



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

| | | | |
|----------------|---|----------|---|
| Date Amended: | 06/27/05 | Bill No: | AB 1749 |
| Tax: | Cigarette and Tobacco Products Licensing Act | Author: | Assembly Governmental Organization Committee |
| | Cigarette and Tobacco Products | | |
| Related Bills: | | | |

BILL SUMMARY

This bill contains **Board of Equalization-sponsored provisions** that would accomplish the following:

- Amend Section 22978.4 of the Business and Professions Code to require each distributor and each wholesaler to include on each invoice the date the cigarettes or tobacco products are sold.
- Amend Sections 22978.7 and 22979.7 of the Business and Professions Code to clarify the penalty for second or subsequent violations of the Cigarette and Tobacco Products Licensing Act (Act).
- Amend Section 22979.2 of the Business and Professions Code to include imported cigarettes when computing the administration fee for manufacturers and importers that begin operations after January 1, 2004.
- Amend Section 22980.2 of the Business and Professions Code to clarify that continued sales of cigarettes and tobacco products without a license would constitute a violation of the Act and result in the seizure of such products in the possession of the person by the Board or a law enforcement agency.
- Add Section 30361.5 to the Revenue and Taxation Code to apply excess tax reimbursement to persons that represent amounts as reimbursement for taxes imposed upon the distribution of tobacco products when such amounts are computed upon an amount that is not taxable or is in excess of the tax amount.

In addition to the Board-sponsored provisions, this bill also contains provisions sponsored by the author that would require each distributor and each wholesaler to include the amount of excise taxes due to the Board by the distributor on the sale of cigarettes and tobacco products on each sales invoice. The bill would allow an exception to that requirement for a distributor that is also a retailer and instead require such person to include either one of the following on each invoice for the sale of cigarettes or tobacco products:

- A statement that reads: "All California cigarette and tobacco product taxes are included in the total amount of this invoice."
- The amount of excise taxes due to the Board by the distributor on the distribution of cigarettes 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.

Summary of Amendments

This bill was amended to require each distributor and wholesaler to include on each sales invoice the date cigarette or tobacco products are sold, and allow a distributor that is also a retailer the option to include the amount of excise taxes due to the Board by the distributor or a specified statement. The amendments also make it a violation of the Act and authorize the Board or a law enforcement agency to seize cigarettes and tobacco products in the possession of the person for continued sales without a license, and make other non-substantive technical amendments.

ANALYSIS

Revises the distributor and wholesaler invoicing requirements for the sale of cigarettes or tobacco products

Business and Professions Code Section 22978.4

Current Law

Under current law, Section 22978.4 of the Business and Professions Code requires each distributor and each wholesaler to include specified information on each invoice for the sale of cigarettes or tobacco products. This information includes, in part, the name, address, and telephone number of the distributor or wholesaler and the statement "All California cigarette and tobacco product taxes are included in the total amount of this invoice." Failure to comply with the invoicing requirements is a misdemeanor and punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment.

The invoicing provisions currently do not require distributors and wholesalers to include the date the cigarettes or tobacco products were sold on invoices for the sale of such products.

Proposed Law

This bill would amend Section 22978.4 to require distributor and wholesaler invoices for the sale of cigarettes or tobacco products to include the date such products were sold, which would assist Board investigators in verifying a retailer's tax paid product.

The bill would also revise the requirement that each distributor and wholesaler include the statement "All California cigarette and tobacco product taxes are included in the total amount of this invoice" on each invoice for the sale of cigarettes or tobacco products. Instead, such invoices would include the amount of excise taxes due to the Board by the distributor on the sale of cigarettes and tobacco products. However, a distributor that is also a retailer would have the option to include either one of the following on each invoice for the sale of cigarettes or tobacco products:

- A statement that reads: "All California cigarette and tobacco product taxes are included in the total amount of this invoice."
- The amount of excise taxes due to the Board by the distributor on the distribution of cigarettes and tobacco products.

Background

In 2003, AB 71 (Ch. 892, J. Horton) enacted the Cigarette and Tobacco Products Licensing Act of 2003. Among other things, the Act required every distributor and every wholesaler to annually obtain and maintain a license to engage in the sale of cigarettes and tobacco products. The Act imposed various record-keeping requirements upon distributors and wholesalers, including invoicing for the sale of cigarettes and tobacco products under Section 22978.4. As enacted, each distributor and wholesaler invoice for the sale of cigarettes or tobacco products was required to include the amount of the excise taxes due to the Board by the distributor on the sale of cigarettes and tobacco products. The purpose of the requirement was to prove intent to evade the excise tax if shown on a distributor or wholesaler invoice when such tax has not been paid to the state to allow for criminal prosecution.

In 2004, AB 3092 (Ch. 822, J. Horton) amended Section 22978.4 to replace the invoice requirement to include the amount of excise taxes due to the Board by the distributor on the sale of cigarettes and tobacco products with the statement “All California cigarette and tobacco products taxes due to the board by the distributor on the sale of cigarettes and tobacco products.” This amendment was intended to address a problem that some distributors and wholesalers had complying with the requirement that sales receipts/invoices must state the exact amount of excise taxes paid in each transaction of cigarettes and tobacco products. The problem for these distributors and wholesalers was that they did not have the software that would allow them to break out the exact amount of excise taxes paid, particularly when their inventory of the same name brand products is purchased at different prices. Changing the reporting requirement on the invoice relieved the distributors and wholesalers of this problem while maintaining the distributors and wholesalers knowledge and intent that all California cigarette and tobacco product taxes have been paid.

Comments

1. **The date the cigarette or tobacco products are sold.** Including the date on each distributor and wholesaler invoice for the sale of cigarettes and tobacco products would be an important tool to allow Board investigators to match cigarettes and tobacco products on a retailer’s shelf to distributor or wholesaler invoices for the purpose of verifying tax paid product.
2. **The excise taxes due to the Board by the distributor.** This amendment would require each distributor and each wholesaler to include the amount of excise taxes due to the Board by the distributor, unless otherwise specified, on each distributor and wholesaler sales invoice. A distributor that is also a retailer would be authorized to include the amount of tax due to the Board by the distributor or the statement specified in existing law. This amendment would continue to prove knowledge and intent to evade the excise tax when such tax has not been paid to the state.

However, Board staff is concerned that this amendment could be problematic for wholesalers. The tobacco products tax is based on the wholesale cost of such products, which could fluctuate based on variables such as the distributor purchased from and the time of purchase. As such, the tobacco products tax due to the Board by a distributor on the same name brand of tobacco products in a wholesaler's inventory could vary. For example, a wholesaler purchases several identical cans of chewing tobacco¹ from two distributors in a number of transactions. The excise tax paid by the distributor on the chewing tobacco in each transaction is separately stated on its sales invoice to the wholesaler, but is different depending on which distributor the product was purchased from and the timing of the purchase. When the wholesaler resells the cans of chewing tobacco to another wholesaler or retailer, it would seem difficult for that wholesaler to include the amount of excise tax due to the Board by the distributor for each can of chewing tobacco.

For the purpose of proving knowledge and intent to evade the excise tax for criminal prosecution, either of the following is workable for the Board:

- A statement that reads: "All California cigarette and tobacco product taxes are included in the total amount of this invoice."
- The amount of excise taxes due to the Board by the distributor on the distribution of cigarettes and tobacco products.

Clarify the penalty for second or subsequent violations of the Act
Business and Professions Code Sections 22978.7 and 22979.7

Current Law

Under current law, Section 22974.7 of the Business and Professions Code provides that in addition to any other civil or criminal penalty provided by law, upon a finding that a retailer has a second or any subsequent offense of any provision of the Cigarette and Tobacco Products Licensing Act of 2003, the Board may, in addition to revoking or suspending the license or licenses of the retailer, impose a civil penalty in the amount not to exceed the greater of five times the retail value **of the seized** cigarettes or tobacco products, or five thousand dollars (\$5,000).

Sections 22978.7 and 22979.7 are identical to Section 22974.7 with the exception of the amount of civil penalty relating to the civil penalty amount of five times the retail value of the cigarettes or tobacco products **seized**.

Proposed Law

This bill would amend Section 22978.7 and 22979.7 to clarify that in the case of a second or any subsequent offense, the civil penalty would apply to the retail value of the **seized** cigarettes or tobacco products, consistent with Section 22974.7.

¹ Tobacco products

Comment

Current Sections 22978.7 and 22979.7 are ambiguous as to what the basis for retail value of cigarettes or tobacco products is to be used to compute the civil penalty. For example, would the civil penalty be computed based on the retail value of cigarettes or tobacco products seized or the retail value of all cigarette or tobacco products inventory?

Include imported cigarettes when computing the administration fee for manufacturers and importers that begin operations after January 1, 2004

Business and Professions Code Section 22979.2

Current Law

Under current law, Section 22979.2 of the Business and Professions Code requires that, **on or before January 1, 2004**, every manufacturer and every importer pay to the Board an administration fee. The amount of the administration fee is one cent (\$0.01) per package of cigarettes (1) manufactured or imported by the manufacturer or the importer and (2) shipped into this state during the 2001 calendar year as reported to the Board.

All manufacturers and all importers that begin operations in the state **after January 1, 2004** are charged a fee commensurate with their respective market share of (1) *cigarettes manufactured or imported by the manufacturer* and (2) sold in this state during the next calendar year as estimated by the Board. The amount of the fee may not be less than that paid by the smallest manufacturer that began operations prior to January 1, 2004, but may not be more than that paid by the eighth largest manufacturer.

Proposed Law

This bill would amend Section 22979.2 to correct an inadvertent drafting error to clarify that cigarettes manufactured or imported by the importer would be used to compute the administration fee for importers that begin operations after January 1, 2004. This would be consistent with the computation of the fee for importers that commence business on or before January 1, 2004.

Comment

The calculation of the administration fee for importers that begin operations after January 1, 2004 is not consistent with the calculation for importers that began operations on or before January 1, 2004. The fee calculation for manufacturers and importers that begin operations after January 1, 2004 does not consider cigarettes manufactured or imported by the importer.

Clarify that continued sales without a license would constitute a violation of the Act and result in the seizure of all cigarette and tobacco products in the possession of the person by the Board or a law enforcement agency

Business and Professions Code Section 22980.2

Current Law

Under current law, Section 22980.2 of the Business and Professions Code provides that a person or entity that engages in the business of selling cigarettes or tobacco products in this state **without a license** or after a license has been suspended or revoked is guilty of a misdemeanor. Such a violation is punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment.

Continued sales after a notification of suspension or revocation is a misdemeanor punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment, and results in the seizure of all cigarettes and tobacco products in the possession of the person by the Board or a law enforcement agency.

Proposed Law

This bill would amend Section 22980.2 to make continued sales **without a license** a misdemeanor punishable by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment, and results in the seizure of all cigarettes and tobacco products in the possession of the person by the Board or a law enforcement agency.

Comments

Although existing law prohibits a person from engaging in the business of selling cigarettes or tobacco products in this state without a license, it does not authorize the seizure of all cigarette and tobacco products in possession of the person for continued sales without a license. Persons selling without a license would include persons that never applied or were issued a license.

With respect to Section 22980.2, the Board or a law enforcement agency is only authorized to seize cigarettes or tobacco products from persons that continue to sell such products after notification of a revocation or suspension. However, cigarettes or tobacco products in a person's possession that never had a license and continued to sell could not be seized.

This provision would make the Board's and law enforcement agency's ability to seize cigarettes and tobacco products from persons that continue to sell without a license or after a notification of suspension or revocation consistent.

Apply excess tax reimbursement to persons that represent amounts as reimbursement for taxes imposed upon the distribution of tobacco products when such amounts are computed upon an amount that is not taxable or is excess of the tax amount

Revenue and Taxation Code Section 30361.5

Current Law

Under existing Sales and Use Tax Law, when an amount represented by a person to a customer as constituting reimbursement for taxes due is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid is required to be returned by the person to the customer upon notification by the Board or by the customer that such excess tax has been collected. In the event of his or her failure or refusal to do so, the amount so paid is required to be remitted to the state. Those amounts remitted to the state will be credited by the Board on any amounts due and payable on the same transaction from the person by whom it was paid to this state and the balance, if any, shall constitute an obligation due from the person to this state.

The Cigarette and Tobacco Products Tax Law requires every distributor to pay a tax upon his or her distribution of tobacco products, based on the wholesale cost of these products, at a tax rate determined annually by the Board. Distribution is defined to mean, in part, the sale of untaxed cigarettes or tobacco products in this state. However, tobacco products distributors who import tobacco products manufactured outside of the United States (original importer) are exempt from the excise tax imposed on the distribution of tobacco if such sales are to a licensed distributor. As such, an original importer's distribution of tobacco products to a licensed California distributor is not subject to tax and the purchasing licensed distributor owes the excise tax upon their distribution of the tobacco products based upon the wholesale cost of the product.

Proposed Law

This bill would add Section 30361.5 to conform the tobacco products tax law to other tax and fee programs administered by the Board to allow the state to issue a determination for excess tobacco products tax when any person fails to return that excess tax to the customer or to remit those amounts to the state. Amounts remitted to the state would be credited to amounts due and payable from the purchasing licensed distributor, as specified.

Comment

Notwithstanding the exemption provided, the Board has found a few original importers collecting an amount represented as tobacco products tax from licensed distributors. Although these original importers may believe they are doing a favor by collecting and paying the excise tax, *it does not offset or relieve the purchasing licensed distributor's excise tax liability*. Since the tobacco products taxes are not owed by the original importer, they are eligible to claim and receive a refund of all tobacco products taxes incorrectly paid. However, existing law does not require the original importer to return amounts that were represented as tax to the purchasing licensed distributor. This imposes a hardship on licensed distributors that thought they had paid the excise tax on tobacco products only to discover that they still owe the tax, including interest, 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.

original importer is not willing to return the excess amounts collected that were represented as excise tax.

Currently the Board has twelve appeals cases as a result of audits where tobacco product taxes have been assessed against licensed distributors for their purchases from original importers where the original importer has indicated that taxes are included in the price to the distributor.

In addition, a similar issue exists for manufacturers of tobacco products as existing law provides an exemption for manufacturers where their sales are to licensed distributors.

The amendment to replace the word "person" with "customer" is intended to clarify that those excess taxes remitted to the Board by a person that collected the excess tax reimbursement would be credited by the Board on any amounts due and payable from the customer.

COST ESTIMATE

The Board would incur insignificant costs to implement the provisions of this bill.

REVENUE ESTIMATE

This bill would not impact state revenues.

| | | | |
|-----------------------|--------------|--------------|----------|
| Analysis prepared by: | Cindy Wilson | 916-445-6036 | 06/28/05 |
|-----------------------|--------------|--------------|----------|

| | | | |
|----------|-------------------|--------------|--|
| Contact: | Margaret S. Shedd | 916-322-2376 | |
|----------|-------------------|--------------|--|

mcc

1749-2cw.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.