



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

DRAFT

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

BILL SUMMARY

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

- Require a retailer to pay annually the one-hundred dollar license fee to engage in the sale of cigarettes and tobacco products; and
- Limits the total number of retailer licenses issued in a county, and provides for the transfer of a license under specified conditions.

Summary of Amendments

Since the previous analysis, this bill was amended on **May 18, 2009** to (1) provide additional transfer provisions including an unspecified transfer fee, (2) give local governments the exclusive authority to grant public convenience or necessity determinations, (3) allow the Board to use a specific county population estimate, (4) limit the reinstatement period for an expired license to six months, and (5) specify information that the Department of Alcoholic Beverage Control (ABC) and Department of Public Health (DPH) may share with the Board. The **April 28, 2009** amendments allowed partial year retailer licenses (though the fee is not prorated) and allowed the Board to request additional information on an application. The **April 15, 2009** amendments authorized a local governing body or the Board to issue a license within a county that exceeds the limit for public convenience or necessity.

ANALYSIS

<p>Annual License Fee <i>Business and Professions Code Section 22973</i></p>

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 between businesses. 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.

A retailer that owns or controls more than one retail location where cigarette and tobacco products are sold is required to obtain a separate license for each retail

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. If a license is reinstated after its expiration, the retailer, as a condition precedent to its reinstatement, is required to pay a reinstatement of one hundred dollars (\$100).

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 of 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 amend Section 22973 to impose an annual \$100 per location license fee upon a retailer to engage in the sale of cigarettes or tobacco products. A license is valid for a 12-month period and would be renewable annually upon payment of the fee.

Any subsequent licenses issued to a retailer that owns more than one retail location would be valid for part of the year, beginning from the start date of the new license to the end of the 12-month period of the initial license. The fee is not prorated.

After any partial year periods, any retailer with more than one location would have all of their licenses valid for the same 12-month period as the retailer's initial license.

A retailer would be allowed to submit a single application, or application for renewal, but would need to pay the one hundred dollar (\$100) license fee for each location.

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A licensee may be required to provide licensee and retail location information on the renewal application, including the following: name, address, and telephone number of the applicant/licensee; business name, address, and telephone number for each retail location; and any other information the Board deems necessary to administer the Licensing Act.

This provision would be 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.

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 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: 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 were more than the revenues generated. To address this concern, a sunset date of January 1, 2010, was 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 Board has estimated that the Licensing Act and enhanced cigarette tax stamp generates an additional \$87.7 million in cigarette excise tax annually. The Licensing Act generates an additional \$17.5 million in additional tobacco products excise tax. The resulting additional sales and use tax revenue is estimated to be \$49.2 million annually. The breakdown by fund² is as follows:

² Assumptions: Cigarette revenues would have declined 3% per year without licensing or the new stamp. Tobacco products sales and revenues would not have changed without licensing. Thirty-month implementation period for both licensing and the new stamp (January 1, 2004 through June 30, 2006). Revenues are annual and ongoing. Tobacco products tax rate is for fiscal year 2007-08.

	Tax Rate or Price	Millions
Cigarettes		
Distributions (Millions of Packs)	n.a	100.8
Excise Taxes		
General Fund	\$0.87	\$87.7
Breast Cancer	\$0.10	\$10.1
Proposition 99	\$0.02	\$2.0
Proposition 10	\$0.25	\$25.2
	\$0.50	\$50.4
Sales and Use Taxes		
Average Retail Price Per Pack	\$4.91	
Retail Value of Cigarette Sales	n.a	\$495.0
Sales and Use Taxes, Total	9.00%	\$44.5
State General Fund	6.00%	\$29.7
Fiscal Recovery Fund (0.25%)	0.25%	\$1.2
Local	2.00%	\$9.9
Transit	0.75%	\$3.7
Tobacco Products		
Wholesale Sales	n.a.	\$38.8
Excise Taxes		
Proposition 99	45.13%	\$17.5
Proposition 10	28.66%	\$11.1
	16.47%	\$6.4
Sales and Use Taxes		
Retail Mark-Up Over Wholesale Price	35%	n.a.
Estimated Value of Retail Sales	n.a.	\$52.4
Sales and Use Taxes, Total	9.00%	\$4.7
State General Fund	6.00%	\$3.1
Fiscal Recovery Fund (0.25%)	0.25%	\$0.1
Local	2.00%	\$1.0
Transit	0.75%	\$0.4
Total Excise and Sales and Use Taxes		\$154.5
Totals may not sum due to rounding.		

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. The proposed annual tobacco retailer license renewal fee is intended to fund enforcement and compliance laws.
2. **How is the Board currently funded under the Licensing Act?** The Board's costs to enforce and administer the Licensing Act are funded with revenues deposited into the Compliance Fund, which includes license fee revenues, penalties and fines. The Compliance Fund fully reimbursed those costs through fiscal year 2005-06. In 2006-07, the Board's administrative costs were partially offset with cigarette and tobacco products tax revenues. As of 2007-08, substantially all of the Board's costs will be funded in this manner in order to cover the difference between Compliance Fund revenues and expenses. Below is a funding summary for the Licensing Act program, as reflected in the 2009-10 Governor's Budget:

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Fund	2007-08	2008-09	2009-10
General Fund	\$928,000	\$1,047,000	\$1,261,000
Breast Cancer Fund	186,000	209,000	251,000
Cigarette and Tobacco Products Surtax Fund	2,319,000	2,618,000	3,135,000
CA Children and Families First Trust Fund	4,641,000	5,236,000	6,273,000
Cigarette and Tobacco Products Compliance Fund	1,198,000	1,130,000	682,000
Total	\$9,272,000	\$10,240,000	\$11,602,000

3. **The fees generated by this measure would not fully offset the shortfall in the Compliance Fund.** The Board estimates this bill would generate approximately \$3,820,000 in additional revenue that would be deposited into the Compliance Fund (see the Revenue Estimate below). Since the annual shortfall amount appears to be approximately \$8 million beginning in fiscal year 2007-08, this bill would not fully eliminate the Compliance Fund shortfall.
4. **While the local city and county licensing laws generally require an annual licensing fee, the state's Licensing Act currently imposes only a one-time retailer license fee.** Many local cities and counties in California have adopted local tobacco retailer licensing laws, which require a retailer to pay an annual licensing fee and to be subject to suspension or revocation of that license if they are found selling tobacco to minors. Therefore, California retailers engaged in the sale of cigarettes or tobacco products and located in a city or county that has adopted local tobacco retailer licensing laws have two licenses (state and city/county). For example, in addition to the one-time \$100 state tobacco retail license fee, the City of Santa Ana, located in Orange County, requires a \$635 annual city tobacco retail license fee,³ while the County of Los Angeles charges a \$235 annual fee for a county tobacco retail license.⁴
5. **All licenses held by a retailer will be renewed at the same time. The fees are not prorated.** Under existing law, a retailer license is valid for a 12-month period and must be renewed annually. Accordingly, retailers are required to annually renew their license on or before the first day of the month of the retail location start date. For example, if a retailer is licensed to engage in the sale of cigarette or tobacco products on May 17th, they would be required to renew their license on or before May 1st of the following year.

Many retailers also engage in the sale of cigarette or tobacco products from more than one retail location. These additional locations (sub-locations) may have a different start date than the original (master) retail location. Since the Licensing Act does not provide a specific renewal date for a retail license, the Board aligns all of the retailer's sub-location licenses with the renewal date for their master license. The purpose of aligning the renewal dates is to relieve retailers that have multiple

³ City of Santa Ana, Tobacco Retail License Ordinance: [Tobacco Retail License](#)

⁴ County of Los Angeles, Tobacco Retail License:

http://www.lapublichealth.org/tob/pdf/Retailer%20FAQ%20v.6_FINAL.pdf

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locations and various start dates from the burden of renewing each individual license at different dates throughout the year, as well as reduce administrative costs associated with multiple renewal dates. Although the sub-location licenses may have been valid for less than 12 months, the retailer is not adversely affected by the shortened initial year for which the \$100 licensing fee was paid since the retailer license fee is a one-time fee.

In order to get all retail licenses on the same 12-month period the bill was amended to align all subsequent licenses held by a retailer to the retailer's master license and to provide a non-prorated \$100 retailer license fee for each subsequent license. For example, if the retailer's master account has a start date of May 17, and a sub-location was added with a start date of January 17, the sub-location license would only be valid for a four month period (January 1 to April 30) and subject to a \$100 license fee. The sub-location license would then be subject to renewal along with the master license. After the applicable renewal fees are paid, both the master and the sub-location licenses would be valid for the same 12-month period (May 1 to April 30). Aligning the period that all licenses held by a retailer are valid benefits both the state and the retailer. Retailers would be able to renew their licenses by using one renewal application rather than a separate renewal application for each location. It would also make the renewal process more efficient for retailers by eliminating multiple renewal dates throughout the year, which could lead to a retailer allowing their license to expire and subjecting that retailer to reinstatement fees and related penalties. An expired license is subject to a \$100 reinstatement fees, which would be in addition to the proposed renewal fee, and subjects the retailer to citations for unlicensed sales of such products, which for the first offense results in the issuance of a "Warning Notice" to the licensee, and for failure to display a license which carries a five hundred dollar (\$500) fine. The provision would also significantly reduce administrative costs to the Board for computer programming, license processing, following up on closed-out retailer licenses, and reinstating closed-out licenses.

Retailer License Limit per County

Business and Professions Code Section 22973.3

CURRENT LAW

As previously explained, Business and Professions Code Section 22972 requires a retailer who sells cigarette and tobacco products in this state 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, and is required to obtain a separate license for each retail location. A retailer that owns or controls more than one retail location where cigarette and tobacco products are sold is required to obtain a separate license for each retail 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 those licenses 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

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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.

PROPOSED LAW

This bill would add Section 22973.3 to the Licensing Act to limit the total number of cigarette and tobacco retailer licenses issued in a county to one for each 2,500 persons, or fraction thereof, over 18 years old in the county of the retail location. Applications for a retailer license will be granted in the order they are received, subject to the Licensing Act requirements.

In counties where the ratio of retail licenses exceeds the specified ratio of one to each 2,500 adults, the Board would be prohibited from issuing additional retail licenses, except for a renewal, transfer, or public convenience or necessity. Notwithstanding any other law and subject to approval by the Board, a retailer may transfer an existing license to another person under the following conditions:

- For the continued use at the same location upon the sale or transfer of the business holding the license.
- Only to a person who otherwise meets the requirements for the issuance of a new license, and only after first providing 30 days notice to the Board together with an application for transfer, all transfer documents, and evidence that the transferee would meet the requirements for the issuance of a new license.
- The application for transfer shall be in the form prescribed by the Board and contain any information the Board may require.
- An unspecified transfer fee must be submitted with each application.

The Board may issue a 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 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.

In those counties that exceed the county cap ratio, the Board may reinstate an expired license within six months after its expiration.

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

This provision would be operative January 1, 2010.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to reduce the availability of tobacco products in California communities to prevent youth from tobacco use.
2. **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.

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?

3. **Placing a cap on the number of licenses in a county.** This bill effectively places a cap on the total number of licenses that may be issued in a county. The total number of licenses is limited to one license for each 2,500 persons at least 18 years old. In the case where a county has a ratio greater than 1 to 2,500, it appears that a moratorium is effectively put in a place.

The bill was amended to specify that the number of persons in a county is determined by the Population Research Unit of the Department of Finance (DOF). The Board would use DOF reports and estimates to determine the number of persons over 18 years (adult population) for the counties. Although the ABC Act has similar provisions limiting the number of alcohol licenses in a county (see Sections 23816 et. seq.), it appears the Board would be unable to utilize ABC information since the population base for cigarette and tobacco purposes would be the adult county population, while the population for alcohol licensing is the "inhabitants of the county" – the total county population. Not having the same population base to determine the county cap amount would create an additional workload for the Board and not allow the agencies to effectively utilize existing information.

In those counties that exceed the number of licenses allowed, a reinstatement of an expired license could only occur within six months after its expiration. If an expired license is not renewed within that six month period, and, if the county exceeds the cap amount, then the Board would be unable to issue a new license.

4. **All 58 counties would exceed the county cap as soon as the bill becomes effective.** This bill provides a limit on the total number of cigarette and tobacco retailer licenses issued in a county to one for each 2,500 persons, or fraction thereof, over 18 years old in the county of the retail location. In analyzing the DOF county population estimates and comparing the estimated adult population to the Board's registration of the retail licenses in each county as of April 2009, the information indicates that all 58 counties would exceed the county cap as soon as the bill becomes effective.

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Historically, the Board has issued an average of 6,000 new licenses per year, which excludes renewals and reinstatements of expired licenses. Assuming all 6,000 licenses would not be allowed “transfers,” or meet the public convenience or necessity exemption, and therefore an application for a “new license” would be prohibited, then it could take as few as five years for all counties to meet the county cap through attrition. The Board does not have any historical information to establish a baseline for the number of licenses that could meet the “transfer” provisions, nor was the Board able to determine the amount of businesses that may be granted a public convenience or necessity exemption from local governments.

One county in particular, Alpine, would not only exceed the cap, but the Board would be prohibited from issuing any new licenses until the population reaches 2,500. The Board’s cigarette and tobacco retail license information indicates that there are currently five (5) licensed retailers in Alpine County. According to DOF’s, “2008 California Statistical Abstract” Alpine County has a total population as of July 1, 2007, of 1,261 residents. Unless a license can be transferred, or a local government finds public convenience or necessity, then the Board would not issue any new licenses in the foreseeable future.

5. **What effect would this provision 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

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the cigarette and tobacco products taxes⁵, are being used to fund enforcement of youth smoking.

- 6. The “transfer” of a license is allowed, and is defined, but the Board still has administrative concerns.** The bill was amended to allow the transfer of an existing retail license from the retailer to another person for the continued use at the same location, notwithstanding any other law, and provided the person the license is being transferred to otherwise meets the existing requirements for the issuance of a new license. The Board’s overall administrative costs will increase given the additional workload associated with an ability to transfer a license.

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 retail location within a county that exceeds the cap 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 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?

And lastly, this license restriction could have a negative impact on smaller retailers as it ties them to a retail location. For example, if a retailer is forced to move from their existing location, such as the rent becomes unaffordable, the building is destroyed, or a landlord ends the lease, that retailer may not be able to get a new license until the number of licenses in the county falls below the proposed cap.

⁵ R&TC §§30124, 30125, 30131.3 and 30131.4.

7. **“Public convenience or necessity” applies to license issuance for locations within a county that exceeds the retailer license limit, and this exception becomes a local government responsibility.** Local governments would be allowed to make a determination that a location within a county that exceeds the retailer license limit 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 analysis⁶ 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 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.

8. **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.⁷

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 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,

⁶ Senate Committee on Governmental Organization, Staff Analysis, AB 2841 (Hoge), as amended July 2, 1996.

⁷ <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>

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 601 and SB 602, 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.

9. **Related legislation.** SB 601 (Padilla) adds provisions to the Licensing Act to prohibit the issuance of a retail license for a location within 600 feet of a school, except in cases of public convenience or necessity, limits retail licenses to "traditional retail locations", authorizes the DPH to petition the Board to specify other "traditional" retail locations through regulation, and proposes the transfer of a retail license.

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.

COST ESTIMATE

Significant administrative costs would be incurred for both provisions in this bill. Costs would be related to notifying retailers, revising and/or developing computer programming, revising applications and publications, developing procedures to determine the number of licenses per county, developing regulations and procedures to identify and issue licenses to retailers in a county, providing for additional staff time to investigate applications and license transfers, developing procedures to handle transfers of licenses, address legal issues, and answering inquires from licensees. A detailed cost estimate is pending.

REVENUE ESTIMATE**BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

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. Accordingly, the proposed annual renewal fees would total approximately \$3,820,000 (\$100 x 38,200).

REVENUE SUMMARY

Retailer license fee revenues would increase by \$3,820,000 annually under this measure.

Although we are not able to quantify the revenue impact for the retailer licensing cap provision in 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.

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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 Board's formal position.