



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

DRAFT

Date Amended:	<b>06/01/09</b>	Bill No:	<b><a href="#">SB 603</a></b>
Tax:	<b>Cigarette and Tobacco Products Licensing Act</b>	Author:	<b>Padilla</b>
Related Bills:	<b>SB 400 (Corbett) SB 601 (Padilla) SB 602 (Padilla)</b>		

**BILL SUMMARY**

This bill would make the following changes to the Cigarette and Tobacco Products Licensing Act of 2003<sup>1</sup> (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
- Except for renewal or transfer, or public convenience or necessity, the Board would otherwise be prohibited from issuing a cigarette and tobacco products retail license (retail license) for a location in an “area of overconcentration,” as defined; and
- Except for public convenience or necessity, prohibits the Board from issuing a new retail license for a location within 600 feet of a school.

**Summary of Amendments**

Since the previous analysis, this bill was amended to prohibit the issuance of a retail license for a location within 600 feet of a school, except as provided, and to restrict the number of licenses in an area of overconcentration, as specified. The provision related to the restriction of the total number of retail licenses in a county was deleted.

**ANALYSIS**

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

**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 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

<sup>1</sup> Division 8.6 (commencing with Section 22970) of the Business and Professions 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 Board’s formal position*

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.

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 fund<sup>2</sup> is as follows:

---

<sup>2</sup> 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
<b>Cigarettes</b>		
Distributions (Millions of Packs)	n.a	100.8
<b>Excise Taxes</b>		
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
<b>Sales and Use Taxes</b>		
Average Retail Price Per Pack	\$4.91	
Retail Value of Cigarette Sales	n.a	\$495.0
Sales and Use Taxes, Total		
State General Fund	9.00%	\$44.5
Fiscal Recovery Fund (0.25%)	6.00%	\$29.7
Local	0.25%	\$1.2
Transit	2.00%	\$9.9
	0.75%	\$3.7
<b>Tobacco Products</b>		
Wholesale Sales	n.a.	\$38.8
<b>Excise Taxes</b>		
Proposition 99	45.13%	\$17.5
Proposition 10	28.66%	\$11.1
	16.47%	\$6.4
<b>Sales and Use Taxes</b>		
Retail Mark-Up Over Wholesale Price	35%	n.a.
Estimated Value of Retail Sales	n.a.	\$52.4
Sales and Use Taxes, Total		
State General Fund	9.00%	\$4.7
Fiscal Recovery Fund (0.25%)	6.00%	\$3.1
Local	0.25%	\$0.1
Transit	2.00%	\$1.0
	0.75%	\$0.4
<b>Total Excise and Sales and Use Taxes</b>		<b>\$154.5</b>
Totals may not sum due to rounding.		

## COMMENTS

- 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.
- 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:

---

*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.*

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
<b>Total</b>	<b>\$9,272,000</b>	<b>\$10,240,000</b>	<b>\$11,602,000</b>

3. **The fees generated by this bill 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,<sup>3</sup> while the County of Los Angeles charges a \$235 annual fee for a county tobacco retail license.<sup>4</sup>
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

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

<sup>4</sup> County of Los Angeles, Tobacco Retail License:

[http://www.lapublichealth.org/tob/pdf/Retailer%20FAQ%20v.6\\_FINAL.pdf](http://www.lapublichealth.org/tob/pdf/Retailer%20FAQ%20v.6_FINAL.pdf)

*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.*

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.

## ANALYSIS

### Area of Overconcentration

*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

---

*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.*

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 prohibit the issuance of a new retail license for a location in an "area of overconcentration," which is defined as follows:

- an area where the ratio of retail licenses to population in the census tract is greater than the ratio of retail licenses to population in the county overall.

Related definitions include the following:

- "Population in the census tract" means the population as determined by the most recent United States decennial or special census. The population determination shall not operate to prevent an applicant from establishing that an increase of resident population has occurred within the census tract.
- "Population in the county" means the annual population estimate for California counties published by the Population Research Unit of the Department of Finance (DOF).

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 the license would be deemed denied.

This bill provides that the 90 days commences upon receipt of notification from the Board to 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.

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

These provisions 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.

---

*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.*

**COMMENTS**

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to prevent the proliferation of tobacco retail outlets in California communities by allowing overconcentration to be a condition for license denial.
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. **A delayed operative date would provide the Board and retailers an opportunity to successfully implement or prepare for the bill's provisions.** The Board would request a six month delayed operative date in order to identify, calculate, and determine the areas of overconcentration. This is a substantially different workload for the Board and would require the correct identification of all 38,000 licenses into census tracts. Additionally, the Board may need to obtain information from the ABC, possibly amending sharing agreements, regarding their "areas of undue concentration." Board staff would also need information from all cities and counties regarding the proper notification to the local governing body as required of the public convenience or necessity provisions. A delayed operative date may allow current and prospective retailers an opportunity to determine the impact of the bill and to take actions they deem appropriate.
4. **An "area of overconcentration" compares the ratio of retail licenses within a census tract to the ratio of retail licenses in the county.** The bill was amended to define both "population in the census tract" and "population in the county" and provides an applicant the ability to establish that an increase in population has occurred within the census tract. While these amendments addressed a concern previously expressed, there continue to be issues with the administration of these new amendments. These include, but are not limited to, the following:
  - An applicant is not prevented from establishing that an increase of resident population has occurred within the census tract. As explained by the U.S. Census Bureau, a census tract is a small, relatively permanent statistical subdivision of a county; census tracts do not cross county boundaries. All of California is covered by census tracts, which may be adjusted occasionally due to population increases or decreases. The formation, splitting, or combining of census tracts are made by local census statistical area committees. The census tract populations appear to be set every 10 years. Does the author intend that an applicant may present information to the Board

---

*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.*

- to consider a population increase in the census tract? What type of information would the applicant need to present? What standards would the Board use to evaluate a census tract population adjustment? The Board would experience an additional workload related to any presentation of this type by the applicant. Additionally, the Board would note that the applicant would only be able to address the population in the census tract and not the comparative county population. This is because the population in the county is estimated annually by the DOF.
- How often is the area of overconcentration updated? Would the information be readily available to potential applicants? Would the Board have to adjust and make public the “area of overconcentration” ratios for each county and each census tract within the county? The Board would anticipate that the “area of overconcentration” ratio would be of interest to potential retail applicants and that the information could be updated at least annually, after release of the DOF population estimate for California counties. Based upon the ratios the Board would be authorized to either issue additional licenses or further restrict licenses. The Board could experience additional workloads related to the computation and dissemination of this information.
  - Should the Board issue licenses in an area of overconcentration in the order they are received? This bill previously had a provision which placed a cap on the number of licenses in a county. The Board would have issued the retail licenses to qualified applicants in the order in which the applications were received. This requirement does not apply to licenses issued in an area of overconcentration. Did the author intend for the Board to have discretion in issuing licenses to qualified applicants in an area of overconcentration?
  - There could be inconsistency between the ABC and the Board in determining the population within a census tract. Section 23958.4 of the ABC Act has a similar definition for “population within the census tract or census division.” As a matter of consistency in state administration it may be necessary for the ABC and the Board to coordinate any population adjustments to the census tract. To that end, the Board may need to create or revise an information sharing agreement. To the extent that the ABC and Board have requests for the same counties within a similar time frame, and coordinate the census tract population adjustments, the Board may be able to save costs.
5. **What would the effect be if there are areas of overconcentration?** If there is a determination that there are existing areas of overconcentration, the Board would be able to renew, reinstate, and allow for the transfer of an existing license in the affected area. The Board would also be authorized to issue a “new license” to a retailer in the area of overconcentration when the local governing body determines that public convenience or necessity would be served by issuance of the license. The Board would otherwise be precluded from issuing a “new license” until the ratio in the census tract is equal to or less than the ratio in the county. This could have the same effect as a moratorium.
6. **“Public convenience or necessity” applies to license issuance for locations within an “area of overconcentration” and this exception should be a local government responsibility.** Local governments would be allowed to make a determination that a location within an area of overconcentration should be issued a retail license because of “public convenience or necessity.” The Board maintains

that the “public convenience or necessity” determination should only be a local government issue.

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.

7. **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 bill (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 bill is intended to address youth smoking and not the administration and collection of cigarette and tobacco products taxes, it is unclear how this bill 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 bill could result in a 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 taxes<sup>5</sup>, are being used to fund enforcement of youth smoking.

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

---

<sup>5</sup> R&TC §§30124, 30125, 30131.3 and 30131.4.

California was running at a rate of approximately \$182 million, along with \$94 million in tax on other tobacco products.<sup>6</sup>

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, 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 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 bill would not increase taxes, but rather restricts the number of retail licenses that may be issued by the Board. The restriction of licenses in an area of overconcentration may 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, this bill 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. **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

---

<sup>6</sup> <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>

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 limiting effect on the issuance of retail licenses that this bill 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 cigarette and tobacco products 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 if the location is in an area of overconcentration.

### **Retail Proximity to a School**

*Business and Professions Code Section 22973.4*

## **ANALYSIS**

### **CURRENT LAW**

As previously explained, the Board administers the Cigarette and Tobacco Products Licensing Act of 2003, which includes, among other things, the licensing of retail locations that sell cigarette and tobacco products.

---

*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.*

**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.

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 bill 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. **Purpose.** This provision is intended to strengthen California's tobacco control laws and prevent youth from using tobacco.
2. **The June 1, 2009 amendments** prohibit the issuance of a retail license for a location within 600 feet of a school, except as provided, and to restrict the number of licenses in an area of overconcentration, as specified. The provision related to the restriction of the total number of retail licenses in a county was deleted. **The May 18, 2009 amendments** allowed DPH to petition the Board to adopt regulations related to "traditional" retailers, provided local governments with the exclusive authority to grant public convenience or necessity determinations, and specified 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.

---

*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.*

3. **Board's mission and tasks.** As previously discussed, 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. **A delayed operative date would provide the Board and retailers an opportunity to successfully implement or prepare for the bills provisions.** The Board would request a six month delayed operative date in order to successfully implement a process to identify current or future retail locations and determine their proximity to a school. This is a substantially different workload for the Board as there are no similar existing retailer limitations. Additionally, the Board would need to work out details, possibly amending sharing agreements, with the ABC in order to administer the prohibition of retail locations within 600 feet of a school. Board staff would also need information from all cities and counties regarding the proper notification to the local governing body as required of the public convenience or necessity provisions. A delayed operative date may allow current and prospective retailers an opportunity to determine the impact of the bill and to take actions they deem appropriate.
5. **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. 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.
6. **"Public convenience or necessity" also applies to license issuance for locations within 600 feet of a school, and this exception should be a local government responsibility.** Local governments would be allowed to make a determination that a location within an area of overconcentration should be issued a retail license because of "public convenience or necessity." The Board maintains that the "public convenience or necessity" determination should only be a local government issue.

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.

7. **How does the retail proximity to a school restriction affect existing retailers and locations?** If enacted, this bill would be effective January 1, 2010, and the

---

*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.*

proposed retail license restriction related to a retail location's proximity to a school would not apply to the renewal, or reinstatement of a retail license. Those retail locations that are currently licensed would be able to renew or reinstate their license despite the possibility of being located within 600 feet of a school. However, there are no provisions for the transfer of a license for a retail location within 600 feet of a school.

8. **How would the Board handle the proximity to schools prohibition and the "area of overconcentration" restriction?** As the prohibition of license issuance for a retail location within 600 feet of a school applies statewide, and therefore countywide, the Board would first apply this restriction. The Board would then investigate a license application to determine if a retail location is within an area of overconcentration. This could present a license applicant with the potential of having to petition the local governing body to provide a public convenience or necessity exemption for both the retail proximity to a school and in an area of overconcentration. While this would be an administrative process handled by the local governing body, the Board would still need to notify the local governing body that a license application fitting the applicable restrictions has been filed with the Board. Conversely, the Board would need to receive the finding(s) of public convenience or necessity from the local governing body in order to issue a license for a retail location within an area of overconcentration or in proximity to a school.
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 this bill. 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 bill is intended to address youth smoking and not the administration and collection of cigarette and tobacco products taxes, it is unclear how this bill 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 bill 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

---

*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.*

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 taxes<sup>7</sup>, are being used to fund enforcement of youth smoking.

**10. Related legislation.** SB 400 (Corbett) was gutted and amended to revise the definition of “tobacco products” for purposes of the Cigarette and Tobacco Products Licensing Act to include a battery-powered device that can provide inhaled doses of nicotine by delivering a vaporized solution (known as electronic cigarettes).

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 601 was held under submission by the Senate Appropriations Committee.

SB 602 (Padilla) amends provisions of the Licensing Act to revise 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 to administer the annual license fee provision. Although the Board currently collects a one-time fee, the annual fee would be ongoing and would not be pro-rated, however, license renewal dates would be synchronized and renewed on the same date. The Board would need to notify retailers, rewrite computer programs, revise applications and publications, and answer inquires from licensees.

The provisions related to administering licenses in an “area of overconcentration” would result in significant administrative costs. The Board would need to notify retailers, revise applications and publications, develop procedures to define and identify areas of overconcentration, develop regulations and procedures to notify local governments, develop regulations and procedures to identify and issue licenses to retailers in an area of overconcentration, develop procedures to investigate retail licenses consistent with the restrictions, address legal issues, and answer inquires from licensees. The Board may experience increased workloads related to census tract population revisions, and licensing enforcement and tax evasion.

The Board would likewise incur additional administrative costs to administer the retailer proximity to a school provision: similarly notifying retailers, revising applications and publications, developing procedures to identify locations near schools, developing procedures to investigate retail licenses consistent with the restrictions, addressing legal issues, and answering inquires from licensees.

The costs associated with administering the provisions in this bill, operative January 1, 2010, were estimated to be \$2.7 million for fiscal year 2009-10, \$2.5 million for fiscal year 2010-11, and \$2.2 million for fiscal year 2011-12 and each fiscal year thereafter.

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

---

<sup>7</sup> R&TC §§30124, 30125, 30131.3 and 30131.4.

**REVENUE ESTIMATE****BACKGROUND, METHODOLOGY, AND ASSUMPTIONS****Annual License Fee**

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).

**Area of Overconcentration and Retail Proximity to a School**

Board data show that there are about 38,000 licenses for retail locations selling cigarettes and tobacco products. The total number of retailer licenses has remained close to 38,000 since the licensing program began in 2004. While the total number of licenses has remained at this level for many years, Excise Taxes Division staff typically grant new licenses to about 16 percent of this total every year, while the same percentage of licenses are closed out every year. Since this bill applies to new licenses issued after January 1, 2010, existing licensees are "grandfathered," under the bill. However, with a 16 percent annual turnover rate, an average of 6,080 new licenses will be needed to maintain existing sales operations, unless they are transferred.

While we have no specific data, we believe that many of these licenses are granted for existing businesses at existing locations that are sold or change legal organization or for stores in reasonably close proximity to existing locations.<sup>8</sup> An unknown number of these new licenses are likely to be in areas of overconcentration. Under this bill there appear to be two methods to maintain existing retail sales operations for retailers who sell their business or who change their legal organization, but do not change their location. One method is to transfer the license with the sale of a retail business or a change in the legal organization of the business. It seems likely that transfers of licenses will become a common business practice when businesses are sold. The second method is to appeal to the local governmental authority to determine public convenience or necessity so that a license may be issued by the Board. It seems likely that existing retailer locations could remain licensed under either of these two provisions.

Some new licenses are also granted to serve populations expanding geographically into new areas. It seems reasonable to assume that as economic development takes place in large tracks of land, it is likely to not be in areas of overconcentration. As population comes into a previously unpopulated area, retailers can obtain new licenses and sell cigarettes to these residents up to the point of overconcentration.

We have no data for current licenses for locations within 600 feet of schools. Some existing retail businesses within 600 feet of schools may be sold, while others move short distances. Some of these prospective licensees may not receive licenses. To the extent that licenses are not granted under these conditions, there will likely be some revenue losses because it would be less convenient for people to buy cigarettes or tobacco products. We assume that these revenue losses would be negligible.

---

<sup>8</sup> An example of a change in the legal organization of a business is changing from a sole proprietorship to a limited liability corporation or a partnership.

**REVENUE SUMMARY****Annual License Fee**

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

**Area of Overconcentration and Retail Proximity to a School**

The revenue impacts of the bill attributable to areas of overconcentration and retail proximity to a school are likely to be negligible.

Analysis prepared by:	John Cortez	(916) 445-6662	07/07/09
Revenue estimate by:	Joe Fitz	(916) 323-3802	
Contact:	Margaret S. Shedd	(916) 322-2376	
ls			0603-3jc.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 Board's formal position.*