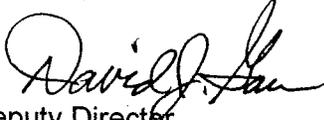


Memorandum

To: Honorable Betty T. Yee, Interim Chairwoman
Honorable Bill Leonard, Interim Vice-Chair
Honorable Michelle Steel, Third District
Honorable Judy Chu, Ph.D., Fourth District
Honorable John Chiang, Controller

Date: January 19, 2007

From: 
David J. Gau, Deputy Director
Property and Special Taxes Department

Subject: ***Cigarette and Tobacco Products Internet Program***

The Board of Equalization has embarked on a program to collect California state excise and use taxes from California consumers purchasing untaxed cigarettes and/or tobacco products for self-consumption in California from out-of-state Internet retailers, or by mail order or telephone. Through a Federal law known as the Jenkins Act, the Board obtains invoices from out-of-state cigarette and tobacco vendors detailing purchases by California customers. While the reporting has fluctuated over the past few years, the Board now receives several thousand invoices each month. Funding in the 2006-07 Budget (BCP No. 2d) allowed the Board to establish additional positions to recover tax revenues from cigarette and tobacco sales on the Internet and mail order by taxpayers.

Following are recent actions pertaining to the Cigarette and Tobacco Products Internet program:

- Approximately 12,000 Cigarette and Tobacco Products Excise Tax Returns and Cigarette and Tobacco Products Use Tax Returns for the third quarter 2006 reporting period were mailed on September 25, 2006. Almost 7,000 taxpayers responded and paid over \$2.2 million in state taxes. Delinquency notices were mailed on January 2, 2007 to approximately 5,300 taxpayers that did not respond.
- Staff has fielded over 5,000 telephone calls since the initial September 2006 mailing. Many of the callers have requested assistance in preparing the tax returns, requested installment payment plans, or have asked for copies of their invoices. The call volume continues to be steady.
- To address the increase in call volume, seven additional phone lines were added to handle the inquiries. Excise Taxes staff also worked with the Board's Information Center to institute an option for the caller to leave a message for a return call in lieu of waiting on hold.
- Approximately 5,600 new and existing taxpayers were mailed tax returns on January 10, 2007 for the fourth quarter 2006 reporting period.

- Program staff has registered over 15,000 new accounts and processed more than 128,000 invoices as of December 31, 2006 from Jenkins Act information. Additionally, approximately 65,000 shipment and delivery records were obtained from two major U.S. common carriers, and staff extracted a sampling of this data for an initial mailing to ascertain the viability of the information and track the level and types of responses received. Unfortunately, these records only contained delivery addresses and tracking numbers -- not the names of the persons who placed the orders. Thus, efforts to trace the delivery of products at a particular address to the person or business that placed the order were not possible. The anticipated revenue stated in the BCP, attributed to common carrier record processing activities, will not be realized since we have been unsuccessful in identifying the actual purchasers. The resources are instead being utilized for processing the Jenkins Act information.
- Staff has been identifying and contacting other Internet sellers and sending letters to inform these sellers of their obligation under the Federal Jenkins Act. We are working closely with the Attorney General's Office on this effort.
- In 1998, a legal contract called the Master Settlement Agreement (MSA) was established between the attorneys general of 46 states (including California) and five U.S. Territories with participating tobacco manufacturers. Under the MSA, seven tobacco companies agreed to limit the advertising, promotion and marketing of cigarettes, and pay the states an estimated \$206 billion. In January 2000, the California Attorney General's office began receiving California's share of the settlement, which is approximately \$1 billion a year. The Board's efforts to collect taxes on Internet and mail order purchases is supported by the California Attorney General's office because it demonstrates California's diligent enforcement of the law as called for in the terms of the MSA, thus helping secure the State's MSA payments. Since 2000, California has received MSA payments of over six billion dollars.

If you have any questions or would like additional information on our enforcement of taxpayer purchases of tobacco products from out-of-state sellers, please don't hesitate to contact me at 916-445-1516, or Ms. Lynn Bartolo at 916-322-9550.

DJG:lrp

cc: Executive Team
Mr. Dave McKillip
Ms. Lynn Bartolo
Mr. Richard Parrott
Mr. Bill Kimsey