Senate Billx2 5 (Leno, et al)
Date: Enrolled
Program: Cigarette & Tobacco Products Licensing Act
Sponsors: American Heart Association, American Lung Association, and American Cancer Society

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Business and Professions Code (BPC) Sections 22950.5, 22958, 22971.7, and 22973.3
Effective June 9, 2016 but operative January 1, 2017

This analysis only addresses the provisions that impact the Board of Equalization (BOE).

Summary: Among other things, this bill:

- Adds a "tobacco product" definition to the Stop Tobacco Access to Kids Enforcement (STAKE) Act[1] that includes an electronic nicotine delivery device, such as an electronic cigarette (e-cigarette), and
- Requires the BOE to suspend or revoke a retailer's Cigarette and Tobacco Products Licensing Act of 2003[2] (Licensing Act) license and impose a civil penalty for furnishing a "tobacco product" to a minor.
- Revises the Licensing Act's "tobacco products" definition for retail licensure purposes to conform to the STAKE Act's "tobacco product" definition.
- Imposes a $265 annual fee for a STAKE Act-defined "tobacco product" retailer license.

Purpose: According to the author, the purpose of this bill is to protect the public against exposure to e-cigarettes.

Fiscal Impact Summary: Annual revenues of $1.908 million.

Existing Law: **Cigarette and Tobacco Products Tax Law[3].** Revenue and Taxation Code (RTC) Section 30451 specifically provides that the BOE shall enforce the provisions of the Cigarette and Tobacco Products Tax Law (CTPTL) and may prescribe, adopt, and enforce rules and regulations relating to its administration and enforcement.

Existing law imposes an 87-cent per package of 20 (43 ½ mills per cigarette) cigarette tax. The CTPTL requires tax payment through the use of stamps or meter impressions that a distributor affixes on each cigarette package prior to the distribution.

RTC Section 30123 imposes a tax upon the distribution of tobacco products, based on the wholesale cost of these products at a tax rate that is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 imposes an additional tobacco products tax at a rate equivalent to the $0.50 per pack cigarette tax. The BOE annually determines the tobacco products tax rate based on the March 1 wholesale cost of cigarettes. The tobacco products rate is 28.13% for fiscal year 2015-16. Distributors pay the tobacco products tax through the use of a tax return that reports the wholesale cost of the tobacco products distributed and calculates the tax due.

RTC Sections 30121 and 30131.1 define "tobacco products" to include, but not be limited to, all forms of cigars, smoking tobacco, chewing tobacco, snuff, and any other articles or products made of, or containing at least 50%, tobacco, but does not include cigarettes.

Licensing Act. The Licensing Act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers, and retailers. BPC Section 22972 requires a retailer to have a license to sell cigarettes and tobacco products in this state. Section 22972 further requires a retailer to obtain a separate license for each retail location that sells cigarettes

[1] Division 8.5 (commencing with Section 22950) of the BPC.
[2] Division 8.6 (commencing with Section 22970) of the BPC.
[3] Part 13 (commencing with Section 30001) of Division 2 of the RTC.

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and tobacco products. Section 22971 defines "tobacco products" to have the same meaning as defined under the CTPTL.

Section 22974.8 requires the BOE to suspend or revoke a retailer's license upon notification by the California Department of Public Health (CDPH) for certain STAKE Act violations.

STAKE Act. The STAKE Act established a statewide enforcement program to take action against businesses that illegally sell tobacco to minors. In general, the STAKE Act requires the CDPH to:

- Implement an enforcement program to reduce the availability of tobacco products to minors and conduct sting operations using 15 and 16 year old minors granted immunity;
- Establish requirements for tobacco product retailers to conspicuously post a notice stating that selling tobacco products to a person under 18 years of age is illegal and subject to penalties;
- Assess civil penalties ranging from $200 to $6,000 against the store owner for violations; and
- Comply with the Synar Amendment (Section 1926 of Title XIX of the federal Public Health Service Act) and prepare an annual report regarding enforcement activities and their effectiveness for the federal government, Legislature, and Governor.

Furthermore, the STAKE Act:

- Requires all persons engaging in the retail sale of tobacco products to check the identification of tobacco purchasers if the purchaser reasonably appears to be under 18 years of age.
- Prohibits any person, firm, or corporation from selling, giving, or in any way furnishing to another person who is under the age of 18 years any tobacco, cigarette, cigarette papers, or any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or any controlled substance.
- Prohibits the selling, offering for sale, or distributing tobacco products from a cigarette or tobacco products vending machine unless such vending machines or appliances are located at least 15 feet away from the entrance of a premises issued an on-sale public premises license, as defined.
- Prohibits advertising of any tobacco product on any outdoor billboard, as specified.
- Prohibits a person engaged in the retail sale of tobacco products from selling, offering for sale, or displaying for sale any tobacco product or tobacco paraphernalia by self-service display, except as permitted. Retailers of blunt wraps cannot place or maintain, or cause to be placed or maintained, any blunt wraps advertising display within two feet of candy, snack, or nonalcoholic beverage displayed inside any store or business or that is less than four feet above the floor.
- Prohibits the distributing or selling of tobacco products directly or indirectly to any person under the age of 18 years through the United State Postal Service or through any other public or private postal or package delivery service, as described.

BPC Section 22958 authorizes an enforcing agency to assess civil penalties against any person, firm, or corporation that sells, gives, or in any way furnishes to another person who is under the age of 18 years, any tobacco, cigarette, cigarette papers, any other instrument or paraphernalia that is designed for the smoking or ingestion of tobacco, products prepared from tobacco, or any controlled substance. Upon CDPH notification, Section 22958 requires the BOE to suspend or revoke a retailer's Licensing Act license upon a civil penalty assessment for a third, fourth, or fifth violation of sales to minors, in accordance with the following schedule:

- A 45-day suspension of the license for a third violation at the same location within a five-year period.
- A 90-day suspension of a license for a fourth violation at the same location within a five-year period.

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- Revocation of the license for a fifth violation at the same location within a five-year period.

Section 22958 also requires the BOE to assess an additional $250 civil penalty. The BOE deposits the penalty amounts collected into the Cigarette and Tobacco Products Compliance Fund (Compliance Fund).

Proposed Law: Among other things, this bill amends BPC Section 22950.5 within the STAKE Act to define "tobacco product" to mean any of the following:

- A product containing, made, or derived from tobacco or nicotine that is intended for human consumption, whether smoked, heated, chewed, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means, including, but not limited to, cigarettes, cigars, little cigars, chewing tobacco, pipe tobacco, or snuff.
- An electronic device that delivers nicotine or other substances to the person inhaling from the device, including, but not limited to, an electronic cigarette, cigar, pipe, or hookah.
- Any component, part, or accessory of a tobacco product, whether or not sold separately.

"Tobacco product" does not include a product that has been approved by the United States Food and Drug Administration for sale as a tobacco cessation product or for other therapeutic purposes where the product is marketed and sold solely for such an approved purpose.

This bill amends BPC Section 22958 to allow an enforcing agency to assess civil penalties against any person, firm, or corporation that sells, gives, or in any way furnishes to another person under 21 years of age any "tobacco product." As a result, Section 22958 requires the CDPH to notify the BOE upon a civil penalty assessment for a third, fourth, or fifth violation that includes any electronic delivery device or component parts, as well as any cigarette, tobacco, or specified related product. Existing law requires the BOE to impose a $250 civil penalty and to take action in accordance with the specified schedule, which includes the suspension or revocation of a retailer's Licensing Act license.

BPC Section 22971.7 is added within the Licensing Act's retailer licensure provisions to define "tobacco product" to mean a tobacco product or device as defined in STAKE Act Section 22950.5.

The bill adds BPC Section 22973.3 to require licensure for retailers of STAKE Act-defined tobacco products that are not subject to tax imposed by the CTPTL (e-device and component part retailer). An annual $265 license fee per location is imposed on these retailers. The BOE will report back to the Legislature no later than January 1, 2019, regarding the adequacy of Licensing Act funding with regard to tobacco products licensing, as required by Section 22973.3. The report shall include data and recommendations about whether the annual licensing fee funding levels are set at an appropriate level to maintain an effective enforcement program.

The license fee applies only to e-device and component part retailers not already licensed to sell cigarettes and tobacco products. If a retailer already possesses a license to sell CTPTL-defined cigarettes and tobacco products, the retailer is also authorized to sell e-devices and component parts under that license.

This bill repeals and adds BPC Section 22980.2 to apply existing penalties to a person that continues to sell electronic delivery devices or component parts without a valid license or after a BOE suspension or revocation notification.

This bill becomes effective on the 91st day after adjournment of the second extraordinary session; however, the provisions impacting the BOE become operative January 1, 2017.

In General: In 1992, Congress passed Section 1926 of Title XIX of the federal Public Health Service Act, commonly called the "Synar Amendment," which requires each state to:

- Have in effect a law prohibiting any manufacturer, retailer or distributor of tobacco products from selling or distributing such products to any individual under the age of 18.

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- Enforce such laws in a manner that can reasonably be expected to reduce the extent to which tobacco products are available to individuals under the age of 18.
- Conduct annual random, unannounced inspections to ensure compliance with the law. These inspections are to be conducted in such a way as to provide a valid sample of outlets accessible to youth.
- Develop a strategy and timeframe for achieving an inspection failure rate of less than 20% of outlets accessible to youth.

Failure to meet the terms and conditions of the Synar Amendment could result in reducing (up to 40%) Substance Abuse Prevention and Treatment (SAPT) block grant funds allocated to California for alcohol and other drug prevention and treatment programs.

To comply with the Synar Amendment, the Legislature passed Senate Bill 1927 (Stats. 1994, Ch. 1009) which established the STAKE Act. The STAKE Act created a new statewide enforcement program to take regulatory action against businesses that illegally sell tobacco products to minors. Enforcement authority and implementation responsibility was delegated to the Department of Health Services.[4]

E-Cigarettes. The California Attorney General Office's Tobacco Highlights includes e-cigarette information:

> "Electronic cigarettes are battery powered devices designed to look and feel like regular cigarettes, but they emit water vapor rather than smoke. The cartridges contain liquid nicotine and various flavors. Known as e-cigarettes or e-cigs, the products have become popular in the past couple of years. The U.S. Food and Drug Administration consider e-cigarettes "drugs or devices" and claims the products must be approved by the FDA before they can be sold in the U.S. To date, no e-cigarettes have been approved by the FDA. Preliminary tests by the FDA found that e-cigarettes contain many impurities and some contain dangerous chemicals. FDA's jurisdiction to regulate e-cigarettes is in litigation, however. E-cigarettes are not governed by the Master Settlement Agreement or by many of California's tobacco laws.
>
> The California Attorney General's Office is concerned that e-cigarettes are being sold in the state without appropriate quality control and with many false or misleading claims about their safety or effectiveness. Many are also in violation of California's Proposition 65 which requires health warnings about dangerous chemicals.
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> California passed a statute prohibiting the sale of electronic cigarettes to minors. (Health & Safety Code §119405). The office is investigating a number of electronic cigarette companies selling e-cigarette products on the Internet to ensure compliance with the statute as well as other consumer protection provisions. Many companies are coming into compliance voluntarily."

Background: In 2003, Assembly Bill 71 (J. Horton, Ch. 890) enacted the Licensing Act, which established a statewide licensure program administered by the BOE to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Currently, the BOE licenses approximately 35,000 retailers and 850 distributors and wholesalers to engage in the sale of cigarettes and tobacco products in California.

As AB 71 was developed and made its way through the Legislature, it was determined that the licensure fees would not permanently sustain the Licensing Act program. Since the Licensing Act enforces the CTPTL and directly benefits the funds established pursuant to that program, the funding for the Licensing Act would eventually shift to the cigarette and tobacco products tax funds: General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Prop. 99) and California Children and Families Trust Fund (Prop. 10). However, there was concern about the Licensing Act program and the impact it would have on the cigarette and tobacco products tax funds if the Licensing Act expenses exceeded the revenues generated. To address this concern, a sunset date of January 1, 2010, was

[4] The CDPH, Food and Drug Branch, now enforces the STAKE Act program.

incorporated into the Licensing Act to make sure the Licensing Act would not harm the cigarette and tobacco products tax funds. Furthermore, AB 71 included uncodified language to clarify that all revenues and expenses generated by the Licensing Act are to be allocated in the same manner as those revenues and expenses are allocated under the Cigarette and Tobacco Products Tax Law to make sure no one cigarette and tobacco product fund benefited or was burdened when the funding shift took place. In 2006, Assembly Bill 1749 (J. Horton, Ch. 501) repealed the sunset date for the Licensing Act due to the amount of additional excise tax revenues generated. The BOE has estimated that the Licensing Act and enhanced cigarette tax stamp generates an additional $66.8 million in cigarette excise tax annually. The Licensing Act generates an additional $24.5 million in additional tobacco products tax. The resulting additional sales and use tax revenue is estimated to be $44.4 million annually.[5]

In 2012, Assembly Bill 1301 (Hill, Ch. 335) amended the STAKE and Licensing Acts to require the BOE to suspend or revoke a retailer license for certain cigarette and tobacco products sales to minors violations.

Commentary:

1. **Summary of Amendments.** The **March 2, 2016 amendments** did not impact the BOE. The **February 29, 2016 amendments** deleted the BOE's requirement to determine a one-time license fee for e-device and component part retailers. Instead, the amendments imposed an annual $265 license fee on these retailers and require the BOE to prepare a legislative report regarding the adequacy of funding for the new licensing requirements. The amendments also allowed a retailer already licensed to sell cigarettes and tobacco products to sell e-devices and component parts under that license.

2. **BOE's mission and tasks.** The BOE's mission "is to serve the public through fair, effective, and efficient tax administration." This bill's licensure requirements for e-cigarette and tobacco component manufacturers, importers, distributors, wholesalers, and retailers depart from the BOE's traditional "tax collection and enforcement" functions. In general, the BOE requires a license, permit, or registration for the various tax and fee programs administered. The licensing, registration, and permit requirements ensure vital tax revenue collection for the state.

   The Licensing Act's declarations and findings state, in part, that manufacturer, importer, wholesaler, distributor, and retailer licensing will help stem the tide of untaxed distributions. However, this bill's e-cigarette and tobacco component licensing requirements relate to health, public safety, or other non-tax purposes.

3. **Tobacco products taxation.** This bill creates a "tobacco product" definition within the STAKE Act and Licensing Act, which includes electronic delivery devices and component parts. This bill does <u>not</u> amend the "tobacco products" definition within the CTPTL. Accordingly, this bill does not impose the cigarette and tobacco products tax upon a tobacco product as defined pursuant to this bill's BPC Section 22950.5 (electronic delivery devices and component parts). The cigarette and tobacco products tax continues to apply to "tobacco products" as defined in RTC Sections 30121 and 30131.1, which reads:

   > "Tobacco products" includes, but is not limited to, all forms of cigars, smoking tobacco, chewing tobacco, snuff, and any other articles or products made of, or containing at least 50 percent, tobacco, but does not include cigarettes.

[5] http://www.boe.ca.gov/legdiv/pdf/CigaretteEvasion.pdf.

4. **License required for retailers that only sell devices or component parts.** This bill includes within the "tobacco product" definition any tobacco product component, part, or accessory, whether or not sold separately. As a result, the bill not only requires licensure for retailers of liquid nicotine, but also retailers of components, parts, and accessories such as an aluminum shell, sensor, smart chip microprocessor, atomizer, coils, tips, o-rings, and vaporized mesh. Requiring licensure for retailers of individual components, parts, and accessories sold without liquid nicotine complicates administration since all components, parts, and accessories would need to be identified by the BOE to determine whether or not those parts are necessary during the device's operation.

   Furthermore, requiring licensure for retailers of component parts is not consistent with the Licensing Act and its enforcement of the CTPTL. For example, the Licensing Act does not require licensure for retailers that sell pipes or similar implements to deliver the traditional pipe tobacco to the user, but do not sell pipe tobacco. As such, BOE staff recommends limiting the licensure requirement to liquid nicotine and any components, parts, and accessories when packaged with liquid nicotine. This suggestion also conforms to BOE staff's recommendation for existing bills and initiatives that propose to impose a related tax under the CTPTL.

5. **Some retailers will pay two fees.** This bill requires a retail licensee to pay an annual $265 license fee to engage in the sale of e-devices and component parts.

   A **new retailer** of cigarettes, CTPTL-defined tobacco products, *and* e-devices and component parts must pay both the one-time $100 and annual $265 license fees in order to sell such products.

   An **existing retailer** already licensed to engage in the sale of cigarettes and tobacco products, as defined in the CTPTL, would be allowed to sell e-devices and component parts under their existing license. It appears that existing retailers would never be subject to the annual $265 license fee.

   Also, BOE staff notes ambiguity in BPC Section 22973.3(g). Paragraph (1) provides that the new licensing requirements do not apply if the retailer already possesses a license to sell CTPTL-defined cigarettes and tobacco products. Paragraph (2) provides that a retailer that possesses a license to sell CTPTL-defined cigarettes and tobacco products may sell e-devices and component parts under that license. Paragraph (2) does not state that a retailer must possess a license to sell CTPTL-defined cigarettes or tobacco products *as of the bill's operative date* in order to sell e-devices and component parts under that license. Therefore, it appears that a new retailer may obtain a license to engage in the sale of cigarettes and tobacco products, and then subsequently begin to sell STAKE Act-defined tobacco products. This seems to allow that new retailer to avoid the $265 annual license fee imposed upon retailers of e-devices and component parts. BOE staff suggests an amendment to clarify the circumstances under which a retailer may sell e-devices and component parts under a license to sell CTPTL-defined cigarettes and tobacco products.

6. **Related legislation.** ABx2 6 (Cooper) is similar. SB 140 (Leno, et al) is also similar to this bill, but was held in the Assembly Governmental Organization Committee.

   SBx2 10 (Beall), ABx2 11 (Nazarian), and AB 2770 (Nazarian) amend BPC Section 22973 to require an annual cigarette and tobacco products retailer license fee. ABx2 11 (Bloom) was ordered to engrossing and enrolling on March 16, 2016.

   ABx2 16 (Bonta and Thurmond), SBx2 13 (Pan), and SBx2 14 (Hernandez) impose a new $2 per pack cigarette tax, an equivalent floor stock tax, and indirectly increase the tobacco products tax. The bills also impose the tobacco products tax on e-cigarettes and define e-cigarettes as a tobacco product under the Licensing Act.

   The second extraordinary session adjourned on March 15, 2016 (ACR 1 (Mayes)).

Costs: The bill results in additional BOE administrative costs to identify, notice, and license e-cigarette and tobacco device retailers and to suspend or revoke retailer licenses for e-cigarette and tobacco device sales to minors violations. These costs include: e-cigarette identification, notification, and registration; publication and form revisions; compliance, inspection and enforcement tasks; public inquiry responses; and related computer programming. These costs are estimated to be $2.1 million for Fiscal Year (FY) 2016-17, $1.3 million for FY 2017-18, $1.1 for FY 2018-19, and $1 million for FY 2019-20 and ongoing.

Revenue Impact:

Background, Methodology, and Assumptions. BOE records indicate 33,881 retailers were registered to sell cigarettes and tobacco products as of February 1, 2016. Estimated revenue impact is based on the following assumptions:

- About 90% of retailers that currently sell cigarettes or tobacco products also sell electronic delivery devices and component parts.
- Based on an industry survey, there are about 1,100 retailers that sell electronic delivery devices and component parts, but do not sell cigarettes or tobacco products.
- No long-term growth is expected in the total number of registrants. This assumption is consistent with BOE records since the licensing program began in 2004.
- Changes in ownership of retailers of cigarettes and tobacco products as defined by this bill will be about 20% per year, the same as under current law. This implies annual fees of about 20% of the number of registrants even if there is no increase in the total number of registrants.
- An annual retail license fee of $265 for STAKE-Act defined retail licenses.

Revenue Summary. Based on the preceding data and assumptions, we estimate annual revenues of $291,500 (1,100 retailers x $265 annual license fee) for stand-alone electronic delivery device and component part retailers. Additionally, a 20% ownership turnover rate for the 90% of retailers already licensed to sell CTPTL-defined cigarettes and tobacco products implies ongoing annual revenues of $1.616 million ((33,881 retailers x 90% x 20%) x $265 annual license fee). Total annual revenues are estimated to be $1.908 million.

This revenue estimate does not account for any further changes in economic activity that may or may not result from enactment of the proposed law.