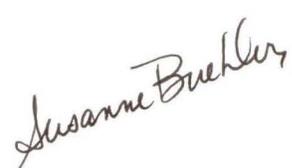


**M e m o r a n d u m**

To: Honorable Diane L. Harkey, BTC Chair  
Honorable George Runner, First District  
Honorable Fiona Ma, CPA, Second District  
Honorable Jerome E. Horton, Fourth District  
Honorable Betty T. Yee, State Controller

Date: May 25, 2016

From: Susanne Buehler, Deputy Director  
Business Tax and Fee Department (MIC 43) 

Subject: **Board Meeting, June 14-15, 2016**  
**Business Taxes Committee**  
**Request approval to publish Proposed Regulation 4001, *Retail Stock***

Staff requests your approval and authorization to publish proposed Regulation 4001, *Retail Stock* (Exhibit 1). The proposed regulation defines the term “retail stock” as it relates to the Cigarette and Tobacco Products Tax.

**I. Background**

Tax is imposed on the “distribution” of cigarettes and tobacco products. Revenue and Taxation Code (RTC) section 30008 of the Cigarette and Tobacco Products Tax Law defines “distribution” as the sale or use of untaxed cigarettes and tobacco products or “the placing in this state of untaxed cigarettes or tobacco products in a vending machine or in retail stock for the purpose of selling the cigarettes or tobacco products to consumers.” However, while the statute mentions “retail stock,” the term is not defined either in the statute or by regulation. This has led to inconsistent interpretations of what constitutes retail stock. Because retail stock must be comprised of tax-paid products only, it is essential that clear guidelines are promulgated to assist sellers, in particular those businesses that are both distributors and retailers.

This topic was originally presented at the January 2016 Business Taxes Committee Meeting. At that meeting, Service Employees International Union (SEIU) shared its concerns with staff’s proposed language. The Board recommended staff hold an additional interested parties meeting to further discuss proposed Regulation 4001. Additional submissions were received, and staff presented the topic at the March 30, 2016, Business Taxes Committee Meeting. At this meeting, the Board instructed staff to continue to work with the interested parties and to develop one recommendation that could be agreed upon by all parties. Staff continued to communicate with the interested parties, and received suggested language submitted jointly by Mr. James Dumler of McClellan Davis and SEIU. Based on review of the submission, staff has changed its recommendation to incorporate the proposed joint submission of regulatory language (hereinafter referenced as “staff recommendation”).

## II. Staff's Recommendation

Staff recommends the Board approve and authorize publication of proposed Regulation 4001, as provided in Exhibit 1. The proposed regulation will create consistent and clear definitions of terminology frequently used in the taxation of cigarette and tobacco products. The proposed regulation also provides several examples to help business owners interpret the different terms. The additional clarification and examples demonstrating when items are retail stock will allow business owners to more easily determine when their products have been placed into retail stock. This will allow them to more easily identify when excise tax is due on their products. In addition to defining the term, the proposed regulation:

- includes examples to help clarify the application of tax;
- provides examples of secured areas where products not considered retail stock can be stored;
- explains that when a person is both a licensed retailer and a licensed distributor and makes all sales to retail customers, all inventory is held in retail stock;
- provides a presumption of distribution for products no longer in the distributor's possession; and
- explains how distributors can overcome this presumption.

## III. Revisions from March 30, 2016, submission

### Additional Examples (a)(2) and (a)(2)(A)

Additional examples have been added at the suggestion of SEIU to help define storage areas for products not considered "retail stock." By providing additional examples, taxpayers are given a more thorough understanding of how and where they can keep these products. Staff believes this will help retailers avoid citations for not storing "non-retail stock" items properly.

### Sales for resale to other licensees (b)

The language in this subdivision has been agreed upon by both staff and interested parties. This verbiage is the same as staff's recommended language presented on March 30, 2016. SEIU's recommendation, included in staff's March issue paper, had the term "substantially all" in place of "any." However, since this topic was last presented, SEIU and staff have agreed that "any" is sufficient, and the staff recommended language for (b) will work for all parties.

### Examples of evidence that may overcome the distribution presumption (c)(2)

Based on SEIU's recommendations, timely filed police reports and purchase invoices have been designated as required in overcoming the presumption of distribution. Maintaining current purchase invoices is required by law, so adding this requirement is reinforcing the importance of record retention. In addition, most interested parties felt if a theft occurred, requiring a police report was reasonable, as many business owners normally file a police report as a part of their business practices. Accordingly, making this a filing requirement would not be burdensome.

## IV. Conclusion

Staff requests approval of proposed Regulation 4001, *Retail Stock*. By providing definitions and examples, this regulation will clarify the law helping taxpayers make educated business decisions in regards to retail stock.

Approved



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Mr. David J. Gau  
Executive Director

SB:ls

Attachment

cc: Mr. Russell Lowery  
Mr. Sean Wallentine  
Ms. Genevieve Jopanda  
Ms. Kari Hammond  
Ms. Yvette Stowers  
Mr. David J. Gau  
Mr. Randy Ferris

**Regulation 4001. Retail Stock.**

**(a)** “Retail stock” means and includes:

(1) All cigarettes and tobacco products intended and available for sale to consumers by a person who holds a retailer license; and

(2) All cigarettes and tobacco products displayed for sale to consumers by a person who concurrently holds a distributor license and a retailer license at the same location. Cigarettes and tobacco products that are stored in the area where retail sales are made are deemed to be retail stock. Cigarettes and tobacco products that are securely stored away from the area where retail sales are made, are not considered retail stock. Examples of separated and segregated from retail stock include, but are not limited to, the following secured areas:

- store room or closet,
- back office,
- inside a locked cabinet, safe or other similar storage container, or
- behind a locked wire-cage door or similar encumbrance.

Untaxed cigarettes and tobacco products must be in the original manufacturer packaging, with an unbroken seal, and they must be secured, segregated, and separated from inventory accessible by consumers. Untaxed tobacco products must be segregated and secured separately from tax-paid tobacco away from the retail area.

(A) Walk-in humidors. Tobacco products inside a walk-in humidor displayed for sale to consumers are retail stock. Tobacco products inside a walk-in humidor in the original manufacturer packaging with an unbroken seal, secured, segregated and separated from retail stock, and not displayed for sale to consumers, are non-retail stock. Examples of separated and segregated from retail stock include, but are not limited to, the following:

- inside a locked cabinet, safe or other similar secured storage container, or
- behind a locked wire-cage door or similar encumbrance.

(b) A person who is both a licensed retailer and a licensed distributor, but who only makes retail sales to consumers and does not make any sales for resale to other licensees, holds all inventory intended for sale in retail stock.

**(c)** Presumption of Distribution

(1) All cigarettes and tobacco products placed in retail stock have been distributed. Tax is due upon distribution.

(2) Unless the contrary is established, it shall be presumed that all cigarettes and tobacco products no longer in a distributor’s possession, including when they have been lost through an unexplainable disappearance, have been distributed. The presumption may be rebutted by a preponderance of the evidence demonstrating that an explainable disappearance, such as theft, has occurred.

Examples of evidence that may overcome the presumption include, but are not limited to, the following:

- (A) Police reports (Required and must have been filed timely)
- (B) Insurance claims
- (C) Insurance reimbursements
- (D) Video surveillance
- (E) Photographs
- (F) Detailed tobacco inventory reports
- (G) Cigarette and tobacco purchase invoices (Required)
- (H) Proof of prosecution related to charges of theft of cigarettes or tobacco products

Note: Authority: Sections 30008, 30109, Revenue and Taxation Code.