Michele Pielsticker (Chief) 916.322.2376
Sheila T. Waters (Analyst) 916.445-6579

Assembly Bill 1901 (Quirk)
Date: 08/01/16
Program: Cigarette Tax
Sponsor: Board of Equalization
Revenue and Taxation Code Section 30473.5
Effective: January 1, 2017

Summary: Makes it a crime for a person to possess, sell, or offer to sell, or buy or offer to buy, any "unaffixed" cigarette tax stamp and authorizes the Board of Equalization (BOE) to seize and destroy these stamps aggregated for reuse purposes.

Summary of Amendments: The amendments since the previous analysis add legislative findings and declarations.

Purpose: To combat a used cigarette tax stamp scheme, minimize tax evasion opportunities, and assist in making the marketplace fair and equitable for those that are legitimately paying this excise tax.

Fiscal Impact Summary: Possibly deter $400,000 in cigarette tax evasion annually.

Existing Law: Existing law[1] imposes an 87-cent excise tax on each pack of cigarettes (generally 20 cigarettes in each pack). The law requires cigarette distributors to pay the tax by purchasing cigarette tax stamps. Distributors are required to attach the stamp to each pack of cigarettes prior to distribution.

Under existing law,[2] any person who possesses, sells, or offers to sell, or buys or offers to buy, any false or fraudulent cigarette tax stamps is guilty of a misdemeanor, punishable by a fine or imprisonment up to one year in a county jail, or by both the fine and imprisonment.

To ensure compliance with the law, existing law[3] authorizes a BOE employee to inspect any place for which there is evidence of a taxpayer's failure to comply. The law[4] subjects any cigarette product to seizure and forfeiture when the stamp is affixed or the tax is paid in a manner that violates the law, whether or not the violation is subject to a defense, as provided. As a nonsalable product, the law authorizes the BOE to destroy the forfeited cigarettes.

Existing law does not provide for the seizure and destruction of used cigarette tax *stamps* aggregated for reuse purposes on a routine retail inspection. Also, existing law has no criminal sanctions or penalties related to a person's possession, sale, or purchase of used cigarette tax stamps.

Proposed Law: This bill makes it a misdemeanor for any person to possess, sell, or offer to sell, or buy or offer to buy, any "unaffixed" cigarette tax stamps. The crime is punishable by a fine of up to $5,000 for less than 2,000 stamps, or up to $50,000 for more than 2,000 stamps, or fine and imprisonment for not less than one year. The bill also authorizes the BOE to seize and destroy these stamps aggregated for reuse purposes.

The bill specifies that "unaffixed stamps" means stamps for which the tax has previously been paid by a licensed distributor and previously affixed to a package. The bill provides that the term does not include any unused and unapplied rolls of stamps or loose stamps acquired from the BOE or its authorized agent and in the possession of a licensed distributor.

The bill contains legislative findings and declarations related to the bill's provisions.

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[1] Part 13 (commencing with Section 30001) of Division 2 of the RTC.
[2] RTC Section 30473.5.
[3] RTC Section 30435.
[4] RTC Section 30436.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Commentary:

1. **Effect of the bill.** This change makes it a crime to possess or sell used "unaffixed" cigarette tax stamps and allows the BOE staff and other law enforcement agents to seize and destroy these stamps.

2. **The August 1, 2016 amendments** add legislative findings and declarations**.** The **March 14, 2016 amendments** clarified that "unaffixed stamps" means stamps for which the tax has previously been paid by a licensed distributor and previously affixed to a package.

3. **Used cigarette tax stamp scheme explained.** Cigarette tax stamps, resembling stickers, are encrypted with the date, distributor's information, and the cigarette brand. The BOE's inspection teams authenticate tax stamps through the use of specified scanning devices which, among other things, show that the scanned stamps belong to that specific cigarette brand.

   The BOE inspection teams have recently identified cigarette tax evasion schemes involving reused cigarette tax stamps. For example, an inspector's scan revealed that a stamp affixed to a Marlboro-branded pack had originally been applied to a Camel-branded pack. In these situations, while the distributor appropriately paid the cigarette tax through his or her stamp purchase and appropriately affixed the stamp to the product, the stamp itself was subsequently reused and affixed to another cigarette pack.

   These used stamps can be acquired simply by retailers searching trash bins or offering to unwrap packs for customers and retaining the wrappers containing the stamps.

   By applying used stamps to an untaxed cigarette pack, taxpayers may evade the tax and disguise duty free, counterfeit, stolen, smuggled, and otherwise untaxed cigarettes as legitimate. The majority of these used stamps appear to be affixed to counterfeit and duty free cigarettes.

   During inspections and joint operations with other law enforcement agents, staff has found retail shops accumulating a significant number of used stamps and storing them in places such as trash bags located behind the storefront counter or drawers behind the register area.

   In a more sophisticated scheme discovered during an enforcement operation, staff found a storage unit containing 205,694 unaffixed used stamps with a tax value of $178,954 placed on transfer sheets and prepared for affixation to cigarette packs. In this instance, the used stamps were also labeled by the cigarette brand to which they had been affixed originally. As a result, the unsuspecting consumer would receive a counterfeit pack of cigarettes and the tax would be evaded. Within the past year, staff also found an additional, larger collection of used stamps in a separate scheme, as well as numerous smaller collections at retail stores.

4. **No legitimate reason to collect these stamps.** Cigarette tax stamps are generally not used for collectibles, as are postage stamps or trading cards. Therefore, used cigarette tax stamps do not have a value to the person collecting or aggregating them, except for tax evasion purposes.

Costs: BOE will incur absorbable administrative costs to notify affected retailers, amend appropriate publications, and answer inquiries.

Revenue Impact: The magnitude of the "unaffixed" stamp issue is unknown. However, assuming the tax value associated with the cases identified above during the past 12 months is representative of future years, enactment of this bill could deter tax evasion of about $400,000 annually.

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