



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	07/15/10	Bill No:	AB 2496
Tax:	Cigarette and Tobacco Products Tax Cigarette and Tobacco Products Licensing Act	Author:	Nava
Related Bills:			

This analysis will only address the bill's provisions which impact the State Board of Equalization (BOE).

BILL SUMMARY

Among other things, this bill would make the following BOE-related changes:

- Impose additional licensing requirements upon every manufacturer and every importer for the purpose of enforcement of the Model Statute¹ and Tobacco Directory Law in order to be eligible to obtain and maintain a license under the Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act);
- Expand the BOE's inspection authority under the Licensing Act to any site where evidence of activities involve violations of the Tobacco Directory Law;
- Prohibit for purposes of the Licensing Act an importer, distributor, wholesaler, distributor functioning as a wholesaler, or retailer from purchasing, obtaining, or otherwise acquiring any package of cigarettes to which a stamp is affixed in violation of the Tobacco Directory Law;
- Allow a licensed retailer a 60-day period to sell cigarettes removed from the Tobacco Directory before such products become subject to seizure and destruction;
- Expand the actions the BOE may take for violations of the Tobacco Directory's prohibitions from a distributor to any person for, in part, selling, acquiring and possessing cigarettes of a tobacco product manufacturer or brand family not included in the Tobacco Directory;
- Require a foreign tobacco product manufacturer to submit to the BOE certain Alcohol and Tobacco Tax and Trade Bureau forms;
- Add to the Cigarette and Tobacco Products Tax Law additional non-face-to-face sales restrictions, including new delivery seller requirements;

SUMMARY OF AMENDMENTS

Since the previous analysis, this bill was amended to, among other things, (1) allow a manufacturer or importer to post a surety bond in lieu of waiving sovereign immunity and remove the requirement to provide a copy of any corresponding federal permit for purposes of granting or maintaining a Licensing Act license, (2) make a manufacturer or importer license subject to revocation if the licensee raises a sovereign immunity defense, (3) incorporate the delivery sales provisions into existing face-to-face sale

¹ Article 3 (commencing with Section 104555), Chapter 1, Part 3, Division 103 of the Health and Safety Code.

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.

provisions, (4) revise the notification provisions for pending administrative action and removal from the Tobacco Directory, and (5) delete the provisions that would have expanded the BOE's seizure authority.

ANALYSIS

CURRENT LAW

Cigarette and Tobacco Products Tax Law (Tax Law). Under existing law, the BOE administers the Tax Law (Part 13 commencing with Section 30001) of Division 2 of the Revenue and Taxation Code). Revenue and Taxation Code Section 30451 specifically provides that the BOE shall enforce the provisions of the Tax Law and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement.

The current excise tax on cigarettes is 87 cents per package of 20 (43 ½ mills per cigarette). The cigarette tax is paid through the use of stamps or meter impressions. An appropriate stamp is affixed to, or an appropriate meter impression is made on, each package of cigarettes prior to the distribution of the cigarettes.

The tobacco products tax rate is determined annually by the BOE and based on the March 1 wholesale cost of cigarettes. Currently, the surcharge rate for fiscal year 2009-10 is 41.11 percent. The tobacco products tax is paid through the use of a return on which the distributor reports the wholesale cost of the tobacco products distributed and calculates the tax due.

Face-to-Face Sale. Section 30101.7 defines a "face-to-face sale" to mean a sale in which the purchaser is in the physical presence of the seller or the seller's employee or agent at the time of the sale. A face-to-face sale does not include any transaction conducted by mail order, the Internet, telephone, or any other anonymous transaction method in which the buyer is not in the seller's physical presence.

Persons may engage in a non-face-to-face sale of cigarettes to a person in California provided that both of the following conditions are met:

- The seller has fully complied with all of the requirements of Chapter 10A (commencing with Section 375) of Title 15 of the United States Code, otherwise known as the Jenkins Act.
- The seller has fully complied with either of the following requirements:
 - (1) All applicable California taxes on the cigarettes have been paid.
 - (2) The seller includes on the outside of the shipping container for any cigarettes shipped to a resident in California from any source in the United States an externally visible and easily legible notice located on the same side of the shipping container as the address to which the package is delivered stating as follows:

"IF THESE CIGARETTES HAVE BEEN SHIPPED TO YOU FROM A SELLER LOCATED OUTSIDE OF THE STATE IN WHICH YOU RESIDE, THE SELLER HAS REPORTED PURSUANT TO FEDERAL LAW THE SALE OF THESE CIGARETTES TO YOUR STATE TAX COLLECTION AGENCY, INCLUDING YOUR NAME AND ADDRESS. YOU ARE LEGALLY RESPONSIBLE FOR ALL APPLICABLE UNPAID STATE TAXES ON THESE CIGARETTES."

Tobacco Directory Law. Also incorporated in the Tax Law is the **Tobacco Directory Law**, which more effectively enforces and promotes the purpose of the Model Statute. The Tobacco Directory Law, which can be found in Section 30165.1, requires, in part, the Attorney General to develop and publish on its Internet web site a directory listing the following:

- All tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a participating manufacturer under the Master Settlement Agreement (MSA), or is a non-participating manufacturer (NPM) that has made all required escrow payments.
- All brand families that are listed in the certifications, except as specified.

No person may affix, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied on a tobacco product defined under Section 30165.1 as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.

The Tobacco Directory Law also prohibits a person from:

- Selling, offering, or possessing for sale in this state, or importing for personal consumption in this state, cigarettes of a tobacco product manufacturer or brand family not included in the Attorney General's directory, and
- Selling, distributing, acquiring, holding, owning, possessing, transporting, importing, or causing to be imported cigarettes that the person knows or should know are intended to be distributed in violation of the Tobacco Directory's stamping prohibitions or are not included in the Attorney General's directory.

Section 30435 authorizes an employee of the BOE, upon presentation of the appropriate identification and credentials, to enter into, and conduct an inspection of any place for which there is evidence of failure to comply with the requirements of the MSA, including, but not limited to, the Tobacco Directory Law. Any cigarette or tobacco products that are stamped or to which a meter impression is affixed, or for which tax is paid, in violation of the Tobacco Directory Law, is subject to seizure and forfeiture, pursuant to Section 30436 regardless of whether the violation is subject to a defense, as provided. The seized cigarettes or tobacco products are forfeited to the state and must be destroyed.

Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act). Division 8.6 of the Business and Professions Code established the Licensing Act, which created a statewide licensure program for the sales of cigarettes and tobacco products to address the unlawful distribution and untaxed sales of cigarettes and tobacco products.

In part, Sections 22979 and 22979.21 require every manufacturer and every importer to obtain and maintain a license to engage in the sale of cigarettes or tobacco products. In order to be eligible for a license, a manufacturer or importer is required to meet specified requirements, such as consenting to jurisdiction of the California courts for the purpose of enforcement of the Licensing Act, appoint a registered agent for service of process in this state, and identify the registered agent to the BOE.

The Licensing Act also authorizes, pursuant to Section 22980, any peace officer or BOE employee granted limited peace officer status to enter any place, as described, and

conduct inspections. In part, inspections may be at any place at which cigarettes or tobacco products are sold, produced, or stored, or at any site where evidence of activities involving evasion of cigarette or tobacco products may be discovered.

The Licensing Act also imposes specified prohibitions and penalties in Business and Professions Code Sections 22980.1 through 22982. Among the prohibitions, subdivision (g) of Section 22980.1 provides that no importer, distributor, or wholesaler, or distributor functioning as a wholesaler, or retailer, shall purchase, obtain, or otherwise acquire any package of cigarettes to which a stamp or meter impression may not be affixed in accordance with the Tax Law, or any cigarette obtained from a manufacturer or importer that cannot demonstrate full compliance with all requirements of the federal Cigarette Labeling and Advertising Act (15 U.S.C. Sec. 13335a et seq.) for the reporting of ingredients added to cigarettes. Section 22981 provides that any violation of the Licensing Act by any person, except as otherwise provided, is a misdemeanor. Each offense is punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment.

Federal Jenkins Act. Chapter 10A of Title 15 of the United States Code (also known as the Jenkins Act) requires any person that sells, transfers, or ships cigarettes or smokeless tobacco for profit in interstate commerce and ships the cigarettes or smokeless tobacco into a state that imposes a tax on cigarettes or smokeless tobacco to:

- File with the Attorney General and the state's tobacco tax administrator a statement setting forth certain information, including name, address and telephone number.
- Not later than the 10th of each calendar month, file with the tobacco tax administrator a memorandum or a copy of the invoice for each and every shipment of cigarettes or smokeless tobacco made during the previous calendar month in that state. This information is required to show, among other things, the name and address of the person to whom the shipment was made, the brand, and quantity of the shipment.

The Jenkins Act also requires each delivery seller to comply with specified shipping (labeling requirements, weight restrictions, age verification) and recordkeeping requirements, all State, local, tribal, and other laws generally applicable to sales of cigarettes or smokeless tobacco as if the delivery sales occurred entirely within the state, and tax collection requirements. A delivery seller is defined as any person who makes a sale of cigarettes or smokeless tobacco to a consumer if: (1) the consumer submits the order by telephone or other method of voice transmission, mail, Internet or other online service, or the seller is otherwise not in the physical presence of the buyer when the request for purchase is made, and (2) the cigarettes or smokeless tobacco are delivered to the buyer by common carrier, private delivery service, or other method of remote delivery, or the seller is not in the physical presence of the buyer when the buyer obtains possession of the cigarettes or smokeless tobacco.

The Jenkins Act was recently amended by S. 1147, known as the Prevent All Cigarette Trafficking Act or PACT Act. The PACT Act became operative July 1, 2010 and expanded the Jenkins Act to include smokeless tobacco and incorporated "delivery seller" provisions, which among other things require delivery sellers to comply with the state's laws imposing excise taxes, licensing, and stamping requirements.

PROPOSED LAW

Among other things, this bill makes changes to the Licensing Act and Tax Law to enhance enforcement of the MSA and subsequent legislation (Model Statute and Tobacco Directory Law).

Licensing Act. This bill would amend Business and Professions Code Section 22979 to require a manufacturer or importer to consent to the jurisdiction of the California courts and waive any sovereign immunity defense for the purpose of enforcement of the Model Statute and the Tobacco Directory Law and regulations adopted pursuant thereto. In lieu of waiving any sovereign immunity defense, a manufacturer or importer would be allowed to post a surety bond, as described, that may be drawn upon by the Attorney General for specified purposes.

This bill would also amend Section 22980 to allow any peace officer or BOE employee granted limited peace officer status, upon presentation of appropriate credentials, to enter any site where evidence of activities involving violations of the Tobacco Directory Law may be discovered. Such inspections must be performed in a reasonable manner and at times that are reasonable under the circumstances, taking into consideration the normal business hours of the place to be entered.

And lastly, this bill would amend Section 22980.1 to prohibit an importer, distributor, wholesaler, distributor functioning as a wholesaler, or retailer from purchasing, obtaining, or otherwise acquiring any package of cigarettes to which a stamp or meter impression may not be affixed in accordance with the Tobacco Directory Law.

Tax Law. This bill would amend Section 30101.7 to prohibit a person from making a delivery sale of cigarettes or tobacco products, as defined, to a consumer in California unless the delivery seller fully complies with the Jenkins Act, obtains and maintains a Licensing Act license, complies with the Model Statute, and reports its delivery sales to the Attorney General.

The bill would also make numerous amendments to Section 30165.1, the Tobacco Directory Law. Those amendments impacting the BOE's administration of the Tax Law are as follows:

- Requires a distributor or wholesaler, within seven days of receiving a notice of pending administrative action, a notice of removal of any tobacco product manufacturer or brand family from the Tobacco Directory, or a notice declining to remove a tobacco product manufacturer or brand family from the directory, to provide a copy of the notice to each of its existing customers. A licensed distributor and wholesaler could continue to purchase, stamp (distributor), or sell products affected by the notice of pending administrative action for no more than 40 days following the issuance of that notice. A licensed retailer would be provided a 60 day sell-off period from the effective date of the removal notice to sell the affected cigarettes purchased prior to removal from the directory. On and after the 61st day, the cigarettes are contraband and become subject to seizure and destruction by the BOE.
- Expands the prohibition for any person selling, offering, or possessing for sale in this state or import for personal consumption in this state, to also include shipping or otherwise distributing into or within this state, cigarettes of a tobacco product manufacturer or brand family not included in the directory.

- Authorizes the BOE or Attorney General to require an importer to submit any additional information, including, but not limited to, samples of the packaging or labeling of each brand family, as is necessary to enable the Attorney General to determine whether a tobacco product importer has complied, is in compliance, and will continue in compliance with the Tobacco Directory Law, the Model Statute, and any regulations promulgated pursuant thereto.
- Expands from a distributor to any person the imposition of penalties for violating the Tobacco Directory Law. In the case of the first offense, the BOE would be authorized to revoke or suspend the license or licenses issued to the person by the BOE. In addition to distributors, this amendment would now subject wholesalers and retailers to license revocation and suspension. And the licenses subject to suspension and revocation would be expanded from licenses issued to distributors and wholesalers under the Tax Law to also include a retailer, distributor and wholesaler licenses issued under the Licensing Act. In the case of a second or any subsequent offense, the BOE would be authorized to impose a civil penalty in an amount not to exceed the greater of five times the retail value of the cigarettes, as defined, or five thousand dollars (\$5,000).

This bill would also add Section 30165.2 to the Revenue and Taxation Code to require as a condition of selling cigarettes in the state, every tobacco product manufacturer, as defined in the Tobacco Directory Law, whose cigarettes are to be sold in the state whether directly or through a distributor, importer, retailer, or similar intermediary or intermediaries to, at the election of the tobacco product manufacturer, either:

- Submit to the Attorney General a true and correct copy of each and every applicable return of the tobacco product manufacturer.
- Submit to the United States Treasury a request or consent under Internal Revenue Code Section 6103(c) authorizing the Alcohol and Tobacco Tax and Trade Bureau to disclose the applicable returns of manufacturer to the Attorney General.

A foreign tobacco product manufacturer whose cigarettes are imported into the United States by an importer or importers would be required to submit, or cause each of its importers to submit, to the Attorney General and the BOE each and every applicable return, form, or report filed with the Alcohol and Tobacco Tax Trade Bureau and the United States Customs and Border Patrol that includes any information about cigarettes of that foreign tobacco product manufacturer imported into the United States, and a report of the sales of each brand family in this state, as specified. The Attorney General and the BOE would be prohibited from disclosing any applicable returns or any information contained therein, except as necessary to carry out the functions and duties of the Department of Justice or BOE, or as otherwise provided.

A tobacco product manufacturer who does not comply with the above requirements would, after 30 days notice by the state to the tobacco product manufacturer of the failure to comply, be removed, along with its brand families, from the tobacco directory unless the tobacco product manufacturer has brought itself into compliance by the end of the 30-day period.

Any tobacco manufacturer or importer that intentionally provides any applicable return containing materially false information shall be liable for a civil penalty in an amount not to exceed the greater of either of the following:

- Five times the retail value of the cigarettes or tobacco products defined as cigarettes under this section and about which false information was provided.
- Five thousand dollars (\$5,000).

The Attorney General would be authorized to promulgate regulations to implement and carry out proposed Section 30165.2.

This bill would become effective January 1, 2011.

IN GENERAL

Under the November 1998 MSA between the State of California, other states, and tobacco product manufacturers, each tobacco company must make annual payments to the participating states in perpetuity, totaling an estimated \$206 billion through 2025. California's share of the revenue is projected to be \$25 billion over the next 25 years, based on receiving approximately 12.8% of the total payments. The payments will be split 50/50 between state and local governments under a Memorandum of Understanding negotiated by the Attorney General and various local jurisdictions (cities and counties) which had also sued the tobacco companies.

The payment provisions of the MSA apply to "participating manufacturers" which include both original signatories to the MSA, as well as other companies which subsequently agree to be bound by the MSA. In return for these payments, the states have agreed to release the cigarette manufacturers from all claims for damages, penalties, and fines. In addition, the participating manufacturers have agreed to certain non-economic terms that restrict their advertising and marketing practices and control their corporate behavior. The primary purpose of these restrictions is to prevent marketing of cigarettes to minors and thereby reduce smoking by minors.

The MSA prompted states to enact the Model Statute by creating a significant financial incentive: Settling States that enact and "diligently enforce" the Model Statute would not be subject to severe reductions to their MSA payments. All Settling States have enacted Model Statutes requiring NPM reserve (escrow) funds, including California. California's "Model Statute" was enacted in 1999 pursuant to Senate Bill 822 (Escutia, Chapter 780). That bill, among other things, authorized the BOE to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by tobacco products manufacturers who do not participate in the MSA.

While the Settling States, such as California, have been aggressively enforcing the provisions of the Model Statutes, enforcement has proved costly and cumbersome. Accordingly, almost every state has enacted Complementary Legislation to make state enforcement of the Model Statutes more effective and thereby promote the purposes for which the Model Statutes were enacted.

In 2003, California enacted Complementary Legislation (Tobacco Directory Law) pursuant to Assembly Bill 71 (Horton, Chapter 890). Generally, these statutes:

- Require the Attorney General to develop and publish on its Internet web site a directory of all tobacco manufacturers that have provided current, timely, and accurate certifications that certify the tobacco manufacturer is either a participating manufacturer under the MSA, or is a NPM that has made all required escrow

payments, and all brand families that are listed in the certifications, except as specified.

- Prohibit a person from affixing, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.
- Subject violators, principally manufacturers and distributors, to civil and criminal penalties and license suspension or revocation.

COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the Attorney General and is intended to allow for better enforcement of Internet and other delivery sales of cigarettes and tobacco products in this state, strengthen the Attorney General's and BOE's ability to diligently enforce the Model Statute and Tobacco Directory Law, and to provide retailers relief of any financial hardship resulting from cigarettes and tobacco product inventory that immediately becomes illegal to sell upon removal from the Tobacco Directory.
2. The **July 15, 2010, amendments** related to the BOE (1) allow a manufacturer or importer to post a surety bond in lieu of waiving sovereign immunity and remove the requirement to provide a copy of any corresponding federal permit for purposes of granting or maintaining a Licensing Act license, (2) make a manufacturer or importer license subject to revocation if the licensee raises a sovereign immunity defense, (3) incorporate the delivery sales provisions into existing face-to-face sale provisions, (4) revise the notification provisions for pending administrative action and removal from the Tobacco Directory, and (5) delete the provisions that would have expanded the BOE's seizure authority. The **May 20, 2010, amendments** made corrections to the Legislative Counsel's Digest and other non-substantive changes. The **May 13, 2010, amendments**, among other things, (1) clarified that the Attorney General shall transmit a written notice of a tobacco manufacturer or brand family removed from the Tobacco Directory to each licensed wholesaler, (2) deleted the refund provisions for distributors, wholesalers, and retailers in possession of removed cigarettes on the effective date of their removal from the directory, (3) required foreign tobacco product manufacturers, or their importers, to submit each and every applicable return, as defined, to the Board, and (4) made changes to the delivery sales order provisions, such as removing references to "track and trace" and revising definitions. The **April 14, 2010 amendments**, among other things, (1) added additional manufacturer and importer requirements to obtain and maintain a Licensing Act license, (2) deleted the requirement for an appropriate stamp or meter impression to be made upon any rolls of tobacco described as a little cigar, (3) required the BOE to file a lien for a tax penalty in the same amount as the unpaid refund against, and to revoke the Licensing Act license of, a manufacturer, importer, distributor or wholesaler that fails to provide a refund of all moneys paid for product removed from the Tobacco Directory, (4) incorporated delivery seller provisions for specified non-face-to-face sales of cigarettes or tobacco products to a consumer, and (5) expanded the cigarettes subject to seizure by the BOE and forfeiture to the state to

include packages that fail to meet the marking, labeling, and stamping requirements or provide or affix the information in the manner specified.

3. **What is the BOE's enforcement role for the Model Statute?** The BOE has several responsibilities with respect to "diligent enforcement" of the Model Statute, which protects the state's approximately \$900 million annual revenue payment stream from the MSA. The BOE's enforcement role, which coincides with administration of the Tax Law, is as follows:

- The Model Statute requires NPMs to place into a qualified escrow fund by every April 15 an amount, as specified, based on units sold during the previous year. "Units sold" is generally defined to mean the number of individual cigarettes sold in the state by the applicable tobacco product manufacturer as measured by excise taxes collected by the state on packs bearing the excise tax stamp of the state. The BOE is authorized to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by NPMs.

As a result of this provision, the BOE provides the Attorney General with annual statistics of cigarettes sold in California by NPMs. The BOE compiles this information measured by the excise tax reported to the BOE, which is adjusted by BOE staff to remove brands that are considered a "cigarette" for tax purposes, but not for purposes of the Model Statute.

- The Tobacco Directory Law prohibits a distributor from affixing a tax stamp to a package of cigarettes, or paying the tax on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on Tobacco Directory². A violation of this prohibition could result in the revocation or suspension of the license or licenses of the distributor and/or a civil penalty and subject such products to seizure and forfeiture by the BOE.
- The Licensing Act requires every manufacturer or importer required to obtain and maintain a license to engage in the sale of cigarettes. In order to be eligible to obtain and maintain a license, a manufacturer or importer that is a "tobacco products manufacturer" pursuant to the Model Statute must 1) certify to the BOE that it is a "participating manufacturer" or is in compliance with the Model Statute, and 2) submit to the BOE a list of all its brand families. AB 71 also gave the authority to the BOE to revoke or suspend the license of a distributor for selling product not listed on the California Tobacco Directory.
- The Tax Law allows an employee of the BOE, upon presentation of the appropriate identification and credentials, is authorized to enter into, and conduct an inspection of, any building, facility, site, or place, for which there is evidence of the failure to comply with the requirements of the Model Statute or the Tobacco Directory Law. The Tax Law also authorizes the BOE to seize cigarettes or tobacco products to which a tax stamp is affixed, or tax paid, in violation of the Tobacco Directory.

² Tobacco products commonly known as "little cigars" currently do not have to be listed in the tobacco directory in order to be lawfully sold in California. The AG may decide in the future to require that certain brands of little cigars be listed in this Directory.

4. **Should the Tobacco Directory Law and related enforcement provisions be in the Tax Law?** Revenue and Taxation Code Section 30451 requires the BOE to enforce the provisions of the Tax Law. The Tobacco Directory Law was added to the Tax Law in 2003 pursuant to AB 71 (Ch. 890, J. Horton). Although the Tobacco Directory Law contains mostly non-tax provisions enforced by the Attorney General, it also includes provisions that appropriately tie-in with the Tax Law enforced by the BOE.

However, this bill proposes to expand the Tobacco Directory Law, much of it unrelated to the BOE's enforcement and administration of the Tax Law. Since the Tobacco Directory Law is primarily related to enforcement of the Model Statute, it is suggested that the bill be amended to place the Tobacco Directory Law in the Health and Safety Code along with the Model Statute, which is located in Article 3 (commencing with Section 104555), Chapter 1, Part 3, Division 103 of the Health and Safety Code. It is further suggested that the current BOE Tobacco Directory Law responsibilities, which are tax-related, remain in the Tax Law.

In addition to maintaining only tax-related provisions within the Tax Law, these suggested amendments would more clearly define the BOE's and Attorney General's role for enforcement of the Model Statute and funding for those costs. Funding under the Tax Law is provided by the cigarette and tobacco products tax funds, specifically, the General Fund, Breast Cancer Fund, Cigarette and Tobacco Products Surtax Fund (Proposition 99), and the California Children and Families Trust Fund (Proposition 10).

5. **Notification of brand family or manufacturer removal from the Tobacco Directory.** Under current law, cigarettes or tobacco products to which a tax stamp is affixed, or for which tax is paid, is subject to seizure and forfeiture by the BOE at the time the manufacturer or any of its brand families are removed from the tobacco directory. When a manufacturer or brand family is removed from the Tobacco Directory, only distributors are notified of the removal by e-mail. Wholesalers and retailers must check the Tobacco Directory, which is located on the Attorney General's website, for recent changes to the directory, such as removals. As such, wholesalers and retailers are typically not aware that a manufacturer or a brand family has been removed from the directory when found by BOE inspectors to be selling, offering, or possessing for sale removed product.

To provide better notification of any action taken against manufacturers or brand families, this bill would require each distributor and wholesaler to be notified of a pending administrative action, if the Attorney General declines to remove a manufacturer or brand family, and removal of a manufacturer or brand family from the directory, and within seven days of receiving such a notice from the Attorney General, to provide each existing customer with a copy of that notice. This provisions is intended to ensure that all sellers receive a copy of the notices; however, there is no specific penalty or enforcement action for a distributor or wholesaler that fails to provide a copy of the removal notice to existing customers.

6. **Sell-off period for product removed from the Tobacco Directory.** Currently, cigarettes or tobacco products of a manufacturer or its brand families become illegal to sell, offer, or possess for sale upon removal from the Tobacco Directory. Even with proper notice of such removal, it is a financial hardship on distributors,

wholesalers, and retailers who have an inventory of the removed products that they can no longer sell.

To address this hardship, this bill would provide a licensed retailer 60 days from the effective date of the removal notice to sell the affected product. These sell-off provisions should be amended to be more compatible with the prohibitions provided in subdivision (e)(2) and (3), such as acquiring, transporting, importing cigarettes not included in the Tobacco Directory. Aligning the prohibitions would avoid, in part, the seizure and destruction of cigarettes from a grocery store that offers a grocery delivery service. Although the grocery store would be allowed to sell cigarettes during the 60 day sell-off period, it would be prohibited from transporting or delivering the delisted product.

7. **Penalty expanded beyond distributor for violations.** Under existing law, the Tobacco Directory, pursuant to Section 30165.1(i), imposes civil or criminal penalties upon a distributor for violations of the Tobacco Directory and authorizes the BOE to suspend or revoke the distributor's license. This bill would expand those penalties to any person for violations, including all license holders (manufacturer, importer, distributor, wholesaler, and retailer). It also expands the licenses subject to suspension or revocation to include those issued under the Tax Law.

The expanded penalty provisions would also include consumers who purchase and/or import cigarettes not appearing on the directory, which could be tracked and enforced through the BOE's Cigarette and Tobacco Product Internet Program. That program focuses on the collection of California state excise taxes and use taxes from California consumers purchasing untaxed cigarettes and/or tobacco products from out-of-state Internet retailers, and/or by way of mail or telephone, for self-consumption in California.

8. **Necessary amendments.** BOE staff has been working with the sponsor and the author's staff to address concerns regarding additional BOE administrative responsibilities imposed by this measure that are outside the purview of the BOE. Agreement has been reached to amend the bill as follows:

- **Delivery Sales.** Under existing law, Tax Law Section 30101.7 is intended to facilitate the collection of all applicable state surtaxes (cigarette and tobacco products taxes) and sales and use taxes. These taxes are administered and collected by the BOE. As amended, the intent of this section is expanded to also include compliance with the PACT Act and Model Statute, which include provisions outside the BOE's purview of tax administration and collection. As discussed earlier, the BOE is required to enforce the provisions of the Tax Law, which includes Section 30101.7. As such, this section could be interpreted to mean that the BOE is required to administer and enforce its provisions, which include, in part, a delivery seller's compliance with all California laws applicable to sales of cigarettes and tobacco products, such as age verification, and shipping requirements, such as weight restrictions. Section 30101.7 should be amended to clarify that the BOE's administrative responsibility is limited to collection of the applicable taxes and administration of the Licensing Act, as required under existing law.

In addition, subdivision (f) of that same section should be permissive rather than a required action by the BOE. According to Attorney General staff, this

subdivision is intended to make it clear that the BOE is authorized, not required, to share any information received regarding PACT Act compliance since existing Tax Law makes certain BOE information confidential. However, it appears this subdivision is duplicative and unnecessary since Section 30165.1(g)(2) would also authorize the BOE to share all information related to Section 30101.7 compliance, notwithstanding the disclosure provisions contained in existing Tax Law. It is suggested that subdivision (f) be deleted.

- **Surety Bond.** This bill would amend the Licensing Act, Section 22979, to allow a manufacturer or importer to post a surety bond in lieu of waiving any sovereign immunity defense. The section also provides that the Attorney General may draw upon the bond for, among other things, tax obligations. However, manufacturers and importers are not taxpayers for purposes of the Tax Law. The cigarette and tobacco products tax is imposed upon distributors. Accordingly, the surety bond would be drawn upon only for the purpose of unsatisfied escrow obligations, claims for penalties and monetary damages, and any other liabilities that are subject to the licensee's claim, none of which are related to a Tax Law or Licensing Act obligation.

The BOE is required under Business and Professions Code Section 22971.2 to administer and enforce the provisions of the Licensing Act. As such, the BOE would be required to administer and enforce the proposed surety bond requirement. In addition to the bond not being related to Tax Law or Licensing Act enforcement, administration and enforcement of such surety bonds would create a significant BOE workload. BOE staff has asked that Section 22979 be amended to make it clear that the surety bond is to be administered and enforced by the Attorney General or an agency with whom the Attorney General contracts.

Similar surety bond language is also proposed to be added to Tax Law Section 30165.1(c)(4), which also requires similar clarifying language.

In addition, BOE staff has suggested to the sponsor the following clarifying amendments:

- **Tax Law Section 30101.7.** As amended, this section contains definitions for terms that are not referenced within the section and therefore appear unnecessary. These terms include "face-to-face sale," "Indian country," and "interstate commerce."
- **Tax Law Section 30165.1(c)(3).** This paragraph, in part, requires that the Attorney General notify all licensed distributors and wholesalers of its recommendation to remove a manufacturer or brand family from the Tobacco Directory for cause. The distributor and wholesaler would be allowed to continue purchasing, stamping (distributor), and selling products subject to action for no more than 40 days following issuance of the notice of pending administrative action. Is it possible for the Attorney General action to remove or decline to remove a manufacturer or brand family to take more than 40 days? If administrative action exceeds that 40 day period, a distributor and wholesaler would be prohibited from purchasing, stamping, and selling products prior to a final determination by the Attorney General. What if the Attorney General

ultimately declines to remove the manufacturer or brand family from the directory after the 40 day period has elapsed?

- **Tax Law Sections 30165.1(g)(4).** This paragraph makes an unnecessary reference to the BOE, which should be removed. It appears the added reference was a simple oversight since the information would be used only by the Attorney General to ensure compliance with the Tobacco Directory law, reporting requirements, and the Model Statute.

COST ESTIMATE

The BOE would incur administrative costs related to revising Licensing Act application forms for manufacturers and importers, issuing citations to licensees for purchasing, obtaining or otherwise acquiring cigarettes stamped in violation of the Tobacco Directory law, and for additional cigarette and tobacco products seizures. These costs are estimated to be minor and absorbable.

The BOE would also incur moderate on-going costs to administer and enforce the proposed surety bond provisions contained in Business and Professions Code Section 22979 and Tax Law Section 30165.1(c)(4). A detailed cost estimate is pending; however, these costs are estimated to be under \$100,000. If the bill is amended to clarify that the bonds would be administered by the Attorney General or an agency it contracts, the Board would not incur these costs.

REVENUE ESTIMATE

This bill may have a positive impact on the state excise tax collected on sales of cigarettes and tobacco products and also on use tax collected on cigarettes and tobacco products purchased from out-of-state retailers. However, the BOE has no way of measuring the potential impact these provisions may have, and therefore, cannot provide an estimate at this time.

Analysis prepared by:	Cindy Wilson	916-445-6036	08/0310
Contact:	Margaret S. Shedd	916-322-2376	
Is			2496-4cw.doc

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.