Prevention and Admin. Fund	(0320)	
Integrated Waste Management	(0387)	
Underground Storage Tank Fund	(0439)	
Energy Resources Programs Account	(0465)	
CA. Children and Families First Trust Fund	(0623)	879
Timber Tax Fund	(0965)	
Gas Consumption Fund	(3015)	
Water Rights Fund	(3058)	
Cig. and Tobacco Prod. Compl. Fund	(3067)	

Federal Funds

Other Funds

Reimbursements (0995)

**DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES**

Staff Benefits Detail:	Current Year	Budget Year
	<i>(Whole Dollars)</i>	
OASDI		\$42,600
Health Insurance		54,400
Retirement		77,800
Workers' Compensation		10,000
Industrial Disability Leave		500
Non-Industrial Disability Leave		700
Unemployment Insurance		500
Other		1,400
TOTAL		\$188,000

Classification	Positions <u>b/</u>		Salary <u>c/</u>	Amount	
	CY	BY		CY	BY
Legal Department:					
Investigations Division:					
Associate Tax Auditor		1.0	\$57,108		\$57,100
Business Taxes Specialist I		3.0	66,036		198,100
Administration Department:					
Accounting Section:					
Accountant Trainee		.5	40,044		20,000
Associate Admin. Analyst-Account.Syst.		1.0	59,964		60,000
Property and Special Taxes Department:					
Excise Taxes:					
Compliance Section:					
Business Taxes Representative		1.0	39,612		39,600
Tax Technician II		1.5	32,604		48,900
Audit Section:					
Associate Tax Auditor		1.0	57,108		57,100
Tax Auditor		1.0	43,068		43,100
Blanket Funds:					
Overtime (Various)		(.6)			33,400
Temporary Help					
TOTAL SALARIES AND WAGES		10.0			\$557,300

b/ Permanent positions effective July 1, 2005.
c/ The salary is the mid-level salary for the stated classification.