

Memorandum

To : Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member
Honorable Bill Leonard
Honorable Steve Westly

Date : July 12, 2006

From : Ramon J. Hirsig 
Executive Director

Subject : **Bureau of State Audit's (BSA) June 2006 Report on the Board's Implementation of the Cigarette and Tobacco Products Licensing Act (AB 71)**
July 18, 2006 Board Meeting, Executive Director's Report, Item P1.1

In her report dated June 29, 2006, to the Governor and Legislative Leaders, State Auditor, Ms. Elaine Howle, concurred that the Board's implementation of the provisions of the Cigarette and Tobacco Products Licensing Act of 2003 (Act) has increased cigarette tax compliance in California and has contributed to raising state revenue. The BSA's analysis indicated total combined cigarette tax revenues were \$49 million higher in 2004 and nearly \$73 million higher in calendar year 2005. Additionally, improved compliance among tobacco product retailers led to a 38.9 percent increase in revenue totaling \$14 million in 2004. The BSA report concluded that the most likely reason for these increases was the implementation of the Act.

The BSA does recommend in the audit that a new updated estimate of cigarette tax evasion in the state be completed.

The BSA's analysis also pointed out the following about the Board's administration of the enforcement program under the Act:

- A reasonable approach is taken in selection of retail inspection locations.
- Limited Peace Officer status was a key element to the Board's effective enforcement of the Act.
- When needed, appropriate procedures were properly expanded to include the issuance of criminal citations.
- Board Divisions follow well established procedures and protocol for conducting inspections and investigations, issuing citations, and assessing penalties for civil citations.
- Board Divisions coordinate their efforts to ensure that all entities involved in the sale of cigarettes and tobacco products comply with the act.
- Board Divisions continue to license new entities and ensure that transfers between existing entities are properly licensed, and all applicable fees collected.
- Board Divisions maintain information on licensees, ensure that wholesalers and distributors stay current with their annual license fees, and makes certain that retailers renew their licenses annually.
- Because Board approved procedures are followed, case-to-case consistency is maintained. This consistency has ensured the proper enforcement of the Act.

In terms of further improvements, the Board staff is currently preparing an updated estimate of cigarette tax evasion in the state. The Board's last estimate was prepared for Fiscal Year 2001-2002 and reflected cigarette tax evasion at \$292 million dollars a year. The State Auditor believes that some factors used by the Board to calculate the benefits of the Act are overstated, because they are based on the results of cigarette inspections possibly in atypical areas where illicit cigarette sales are more likely to occur.

The Board's Chief Economist, Mr. Joe Fitz, is working with the Investigations Division (ID) and Excise Taxes Fees Division (ETFD) in order to develop an updated estimate of the underground economy with regard to cigarette and tobacco tax evasion. Mr. Fitz is in the process of collecting post-Act implementation data for his re-calculation of a more reliable figure for California's cigarette tax evasion. Although ID did focus enforcement in atypical areas, as pointed out in the report, further calculations and projections will take into account this factor, which may or may not affect the estimated amount of tax evasions.

Please feel free to contact Gil Haas, Chief of ID, at 324-2684 or Chief Counsel Kristine Cazadd at 445-4380 if you have any further questions or concerns.

RJH:sj

cc: Ms. Audrey Noda
Mr. Neil Shah
Mr. Alan LoFaso
Ms. Barbara Alby
Ms. Marcy Jo Mandel
Ms. Kristine Cazadd
Mr. David Gau
Ms. Margaret Shedd