

Cigarette and Tobacco Products Taxes Revenue Recovery

Purpose:

BOE requests continued and new funding to permanently establish the resources to support the Cigarette and Tobacco Products Taxes Revenue Recovery efforts. These permanent positions will increase revenue recovery and enhance overall voluntary compliance in the cigarette and tobacco product tax programs.

Justification:

- BOE anticipates this proposal will recoup \$32.9 million in revenue in FY 2008-09 and \$46.1 million in FY 2009-10 and ongoing related to out-of-state tax avoidance, accounts receivable recovery, audits of cigarette and tobacco products distributors, and enforcement activities to diminish cigarette and tobacco products tax evasion.
- Deters tax evasion by providing a permanent audit and enforcement presence.
- Provides a mechanism for consumers to report and pay their excise and use tax related to their purchases of cigarettes and tobacco products from out-of-state sellers.
- Increases voluntary compliance by facilitating the receipt of additional tax revenues which benefits the State's the General Fund and Special Funds.
- Provides a program benefit-to-cost ratio of 10 to 1.

		FY 2008-09	FY 2009-10
Expenditures	Total	\$4,191,000	\$4,114,000
	Continuation	1,833,000	1,769,000
	New	2,358,000	2,345,000
Funding Source	General Fund	\$385,000	\$375,000
	Special Funds	3,806,000	3,739,000
Positions	Total	47.5	47.5
	Continuation	20.2	20.2
	New	27.3	27.3

Background:

- The increase in the tax rate on cigarettes and other tobacco products caused by the combination of Proposition 99 (January 1989) and Proposition 10 (January 1999) resulted in an increase of cigarette and tobacco products tax revenues.
- The higher tax rate has also caused an increase in the illegal consumption and distribution of cigarettes and tobacco products, and an increase in unanticipated workload related to the administration and enforcement of the cigarette and tobacco products tax laws.
- Many consumers and retailers began purchasing cigarettes and tobacco products from unlicensed out-of-state sellers via the Internet and/or mail order catalog. Unlicensed out-of-state sellers do not collect the California excise and use taxes, however, under a federal law (the Jenkins Act) these out-of-state sellers are required to provide monthly reports to the BOE.
- In response to complaints received from licensed California cigarette and tobacco products distributors, retailers, wholesalers, and manufacturers regarding an unfair competitive advantage to unlicensed out-of-state sellers, and the loss of potential tax revenues, the BOE established the Cigarette Internet (CI) Program.

STATE BOARD OF EQUALIZATION

FISCAL YEAR 2008-09

TITLE OF PROPOSED CHANGE:

Cigarette and Tobacco Products Taxes Revenue Recovery

SUMMARY OF PROPOSED CHANGES:

The Board of Equalization (BOE) anticipates this proposal will generate additional revenue of \$32.9 million in FY 2008-09 and \$46.1 million in FY 2009-10 and in ongoing years. Therefore, the ongoing benefit-to-cost ratio for this proposal is estimated to be 10 to 1.

The proposed 47.5 permanent positions will increase revenue recovery and enhance overall voluntary compliance in the cigarette and tobacco product tax programs. This proposal requests \$4,191,000 (\$385,000 General Fund and \$3,806,000 Special Funds) in Fiscal Year (FY) 2008-09 and \$4,114,000 (\$375,000 General Fund and \$ 3,739,000 Special Funds) in FY 2009-10 and ongoing to fund 47.5 positions: 27.3 new positions and the permanent continuation of 20.2 limited-term positions due to expire June 30, 2008.

STATE BOARD OF EQUALIZATION
Cigarette and Tobacco Products Taxes Revenue Recovery
Fiscal Year 2008-09

A. Nature of Request

The Board of Equalization (BOE) proposes to increase revenue recovery and enhance overall voluntary compliance in the cigarette and tobacco product tax programs. As a result of this effort, the BOE estimates a gain of **\$32.9 million** in revenue in Fiscal Year (FY) 2008-09 and **\$46.1 million** in FY 2009-10 and in ongoing years. (See Exhibit 1, pager 14 and 15 for Revenue Analysis) Therefore, the estimated ongoing benefit-to-cost ratio of this proposal is **10 to 1**.

This proposal requests \$4.2 million in FY 2008-09 and \$4.1 million in FY 2009-10 and ongoing for 47.5 positions and related resources for cigarette and tobacco products tax revenue recovery and effective tax enforcement, audit, compliance and support activities. The positions are requested as follows:

- **35.0** positions in the Excise Taxes Division (ETD) (12.0 limited-term converted to permanent and 23.0 new permanent positions)
- **9.0** positions in the Investigations Division (ID) (6.0 limited-term converted to permanent and 3.0 new permanent positions)
- **3.5** positions relating to Boardwide administrative support functions (2.2 limited-term converted to permanent and 1.3 new permanent positions)

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 Code. Denial of this proposal would:

- Result in the inability to recover \$32.9 million in revenue in FY 2008-09 and \$46.1 million in FY 2009-10 and in ongoing years, which would impact the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families First Trust Fund.
- Result in BOE's failure to diligently enforce the Master Settlement Agreement (MSA), risking a loss of MSA payments. Payments from the MSA average up to \$800 million to the state annually.
- Result in an increase in cigarette & tobacco products tax evasion.¹
- Create unfair competition between licensed California businesses and out-of-state sellers that do not collect taxes on cigarette and tobacco products.
- Prevent the BOE from complying with the intent of the law which is to fully administer all components of the tax program.

B. Background/History

The Cigarette and Tobacco Products Tax Law imposes an excise tax on the distribution of cigarettes and a tax on the distribution of tobacco products such as cigars, chewing tobacco, pipe tobacco and snuff in this state. The tax rate on tobacco products is at a 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 cigarettes and the tobacco products tax to 61.53% on the wholesale cost of tobacco products.

¹ BOE estimates that there is \$276 million in cigarette and tobacco taxes lost to evasion each year. Approximately \$182 million in cigarette taxes (or 209 million packs) go unreported each year, along with \$94 million in tax on other tobacco products such as snuff, cigars, and chew. Of the \$182 million in cigarette taxes, the BOE estimates that \$125 million is evaded by businesses and estimates \$57 million in tax going unreported by consumers each year. The remaining \$94 million is unreported tobacco products, BOE estimates \$87 million in tobacco tax is evaded by businesses and \$7 million in tobacco tax going unreported by consumers each year. Source: "Estimates of California Cigarette Excise Tax Revenue Losses" released on June 20, 2007.

B. Background/History (Continued)

While Proposition 99, enacted by the voters of California and effective January 1, 1989, increased the excise tax by \$.25 per pack of cigarettes and 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 workload associated with the other tobacco products tax until the passage of Proposition 10 in January 1999.

The increase in the tax rate on cigarettes and other tobacco products caused by the combination of Proposition 99 and Proposition 10 resulted in an increase of tobacco products tax revenues. However, the higher tax rate has also caused an increase in the illegal consumption and distribution of cigarettes and tobacco products, and an increase in unanticipated workload related to the administration and enforcement of the cigarette and tobacco products tax laws. Under FY 2005-06 BCP 1 "Proposition 10 - Ongoing Cigarette and Tobacco Products Taxes Workload," BOE was authorized positions for the continuation of compliance, audit, and investigative functions related to workload associated with Proposition 10.

As a result of these tax increases, many consumers and retailers began purchasing cigarettes and tobacco products from out-of-state sellers via the Internet and/or mail order catalog. These out-of-state sellers do not collect the California excise and use taxes. However, under a federal law (the Jenkins Act), these out-of-state sellers that ship cigarettes to California customers are required to provide monthly reports to the BOE.

In response to complaints received from licensed California cigarette and tobacco products distributors, retailers, and manufacturers and the loss of potential tax revenues, the BOE established the Cigarette Internet (CI) Program. This program informs consumers and retailers of their tax obligations on their purchases of untaxed cigarettes and tobacco products. The CI Program also notifies out-of-state sellers of their requirement to provide BOE with information regarding their sales to California customers. BOE submitted FY 2006-07 BCP 2d "Enforcement of Consumer Purchases of Tobacco Products from Out-of-State Sellers" and received resources on a two-year, limited-term basis to address the workload related to consumer Internet purchases of cigarettes and tobacco products.

In order for BOE to be successful in collection of the cigarette and tobacco products tax the ETD requests converting 12.0 limited-term positions to permanent and the addition of 23.0 new permanent positions. Accordingly, in order to maintain the efficiency of the investigative program, the Investigation Division requires the conversion of 6.0 limited-term positions to permanent and the addition of 3.0 new positions. In addition, this request includes the conversion of 2.2 limited-term positions to permanent and the addition of 1.3 new positions relating to Boardwide administrative support functions.

C. State Level Considerations

This proposal allows the BOE to proactively address the revenue recovery areas, generate new state revenue without increasing taxes, and enhance overall voluntary tax compliance with the Cigarette and Tobacco Products Tax Law. The California Legislature and Members of the BOE recognize that California is experiencing a budget shortfall and are exploring areas where revenues can be increased without increasing taxes to address the budget deficit. Approval of this proposal will increase administration and enforcement of the provisions associated with the Cigarette and Tobacco Products Tax Law, as intended by the California Legislature and industry.

C. State Level Considerations (Continued)

This proposal is consistent with BOE's mission statement "to serve the public through fair, effective, and efficient tax administration." Additionally, this proposal is consistent with BOE's Strategic Plan goals and objectives. Specifically, Goal No. 1: Maximize Voluntary Compliance in BOE's Programs and Goal No. 2: Improve the Efficiency of BOE's Tax Program. The CI Program provides a mechanism for consumers to voluntarily comply with their excise and use tax obligations and protects legitimate California businesses from unfair competition by out-of-state sellers who do not collect these taxes.

This proposal allows the BOE to comply with the administrative mandates of Proposition 10 (California Children and Families First Act of 1998).

This proposal also demonstrates "due diligence" in the enforcement of the MSA. By failing to diligently enforce the MSA, the State of California could potentially lose an average of \$800 million annually in payments.

D. Justification and Analysis of All Feasible Alternatives

Alternative 1 – Approve full request of \$4.2 million in FY 2008-09 and \$4.1 million in FY 2009-10 and ongoing for the conversion of 20.2 limited-term positions converted to permanent and 27.3 new permanent positions for Cigarette and Tobacco Products Taxes Revenue Recovery Workload resources.

This alternative requests permanent funding for the 47.5 positions (20.2 continuing and 27.3 new permanent positions), and blanket funds for workload related to cigarette and tobacco products taxes revenue recovery. Those areas of revenue recovery include out-of-state tax avoidance, accounts receivables, discovery audits, and enforcement efforts related to cigarette and tobacco products taxes. The following is a summary of the total resources requested:

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

SUMMARY OF REQUESTED POSITIONS	# POSITIONS REQUESTED
I. EXCISE TAXES DIVISION (ETD)	
a. Compliance – New and Continued Positions	
Compliance – Continued Positions	
Tax Technician II	6.5
Tax Technician III	1.0
Business Taxes Representative	3.5
Business Taxes Compliance Specialist	1.0
Sub Total ETD Continued Compliance Positions	12.0
Compliance – New Positions	
Office Assistant (General)	2.0
Tax Technician III	2.0
Business Taxes Representative	9.0
Sub Total ETD New Compliance Positions	13.0
Total ETD Compliance Positions	25.0
b. Audit – New Positions	
Associate Tax Auditor	4.0
Business Taxes Specialist I	3.0
Total ETD Audit New Positions	7.0
c. ETD Administrative Support – New Positions	
Office Assistant (General)	1.0
Business Taxes Compliance Supervisor II	1.0
Business Taxes Administrator III	1.0
Total ETD Administrative Support New Positions	3.0
Total ETD Positions Requested	35.0
II. INVESTIGATIONS DIVISION (ID)	
New and Continued Positions	
Continued Positions	
Associate Tax Auditor	1.0
Business Taxes Specialist I	4.0
Business Taxes Specialist II	1.0
Sub Total ID Continued Positions	6.0
New Positions	
Business Taxes Specialist I	2.0
Business Taxes Specialist I	1.0
Sub Total ID New Positions	3.0
Total ID Positions	9.0
III. BOARDWIDE ADMINISTRATIVE SUPPORT	
Continued Positions	
Accountant Trainee (Financial Management Division)	0.5
Associate Administrative Analyst, Accounting System (Financial Management Division)	1.0
Tax Technician I (Customer & Taxpayer Services Division)	0.75
Sub Total Boardwide Admin Support Function Continued Positions	2.2
New Positions	
Tax Technician I (Customer & Taxpayer Services Division)	0.75
Personnel Specialist (Human Resources Division)	0.25
Associate Personnel Analyst (Human Resources Division)	0.25
Sub Total Boardwide Admin Support Function New Positions	1.3
Total Boardwide Administrative Support Positions	3.5
Total Positions Requested	47.5

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

I. Excise Taxes Division (ETD) - 35.0 positions

The ETD is requesting a total of 35.0 positions in the compliance, audit, and ETD administrative support areas to address ongoing and new workload related to out-of-state tax avoidance, accounts receivable recovery, tax audit activities and ETD administrative support.

a. ETD Compliance – 25.0 positions

The ETD Compliance Section is requesting 25.0 positions (12.0 limited-term, due to expire June 30, 2008, converting to permanent and 13.0 new permanent positions) to address new and ongoing workload related to out-of-state tax avoidance and accounts receivable recovery. Exhibit 2, pages 16 and 17 provides workload estimates for each of these areas.

Out-of-State Tax Avoidance

The ETD Compliance Section requests 19.0 positions (12.0 limited-term converted to permanent and 7.0 new permanent positions) to work on out-of-state tax avoidance. 3.5 of these positions originated in an FY 2005-06 BCP "Proposition 10 - Ongoing Cigarette and Tobacco Products Taxes Workload" and these positions were used to implement a pilot CI Program. These 3.5 positions are due to expire on June 30, 2008. These positions will continue to be used for the CI program.

At the introduction of the CI Program, the primary focus was to educate consumers regarding their tax obligations related to purchases through the Internet and to allow them the opportunity to voluntarily report tax due. The workload demand in the CI program had shown that these 3.5 positions were not sufficient to handle the volume of invoices and referrals related to consumer purchases of cigarettes and tobacco products. Due to this growing workload, BOE submitted FY 2006-07 BCP 2d "Enforcement of Consumer Purchases of Tobacco Products from Out-of-State Sellers" and received 8.5 positions on a two-year limited-term basis (due to expire June 30, 2008), to address this increased volume of workload related to consumer Internet purchases of cigarettes and tobacco products. BOE is requesting the continuation of these 12.0 positions on a permanent basis to address the continuing workload.

Within the CI program, the ETD is not appropriately staffed to clear delinquencies, issue billings, or perform collection functions related to non-compliance and underreporting by consumers. Therefore, ETD is requesting 7.0 new permanent positions to more aggressively collect all excise taxes on cigarettes and accurately report all distributions (including consumer purchases from out-of-state sellers) of Non-Participating Manufacturer's cigarettes as part of the MSA.

The CI program is supported by the Attorney General's Office Tobacco Litigation Section as conveyed in their letter dated June 11, 2007 (see Exhibit 7, pages 28 and 29 attached). The CI program also demonstrates the state's continued due diligence efforts in its enforcement of the MSA and has been praised by the California Bureau of State Audits. These positions are being requested in support of this effort.

Accounts Receivable Recovery

The ETD Compliance Section requests 6.0 new permanent positions because of unanticipated and steady increase in accounts receivable (AR) workload that derives from current and future anticipated workload growth in both audit and compliance billings in the Cigarette and Tobacco Products Tax Programs. These billings come from underpayments of tax as determined by ETD staff performing field or desk audits and through tax return reconciliation and delinquency processing. The accounts receivable workload also includes billings that originate from the ID tax fraud investigations. This proposal requests 6.0 new permanent positions required to efficiently address the current and ongoing AR collections workload on a timely basis.

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

b. ETD Audit Section – 7.0 positions

ETD Audit Section is requesting 7.0 new permanent positions plus \$102,400 in associated travel expenses to perform tax audit activities and ensure proper oversight of the Cigarette and Tobacco Tax Programs. Specifically, these positions will perform tax audit functions related to ID referrals processing and common carrier leads, routine cigarette and tobacco products audits, and Cigarette Internet program petitions. Exhibit 3, pages 18 and 19 provides workload estimates.

Tax Audit Activities - ID Referrals and Common Carrier Leads

ETD Audit Section is requesting 3.0 new positions to work on ID referrals, common carrier shipments, and leads from common carrier records.

Referrals from ID and common carrier leads represent workload above and beyond routine audits of accounts. In the past, this workload was absorbed in other tax programs. However, this option is no longer available to address the ongoing workload. ETD Audit Section will require additional audit staff to cover the workload.

The establishment of 1.0 new permanent Business Taxes Specialist I position is requested and will be responsible for handling ongoing workload consisting of the most complex Cigarette and Tobacco Products Tax audit referrals from the BOE's ID. It is anticipated that this position will also perform field audits of the most complex nature and the level of assignments are expected to require a greater level of detailed field audit knowledge. The Business Taxes Specialist I position will also be responsible for ID referral cases that are expected to be petitioned or appealed.

The establishment of 2.0 new permanent Associate Tax Auditor (ATA) positions is requested to handle ongoing workload in excess of available staff for referrals from ID. The first ATA position will be responsible for performing Cigarette and Tobacco Products Tax field audits from referrals received from the BOE's ID. The second ATA position will handle the backlog of Cigarette and Tobacco Products Tax audit investigations involving common carrier shipments. ID has taken a pro-active approach toward obtaining information from common carriers and freight haulers who deliver cigarette and tobacco products within California. This is resulting in an additional, ongoing ETD Audit workload related to shipments from out-of-state companies. In past years, the ETD had temporarily absorbed this workload by utilizing staff from other programs, but this is no longer an option. It is anticipated that this position will perform desk audits.

Tax Audit Activities – Audit Workload

ETD Audit Section is requesting 2.0 new permanent ATA positions for audit workload of licensed cigarette distributors and licensed tobacco products distributors.

The establishment of 1.0 permanent ATA position will be responsible for handling ongoing workload consisting of audits of licensed tobacco products distributors. ETD Audit received an ATA position for Proposition 10 workload, but the position was diverted to the Investigations Division to meet operational needs. The ETD audit staff cannot absorb the additional workload without the establishment of this position. Currently, there are 594 accounts in the tobacco products tax program including 96 large, 40 medium, and 458 small, licensed tobacco products distributor accounts. The expectation is to audit 35 percent of large volume accounts, 18 percent of medium volume accounts and 6 percent of small volume accounts over a three-year period. In the aggregate, this position will audit 68 accounts over a three-year period. For periodic account audits, 115 hours are required for each large audit and 44 hours for each medium and small audit.

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

The establishment of another 1.0 permanent ATA position is requested and will be responsible for handling ongoing workload consisting of periodic audits of licensed cigarette distributors. Currently, there are 125 accounts in the cigarette tax program including 24 large, 47 medium, and 54 small, licensed cigarette distributor accounts. The expectation is to audit 50 percent of large volume accounts, 38 percent of medium volume accounts and 41 percent of small volume accounts over a three-year period. In the aggregate, this position will audit 60 accounts over a three-year period. For periodic account audits, 160 hours are required for each large audit, 100 hours for each medium audit, and 50 hours for each small audit.

Tax Audit Activities – Cigarette Internet (CI) Program Appeals Cases

Additionally, ETD Audit Section requests 2.0 new permanent Business Taxes Specialist I positions to handle ongoing workload consisting of appeals cases resulting from billings to consumers of cigarette and tobacco products through the CI Program.

As proposed in this alternative, the CI Program will become fully implemented by addressing delinquencies which includes issuing billings and pursuing collection of tax liabilities. This is anticipated to result in 253 filings of petitions, late protests, and claims for refund, which will be handled through the appeals process by the Business Taxes Specialist I.

c. ETD Administrative Support – 3.0 positions

With the additional staff, the ETD is requesting 3.0 new permanent positions for supervisory and administrative support. ETD requests a Business Taxes Administrator III and a Business Taxes Compliance Supervisor II in order to maintain its span of control and an adequate staff to supervisor ratio. The current line supervisor to staff ratio in the ETD is 10.1 to 1. Upon approval of the positions requested in this BCP, the ratio would increase slightly to 10.4 to 1. These management positions will establish and maintain policy, procedures, provide guidance in employee development, address personnel issues, review and approve staff work, provide guidance on complex issues, and other management and supervisory functions. In addition to these duties the BTA III will represent the ETD and act as liaison with other state and federal regulatory agencies in duties relating to the cigarette and tobacco products tax programs. ETD would also need an Office Assistant to assist with clerical functions such as receptionist duties, filing, assignment control, mail distribution, and general administrative support. Exhibit 4, page 20 provides workload estimates.

II. Investigations Division – 9.0 positions

Due to ongoing efforts by individuals and organized crime to evade cigarette and tobacco products taxes for personal gain, as well as to finance illicit criminal activities, ID is requesting 9.0 positions (6.0 limited-term, due to expire June 30, 2008, converted to permanent and 3.0 new permanent positions). Of the 9.0 positions, 6.0 limited-term and 1.0 new position are related to enforcement activities to diminish cigarette and tobacco products tax evasion. The remaining 2.0 position are requested to be established to handle workload related to cigarette tax stamp refunds. Exhibit 5, pages 21 – 23 provides workload description and estimates for Investigations Division resource request.

Enforcement Activities to Diminish Cigarette and Tobacco Products Tax Evasion

It is necessary that the 6.0 limited-term positions authorized by FY 2005-06 BCP No. 1 and FY 2006-07 BCP 2d continue on permanent basis and 1.0 new position be established. These 7.0 positions are critical for enforcement activities to diminish cigarette tax evasion.

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

First, continuation of these 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, wholesalers, and retailers who depend on the state to protect their interests and stifle others from getting involved in illegal activities, which includes violence, organized crime, weapons, and/or narcotics.

Distributor Cigarette Tax Stamp Refund Workload

Additionally, ID is requesting 2.0 new positions to handle workload related to cigarette tax stamp refunds. Senate Bill 1701 (*Stats. 2002, Ch. 881*) mandated that the BOE replace the heat applied cigarette tax stamp with a data encrypted tax stamp generated by a technology capable of being read by a scanner or similar device. During the transition period of the old stamp to the new stamp in 2005, distributors could submit a request for refund of their old stamps to ETD. ETD coordinated refund workload by utilizing District Office staff to validate the stamps, prepare a claim for refund, and witness destruction of the product. However, when the new stamp was introduced, District Office staff could no longer validate the stamps due to scanning equipment costs and on-going training associated with utilization of the new stamp encryption technology.

The refund process is also an important part of the MSA compliance because product that is destroyed is tracked by brand family and must be accounted for in determining market share which is used to calculate escrow payments by non-participating manufacturers. While it was anticipated that the number of requests for tax stamp refunds would drop off after full implementation of the new high-tech tax stamp in 2005, this has not been the case. In 2006, ID received 78 stamp verification referrals from the ETD for tax stamp refunds. The verification and authentication of the stamp refunds were handled by existing ID staff that were pulled off their normal duties—felony tax evasion investigations.

Accordingly, in order to maintain the efficiency of the investigative program, ID needs 2.0 additional positions. This will require a budget augmentation for staffing in addition to the corresponding travel expenses for these 2.0 positions. ID cannot continue to be effective against tax evasion and continue to have a positive impact mitigating felony cigarette and tobacco products tax evasion without resuming prior enforcement levels. The 2.0 positions will allow the ID to continue encouraging voluntary compliance and mitigate tax avoidance.

Customer and Taxpayer Services Division

The Customer and Taxpayer Services (CATS) will require 1.5 Tax Technician (TT) I positions. This 1.5 position is split in two .75 positions. One .75 limited-term TT I position was received in FY 2006-07 BCP No. 2d "Enforcement of Consumer Purchases of Tobacco Product from Out-of-State Sellers." This .75 limited-term position is due to expire June 30, 2008, and is requested in this BCP to continue on a permanent basis. Also, .75 of a new TT I position is requested to address new workload. Thus, the total 1.5 positions will address continuing and new workload related to inquiries/questions on consumer enforcement issues associated with this ETD revenue recovery effort.

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

III. Boardwide Administrative Support – 3.5 Positions Plus Overtime and Temporary Help

Since July 2006, CATS has taken a total of 18,421 calls. This is based on the total number of calls transferred by Information Center Customer Service Representatives (CSR), and calls directly handled by the Information Center CSR's. Exhibit 6, pages 24 - 27 provides workload estimates.

Additionally, CATS requests continuation of the 92 overtime hours at various classifications for translation services and forms and publications workload. CATS also requests \$50,000 for the printing of posters, flyers, special notice mailings, forms and new publications. These services are needed to educate the public regarding the purchase of cigarettes and/or tobacco products over the Internet and encourage voluntary compliance through media outreach. Exhibit 6, page 24 provides workload description and estimates for CATS resource request.

Financial Management Division – Accounting Section

The Accounting Section maintains the California Children and Families First Trust Fund, and the appropriate registers and general ledger accounts. To accommodate this workload, the Accounting Section will require 1.5 limited-term positions converted to permanent. These 1.5 limited-term positions were received in FY 2005-06 BCP 1 "Proposition 10 – Ongoing Cigarette and Tobacco Products Taxes Workload" and are due to expire June 30, 2008. The positions consists of 0.5 Accountant Trainee and 1.0 Associate Administrative Analyst, Accounting Systems.

The Accounting Section analyzes and allocates collected cigarette and tobacco tax revenue to specific funds as directed by the legislature. 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. The Accounting Section also requests continuation of the 38 overtime hours to maintain the workload. Exhibit 6, page 24 provides workload estimates.

Human Resources Division (HRD)

The HRD is responsible for personnel functions for all BOE employees and therefore requires two .25 new positions (.25 Associate Personnel Analyst and .25 Personnel Specialist) based on the addition of 27.3 new permanent positions in the ETD. The addition of staff will assist HRD to absorb critical work as well as ensure the processing of the BOE's current critical personnel-related workload.

The Associate Personnel Analyst is needed to work in both the Organizational Services Section and Examination and Recruitment Section which includes attracting, hiring, and retaining staff at BOE. The Personnel Specialist position is needed to work in the Personnel Transactions Section which includes administering pay and benefits and processing appointments and separations for all BOE employees. Exhibit 6, pages 25 and 26 provides workload estimates.

Cashier Unit

The Cashier Unit is required to open mail, batch return forms, and deposit payments. Based on program statistics gathered since July 2006, it is anticipated that the new workload will consist of 34,000 incoming tax returns, 12,000 billing remittances and payment documents. This workload will require 657 hours yearly in overtime/temporary help at the Office Assistant classification (46,000 items divided by 70 items per hour). Exhibit 6, page 26 provides workload estimates.

D. Justification and Analysis of All Feasible Alternatives – (continued)

Data Entry Unit

The Data Entry Unit is responsible for entering all information from returns, which is then transferred into BOE's Integrated Revenue Information System (IRIS). Based on program statistics, Data Entry requests 574 overtime hours to address new workload related to 34,000 CI and UI returns and 6,000 CI and 6,000 UI billings. Exhibit 6, page 27 provides workload description and estimates for the Data Entry Unit.

Mail Services Unit

The Mail Services Unit is responsible for processing the outgoing tax returns and incoming mail. Based on program statistics, the Mail Services Unit estimates 41,000 tax returns mailed and 29,000 incoming returns, billing remittances and payment documents. As a result of this new ETD revenue recovery effort, the handling and processing of the additional mail will require 48 hours of overtime at the Machine Operator I/II and Office Assistant levels. Additionally, the Mail Services Unit will need \$13,571 for postage costs. Exhibit 6, page 27 provides workload estimates.

Alternative 1 – Pros and Cons

Pros:

- Recoups an estimated **\$32.9 million** in revenue in FY 2008-09 and **\$46.1 million** in FY 2009-10 and ongoing related to out-of-state tax avoidance, accounts receivable recovery, audits of cigarette and tobacco products distributors, and enforcement activities to diminish cigarette and tobacco products tax evasion.
- Protects state's annual revenue base of approximately \$1.0 billion. Demonstrates "due diligence" in the enforcement of the MSA.
- Provides permanent funding for ongoing program workload. Permanent funding helps in retention of qualified staff.
- Deters tax evasion by providing a permanent audit and enforcement presence.
- Provides a mechanism for consumers to report and pay their excise and use tax related to their purchases of cigarettes and tobacco products from out-of-state sellers.
- Increases voluntary compliance by facilitating the receipt of additional tax revenues which benefits the State's the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families First Trust Fund.
- Responds to California industry concerns regarding Internet sales of cigarette and tobacco products from out-of-state sellers.
- Increases distribution and sales of legal cigarette and tobacco products for licensed California cigarette and tobacco products distributors.
- Supported by the California Attorney General Office Tobacco Litigation Section.

Cons:

- Requires budget augmentation.
- Increases level of authorized positions.

D. Justification and Analysis of All Feasible Alternatives (continued)

Alternative 2 - Approve \$4.2 million to convert 20.2 limited-terms to permanent and approve the establishment of 27.3 positions on a 3-year limited-basis for Cigarette and Tobacco Products Taxes Revenue Recovery Workload resources.

This alternative provides permanent funding for 20.2 limited-term positions, expiring on June 30, 2008, and 3-year, limited-term funding for 27.3 new positions and blanket funds related to Cigarette and Tobacco Products Tax Revenue Recovery Workload. This alternative will address workload related to cigarette and tobacco products taxes revenue recovery. Those areas of revenue recovery include out-of-state tax avoidance, accounts receivables, tax audits, and enforcement efforts related to cigarette and tobacco products taxes. Permanent funding is necessary for all continuing positions because the workload is permanent and ongoing. However, funding for the 27.3 new positions related to out-of-state tax avoidance, accounts receivable recovery, and tax audit activities would be limited term. Statistics on these new revenue recovery activities would be presented at the end of the limited term period to justify permanent funding.

Pros:

- Over the 3-year limited-term period, BOE would recoup an estimated **\$32.9 million** in revenue in FY 2008-09 and **\$46.1 million** in FY 2009-10 and ongoing related to out-of-state tax avoidance, accounts receivable recovery, tax audits of cigarette and tobacco products distributors, and enforcement activities to diminish cigarette and tobacco products tax evasion.
- Provides permanent funding for ongoing program workload. Permanent funding helps in retention of qualified staff.
- Would allow ETD to evaluate the effectiveness and cost-benefit of the new positions during their 3-year limited-term.
- Deters tax evasion by providing a permanent enforcement presence.
- Provides a mechanism for consumers to report and pay their excise and use tax related to their purchases of cigarettes and tobacco products from out-of-state sellers.
- Increases voluntary compliance by facilitating the receipt of additional tax revenues which benefits the State's the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families First Trust Fund.
- Increases distribution and sales of legal cigarette and tobacco products for licensed cigarette and tobacco products distributors and retailers operating in California.
- Supported by the California Attorney General Office Tobacco Litigation Section.

Cons:

- After 3 years, accounts receivable, audit activities, and certain out-of-state tax avoidance workload would not be addressed and BOE would not recover associated annual revenue.
- Does not support the BOE required due diligence in the enforcement of the MSA and puts the State of California at risk of potentially losing an estimated \$800 million annually.
- Does not protect California's licensed cigarette and tobacco products distributors and retailers from tax evaders and consumer's purchases from out-of-state sellers.
- Difficult to retain qualified staff when positions are limited-term.
- Requires BOE to submit another budget change proposal in 3 years for workload that is permanent and ongoing.
- Requires budget augmentation.
- Increases level of authorized positions.

E. Outcomes and Accountability

This proposal augments the existing Cigarette and Tobacco Products Tax program in addressing areas of out-of-state tax avoidance by consumers, collections of accounts receivables, audits of distributors and common carriers, and enforcement of activities related to tax evasion schemes and ID referral and billings. Accordingly, the associated revenue gain will be measured by the number of CI/UI returns and invoices processed, the number of cleared collections assignments and additional audits that are completed beginning July 1, 2008. Total assessments will be calculated and compared to prior years to establish the actual gain in revenues. Statistical reports that provide detailed and summarized compliance and audit results are currently in place. New staff will be hired beginning July 1, 2008. Prescreening and non-commitment interviews of potential candidates will begin prior to the fiscal year in order to gain the immediate benefit of the increased staff with the approval of the new funding.

F. Timetable

Full implementation July 2008 per the following timetable:

January 2008-June 2008	July 2008-June 2009+
<ul style="list-style-type: none"> • Develop seating plan and identify any workstations, PCs, telephones, and other equipment needs. • Prepare duty statements and training plans for new staff. • Advertise new positions and conduct hiring interviews. • Develop implementation and training phase. 	<ul style="list-style-type: none"> • Continue registering CI/UI taxpayers. • Continue processing invoices related to cigarette and tobacco product Internet purchases. • Continue processing and handling CI/UI tax returns, payments, taxpayer inquires, correspondence, and account maintenance. • Continue enforcement activities. • Hire new personnel July 1, 2008. • Train new investigation, audit and compliance staff. • Implement revenue recovery activities related to out-of-state tax avoidance; accounts receivables; tax audits, and enforcement. • Monitor progress of resources.

G. Recommendation

Alternative 1 is strongly recommended. By providing 47.5 positions and related resources identified in Alternative 1, BOE can recoup an estimated **\$32.9 million** in revenue in FY 2008-09 and **\$46.1 million** in FY 2009-10 and in ongoing years in cigarette and tobacco product taxes. With a compliance, audit, and investigative presence, the BOE can significantly reduce the illegal consumption and distribution of cigarettes and tobacco products and collect the taxes due from consumers purchasing untaxed cigarettes and/or tobacco products from out-of-state sellers. As a result, consumers and business owners buying untaxed tobacco products will be forced to buy from licensed sources in California. Also, by permanently establishing the BOE's compliance, audit and enforcement staff, the BOE will encourage voluntary compliance with the cigarette and tobacco products tax law, help to recover revenue lost to cigarette and tobacco products tax fraud, and decrease criminal activities in California. This alternative is also supported by the Attorney General's Office Tobacco Litigation Section as conveyed in their letter dated June 11, 2007 and demonstrates the state's continued due diligence in its enforcement of the MSA.

Exhibit 1

EXCISE TAXES DIVISION REVENUE ANALYSIS

The ETD proposes to increase revenue and enhance overall voluntary compliance within the cigarette and tobacco products tax programs. This proposal includes resources to collect revenue in the following areas:

Revenue Recovery Area	FY 08-09 (in millions)	FY 09-10+ (in millions)
Out-of-State Tax Avoidance	\$ 6.0	\$ 6.0
Accounts Receivables	\$16.8	\$30.0
Tax Audit Activities	\$10.1	\$10.1
Total Estimated Revenue	\$32.9	\$46.1

Out-of State Tax Avoidance

ETD estimates a total of \$6.0 million in FY 2008-09 and ongoing in additional tax revenue from out-of-state tax avoidance. From the period July 2006 to June 2007, the CI Program has recouped \$4.0 million from voluntary compliance. Based on these statistics, ETD Compliance Section estimates \$4.0 million in annual revenue related to voluntary compliance. Additionally, ETD Compliance staff has reconciled invoice information to tax return information and has determined that there is \$6.0 million related to non-compliance and underreporting (or \$5.2 million annually based on an estimated 120,000 invoices annually). ETD conservatively estimates that staff can recoup \$2.0 million annually related to non-filing and underreporting.

Accounts Receivable

ETD estimates additional excise tax revenue of \$16.8 million in FY 2008-09 and \$30.0 million in FY 2009-10 and ongoing related to accounts receivables. In June 2005, the ETD had 1,100 collectable accounts receivable cases (not including 822 aged Cigarette Internet program liabilities) that totaled \$138 million. Currently, the ETD has 1,625 collectable accounts receivable cases (not including 767 aged collectable receivables in Cigarette Internet program liabilities) that total \$185 million related to the cigarette and tobacco products accounts receivables. This accounts receivable backlog and the ongoing increase in workload is derived from investigation, audit and compliance billings. Because many of the billings are related to fraud, more time is involved to work these cases and there is generally a lower recovery rate as assets are hidden or the person is in prison. Nevertheless, ETD has an obligation to address the backlog and actively work new and ongoing accounts receivable cases. ETD reasonably assumes that it can recoup \$9.2 million (5% of \$185 million) of the current accounts receivables.

Additionally, ID is projecting the following billable revenue:

Position Requested	Cases	Billable Revenue per Case	Billable Revenue
Associate Tax Auditor	12	\$2,700,000	\$32,400,000
Business Taxes Specialist I	15	\$2,700,000	\$40,500,000
Business Taxes Specialist II	1	\$3,160,000	\$ 3,160,000
Total Estimated Billable Revenue			\$ 76,060,000

Exhibit 1 (Continued)

ETD estimates that it can recover \$7.6 million of these projected new ID billings (10% of the billable revenue). Thus, total estimated revenue for FY 08-09 is \$16.8 million (\$9.2 million plus \$7.6 million).

ETD estimates that accounts receivable will grow to \$200 million by FY 2009-10 before holding steady with the additional resources in place. Once adequately staffed, ETD will be able to respond more quickly to these billings and take appropriate actions earlier in the collection cycle. ETD reasonably assumes its recovery rate will improve to a minimum of 15% and result in \$30.0 million (15% of \$200 million) in revenue on an ongoing basis by FY 2009-10.

Tax Audit Activities

ETD estimates \$10.1 million in revenue recovery related to audit activities. The projected revenue associated with each auditor position is estimated at \$1,443,200 (1,600 hours x \$902 tax change per hour = \$ 1,443,200), exclusive of overtime hours. Total projected annual revenue is \$10,102,400 (\$1,443,200 x 7.0 positions = \$10,102,400). For the two BTS I audit positions proposed for CI program appeals cases, revenue is also considered since audit staff would have to be redirected from field audit positions to perform the petition, late protest, and refund functions; thus reducing audit recovery revenues.

Exhibit 2

EXCISE TAXES DIVISION COMPLIANCE SECTION

OUT-OF-STATE TAX AVOIDANCE & ACCOUNTS RECEIVABLE RECOVERY WORKLOAD ESTIMATES

**CONTINUING WORKLOAD FUNCTIONS FOR
OUT-OF-STATE TAX AVOIDANCE**

**M = Minutes
H = Hours Time Per
Occurrence Occurrences
per Year Total
Hours**

Invoice Processing & Registrations-Tax Tech II				
Registering affected businesses/taxpayers	M	5	20,860	1,738
Account maintenance	M	5	5,178	432
Adding invoice information to database	M	4	120,000	8,000
Maintaining invoice information to database	M	4	7,200	480
Maintaining/tracking hard copy invoices	M	5	2,200	183
Handling taxpayer inquiries (phones)	M	10	5,000	833
Returned mail/address search	M	3	2,448	122
Total Tax Tech II Hours Needed				11,788
Overtime hours				88
Total Positions Requested (1,800 Hours Per Position)				6.5

Billings/ Tax Tech III				
Review/analyze returns & schedules (Comping)	M	2	34,000	1,133
Issue billings for NR,PR,LR, & comp errors	M	5	2,300	192
Issue billings for payment plans	M	5	2,656	221
Process claims for refunds	M	15	200	50
Process delinquencies	M	2	18,000	600
Total Tax Tech III Hours Needed				2,196
Overtime hours				396
Total Positions Requested (1,800 Hours Per Position)				1.0

Phone Advisory/ Bus Taxes Rep				
Handling tax law & billing questions (phones)	M	15	10,649	2,662
Prepare correspondence related to invoice information & tax law questions	M	30	2,130	1,065
Review and monitor Payment plans	M	30	3,000	1,500
Relief from penalty, declaration of timely mailing, extensions	M	30	2,400	1,200
Total Bus Taxes Rep Hours Needed				6,427
Overtime hours				127
Total Positions Requested (1,800 Hours Per Position)				3.5

Compliance & Collections/Bus Taxes Comp Spec				
Jenkins Act compliance letters/AG ltrs/ATF ltrs	H	8	48	384
Training/Lead Person/Review for Tax Tech's & BTR's	M	12	6,240	1,248
Internet inquiries & other correspondence	M	10	72	12
Approvals (ROPs, Refunds, Payment Transfers)	M	3	2,340	117
Excise Tax Forms Clearance Coordinator	H	8	12	96
Offer in compromise review	M	10	72	12
Lexus Nexus/skip tracing	M	2	520	17
Total Bus Taxes Comp Spec Hours				1,886
Overtime hours				86
Total Positions Requested (1,800 Hours Per Position)				1.0

TOTAL OF POSITIONS FOR OUT-OF-STATE TAX AVOIDANCE-CONTINUING WORKLOAD				12.0
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Exhibit 2 (Continued)

EXCISE TAXES DIVISION COMPLIANCE SECTION

OUT-OF-STATE TAX AVOIDANCE & ACCOUNTS RECEIVABLE RECOVERY WORKLOAD ESTIMATES

NEW WORKLOAD FUNCTIONS FOR OUT-OF-STATE TAX AVOIDANCE	M = Minutes H = Hours	Time Per Occurrence	Occurrences per Year	Total Hours
ETD Admin Support/Office Assistant				
Scanning and indexing - CI/UI returns	M	2	166,000	4,150
Telephone reception - CI/UI redirected Calls	M	1	1,500	25
Total Office Assistant Hours Needed				4,175
Overtime hours				572
Total Positions Requested (1,800 Hours Per Position)				2.0

Billings/ Tax Tech III				
Issue compliance assessment on underreported returns/delinquent returns	M	10	12,000	2,000
Handle inquiries on compliance assessments	M	15	6,000	1,500
Clear delinquencies	M	2	9,000	300
Total Tax Tech III Hours Needed				3,800
Overtime hours				200
Total Positions Requested (1,800 Hours Per Position)				2.0

Collection/Bus Taxes Rep				
Follow-up on delinquency letters	M	10	9,000	1,500
AR Collection/CI/UI compliance assessments	H	2	2,400	4,800
Total Bus Taxes Rep Hours Needed				6,300
Overtime hours				900
Total Positions Requested (1,800 Hours Per Position)				3.0

TOTAL POSITIONS FOR OUT-OF-STATE TAX AVOIDANCE-NEW WORKLOAD	7.0
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TOTAL POSITIONS FOR THE OUT-OF-STATE TAX AVOIDANCE-NEW AND CONTINUED WORKLOAD	19.0
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NEW WORKLOAD FUNCTIONS FOR ACCOUNTS RECEIVABLE RECOVERY	M = Minutes H = Hours	Time Per Occurrence	Occurrences per Year	Total Hours
Collection/Bus Taxes Rep				
A/R Collections/average complexity	H	8	250	2,000
A/R Collections/complex	H	80	100	8,000
Total Bus Taxes Rep Hours Needed				10,000
Overtime hours				160
Total Positions Requested (1,800 Hours Per Position)				6.0

TOTAL POSITIONS FOR THE ACCOUNTS RECEIVABLE RECOVERY - NEW WORKLOAD	6.0
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Exhibit 3

EXCISE TAXES DIVISION AUDIT SECTION
TAX AUDIT WORKLOAD

ID Referrals and Common Carrier Leads

Three positions are proposed to work on ID referrals and leads from common carrier records.

Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Business Taxes Specialist I (Audit)					
	Complex Field Audits	H	80	20	1,600
	Complex Desk Audits	H	40	14	560
	Total Hours per year				2,160
	Overtime Hours				560
	Position based on 1,600 hours				1.0

Audit Referral Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Associate Tax Auditor					
	Field Audits	H	80	14	1,120
	Desk Audits	H	40	20	800
	Total Hours per year				1,920
	Overtime Hours				320
	Position based on 1,600 hours				1.0

Common Carrier Audit Referral Workload Detail					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Associate Tax Auditor -					
	Audit Referrals	H	40	44	1,760
	Total Hours per year				1,760
	Overtime Hours				160
	Position based on 1,600 hours				1.0

TOTAL POSITIONS FOR TAX AUDIT ACTIVITIES - ID REFERRALS & COMMON CARRIERS	3.0
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Exhibit 3 (Continued)

EXCISE TAXES DIVISION AUDIT SECTION
TAX AUDIT WORKLOAD

Audit Workload

Two positions are proposed for routine audit workload, comprised of audits of licensed cigarette distributors and licensed tobacco products distributors.

Existing and Ongoing Audit Inventory Workload Detail (Licensed Tobacco Products Distributors)					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Associate Tax Auditor					
	Large size account audits	H	115	11	1,265
	Medium size account audits	H	44	2	88
	Small size account audits	H	44	9	396
	Total Hours per year				1,749
	Overtime Hours				149
	Total Positions Requested (1,600 Hours Per Position)				1.0

Existing and Ongoing Audit Inventory Workload Detail (Licensed Cigarette Distributors)					
Classification	Activity	Time Measure		On-going Activities	
		H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Associate Tax Auditor					
	Large size account audits	H	160	4	640
	Medium size account audits	H	100	6	600
	Small size account audits	H	50	10	500
	Total Hours per year				1,740
	Overtime Hours				140
	Total Positions Requested (1,600 Hours Per Position)				1.0
TOTAL POSITIONS FOR TAX AUDIT ACTIVITIES - AUDIT WORKLOAD					2.0

CI Program Appeals Cases

Additionally, ETD Audit Section requests 2.0 BTS I positions to handle ongoing workload consisting of appeals cases resulting from billings to consumers of cigarette and tobacco products through the CI Program.

Classification/ Tasks	Time per Occurrence	Number of Occurrences	Total Hours Needed
Business Taxes Specialist I			
Petitions, Late Protests, & Refunds	16	253	4,048
Total Overtime Hours Requested			448
Total Positions Requested (1,800 hours per Positions)			2.0
TOTAL POSITIONS FOR TAX AUDIT ACTIVITIES - CI PROGRAM APPEALS CASES			2.0

EXCISE TAXES DIVISION COMPLIANCE SECTION
ETD ADMINISTRATIVE SUPPORT WORKLOAD ESTIMATES

NEW WORKLOAD FUNCTIONS FOR ETD ADMINISTRATIVE SUPPORT	Total Hours
Office Assistant (administrative support, receptionist, mail, general filing, etc.)	1,800
Business Taxes Administrator III (Establish and maintain policy, procedures, represent the ETD, act as liaison with other state and federal regulatory agencies in duties relating to the cigarette and tobacco products tax programs.)	1,800
Business Taxes Compliance Sup II (Provide guidance in employee development, address personnel issues, review and approve staff work, provide guidance on complex issues and other supervisory functions.)	1,800
Total ETD Administrative Support Hours	5,400
Total Positions Requested (1,800 Hours Per Position)	3.0
TOTAL OF POSITIONS FOR THE ETD ADMINISTRATIVE SUPPORT-NEW WORKLOAD	3.0

Exhibit 5

INVESTIGATIONS DIVISION
ENFORCEMENT ACTIVITIES WORKLOAD

Enforcement Activities to Diminish Cigarette and Tobacco Products Tax Evasion

3.0 of the BTS I/Investigators can annually investigate an average of 9 felony cigarette or tobacco tax cases per year with an average billable amount of \$2.7 million tax dollars per case. 1.0 new BTS I position will work 3 new felony cases with an average billable amount of \$1.35 million tax dollars per case.

Additionally, the ID has taken a pro-active approach toward obtaining information from the common carriers and freight haulers who deliver cigarette and tobacco products within California. As a result, the ID has recently begun receiving delivery information, with greater level of detail, which is being used to develop felony criminal investigations, identify criminal trends and will be used to establish civil billings. An Associate Tax Auditor (ATA) can conduct an average of 12 cigarette or tobacco tax audits per year with an average billable amount of \$2.7 million tax dollars per case.

ID also received 1.0 BTS I in FY 2006-07 BCP 2d "Enforcement of Consumer Purchases of Tobacco Products from Out-of-State Sellers" to address workload associated with common carriers. The workload associated with audits of common carrier deliveries to unregistered consumers and/or unlicensed distributors results in additional criminal investigations and field inspections by the ID that requires continuation of this position. The delivery information is used by Investigators and Inspectors when conducting ongoing cases, new complaints and routine inspections. BTS I/Investigators can annually investigate an average of 10 new leads resulting in 3 criminal investigations with an average billable amount of \$2.7 million tax dollars per case. The workload identified below is based on historical criminal investigations resulting from common carrier and other subpoenaed delivery reports:

Classification	Total Investigations	Hours per Investigation _a/	Total Hours
Business Taxes Specialist I/Investigator			
Complaints	27	10	270
Cases	12	617	7404
Total Hours			7674
Overtime Hours			74
Total Positions Required (1,520 Hours Per Position)			5.0

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

The BTS II Investigator can annually investigate an average of 1 felony case per year with an average billable amount of an estimated \$3.16 million per case.

The BTS II Investigator must work independently, acting as a lead to a professional staff that conducts the most complex, sensitive criminal felony investigations, involving multi-jurisdictional county, state and federal agencies. These investigations include preparing criminal complaints and executing search warrant on multi-jurisdictional cases. The BTS II investigator must also be relied upon to analyze and assimilate large volumes of investigative information in a short time frame, make sound decisions and take appropriate actions.

Exhibit 5 (Continued)

INVESTIGATIONS DIVISION
ENFORCEMENT ACTIVITIES WORKLOAD

Classification	Total Investigations	Hours per Investigation _a/	Total Hours
Business Taxes Specialist II			
Cases	1.10	1383	1521
Special projects		80	80
Total Hours			1601
Overtime Hours			81
Total Positions Required (1,520 Hours Per Position)			1.0

_a/ Average hours per investigation is based on historic data

When an Investigator initiates a criminal case, a civil audit is prepared by the ATA. This position is responsible for completion of civil audits as a result of criminal investigations. This position is also responsible for the completion of civil audits resulting from district and program referrals which do not result in criminal prosecutions. For every three criminal prosecutions there are on average, three civil audits. In addition, there is on average, one civil audit required for a case that did not result in a criminal prosecution. This can be a result of additional individuals, corporations, etc., discovered during an ongoing criminal prosecution; insufficient evidence gathered for a criminal prosecution or a prosecuting attorney declining to prosecute.

Classification	Total Audits	Hours per Audit _a/	Total Hours
Associate Tax Auditor			
Audits from prosecutions	9	145	1305
Audits without prosecutions	3	145	435
Total Hours			1740
Overtime Hours			140
Total Positions Required (1,600 Hours Per Position)			1.0

a/ Average hours per audit are based on historical trends

ID ENFORCEMENT ACTIVITIES TO DIMINISH CIGARETTE AND TOBACCO PRODUCTS TAX EVASION	7.0
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Exhibit 5 (Continued)

INVESTIGATIONS DIVISION
ENFORCEMENT ACTIVITIES WORKLOAD

Distributor Cigarette Tax Stamp Refund Workload

Each stamp refund request takes approximately 32 hours to complete (see workload table below) and requires two ID staff for security purposes. ID expects the number of requests for refunds will continue at approximately the same rate as in 2006.

Workload Activity	Time Measure		On-going Activities	
	H = Hours M = Minutes	Time Per Occurrence	Occurrences Per Year	Total Hours
Cigarette Tax Stamp Refunds				
Distributor Contact – letter/calls, scheduling, LD instructions	H	1	80 ¹	80
Scanning / facilitation of tax stamp destruction	H	26	80	2,080
Inspection	H	3	80	240
Write-up / Close-out	H	2	80	160
Distributor Licenses – New/Close-Outs				
Operation Inspections – tax compliance evaluation, preliminary investigation of suspect operations	H	4	132 ²	528
Total Hours Required				3,088
Overtime Hours				48
Total Positions Requested (1,520 Hours Per Position)				2.0
Travel Expenses:				
In-State	\$19,400			\$24,000
Out-of-State	\$4,600			

¹ Based on number of cigarette tax stamp refunds in 2006.

² Represents 20% cigarette and tobacco distributor license turnover.

ID Distributor Cigarette Tax Stamp Refund Workload	2.0
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BOARDWIDE ADMINISTRATIVE SUPPORT

Customer and Taxpayer Services Division:

The Customer and Taxpayer Services (CATS) will require 1.5 Tax Technician I (.75 continuing and .75 new) to address workload related to inquiries/questions on consumer enforcement issues

Classification	Projected Calls to Info Center	Calls per CSR/PY	Positions Needed (1,800 Hours Per Position)
Tax Technician I	18,421	12,000	1.5

Additionally, CATS requests continuation of the 92 overtime hours at various classifications for translation services and forms and publications workload.

Classification	Hours Requested
Digital Composition Specialist III (Forms & Pubs)	6
Associate Government Program Analyst (Forms & Pubs)	2
Associate Tax Services Specialist (Forms & Pubs)	2
Staff Services Analyst Translation Program (Forms & Pubs)	80
Staff Services Analyst (Forms & Pubs)	2
Total OT Hours Requested	92

Financial Management Division - Accounting Section:

Task Description	Assoc. Admin. Analyst Acct. Systems	Accountant Trainee	Total 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 checks	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 BOE 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 (1,800 Hours Per Position)	1.0	0.5	1.5

Exhibit 6 (Continued)

Human Resources Division (HRD):

The HRD is responsible for maintaining personnel administrative duties for all BOE employees. HRD is not currently staffed at a level to meet current workload. Therefore, HRD is requesting two .25 permanent positions to accommodate the increased workload due to the increased number of new BOE employees from the Cigarette and Tobacco Products Taxes Revenue Recovery proposal. These positions are key as we face the challenge of attracting and retaining a well-qualified workforce while competing with the private sector for talent.

.25 Position - Associate Personnel Analyst (APA) (Organizational Services Section/Examination and Recruitment Section) Duties are as follows :

- Recruitment: participating in recruitment events activities, mailings, vacancy and examination announcements, and review transcripts.
- Examination Processing: job analysis, examination development, internet examination maintenance, examination administration, and examination appeals.
- Hiring: VPOS announcements, 628 review, position allocation determinations, and liaison activity with DPA.
- Employee Performance activities include: consultation to and preparation of probationary reports, counseling and corrective memorandums, adverse actions, and interpreting statewide personnel management policies.
- Management/Employee Consultation: consultation on organization structure, preliminary review of employee issues related to performance, medical issues, and FMLA entitlement, correspondence to employees, management, and control agencies; training, telephone calls, and emails.

WORKLOAD DETAIL			
Activity	Factors And Weights (Hours per Occurrence)	Occurrences Per Year	Total Hours
Recruitment	6.32	25 a/	158
Examination Processing	2.04	25 a/	51
Hiring	5.75	25 a/	144
Employee Performance	2.25	25 a/	56
Management Consultation	2.25	25 a/	56
Total APA Hours			465
Total Positions Requested (1,800 Hours Per Position)			.25

a/ based on ¼ of 100 employees

.25 Position - Personnel Specialist (PS) (Personnel Transactions Section) Duties are as follows :

- Hiring/Appointment Process: certification appointment process, verification of the minimum qualifications prior to appointment, salary determinations, position control activities, and appointments.
- Attendance/Pay and Benefits: all payroll activities (regular and miscellaneous), benefit administration, maintaining leave balance information, timekeeping, and disability claims administration.
- Administrative Detail: correspondence to employees, control agencies, and other jurisdictions; employment verification, subpoena documentation, retroactivity reports, accounts receivable, MIRS reports, service awards, EDD claims, and security monitoring.
- Employee contact: emails; telephone calls, and personal contact.

Exhibit 6 (Continued)

WORKLOAD DETAIL			
Activity	Factors and Weights (Hours per Occurrence)	Occurrences Per Year	Total Hours
Hiring/Appointment Process	5.75	25 a/	143
Attendance/Pay and Benefits	6.55	12 b/	78
Administrative Detail (Reports, Training, Correspondence)	5.25	12 b/	63
Employee Contact	15	12 b/	180
Total PS Hours			464
Total Positions Requested (1,800 Hours Per Position)			.25

a/ based on ¼ of 100 employees

b/ per month

Cashier Unit:

WORKLOAD DETAIL		
Office Assistant		
	FY 2008-09	FY 2009-10
Number of items per hour	70	70
Number of item per year	46,000	46,000
Total OT Hours Required	657	657

BOARDWIDE ADMINISTRATIVE SUPPORT

Data Entry Unit:

	# of Returns	Average. Keystrokes per return - 125	Average. Keystrokes per hour	Total Hours
Returns Filed-CI	17,000	2,125,000	8,000	266
Returns Filed-UI	17,000	2,125,000	8,000	266
	# AR documents	Average Keystrokes per document - 28	Average Keystrokes per hour	Total Hours
# A/R Documents Submitted-CI	6,000	168,000	8,000	21
# A/R Documents Submitted-UI	6,000	168,000	8,000	21
Total OT Hours Requested				574

Mail Services Unit:

<u>Return Mailing</u>	Hours Needed
41,000 Returns/Billings	
Mail Machine Operator I	14
Mail Machine Operator II	14
<u>Incoming Mail</u>	Hours Needed
29,000 Incoming Mail Pieces	
Mail Machine Operator I	2
Mail Machine Operator II	2
Office Assistant (General)	16
Total OT Hours Requested	48



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JUN 13 2007

DEPUTY DIRECTOR
PROPERTY AND SPECIAL TAXES

David Gau, Deputy Director
Property and Special Taxes Department, MIC: 63
Board of Equalization
450 N Street
Sacramento, CA 95814

Dear Mr. Gau:

I am writing in support of the continuation and proposed enhancement of the Board's cigarette Internet program.

I am an attorney in the Attorney General's Tobacco Litigation and Enforcement Section, and I am also Chair of the Tobacco Internet Working Group, a group composed of approximately 25 states. The Group's goal is to stop illegal online tobacco sales which, among other things, violate the Jenkins Act and states' remote sales laws. The following examples demonstrate the ways in which the Board's staff has helped us achieve that goal:

- At my request, the Excise Taxes Division sent two employees to the ATF office in Virginia to review and retrieve cigarette sales records of an out-of-state online cigarette retailer we sued for violating the Jenkins Act. These records supported our claims that the retailer failed to file Jenkins Act reports in connection with shipments of cigarettes into California;
- Staff provided technical expertise both on DOJ proposed legislation to ban the direct delivery of tobacco products through Internet and mail order sales to consumers and on regulations regarding the taxing provisions of the federal Contraband Cigarette Trafficking Act;
- Staff provided information concerning brands of cigarettes shipped to California consumers to assist us in determining whether certain cigarette manufacturers' direct buying customers are selling their cigarettes over the Internet, in violation of Agreements with the Attorneys General;
- Staff provided information and assistance to our office regarding investigations and enforcement actions against Internet cigarette sellers.

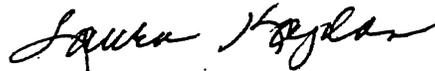
David Gau

June 11, 2007

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Finally, with the Board's assistance we have been able to obtain records of thousands of unreported shipments of cigarettes into California which we have passed onto the Board for collection. The Board's efforts to collect these unpaid state excise taxes discourage tax evasion and the sale of low-cost cigarettes, which in turn drives consumption down. For this reason, we wholeheartedly support an enhancement of this program.

Sincerely,



LAURA KAPLAN
Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

DATE: August 15, 2007

STATE OF CALIFORNIA
 BUDGET CHANGE PROPOSAL--FISCAL DETAIL
 STATE OPERATIONS
 FISCAL YEAR 2008-09
 (Dollars in Thousands)

Title of Proposed Change: Cigarette and Tobacco Products Taxes Revenue Recovery

Program/Element/Component: _____

	PERSONNEL YEARS			CY	BY	BY + 1
	CY	BY	BY + 1			
TOTAL SALARIES AND WAGES <i>_a/</i>		48.0	48.0		\$2,585	\$2,586
Salary Savings		-2.4	-2.4		-120	-120
NET TOTAL SALARIES AND WAGES		45.6	45.6		2,465	2,466
Staff Benefits <i>_a/</i>					855	856
NET TOTAL SALARIES AND WAGES		45.6	45.6		3,320	3,322
Distributed Administration <i>_b/</i>					305	299
TOTAL PERSONAL SERVICES		45.6	45.6		\$3,625	\$3,621

OPERATING EXPENSE AND EQUIPMENT

General Expense				\$123	\$76
Distributed Administration				76	75
Printing				50	50
Communications				26	19
Postage				14	14
Travel--In-State				125	125
Travel--Out-of -State				26	26
Training				28	28
Facilities Operations				80	80
Consulting & Professional Services: Interdepartmental					
Consulting & Professional Services: External					
Department of Technology Services					
Data Processing				18	
Equipment					
Other Items of Expense: (Specify Below)					

_a/ See pages 32 & 33 of 34 for itemized staff benefits and classification detail.

_b/ Represents Distributed Administration costs resulting from this BCP. The Distributed Administration costs for existing BOE programs will reflect a corresponding decrease which will be addressed in the Planning Estimate process.

	CY	BY	BY + 1
TOTAL OPERATING EXPENSE AND EQUIPMENT		\$566	\$493
TOTAL EXPENDITURES (State Operations)		\$4,191	\$4,114

Source of Funds

General Fund	(0001)	\$385	\$375
Special Funds:			
Breast Cancer Fund	(0004)	77	75
State Emergency Telephone	(0022)		
Propane Surcharge Fund	(0051)		
Motor Vehicle Fuel Account	(0061)		
Occupational Lead Prevention Fund	(0070)		
Childhood Lead Poisoning Prev. Fund	(0080)		
Cig. and Tobacco Prod. Surtax Fund	(0230)	963	941
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)	2,766	2,723
Federal Trust Fund	(0890)		
Timber Tax Fund	(0965)		
Gas Consumption Surcharge Fund	(3015)		
Water Rights Fund	(3058)		
Elec. Waste Recovery and Recycling Acct.	(3065)		
Cig. and Tobacco Prod. Compliance Fund	(3067)		
Federal Funds			
Other Funds			
Reimbursements	(0995)		
Net Total Augmentation (Source of Funds)		\$4,191	\$4,114

**DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES**

Staff Benefits Detail:				CY	BY	BY + 1
				<i>(Whole Dollars)</i>		
OASDI					\$188,573	\$188,649
Health Insurance					270,320	270,374
Retirement					386,466	386,545
Workers' Compensation					928	928
Industrial Disability Leave					1,626	1,626
Non-Industrial Disability Leave					1,176	1,176
Unemployment Insurance					348	348
Other					5,996	5,997
TOTAL					\$855,433	\$855,643

Classification	Positions			Salary Range	Amount		
	CY	BY	BY + 1		CY	BY	BY + 1
Property & Special Taxes Dept.							
Excise Taxes Division							
Business Taxes Admin II/III (ETD Supp)	N	1.0	1.0	95,364	\$95,364	\$95,364	
Business Taxes Comp Sup II (ETD Supp)	N	1.0	1.0	64,992	\$64,992	64,992	
Business Taxes Compliance Sp (Comp)		1.0	1.0	59,100	\$59,100	59,100	
Business Taxes Rep		2.5	2.5	40,992	\$102,480	102,480	
Business Taxes Rep (Prop 10)		1.0	1.0	40,992	\$40,992	40,992	
Business Taxes Rep	N	9.0	9.0	40,992	\$368,928	368,928	
Business Taxes Specialist I	N	3.0	3.0	71,580	\$214,740	214,740	
Office Assistant (General)	N	3.0	3.0	26,460	\$79,380	79,380	
Tax Technician II (BOE)		5.0	5.0	33,756	\$168,780	168,780	
Tax Technician II (BOE) (Prop 10)		1.5	1.5	33,756	\$50,634	50,634	
Tax Technician III (BOE) (Prop 10)		1.0	1.0	37,752	\$37,752	37,752	
Tax Technician III (BOE)	N	2.0	2.0	37,752	\$75,504	75,504	
Associate Tax Auditor (BOE) (Audit)	N	4.0	4.0	62,052	\$248,208	248,208	
Administration Dept.							
Fiscal Management Division							
Accountant Trainee (BOE Ad Sup) (Prop 10)		.5	.5	41,448	\$20,724	20,724	
Asso Ad Ana-Acct.Syst.(BOE Ad Sup) (Prop 10)		1.0	1.0	49,140	\$49,140	49,140	
Human Resources Division							
Associate Personnel Analyst	N	.3	.3	56,292	\$16,888	16,888	
Personnel Specialist	N	.3	.3	34,740	\$10,422	10,422	
Executive Dept.							
Customer & Taxpayer Ser Div							
Tax Technician I (BOE) CATS (BOE Sup)		.8	.8	28,428	\$22,742	22,742	
Tax Technician I (BOE) CATS (BOE Sup)	N	.8	.8	28,428	\$22,742	22,742	

Legal Dept.

Investigation Division

Associate Tax Auditor (BOE) (Prop 10)		1.0	1.0	62,052	\$62,052	62,052
Business Taxes Specialist I	N	3.0	3.0	71,580	\$214,740	214,740
Business Taxes Specialist I (Prop 10)		3.0	3.0	71,580	\$214,740	214,740
Business Taxes Specialist I		1.0	1.0	71,580	\$71,580	71,580
Business Taxes Specialist II (Prop 10)		1.0	1.0	74,880	\$74,880	74,880

Blanket Funds:

Overtime (Various)		(3.0)	(3.0)		191,267	191,805
Temporary Help		.3	.3		6,271	6,271

TOTAL SALARIES AND WAGES		<u>48.0</u>	<u>48.0</u>		<u>\$2,585,042</u>	<u>\$2,585,580</u>
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_a/ The salary is the mid-step of the salary range for the stated classification.

SUPPLEMENTAL INFORMATION

Dollars in Thousands

	<u>Current Year</u>	<u>Budget Year</u>	<u>Budget Year + One</u>
Proposed Equipment:			
	<hr/>	<hr/>	<hr/>
Total	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Proposed Contracts:			
	<hr/>	<hr/>	<hr/>
Total	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
One-Time Costs:			
General Expense		\$47	
Communications		7	
Data Processing		18	
	<hr/>	<hr/>	<hr/>
Total	<hr/> <hr/>	<u>\$72</u>	<hr/> <hr/>
Future Savings:			
N/A			
	<hr/>	<hr/>	<hr/>
Total	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Full-Year Cost Adjustments:			
N/A			
	<hr/>	<hr/>	<hr/>
Total	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>