



STATE BOARD OF EQUALIZATION

PROPERTY AND SPECIAL TAXES DEPARTMENT
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State Controller

CYNTHIA BRIDGES
Executive Director

January 4, 2013

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the January 15, 2013, Business Taxes Committee (BTC) meeting. This meeting will address proposed Regulation 4801, *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person* and request publication of amendments to Regulations 4601, 4603, 4604 and 4605, approved at the June 26, 2012, BTC meeting.

Action 1 on the Agenda concerns proposed Regulation 4801 of the Cigarette and Tobacco Products Licensing Act (Act) which formalizes the Board's current policy and documentation requirements on transfers of cigarettes and tobacco products between retail stores owned by the same person.

Action 2 on the Agenda concerns approved amendments to Regulation 4601, *Service of a Notice of Violation or Warning Notice*, and Regulations 4603, 4604 and 4605 which provide Board staff additional flexibility in setting suspension periods for violations of the Act when mitigating circumstances are present.

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in these issues. Thank you for the input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m. on January 15, 2013**, in Room 121 at the address shown above.

Sincerely,

David J. Gau, Deputy Director
Property and Special Taxes Department

DJG:pb

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District (MIC 72)
Honorable Michelle Steel, Vice Chair, Third District (MIC 77)
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. Robert Thomas, Board Member's Office, Fourth District
Mr. Joel Angeles, Board Member's Office, Third District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Yvette Stowers, Board Member's Office, First District
Mr. Andrew Jacobson, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges
Mr. Randy Ferris
Ms. Lynn Bartolo
Mr. Robert Tucker
Mr. Stephen Smith
Mr. Todd Gilman
Mr. Randy Silva
Mr. Bill Benson
Ms. Kirsten Stark
Ms. Debbie Kalfsbeek
Mr. Phillip Bishop
Ms. Lynn Whitaker
Mr. Barry Ivy

AGENDA — January 15, 2013 Business Taxes Committee Meeting
Proposed Regulation 4801 Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person

Action Item	Regulatory Language Proposed by Staff	
<p>Action 1 - Proposed Regulation 4801</p>	<p><u>(a) GENERAL. Every retailer of cigarettes and tobacco products is required to maintain purchase invoices for all cigarettes and tobacco products purchased and make those invoices available for inspection by the Board or a law enforcement agency. A licensed retailer owning multiple locations who wishes to transfer cigarettes and tobacco products between its licensed locations shall prepare a transfer log or document at the time of transfer and maintain the records for four years from the date of transfer. A copy of the transfer log or document, accompanied by a copy of the original purchase invoice(s) documenting the purchase of each item transferred, must be kept at both the transferring and receiving locations involved in the transfer for at least one year after the transfer. These transfer logs or documents will be utilized by Board staff for inventory reconciliation and must be provided upon request at the time of the inspection. Copies of original purchase invoices may be maintained at the receiving location on alternative storage media as prescribed in Regulation 4901 (h). The taxpayer must provide facilities and equipment for reading, locating, and reproducing any invoices maintained on alternative storage media.</u></p> <p><u>(b) SPECIFIC APPLICATION. The transfer log or document shall show the following:</u></p> <p>(1) <u>The transferring retail location, license information, supplier’s name, invoice number, and the date the bulk cigarettes and tobacco products purchase was made;</u></p> <p>(2) <u>The receiving retail location(s), license information, and date the cigarettes and tobacco products were transferred; and,</u></p> <p>(3) <u>A legible itemized listing of cigarettes and tobacco products transferred using the description as found on the original invoice, including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.</u></p>	

AGENDA — January 15, 2013 Business Taxes Committee Meeting
Proposed Regulation 4801 Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person

Action Item	Regulatory Language Proposed by Staff	
Action 1 cont.	<p><u>(c) The transfer of cigarettes and tobacco products shall only be allowed when the legal entity licensed as the retailer for the retail location transferring the cigarettes and tobacco products is the same legal entity that is licensed as the retailer at the retail location receiving the cigarettes and tobacco products. As an example, a transfer between a location licensed as a sole proprietorship and a location licensed as a partnership where the sole proprietor is one of the partners would not qualify under this section since the same legal entity does not own both locations. As another example, a transfer between a location licensed to a parent corporation and a location licensed to its wholly owned subsidiary corporation would not qualify under this section since the parent corporation and its wholly owned subsidiary corporation are separate legal entities.</u></p> <p><u>(d) Records of the transfer shall be made available to the Board or its authorized representative for examination upon request. Failure to provide such documentation when requested can result in the seizure of the cigarettes or tobacco products that are claimed to be transferred and the issuance of a citation. Transfer logs or documents not provided upon request at the time of inspection, or created or provided during or after an inspection has commenced, or created or provided after a seizure and/or citation are not acceptable and cannot be used for the return of seized product or dismissal of a violation.</u></p>	

Issue Paper Number 12-009



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposed Regulation 4801, *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

I. Issues

Should the Board of Equalization (Board) authorize publication of a new regulation, under the Cigarette and Tobacco Products Licensing Act (Act), to provide guidelines on the documentation and retention requirements for transfers of cigarettes and tobacco products between retail stores owned by the same legal entity?

II. Alternative 1 - Staff Recommendation

Item 1 - Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

Staff recommends the approval of proposed Regulation 4801 regarding transfers of cigarettes and tobacco products between retail stores owned by the same person. Approving the proposed regulation provides Board staff and licensed retailers who own multiple locations with regulatory guidance for satisfying the documentation and invoice requirements required by statute in order to establish the tax-paid status of the product being transferred. See Exhibit 2 for staff's proposed regulation.

III. Other Alternative(s) Considered

Item 1 - Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

Consider approving a regulation prohibiting the transfer of any cigarettes or tobacco products between retail locations owned by the same person, thereby creating a "bright line" prohibiting transfers as recommended by some Interested Parties.

IV. Background

On October 12, 2003, the State of California enacted the Cigarette and Tobacco Products Licensing Act (Assembly Bill 71, Horton [Chapter 890, Statutes 2003]) which established a statewide licensing program under Division 8.6 (commencing with Section 22970) of the Business and Professions Code (B&P Code). The Act imposes licensing requirements on all retailers, wholesalers, and distributors of cigarettes and tobacco products and all manufacturers and importers of cigarettes. Assembly Bill 1749 (Chapter 501, Statutes 2006) added the same licensing requirements to manufacturers and importers of tobacco products. These licensing requirements are in addition to other permits and licenses that may be required depending on a person's business operations. The Act intended to address the problem of untaxed distributions and illegal sales of cigarettes and tobacco products in California and includes provisions for new recordkeeping requirements, identifies violations that may result in license suspensions or revocations including the imposition of civil and criminal penalties, and authorizes Board staff to inspect and seize any untaxed cigarettes or tobacco products. Inspections are performed by the Board's Investigations Division (ID) staff and, based upon the findings during the course of their inspections, may result in the issuance of citations and penalties for violations.

The Act authorizes the Board to administer and enforce the provisions of the Act and to prescribe, adopt, and enforce rules and regulations relating to its administration and enforcement. Since the inception of the Act, the Board has prescribed and adopted regulations to clarify the provisions with the intent to uniformly administer and enforce the provisions of the Act, and to provide guidance and clarity of the Act's provisions to licensed and unlicensed cigarette and tobacco product retailers, wholesalers, distributors, manufacturers, and importers.

Based on recent citations and related appeals proceedings involving the seizure of cigarettes and tobacco products due to a retailer's failure to maintain documentation supporting an assertion that tax-paid product was transferred from one licensed retail location to another licensed retail location owned by the same legal entity, the Special Taxes and Fees Division was asked to develop a new regulation to formalize the Board's existing policies regarding documentation requirements for the transfer of cigarettes and tobacco products between licensed retail locations owned by the same legal entity. Transfers of cigarettes and tobacco products between licensed retail locations owned by the same legal entity excludes sales transactions of cigarettes and tobacco products between licensed retail locations which are expressly prohibited by Revenue and Taxation Code (R&T Code) section 30478.

In April 2011, Board staff provided guidance to licensees and staff on its current transfer policies through an update to Publication 78, *Sales of Cigarettes and Tobacco Products in California*, and a letter sent to 1,790 legal entities owning multiple cigarette and tobacco products licensed retail locations. Both the letter and Publication 78 provided that:

“Generally, the transfer of cigarettes and tobacco products are not permitted. However, if you own more than one store and licenses are held by the same legal entity, you may be allowed to transfer cigarettes and tobacco products between stores belonging to the same legal entity. When transferring cigarettes and tobacco products, legible transfer records and copies of the original purchase invoice must be kept at each location involved in the transfer. Such transfer records which must be prepared at the time of transfer, must include the address of each store, the purchase invoice date, the purchase invoice number, the supplier's name on the invoice, including type of packaging, flavor and or style, and the

amounts of items transferred. Failure to provide such documentation when requested can result in the seizure of the claimed transferred product.”

The above guidance represents the basis for the proposed Regulation.

Interested Parties (IP) meetings were held on March 6, 2012, and May 4, 2012. Divergent positions were taken by SEIU Local 1000, representing Business Taxes Specialists and Business Taxes Compliance Specialists in the Investigation Division,¹ and Mr. Dennis Loper, representing the California Distributors Association, who both opposed allowing transfers, and Mr. Scott Louie representing Chevron, and Mr. Ron Michelson, owner of two Briar Patch smoke shops, who both support allowing transfers. Those opposed to allowing transfers argue that the Act does not allow transfers and that only those cigarette and tobacco products sold to the licensed retailer store location may be sold at that licensed location. Those in support of allowing transfers argue that the Act does not specifically prevent transfers and not allowing transfers of cigarette and tobacco product between stores owned by the same person adds an undue burden on retailers owning more than one retail store. For a full discussion on the two IP meetings, please see the Issue Paper presented at the June 26, 2012, BTC meeting at: <http://www.boe.ca.gov/meetings/pdf/IP-Cigarette.pdf>.

Although the Act does not specifically provide for transfers of cigarette and tobacco products between retail locations owned by the same person, the Act does not preclude such transfers either. Mr. Steven Alari representing SEIU Local 1000, acknowledged at the May 4, 2012, IP meeting that there are no provisions in the Act that specifically preclude transfers. The Act requires that a retailer of cigarettes or tobacco products obtain a retailer’s license for each retail location in which cigarettes or tobacco products are sold, maintain purchase invoices that meet the requirements set forth in section 22978.4 of the B&P Code for all cigarettes or tobacco products the retailer purchased for a period of four years and that these records be maintained at the retail location for at least one year after purchase. Section 22978.4 also prescribes form and content requirements for invoices issued by distributors and wholesalers. Besides requiring distributor and wholesaler information, each invoice must contain the name, address and license number of the customer, an itemized listing of cigarette and tobacco products sold, date of sale, and the amount of excise taxes due to the Board by the distributor or a statement that reads: “All California cigarette and tobacco product taxes are included.”

A retail location is defined under section 22971 (q) of the Act as any building from which cigarettes or tobacco products are sold at retail, or a vending machine. “Sale” is defined in Section 30006 of the R&T Code as any transfer of title or possession for consideration, exchange or barter, in any manner or by any means whatever. As a result, the Act does not require a retailer to maintain a license at a warehouse or storage location from which retail sales are not made. The Act also does not require that a distributor or wholesaler deliver only to the address of the licensed retail location. Section 22978.4 (a)(4) requires that a distributor or wholesaler include on any invoice the name, address, and license number of the retailer, distributor, or wholesaler to whom cigarettes or tobacco products are sold. It does not require that the product be delivered to the address where the retail license is held. There would appear to be good reasons for not requiring such a limitation, as had such a requirement been included in the Act, traditional cash and carry purchases would be prohibited, and vending machine operators would only be able to take delivery at the location of a licensed vending machine, which is generally located at another person’s business. One could therefore make an argument that without such delivery limitations the Act contemplates transfers of cigarettes and tobacco products between retail or storage locations owned by the same legal entity so long as the invoice retention requirements are satisfied at each retail location.

¹ The initial position taken by SEIU Local 1000 was not supported by ID management who supports and actively participated in the drafting of proposed Regulation 4801.

V. Discussion

At the June 26, 2012 BTC meeting, staff presented proposed Regulation 4801, and requested the Board's approval and authorization to publish the proposed Regulation in order to begin formal rulemaking. Mr. Alari, representing SEIU Local 1000, was the sole public speaker. Mr. Alari reiterated his position that the Board should prohibit transfers thereby creating a "bright line" for ID staff to follow when performing inspections. Mr. Alari noted that allowing transfers further complicates the reconciling of the tobacco product purchases to the tax-paid invoices during an inspection and thereby makes it more difficult to identify evasion of the cigarette and tobacco products excise taxes. While some Board Members expressed support for staff's proposed regulation, there were also concerns raised that the regulation may not be clear in what constitutes "same legal entity." In addition, concerns were raised regarding the need for adequate inventory controls when transferring products in order to prevent the blending of tax-paid and ex-tax product and to provide ID inspectors with the documents necessary to reconcile the tobacco product inventory to their original purchase invoices in order to verify the tax-paid or ex-tax status of the product. Enhancements were also suggested to the sample transfer log to include all the required elements in the proposed regulation that are necessary to satisfy the inspectors. Therefore the matter was held over and staff was directed to work with ID and interested parties to further address these concerns in the regulation and the sample transfer log.

Same Legal Entity/Same Person

Legal entity is used in the regulation to more clearly convey the statutory definition of "person" in the Act. Person is defined in section 22971 (n) of the Act to mean a person as defined in section 30010 of the R&T Code which includes any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, trustee, syndicate, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. Person is commonly defined to include an individual man, woman, or child and is not commonly thought of in the context of the definition above, whereas, "legal entity" conveys a broader meaning, more in line with the legal definition for "person" in the Act. For purposes of the regulation "same legal entity" was used in place of "same person" to better convey the R&T Code definition of "Person."

Because of the misconception that could arise in situations involving transfers between sole proprietors and partnerships where the sole proprietor is also a partner, Regulation 4801(c) provides a specific example to address this non-qualifying transfer. To provide additional clarity and address situations involving a parent corporation making a non-qualifying transfer to its wholly owned subsidiary, another potentially problematic scenario, staff added another example to Regulation 4801(c) specifically addressing this non-qualifying situation. The following underlined changes to 4801(c) are recommended to provide additional clarity to what is meant by "same legal entity":

(c) The transfer of cigarettes and tobacco products shall only be allowed when the legal entity licensed as the retailer for the retail location transferring the cigarettes and tobacco products is the same legal entity that is licensed as the retailer at the retail location receiving the cigarettes and tobacco products. As an example, a transfer between a location licensed as a sole proprietorship and a location licensed as a partnership where the sole proprietor is one of the partners would not qualify under this section since the same legal entity does not own both locations. As another example, a transfer between a location licensed to a parent corporation and a location licensed to its wholly owned subsidiary

corporation would not qualify under this section since the parent corporation and its wholly owned subsidiary corporation are separate legal entities.

Inventory Control

A recurring concern for SEIU Local 1000 is that transfers further complicate an already complicated inspection by making it more difficult to reconcile the tobacco product inventory at the location to their original invoices to determine if they were purchased tax-paid from a licensed distributor or wholesaler. The regulation requires a document or transfer log that includes all the essential elements called for in subsection (b) of proposed Regulation 4801 along with a copy of the original invoice to be maintained at both retail locations involved in the transfer for inventory reconciliation purposes. Subsection (b) provides:

- (b) **SPECIFIC APPLICATION.** The transfer log or document shall show the following:
- (1) The transferring retail location, license information, supplier's name, invoice number, and the date the bulk cigarettes and tobacco products purchase was made;
 - (2) The receiving retail location(s), license information, and date the cigarettes and tobacco products were transferred; and
 - (3) A legible itemized listing of cigarettes and tobacco products transferred using the description as found on the original invoice including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.

In an attempt to address SEIU's concern, ID plans to update their Inspection Manual to include a requirement that an Inspector ask at the beginning of the inspection if transfers occur and if they do, to secure the transfer log at that time. Having this information upfront provides the Inspector with the knowledge of what to expect as they conduct the inspection and what will be involved as they reconcile the inventory to the invoices and transfer log at the location. To further stress the requirement that the transfer log be made available at the beginning of the inspection and that these transfer logs are necessary for inventory reconciliation, the following underlined changes are recommended to subsections (a) and (d) of Regulation 4801:

(a) **GENERAL.** Every retailer of cigarettes and tobacco products is required to maintain purchase invoices for all cigarettes and tobacco products purchased and make those invoices available for inspection by the Board or a law enforcement agency. A licensed retailer owning multiple locations who wishes to transfer cigarettes and tobacco products between its licensed locations shall prepare a transfer log or document at the time of transfer and maintain the records for four years from the date of transfer. A copy of the transfer log or document, accompanied by a copy of the original purchase invoice(s) documenting the purchase of each item transferred, must be kept at both the transferring and receiving locations involved in the transfer for at least one year after the transfer. These transfer logs or documents will be utilized by Board staff for inventory reconciliation and must be provided upon request at the time of the inspection. Copies of original purchase invoices may be maintained at the receiving location on alternative storage media as prescribed in Regulation 4901 (h). The taxpayer must provide facilities and equipment for reading, locating, and reproducing any invoices maintained on alternative storage media.

(d) Records of the transfer shall be made available to the Board or its authorized representative for examination upon request. Failure to provide such documentation when requested can result in the seizure of the cigarettes or tobacco products that are claimed to

be transferred and the issuance of a citation. Transfer logs or documents not provided upon request at the time of inspection or created or provided during or after an inspection has commenced, or created or provided after a seizure and/or citation are not acceptable and cannot be used for the return of seized product or dismissal of a violation.

In regard to blending, unfortunately due to the fungible nature of certain types of tobacco products, one invoice for tax-paid product could be used in an attempt to satisfy the invoicing requirements of purchases for tobacco products that were not tax paid. These attempts to evade tax have occurred historically and continue today within this particular industry, primarily with tobacco products because such products are not stamped. Blending may occur whether a person owns one location or multiple locations. Transfers can complicate the reconciliation, but prohibiting transfers will not prevent blending. As an example, if at the location there is never more inventory than there is tax-paid invoice support and the dates of that inventory reconcile with that of the supporting invoices, one would come to the conclusion, without other evidence, that the product on the shelf was tax paid and purchased from a licensed wholesaler or distributor. However, untaxed purchases of the same product from an unlicensed person could be comingled with the tax-paid inventory without raising suspicion so long as the shelf stock never exceeds the amount of inventory supported by tax-paid invoices.

Sample Transfer Log

Following the first IP meeting, it was suggested that an example of a transfer log would be helpful to visually depict what the regulation's required elements contemplated in regard to the documentation needed to support a transfer. The sample transfer log (Exhibit 3) is not a subsection to the regulation but an illustrative example of what a taxpayer may wish to replicate. As noted in the regulation, the taxpayer need only provide a document or transfer log in any format so long as it contains the essential elements as required in subsection (b) of the proposed regulation and is accompanied by a copy of the original invoice in either electronic or hardcopy form. It was noted at the June 26, 2012, BTC meeting that the sample log may not contain a complete enough description of the transferred product in order for ID inspectors to reconcile the tobacco product inventory to the purchase invoices. Staff proposes the following underlined changes to subsection (b)(3) of Regulation 4801:

A legible itemized listing of cigarettes and tobacco products transferred using the description as found on the original invoice including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.

Requiring a description as found on the original invoice allows ID staff to easily identify the transferred product from a variety of products with similar descriptions. This same wording "complete description from original invoice" was incorporated on the sample transfer log under the heading of "Items Transferred." In addition some of the examples were updated with complete invoice descriptions to comply with the requirements.

Comments and Summary

Proposed changes to Regulation 4801 and the Sample Transfer Log were disseminated to interested parties and concerned staff with a request that any comments be returned by August 10, 2012.

As a result of staff's recommended changes to Regulation 4801, Ms. Yvonne Walker, President of SEIU Local 1000, is no longer opposed to the proposed regulation (see Exhibit 4 for copy of letter dated November 29, 2012.)

Mr. Ron Michelson, owner of two Briar Patch smoke shops, commented on the business need for the ability to transfer tobacco products between his two stores in order to meet the needs of customers and

to keep inventory at appropriate levels. “Transferring inventory to the store where it is needed is just good business practice.” Although Mr. Michelson is supportive of the proposed regulation, he expressed some concerns with the transfer log’s format and when product transferred once is transferred again, and in those instances, being able to identify accurate vendor and invoice information. He is also concerned that inspections can occur without notice and if the proprietor or appropriate staff is not available to provide a copy of the transfer log, his tobacco inventory could be confiscated.

With respect to the format of the sample transfer log, any format will suffice so long as the required elements of the regulation are included. This information has been conveyed to Mr. Michelson and has resolved this concern. Subsequent transfers from previously transferred product poses some difficulty in identifying the original invoice from which the product was acquired, but may be remedied by identifying the invoice copy from the original transfer as being the invoice supporting the subsequent transfer. With regard to inspections, unfortunately inspections occur on a random basis without notice. Providing notice would defeat the purpose for the inspection. For instance, if a retailer was notified of an upcoming inspection and this retailer was acquiring cigarettes or tobacco product without the applicable tax they could easily remove the product from their inventory along with the invoices prior to the inspection. Maintaining copies of invoices and transfer logs for one year at the premise are required for any inspection, with or without the regulation and a required business practice in this industry. ID inspectors are known to wait for a period of time for the appropriate personnel to arrive during an inspection, but it is incumbent upon any retailer of cigarettes and tobacco products to have these documents readily available.

To acknowledge the practice of transfers of cigarettes and tobacco products within this industry, the Board has adopted procedures allowing for the transfers of cigarettes and tobacco products between retail locations owned by the same person. These procedures acknowledge the blending concern and are designed to address them through requirements that copies of invoices be maintained at both locations and a transfer log or document be available detailing the amount of product, description of product, and license information of the transferring and receiving locations. Proposed Regulation 4801 is consistent with current Board policies and procedures and is intended to provide for consistent enforcement of the documentary requirement provisions. The proposed regulation will also provide retailers with the documentation and recordkeeping requirements for these types of transfers so as to avoid seizures of the transferred products, along with avoiding citations and fines that may be assessed against the retailer for improper documentation of these transfers.

VI. Alternative 1 - Staff Recommendation

Item 1 – Adopt Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

A. Description of Alternative 1

Regulation 4801 as proposed by staff formalizes the Board’s current policy of allowing transfers of cigarettes and tobacco products between retail stores owned by the same legal entity. It requires that every retailer of cigarettes and tobacco products maintain purchase invoices for all cigarettes and tobacco products purchased and to make those invoices available for inspection by the Board or law enforcement. Licensed retailers owning more than one location may transfer product between locations so long as the retailer prepares a transfer log or other document at the time of transfer and maintains a copy of the transfer log at both the transferring and receiving location along with copies

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of applicable invoices for inspection. These records must be maintained for a period of four years with copies of the log and invoices maintained at each location involved in the transfer for a period of one year. Copies of invoices may be maintained on alternative storage media pursuant to Regulation 4901, *Records*. Facilities and equipment must be provided for reading, locating and reproducing any invoices maintained on alternative storage media.

The transfer log or document shall show the following:

- (1) The transferring retail location, license information, supplier's name, invoice number, and date the bulk cigarettes and tobacco products purchase was made;
- (2) The receiving retail location(s), license information, and date the cigarettes and tobacco products were transferred; and
- (3) A legible itemized listing of cigarettes and tobacco products transferred using the description as found on the original invoice, including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.

Proposed regulation is shown in Exhibit 2.

B. Pros of Alternative 1

- Is consistent with the Board's current policy on transfers.
- Provides regulatory support and guidance to taxpayers and staff.
- Adopts into regulation the retail industry's current business practices regarding transfers between retail stores owned by the same legal entity.

C. Cons of Alternative 1

- Requires a degree of additional verification during an inspection.
- Requires a taxpayer to prepare and maintain an additional document or log to satisfy the records requirement in section 22974 of the B&P Code.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require adoption of proposed Regulation 4801.

E. Operational Impact of Alternative 1

Minor. Although the regulation adopts current policy, staff intends to add the sample transfer log to the Board's website and appropriate publications for the tobacco industry.

F. Administrative Impact of Alternative 1**1. Cost Impact**

Absorbable.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

None, adopts current policy.

H. Critical Time Frames of Alternative 1

None.

VII. Other Alternatives**Item 1 - Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*****A. Description of Alternative**

Direct staff to draft a regulation prohibiting transfers of cigarettes and tobacco products between retail stores regardless of ownership.

B. Pros of Alternative

- Limits the invoice documentation required on site to only those invoices referencing the licensed retail location.
- Prohibition creates a “bright line” on transfers for retailers and Board staff to follow.

C. Cons of Alternative

- Eliminates a retailer’s ability to transfer product to their own stores regardless of the business situation. For instance, retailers would not be allowed to transfer product from a closed store to one that is still in business or from a store that has overbought a product that can be sold at another location. Retailers would also be prohibited from transferring inventory when a supplier is out of a product that is available at another taxpayer owned location, or when there are supplier delays in delivering a product to one retail store but the product is available at another taxpayer owned location.
- May prevent taxpayers with multiple locations from taking advantage of quantity discounts.

D. Statutory or Regulatory Change for Alternative

No statutory change required. However, since the Act does not specifically prohibit the transfer of cigarettes and tobacco products between retail stores owned by the same legal entity, a regulation prohibiting transfers should be considered.

E. Operational Impact of Alternative

Prohibiting transfers would require the Board to rescind the letter mailed April 2011 to retailers owning multiple locations that addressed the current policy allowing transfers. Staff would also need to revise Publication 78, *Sales of Cigarettes and Tobacco Products in California*, and advise industry of the policy change in other outreach materials.

F. Administrative Impact of Alternative**1. Cost Impact**

Additional mailing costs unknown.

2. Revenue Impact

None.

G. Taxpayer/Customer Impact of Alternative

A prohibition of the common practice of transferring cigarettes or tobacco products between a taxpayer's own stores could have a major impact on those retailers operating multiple licensed locations.

H. Critical Time Frames of Alternative

None.

Preparer/Reviewer Information

Prepared by: Policy and Compliance Division, Property and Special Taxes Department

Current as of: December 5, 2012



Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

I. Issues

Should the Board of Equalization (Board) authorize publication of a new regulation, under the Cigarette and Tobacco Products Licensing Act (Act), to provide guidelines on the documentation and retention requirements for transfers of cigarettes and tobacco products between retail stores owned by the same legal entity?

II. ALTERNATIVE 1 - STAFF RECOMMENDATION

Item 1 – Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

Staff recommends the approval of proposed Regulation 4801 regarding transfers of cigarettes and tobacco products between retail stores owned by the same person. Approving the proposed regulation provides Board staff and licensed retailers who own multiple locations with regulatory guidance for satisfying the documentation and invoice requirements required by statute in order to establish the tax-paid status of the product being transferred. See Exhibit 2 for staff’s proposed regulation.

III. Other Alternative(s) Considered

Item 1 – Proposed Regulation 4801 *Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person*

Consider approving a regulation prohibiting the transfer of any cigarettes or tobacco products between retail locations owned by the same person, thereby creating a “bright line” prohibiting transfers, as recommended by some Interested Parties.

Alternative 1 – Staff Recommendation

Item 1: There is nothing in Item 1 of the staff recommendation that would impact revenue. Regulation 4801 as proposed by staff formalizes the Board's current policy of allowing transfers of cigarettes and tobacco products between retail stores owned by the same legal entity. It requires that every retailer of cigarettes and tobacco products maintain purchase invoices for all cigarettes and tobacco products purchased and to make those invoices available for inspection by the Board or law enforcement. Licensed retailers owning more than one location may transfer product between their licensed locations so long as the retailer prepares a transfer log or other document at the time of transfer and maintain a copy of the transfer log at both the transferring and receiving location along with copies of applicable invoices. These records must be maintained for a period of four years with copies of the log and invoices maintained at each location involved in the transfer for a period of one year. Copies of invoices may be maintained on alternative storage media pursuant to Regulation 4901, *Records*. Facilities and equipment must be provided for reading, locating and reproducing any invoices maintained on alternative storage media.

Other Alternative(s) Considered

Item 1: There is nothing in Item 1 of the other alternative(s) considered that would impact revenue. This alternative would prohibit transfers of cigarettes and tobacco products between retail stores regardless of ownership.

Revenue Summary

Alternative 1:

Item 1 – This alternative does not have a revenue impact.

Other alternatives considered:

Item 1 – This alternative does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Acting Chief, Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Ms. Lynn Bartolo, Chief, Special Taxes, Policy and Compliance Division, Property and Special Taxes Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at 916-445-0840.

August 20, 2012

Regulation 4801. Transfers of Cigarettes and Tobacco Products between Retail Stores Owned by the Same Person.

Reference: Section 22971, 22974, 22974.3, and 22978.4, Business and Professions Code

(a) GENERAL. Every retailer of cigarettes and tobacco products is required to maintain purchase invoices for all cigarettes and tobacco products purchased and make those invoices available for inspection by the Board or a law enforcement agency. A licensed retailer owning multiple locations who wishes to transfer cigarettes and tobacco products between its licensed locations shall prepare a transfer log or document at the time of transfer and maintain the records for four years from the date of transfer. A copy of the transfer log or document, accompanied by a copy of the original purchase invoice(s) documenting the purchase of each item transferred, must be kept at both the transferring and receiving locations involved in the transfer for at least one year after the transfer. These transfer logs or documents will be utilized by Board staff for inventory reconciliation and must be provided upon request at the time of the inspection. Copies of original purchase invoices may be maintained at the receiving location on alternative storage media as prescribed in Regulation 4901 (h). The taxpayer must provide facilities and equipment for reading, locating, and reproducing any invoices maintained on alternative storage media.

(b) SPECIFIC APPLICATION. The transfer log or document shall show the following:

- (1) The transferring retail location, license information, supplier's name, invoice number, and the date the bulk cigarettes and tobacco products purchase was made;
- (2) The receiving retail location(s), license information, and date the cigarettes and tobacco products were transferred; and,
- (3) A legible itemized listing of cigarettes and tobacco products transferred using the description as found on the original invoice including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.

(c) The transfer of cigarettes and tobacco products shall only be allowed when the legal entity licensed as the retailer for the retail location transferring the cigarettes and tobacco products is the same legal entity that is licensed as the retailer at the retail location receiving the cigarettes and tobacco products. As an example, a transfer between a location licensed as a sole proprietorship and a location licensed as a partnership where the sole proprietor is one of the partners would not qualify under this section since the same legal entity does not own both locations. As another example, a transfer between a location licensed to a parent corporation and a location licensed to its wholly owned subsidiary corporation would not qualify under this section since the parent corporation and its wholly owned subsidiary corporation are separate legal entities.

(d) Records of the transfer shall be made available to the Board or its authorized representative for examination upon request. Failure to provide such documentation when requested can result in the seizure of the cigarettes or tobacco products that are claimed to be transferred and the issuance of a citation. Transfer logs or documents not provided upon request at the time of inspection, or created or provided during or after an inspection has commenced, or created or provided after a seizure and/or citation are not acceptable and cannot be used for the return of seized product or dismissal of a violation.

**Sample Transfer Log
Cigarettes and Tobacco Products**

Store Transferring Product	Store Receiving Product	Date of Transfer	Items Transferred Complete Description From Original Invoice	Original Purchase From
A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	B Street Market 123 B Street Anywhere, CA LRQ 91-1XXXXX	March 2, 2010	50 packs Marlboro cigarettes Red Hard Pack, 100 5 boxes Romeo y Juliet Reserve Real Churchill Cigars (25ea)	LD Tobacco Distributors LDG 90-2XXXXX February 14, 2010
A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	B Street Market 123 B Street Anywhere, CA LRQ 91-1XXXXX	April 30, 2010	7 rolls Grizzly Long Cut, Mint (5ea) 2 packs Black & Mild cigars, wine flavor (5ea) 3 packs Black & Mild cigars, wine flavor, wood tip (5ea)	S&W Wholesale SWQ 90-3XXXXX April 27, 2010
A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	D Street Market 123 D Street Anywhere, CA LRQ 91-3XXXXX	June 28, 2010	50 packs Marlboro Cigarettes Red King 12 packs Backwoods Sweet (6ea) 6 rolls Copenhagen Regular (5ea)	Tobacco Road Distributors SWQ 90-4XXXXX June 12, 2010
A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	C Street Market 123 C Street Anywhere, CA LRQ 91 2XXXXX	August 15, 2010	8 packs Swisher Cigarillo wood tip (5ea) 10 boxes Salem Gold 100	S&W Wholesale SWQ 90-3XXXXX July 21, 2010
D Street Market 123 D Street Anywhere, CA LRQ 91-3XXXXX	A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	August 28, 2010	6 packs Backwoods Sweet (6ea)	Tobacco Road Distributors SWQ 90-4XXXXX June 12, 2010
A Street Market 123 A Street Anywhere, CA LRQ 91-0XXXXX	E Street Market 123 E Street Anywhere, CA LRQ 91 4XXXXX	October 3, 2010	20 packs Marlboro Cigarettes Gold 100 2 rolls Skoal Long Cut Mint (5ea) 2 rolls Skoal Bandit Wintrg. (5ea)	LD Tobacco Distributors LDG 90-2XXXXX September 29, 2010

Note: Transfer of cigarettes and tobacco products is allowed only when the legal ownership (as registered with the BOE) of the store transferring the product is the same as the legal ownership of the store receiving the product.

For example:

Store Transferring Product	Store Receiving Product	Is the Transfer Allowed?
John Smith –sole proprietor	John Smith – sole proprietor	Yes
John Smith – sole proprietor	John Smith – corporate officer	No
John Smith – sole proprietor	John Smith – partner	No
John Smith Corporation – Parent Corp.	John Smith Jr. – Wholly Owned Sub.	No



November 29, 2012

The Honorable Jerome Horton, Chair
California State Board of Equalization
Sacramento Headquarters Office
450 N Street, MIC:72
Sacramento, CA 95814

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President

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Vice President
for Organizing/Representation

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Vice President for Bargaining

Chairman Horton:

SEIU Local 1000, representing the Business Taxes Specialists and Business Taxes Compliance Specialists in the Investigation Division at the Board of Equalization, writes to inform you of our removal of concerns relating to the Proposed Regulation 4801.

The newly revised Regulation 4801 improves upon the inventory controls that BOE investigators will have at their disposal to ensure excise taxes are being properly paid. We appreciate the Board's willingness to work with our highly skilled and knowledgeable members at the BOE to ensure that California has the best tools and regulations on the books to ensure retailers have a level playing field from which to work.

On behalf of all our members at SEIU Local 1000, we appreciate the Board's work.

Sincerely,

YVONNE R. WALKER
President

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cc: Honorable Betty Yee, First District
Honorable Michelle Steel, Third District
Honorable George Runner, Second District
Honorable John Chiang, State Controller