



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	05/18/09	Bill No:	SB 601
Tax:	Cigarette and Tobacco Products Licensing Act	Author:	Padilla
Related Bills:	SB 602 (Padilla) SB 603 (Padilla)		

BILL SUMMARY

This bill would make the following changes to the Cigarette and Tobacco Products Licensing Act of 2003¹ (Licensing Act):

- Except for public convenience or necessity, prohibits the Board from issuing a new cigarette and tobacco products retail license (retail license) for a location within 600 feet of a school.
- Restricts the issuance of a retail license to “traditional retail locations,” as defined, and authorizes the Department of Public Health (DPH) to petition the Board to define other “traditional” retail locations through the regulatory process. This restriction does not apply to a renewal or transfer of a license.
- Specifies that the proposed retail license restrictions do not preempt a more restrictive local ordinance.
- Requires the DPH, and the Alcoholic Beverage Control (ABC) to provide the Board, upon request, any necessary information regarding retailers to implement the provisions.

Summary of Amendments

Since the last analysis, the bill was amended to (1) expand the definition of “traditional retail location” and authorize the DPH to petition the Board to specify other retail locations that are “traditional,” (2) allow the Board to issue a license to a retail location within 600 feet of a school if a local governing body finds public convenience or necessity, (3) specify that the provisions do not apply to renewals or transfers, (4) allow local jurisdictions to adopt more restrictive ordinances for retail licenses, and (5) requires DPH and ABC to provide the Board, upon request, any necessary information regarding retailers to administer this measure.

ANALYSIS

CURRENT LAW

Chapter 2, License for **Retailers** of Cigarettes and Tobacco Products, of the Licensing Act (commencing with Section 22972) provides that a retailer who sells cigarette and tobacco products in this state is required to have in place a license to engage in the sale of cigarettes and tobacco products and conspicuously display the license at each retail location in a manner visible to the public. A retail license is not assignable or transferable and can not be sold. A person who obtains a retailer license and stops doing business, or never starts doing business, or whose license is suspended or revoked, is required to immediately surrender the license to the Board.

¹ Division 8.6 (commencing with Section 22970) of the Business and Professions Code.

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location. Each retailer is required to submit a one-time license fee of one hundred dollars (\$100) with each application and may submit a single application for multiple locations with a license fee of one hundred dollars (\$100) per location. A "retail location" is defined to mean any building from which cigarettes or tobacco products are sold at retail or a vending machine.

Additionally, Section 22973 authorizes the Board to investigate the truthfulness and completeness of the information provided in a retailer's application. The Board may also issue a license without further investigation to an applicant for a retail location if that applicant holds a valid license from the Department of Alcoholic Beverage Control (ABC) for that same location. A license is valid for a 12-month period, and is renewed annually.

Section 22973.1 provides that the Board is required to issue a license to a retailer upon receipt of a completed application and payment of the fees, unless otherwise specified. Any person or retailer convicted of a felony under the Cigarette and Tobacco Products Tax Law would not be issued a license, or if that person holds a license, that license would be revoked. Any retailer who is denied a license may petition for a redetermination of the Board's denial within 30 days after service upon that retailer of the notice of the denial.

Chapter 3, License for **Wholesalers and Distributors** of Cigarettes and Tobacco Products, of the Licensing Act (commencing with Section 22975) requires that every distributor and wholesaler must annually obtain and maintain a license to engage in the sale of cigarettes or tobacco products. Every distributor and wholesaler must file an initial application and a yearly renewal application accompanied by a fee of \$1,000 for each location. The fee is for a calendar year and may not be prorated. In addition, Chapter 4, License and Administration Fee for **Manufacturers and Importers**, of the Licensing Act (commencing with Section 22979) requires every manufacturer and importer to maintain a license to engage in the sale of cigarettes or tobacco products and to pay a one-time fee.

As provided in Sections 22990 and 22991 all moneys collected pursuant to the Licensing Act are deposited in the Cigarette and Tobacco Products Compliance Fund (Compliance Fund) and are available for expenditure, upon appropriation by the Legislature, solely for the purpose of implementing, enforcing, and administering the Licensing Act.

PROPOSED LAW

This bill would add Section 22973.4 to Chapter 2 of the Licensing Act to prohibit the Board from issuing a new retail license for a location within 600 feet of a public or private elementary or secondary school, unless a local governing body determines that public convenience or necessity would be served by the license issuance.

The Board may issue the new retail license if the local governing body determines public convenience or necessity would be served by the license issuance. If the local governing body fails to make a determination within 90 days of notification, the license would be deemed denied.

This bill provides that the 90 days commences when the Board notifies the appropriate local governing body that a completed application for licensure has been filed by the applicant with the Board, or the local governing body is in receipt of a completed application according to local requirements, whichever is later.

The Board would also be required to limit issuance of a new retail license to “traditional retail locations,” which includes, but is not limited to a grocery store, convenience store, pharmacy, liquor store, gas station, smoke shop, wine and cigar store, superstore, or a tobacco or cigar store. The DPH may petition the Board to adopt regulations that specify other locations that would constitute a traditional retail location.

This bill further specifies that the “traditional retail” licensing provision added by this measure would not apply to a renewal or transfer of a retail license.

None of the bill’s provisions preempt a local jurisdiction from adopting an ordinance that is more restrictive than this section with regard to retailers or proximity to a school.

The measure also requires the DPH, and the ABC to provide, upon request, any necessary information regarding retailers in order to implement the provisions.

The bill would become operative January 1, 2010.

BACKGROUND

In 2003, Assembly Bill 71 (J. Horton, Ch. 890) enacted the Licensing Act, which established a statewide licensure program administered by the Board to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Currently, the Board has approximately 38,000 retailers and 1,000 distributors and wholesalers licensed to engage in the sale of cigarettes and tobacco products in California.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to strengthen California’s tobacco control laws and prevent youth from using tobacco.
2. **The May 18, 2009** amendments allow DPH to petition the Board to adopt regulations related to “traditional” retailers, provides local governments with the exclusive authority to grant public convenience or necessity determinations, and specifies information that the ABC and DPH may share with the Board. The **April 28, 2009** amendments decreased the proposed proximity of a licensed retailer to a school from 1,000 feet to 600 feet, clarified that transfers of retail licenses are prohibited except for license transfers of “traditional” retail locations, and required the Board, ABC, and the DPH to share information to implement the bill’s provisions. The **April 15, 2009 amendments** expanded the definition of “traditional retail location” and authorized the Board to specify other retail locations that are “traditional,” (2) allowed a local governing body or the Board to issue a license to a retail location within 1,000 feet of a school for public convenience or necessity, (3) specified that the provisions do not apply to renewals or transfers, and (4) allowed local jurisdictions to adopt more restrictive ordinances for retail licenses.
3. **Board’s mission and tasks.** The mission of the Board is to serve the public through fair, effective, and efficient tax administration. The provisions in this bill represent a departure from our traditional “tax collection” functions. In general, the Board requires a license, permit, or registration for the various tax and fee programs that we administer. Essentially, the purpose of the licensing/registration/permit is to ensure collection of vital revenues for the state.

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According to the legislative findings in the Licensing Act, the licensing of manufacturers, importers, wholesalers, distributors, and retailers was a comprehensive program to reduce untaxed distribution and illegal sales of cigarette and other tobacco products in California. Although the Licensing Act provided stricter retailer licensing requirements, compared to permit requirements for sales and use tax, the stricter standards were established to support the overall goal of improving tax collection. The licensing restrictions that this bill proposes are intended to relate to health, public safety, or other non-tax purposes. Is the Licensing Act the proper venue for the proposed changes?

4. **The proposed distance in the Licensing Act is the same as in the Alcoholic Beverage Control Act.** Section 22973(b) of the Licensing Act provides that the Board may issue a retail license without further investigation if the retail location is also licensed by the ABC. Section 23789 of the Alcoholic Beverage Control Act allows ABC to refuse issuance of an alcohol permit for a retail location within 600 feet of a church, school, or playground. Since this bill proposes the same standard (600 ft.) as the ABC with respect to schools, then the Board may not need to conduct its own investigation of the retail locations proximity to a school and could rely on the ABC license. It should be noted that the ABC provision is broader and applies to locations other than schools, such as a church, hospital, public playground, or nonprofit youth facility. The Board would need specific information from the ABC regarding the denial of a license due to its proximity to a school, as opposed to denial of a license for proximity to another prohibited location. The Board would also need information on issuance of a license by ABC, such as, was it issued as a matter of public convenience or necessity although the retail location is within 600 feet of a school? If the information from ABC is not detailed enough for Board purposes, then the Board may need to mirror investigative procedures similar to the ABC, including an onsite physical investigation. In addition, not all retail locations that sell cigarettes and tobacco products also sell alcoholic beverages.
5. **A “traditional” retail location would include, but not be limited to,** a grocery store, convenience store, pharmacy, liquor store, gas station, smoke shop, wine and cigar store, superstore, or a tobacco or cigar store. Would this mean that new licenses would not be issued for a donut shop, video store, laundromat, deli, beauty salon, auto repair shop, gift/novelty store, “dollar” store, warehouse club store (unless licensed as a wholesaler/distributor), furniture store, eating and drinking place, hardware store, book store, florist, pet shops, sporting goods store, and auto supply store? The open ended language “but not limited to” makes it unclear.

This bill would additionally authorize the DPH to petition the Board to adopt regulations to further expand the definition of a “traditional” retail location.² The Fact Sheet provided by the author indicates that the bill is intended to reduce tobacco use among youth by limiting access and availability to tobacco products. However, the bill has no legislative findings or definitions that could provide the Board with guidance in determining what retail locations would be considered “traditional.” Although the DPH maintains or produces records, studies, and reports regarding

² Except as otherwise provided by statute, any person may petition the board to adopt, amend or repeal a regulation. The Board must act on such petitions within 30 days of receipt. However, this time may be extended upon agreement of the petitioner. This procedure is set out in Government Code Sections 11340.6 and 11340.7.

illegal youth purchasing patterns from California retail license locations, it is unclear how the Board would consider a DPH rulemaking petition when the enabling statute does not provide guidance. Under this proposed structure the DPH would essentially be determining which retail store types have been compliant with prohibitions in selling tobacco products to minors, as opposed to determining which retailers have been non-compliant. Either way, it is unclear what standard of compliance or non-compliance the DPH and the Board would use to determine if a retail store type should be considered a “traditional” retailer.

The Board would experience increased workload in considering and evaluating applications and petitions of denials of licenses related to a “traditional retailer” regulation.

Furthermore, the ability to petition the Board to adopt, amend, or repeal a regulation may be brought by any party, including retailers, retail associations, a tobacco distributor association, and other interested parties. The Board may experience increased workload in considering and evaluating petitions related to a “traditional retailer” regulation.

6. **“Public convenience or necessity” only applies to license issuance for locations within 600 feet of a school, and this exception becomes a local government responsibility.** It should be noted that there are no provisions for public convenience or necessity for “traditional retailers.” With respect to retail locations within 600 feet of a school, the Board would be prohibited from issuing a “new” retail license unless the local jurisdiction or the Board determines public convenience or necessity. In administering this provision, the Board would not consider a renewal or reinstatement of an existing license as the issuance of a “new” license.

Local governments would be allowed to make a determination that a location within 600 feet of a public or private elementary school should be issued a retail license because of “public convenience or necessity.” Under the ABC Act, Section 23958.4, an applicant for a retail alcohol license in an area of undue concentration also has an opportunity to demonstrate to the local government or the ABC that a license should be issued in an area of undue concentration due to “public convenience or necessity.” Section 23958.4 was added to the ABC Act in 1994 and was amended in 1996 (AB 2841, Ch. 869, Stats. 1996) to provide the applicant the opportunity to demonstrate to ABC that “public convenience or necessity” would be served by issuing the license. According to the legislative analysis³ of AB 2841, the requirements allowing the applicant to show “public convenience or necessity” to the ABC was added because some local governments were not taking timely action in determining the “public convenience or necessity.” According to the sponsor, part of this issue was related to the State’s exclusive authority to license alcoholic beverage retail locations; the local governments had no expertise or interest in taking on responsibilities reserved to the state.

In the case of cigarette and tobacco licensing, the local governing bodies already have the authority and ability to issue local ordinances and licenses. The Licensing Act, Section 22971.3, provides that, with the exception of collection of state taxes, nothing in the Licensing Act preempts or supersedes local tobacco control laws. In

³ Senate Committee on Governmental Organization, Staff Analysis, AB 2841 (Hoge), as amended July 2, 1996.

other words, the local governing bodies have a strong public policy interest in determining public convenience or necessity for cigarette and tobacco licenses; the same can not be said of the Board in determining public convenience or necessity.

7. **How does this bill affect existing retailers and locations?** If enacted, this bill would be effective January 1, 2010, and the proposed retail license restriction related to “traditional retail location” would not apply to the renewal, reinstatement or the transfer (see Comment 8, below) of a retail license. Those retail locations that are currently licensed would be able to renew, reinstate, or transfer their license despite the possibility of not being characterized or classified as a “traditional” retail location.
8. **The bill needs to specifically authorize the “transfer” of a license and specify when a license can or can not be transferred.** The bill provides that “for purposes of a traditional retail location and notwithstanding subdivision (c) of Section 22972, this section shall not apply to the renewal or transfer of a license.” This language appears to make an exception to the existing section in the Licensing Act, Section 22972(c), which specifies that a license is not assignable or transferable. The bill should specifically authorize a retailer to “transfer” an existing license, similar to the “transfer” provisions provided in the author’s companion measure, SB 603, proposed Section 22973.3 (b)(1), which states in part “notwithstanding any other law...a retailer may transfer an existing license to another person...”

In general, the restriction on the transfer of a license was intended to prohibit the transfer of a business between related persons, so that the business can not be transferred for the purposes of evading payment of taxes, fees, or penalties, and to avoid the imposition of a license suspension or revocation. The definition of a “transfer” or additional provisions related to a “transfer” should be added to clarify the author’s intent. Without additional provisions, for example, an existing licensee with a non-traditional retail location that wishes to change their ownership structure from a sole proprietor to a corporation (otherwise meeting the license issuance provisions in Section 22973.1) may not be considered a “transfer,” and a “new” license could not be issued. It should be noted that under the current Licensing Act provisions a new license would be issued for a change in ownership type if the business otherwise meets the licensing provisions.

Additionally, considering the cumulative limiting effects on the issuance of retail licenses that the author’s bills (SB 601, SB 602, SB 603) would have, allowing for the “transfer” of a license may result in the licenses obtaining substantial monetary value and, similar to an ABC license, they may be sold by the license holders – ultimately costing the purchaser an additional expense to acquire a business. While most potential business owners purchasing a business or stock of goods acquire a business through an escrow, it is not required by the Revenue and Taxation Code. There are, however, escrow provisions in the ABC Act which specify the rights and priorities of certain parties and creditors. Without these provisions would the parties and creditors look to the Board to act as an escrow agent? Are escrow provisions in the Licensing Act necessary? If this bill progresses then the Board would need to discuss this issue in more detail with the author.

Moreover, it is important to note that Article 5 of Chapter 6 of the ABC Act has over twenty separate sections related to the issuance and transfer of licenses. Do some of the ABC provisions related to transfers apply to transfers of cigarette and tobacco retail licenses? Should the retail license be transferred if an existing tobacco excise

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tax or sales tax liability is outstanding? Should the Board have the authority to prevent the transfer of a license unless tax liabilities are paid? Are there other situations when a transfer should not occur?

9. **What effect would this bill have on the Cigarette and Tobacco Products Compliance Fund?** Currently, the Board's enforcement costs exceed the amount of revenues from the licensing fees with the shortfall made up by the various cigarette and tobacco products tax funds (comprised of payments made to the state for the excise taxes on the distribution of cigarettes and tobacco products). If the number of retail licenses decreases and the Board has additional administration and enforcement costs, then this would result in additional shortfalls in funding from the Compliance Fund. The Proposition 99 fund, Proposition 10 fund, the Breast Cancer Fund and the General Fund would have to pay for the shortfall. However, since the provisions of this bill are related to sales to minors and not tax collection, it does not appear that the Proposition funds and the Breast Cancer Fund could be used to fund costs associated with the author's bills (SB 601, SB 602, SB 603). If this is the case, then the additional workload imposed by these bills would be borne solely by the General Fund.

As Assembly Bill 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 Cigarette and Tobacco Products Tax Law 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. AB 71 also 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 products fund benefited or was burdened when the funding shift took place. Since this measure is intended to address youth smoking and not the administration and collection of cigarette and tobacco products taxes, it is unclear how this measure would be funded. While the Licensing Act provides that all moneys in the Compliance Fund are to be used for the purpose of implementing, enforcing and administering the Licensing Act, this measure could result in a significantly larger shortfall in the Fund, thus shifting a larger burden of the expense to the cigarette and tobacco products tax funds. As such, it could be construed that the cigarette and tobacco products funds, which existing law requires to be used for the administration and collection of the cigarette and tobacco products taxes⁴, are being used to fund enforcement of youth smoking.

10. **Cigarette and tobacco products tax evasion.** Tax evasion is one of the major areas that can reduce state revenues generated from cigarettes and other tobacco products taxes. Board staff recently estimated that cigarette tax evasion in California was running at a rate of approximately \$182 million, along with \$94 million in tax on other tobacco products.⁵

During the mid-1990's, the Board's cigarette tax evasion estimates changed little since there was little change to cigarette prices and excise taxes during that time. However, two major events that occurred since November 1998 dramatically

⁴ R&TC §§30124, 30125, 30131.3 and 30131.4.

⁵ <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>

increased California excise taxes as well as cigarette prices (excluding taxes): Proposition 10 and the Tobacco Master Settlement Agreement between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, coincided with an increase in the average prices of cigarettes to California consumers by about 50 percent in relation to early November 1998 prices. It is estimated that the impacts of Proposition 10 and the tobacco settlement more than doubled the dollar amount of cigarette tax evasion in California.

Since the 1998 experience, many new measures have been implemented to reduce cigarette and other tobacco products tax evasion. These include the Licensing Act, an encrypted cigarette tax stamp, and various Internet restrictions (such as agreements with UPS, DHL, and FedEx under which those companies have agreed to stop transporting cigarettes directly to individual consumers nationwide and credit card companies adopting policies to prohibit the use of credit cards for the illegal sale of cigarettes over the Internet).

Traditionally the Board has experienced tax evasion with an increase in the excise taxes for cigarette and tobacco products. This measure, along with Senator Padilla's related bills, SB 602 and SB 603, would not increase taxes, but rather restricts the number of retail licenses that may be issued by the Board. While these restrictions may not have an effect on the retail price of the products they will most likely have a direct effect on the value/cost of a license and affect consumer purchasing options. Based on the state's previous experience with alcohol licenses, Board staff believes the proposed retail license restrictions could result in significant value being given to the retail licenses which could lead to an increase in unlicensed sales of cigarette and tobacco products (perhaps even an increase in illegal sales to minors). Additionally, as consumer convenience is affected more consumers may turn to the internet to purchase their cigarette and tobacco products, with state excise and sales taxes being affected to the extent the online retailer does not collect California taxes. The exact effect and magnitude of these responses is uncertain since this state has not had experience with similar retail license restrictions for cigarette and tobacco products. The experience with alcohol licensing restrictions in this state are similar in some respects, but significantly different since alcohol production, distribution, and use is more tightly regulated.

In summary, the author's package of bills, SB 601, SB 602, and SB 603, could counteract the intent of the Licensing Act, which could result in an increased workload for the Board since additional enforcement and resources would be needed to address possible increases in internet sales, unlicensed sales, and other tax avoidance/evasion activities.

11. **Related legislation.** SB 602 (Padilla) adds provisions to the Licensing Act to prohibit the issuance of a new license to a retailer in an "area of overconcentration," and revises the penalty provisions related to illegal sales to minors and changes the reporting requirement related to sales to minors.

SB 603 (Padilla) under the Licensing Act, imposes an annual retailer fee, limits the total number of retailer licenses issued in a county, and provides for the transfer of a license under specified conditions.

COST ESTIMATE

Significant administrative costs would be incurred to notify retailers, revise applications and publications, revise and/or develop computer programming, develop procedures to identify locations near schools, consider and develop regulations and procedures related to traditional retail locations, develop procedures to investigate retail licenses consistent with the restrictions, address legal issues, and answer inquiries from licensees. The Board may experience increased workloads related to regulation petitions, licensing enforcement and tax evasion, and pursuing collection of excise and sales tax from internet purchasers. A detailed cost estimate is pending.

To the extent that excise tax funds will be prohibited from backfilling the Compliance Fund costs, there may be increased cost pressures on the General Fund.

REVENUE ESTIMATE

According to the Board's Excise Taxes Division, there are approximately 38,200 licensed retail locations selling cigarettes or tobacco products in California. This figure has been fairly stable since the inception of the Licensing Act. On average, there are about 6,000 new licenses issued, with a corresponding amount of licenses surrendered.

Although we are not able to quantify the revenue impact for this bill, we believe it would result in a net loss of excise tax, sales tax, and licensing fees due to less convenience for consumers and the retail license restrictions. As this bill progresses and more details are provided, the Board can develop a revenue estimate.

Analysis prepared by: John Cortez (916) 445-6662 05/20/09

Contact: Margaret S. Shedd (916) 322-2376

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