

Fiscal Year 2009-10

TITLE OF PROPOSAL

Cigarette and Tobacco Enforcement

DIVISION PRIORITY NUMBER

PROGRAM IMPACTED

Cigarette and Tobacco Products Programs

SUMMARY OF REQUEST (including impact if request denied)

This proposal requests to establish permanent funding of \$11,293,971 and 95.4 positions in FY 2009-10 and \$13,193,971 for FY 2010-11 and ongoing years to administer and enforce the Cigarette and Tobacco Products Licensing Program. The breakdown of the required resources is as follows: \$8,710,971, Cigarette and Tobacco Products Compliance Fund, (and proportionately, the Breast Cancer, Cigarette & Tobacco Products Surtax, General, and California Childhood & Family Funds) and 87.0 positions to administer and enforce provisions of Assembly Bill (AB) 71, the California Cigarette and Tobacco Licensing Act of 2003 (Chapter 890, Statutes of 2003); and, 8.4 positions and \$683,000 (\$79,000 General Fund and \$604,000 Special Funds) to administer the provisions of AB 1749 (Chapter 501, Statutes of 2006). Incorporated in the requested positions above are 2.0 positions for Investigations Division (ID).

(Continued on next page)

BACKGROUND/HISTORY

Government Code §15604 and Revenue & Taxation (R&T) Code § 30451 requires the Board of Equalization (BOE) to enforce the provisions of the California Cigarette and Tobacco Products Tax Law. The current resources are due to expire January 1, 2010. AB 1749 deleted the January 1, 2010 (AB 71) repeal date and permanently established the licensing program but did not provide the ongoing funding. The positions must be established on a permanent basis to meet operational needs. It is estimated the state is losing millions of dollars in cigarette and tobacco products through tax evasion. AB 71 authorizes any peace officer, or BOE employee with limited peace officer status to conduct inspections. By licensing sellers, performing inspections, and employing an encrypted tax stamp, the supply of illicit cigarette and tobacco products has been substantially reduced. The BOE also enforces the licensure program through actions such as license suspension and revocation. (Continued on next page)

STATE LEVEL CONSIDERATIONS (including impact to other departments)

The BOE is mandated to administer this statewide program to license cigarette and tobacco products businesses at all levels including the importing, manufacturing, distribution, wholesaling, and retailing of cigarettes and tobacco products. Funding of these positions is critical to maintaining ETD, ID and Boardwide operations at adequate levels in the Cigarette and Tobacco Products Licensing Program. Failure to fund the program would impact the revenues for the State General Fund but also legislatively mandated funding for breast cancer, hospital and health education and services, research, and early childhood development. In addition, cigarette and tobacco products tax evasion would likely increase due to lack of enforcement and encrypted stamp technology with overt and covert features. Based on current estimates, cigarette tax evasion has declined 33% (\$87.7 million) and tobacco tax evasion declined 14% (\$15.7 million) as a result of licensing sellers, employing an encrypted tax stamp and enforcement efforts put in place by these statutes. (Continued on next page)

JUSTIFICATION (including link to Strategic Plan)

This proposal is consistent with the BOE's strategic plan. Specifically, this proposal conforms to:

Goal 1: Maximize Voluntary Compliance in BOE's programs, Objective 1- Evaluate current business processes and work cooperatively with stakeholder groups, clarifying and simplifying the laws, regulations, and materials, to enhance taxpayers' understanding of the programs we administer; Objective 5- Identify and analyze areas of noncompliance and develop approaches (such as enhanced partnerships with other governmental agencies) to address targeted areas of concern; Objective 6- Implement effective audit and collection modeling to ensure ease of compliance with the legal requirements of doing business in California.

Goal 2: Create an expanded and Responsive Infrastructure: (Continued on next page)

COSTS AND BENEFITS (BUDGET YEAR ONLY – FISCAL YEAR 2009-10)

New funding Continuation Redirection

COST	REVENUE (if applicable)
\$ 11,293,971	\$ 144,930,000
POSITIONS (if applicable)	COST SAVINGS (if applicable)
95.4	\$ 0

PREPARED AND APPROVED

PREPARED BY	DIVISION CHIEF APPROVAL
Jaime Diaz	Lynn Bartolo
AUTHOR'S TELEPHONE NUMBER	DATE
(916) 323-3950	May 28, 2008

ACTION

<input type="checkbox"/> Concept Approved <input type="checkbox"/> Request Denied	EXECUTIVE DIRECTOR (signature)
	

REQUEST FOR CONCEPTUAL APPROVAL (Continued)

Fiscal Year 2009-10

SUMMARY OF REQUEST (including impact if request denied)

The 2.0 new positions being requested by ID consist of 2.0 Business Taxes Compliance Specialist positions (BTCS) needed to perform authentication of tax stamps for destruction, refunds and credits (R & T Code 30361).

Excise Taxes Division (ETD) is requesting a budget augmentation to establish additional funding necessary to support the continuation the state's use of a cigarette tax stamp with encrypted indicia as mandated by Senate Bill (SB) 1701 (Chapter 881, Statutes of 2002). The state's cigarette tax stamp contract will be put out to bid in 2009 to secure a vendor as of January 1, 2010. An augmentation of approximately \$3,703,071 (yearly) to the budgeted level funding is being requested. This augmentation is necessary since the initial funding levels may prohibit or severely restrict the potential bidders from being able to meet the statutory mandates of the encrypted stamp due to rising costs and the availability of new technologies.

Requested additional funding levels takes into consideration the increases in the cost of living and costs of new technologies that have become available since the initial SB 1701 tax stamp contract was awarded in 2005. It is essential for the procurement process to allow potential vendors a broad range of flexibility so that bidders can offer new technologies and innovative covert and overt enhancements to maintain and/or augment the integrity of the stamp. This additional funding would cover the costs necessary for the potential transition stamp vendors from the current provider to another vendor which includes moving and securing the stamp database. The *additional* funding amount requested is \$1,900,000 effective January 1, 2010 (mid-year) and \$3,800,000 per fiscal year for FY 2010-11 through FY 2014-15. The current budgeted contract amount is \$6,096,929.

BACKGROUND/HISTORY

AB 1749 is an expansion of AB 71 and added language to § 30435 of the R & T Code to allow BOE authority to fine any person up to \$1,000 per each offense for failure to allow inspection. While it was anticipated that the number of refund requests for the new encrypted tax stamp generally affixed to the packages of cigarettes unfit for use would decline after implementation of the new high-tech stamp in 2006, this has not been the case. In FY 2006-07, ID received 86 distributor requests for tax stamp refunds. These requests were handled by existing investigative staff that is redirected from their normal duties including AB 71 compliance inspections and felony tax evasion investigations. ID expects the number of request for refunds will continue at approximately the same rate as FY 2006-07.

The existing encrypted cigarette tax contract was awarded to SICPA on August 9, 2004, and was valid through December 31, 2007. The contract contains two (2) one (1) year options for extension to be exercised at the discretion of BOE. The contract amount is \$18,290,789.19 (\$6,096,929.73/year). On September 12, 2007, the Board Members approved a one year extension and it is anticipated, due to the lengthy Invitation for Bid process that another one year extension will be sought. ETD is requesting the additional funding in advance of the next Invitation to Bid process to allow us to continue to provide a cigarette tax stamp and system with state of the art technology necessary to support the administration of the Cigarette and Tobacco Products Tax Law (R & T section 30161).

STATE LEVEL CONSIDERATION (including impact to other departments)

In regard to the new staff and resources requested by ID and estimating a conservative 25% of AB 71 revenue (\$34.7 million) resulting from staff inspections, 2.0 additional inspection positions may result in further revenue increase. Therefore, permanent funding of these staff resources is necessary to meet this ongoing workload.

JUSTIFICATION (including link to Strategic Plan)

Objective 1- Create a stable yet flexible state-of-the art technology infrastructure using industry best practices; and respond timely, effectively, and efficiently to new tax and fee programs and changes to existing programs.

Objective 3- Continually evaluate the agency's external and internal environments and introduce new or enhanced technology as changing customer needs and expectations are identified.