

Memorandum

To: Mr. Ramon J. Hirsig
Executive Director

Date: January 7, 2009

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



Subject: **Tobacco Products Tax Rate Update**
(January 22, 2009, Deputy Director's Report, Property and Special Taxes)

This is an update regarding the Board's annual determination of the tobacco products tax rate required under Revenue and Taxation Code sections 30126 (Proposition 99) and 30131.5 (Proposition 10).

On November 30, 1988, the Board adopted a staff recommendation that the tobacco products tax rate "be set at the rate of tax on one cigarette divided by the weighted average wholesale cost of a cigarette." The approved formula included the use of the USDA's *Tobacco Outlook* publication as the data source for this wholesale cost. In the fall of 2007, the USDA notified us that they would cease publication of *Tobacco Outlook*. Since then, Excise Taxes Division (ETD) staff, in collaboration with the Board's Chief Economist, Joe Fitz, has been conducting research to locate another independent source of information for wholesale cigarette costs. To date, three possible alternatives have been identified:

Alternative 1 – Use retail cigarette prices as published in *The Tax Burden on Tobacco with a predetermined margin for markup from wholesale cost.**

The Board would be relying on published retail prices and would be tasked with "backing into" the weighted wholesale cost needed for the OTP calculation by utilizing a formula initially established by BOE's Chief Economist and approved annually by the Board.

(*Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*. Orzechowski & Walker is an economic consulting firm located in Washington, D.C.)

Alternative 2 – Annually survey cigarette manufacturers, distributors or importers for whole prices of cigarettes, with validation of the figures to be performed by BOE audit staff.

ETD staff will be required to annually survey a cross-section of the cigarette manufacturers, distributors and importers. Currently, there are 18 registered cigarette manufacturers and 110 registered cigarette distributors/importers. An annual survey would be mailed to licensees, or a selected target group to request documentation of their wholesale costs of cigarettes.

Alternative 3 – Annual adjustment of the previous year's tobacco products tax rate based on the Producer Price Index (PPI) as published by the U.S. Bureau of Labor Statistics for cigarette manufacturers.

The Board would establish a base to begin the rate calculation, (e.g., FY 2008/09 tax rate which was determined using the last published wholesale cigarette prices published in the December 2006 *Tobacco Outlook*). Using this figure, the tax rate would be adjusted based on the PPI for the previous calendar year, using a 12-month average.

I have asked staff to fully explore each alternative and will present a formal Issue Paper to the Board at its March 2009 Sacramento Board meeting to assist the Members in adopting a new data source for calculating the rate-setting formula. This will enable staff to complete the FY 2009/10 OTP rate setting timely for placement on either the Board's April or May 2009 Board meeting calendar for adoption.

With your approval, this item will be placed on the January 22, 2009 calendar under Deputy Director, Property and Special Taxes Department.

DJG:kn

cc: Ms. Diane Olson

Approved:



Ramon J. Hirsig
Executive Director

BOARD APPROVED
at the _____ Board Meeting

Diane Olson, Chief
Board Proceedings Division