

**State of California
Office of Administrative Law**

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JUL 28 2016
Board Proceedings

In re:
Board of Equalization

Regulatory Action:

Title 18, California Code of Regulations

Adopt sections: 4076

Amend sections:

Repeal sections:

**NOTICE OF APPROVAL OF REGULATORY
ACTION**

Government Code Section 11349.3

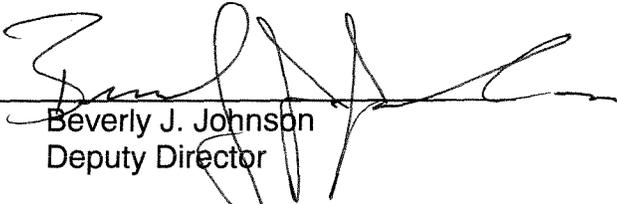
OAL Matter Number: 2016-0614-01

OAL Matter Type: Regular (S)

This rulemaking by the State Board of Equalization adopts section 4076 in Title 18 of the California Code of Regulations to further define the wholesale cost of "Other Than Tobacco Products" (OTP) and clarify how the wholesale cost of OTP should be calculated.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 10/1/2016.

Date: July 27, 2016


Beverly J. Johnson
Deputy Director

For: Debra M. Cornez
Director

Original: David J. Gau
Copy: Richard Bennion

OFFICE OF ADMINISTRATIVE LAW

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DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk
DATE: July 27, 2016
RE: Return of Rulemaking Materials *LW*
OAL Matter Number 2016-0614-01
OAL Matter Type Regular (S)

OAL hereby returns the rulemaking record your agency submitted for review regarding “Wholesale Cost of Tobacco Products.”

If this is an approved matter, it contains a copy of the regulation(s) stamped “ENDORSED APPROVED” by the Office of Administrative Law and “ENDORSED FILED” by the Secretary of State. The effective date of an approved regulation is specified on the Form 400 (see item B.5). **Beginning January 1, 2013**, unless an exemption applies, Government Code section 11343.4 states the effective date of an approved regulation is determined by the date the regulation is filed with the Secretary of State (see the date the Form 400 was stamped “ENDORSED FILED” by the Secretary of State) as follows:

- (1) **January 1** if the regulation or order of repeal is filed on September 1 to November 30, inclusive.
- (2) **April 1** if the regulation or order of repeal is filed on December 1 to February 29, inclusive.
- (3) **July 1** if the regulation or order of repeal is filed on March 1 to May 31, inclusive.
- (4) **October 1** if the regulation or order of repeal is filed on June 1 to August 31, inclusive.

If an exemption concerning the effective date of the regulation approved in this matter applies, then it will be specified on the Form 400. The Notice of Approval that OAL sends to the agency will include the effective date of the regulation. The history note that will appear at the end of the regulation section in the California Code of Regulations will also include the regulation’s effective date. Additionally, the effective date of the regulation will be noted on OAL’s web site after OAL posts the Internet Web site link to the full text of the regulation that is received from the agency. (Gov. Code, secs. 11343 and 11344.)

Please note this new requirement: Unless an exemption applies, Government Code section 11343 now requires:

1. Section 11343(c)(1): Within 15 days of OAL filing a state agency’s regulation with the Secretary of State, the state agency is required to post the regulation on its Internet Web site in an easily marked and identifiable location. The state agency shall keep the regulation posted on its Internet Web site for at least six months from the date the regulation is filed with the Secretary of State.
2. Section 11343(c)(2): Within five (5) days of posting its regulation on its Internet Web site, the state agency shall send to OAL the Internet Web site link of each regulation that the agency posts on its Internet Web site pursuant to section 11343(c)(1).

OAL has established an email address for state agencies to send the Internet Web site link to for each regulation the agency posts. Please send the Internet Web site link for each regulation posted to OAL at postedregslink@oal.ca.gov.

NOTE ABOUT EXEMPTIONS. Posting and linking requirements do not apply to emergency regulations; regulations adopted by FPPC or Conflict of Interest regulations approved by FPPC; or regulations not subject to OAL/APA review. However, an exempt agency may choose to comply with these requirements, and OAL will post the information accordingly.

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "...no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the State Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq. regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2016-0329-01	REGULATORY ACTION NUMBER 2016-0614-015	EMERGENCY NUMBER
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For use by Office of Administrative Law (OAL) only

ENDORSED - FILED
in the office of the Secretary of State
of the State of California**JUL 27 2016**

1:41 PM

2016 JUN 14 A 8:39

OFFICE OF
ADMINISTRATIVE LAW

NOTICE

REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (if any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE		TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE	
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other		4. AGENCY CONTACT PERSON		TELEPHONE NUMBER	FAX NUMBER (Optional)
OAL USE ONLY	ACTION ON PROPOSED NOTICE <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn		NOTICE REGISTER NUMBER 2016, 15-2	PUBLICATION DATE 4/8/2016	

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S) Wholesale Cost of Tobacco Products		1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)	
2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)			
SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)		ADOPT 4076	
		AMEND	
TITLE(S) 18		REPEAL	
3. TYPE OF FILING			
<input checked="" type="checkbox"/> Regular Rulemaking (Gov. Code §11346)	<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.	<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h))	<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
<input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)	<input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)	<input type="checkbox"/> File & Print	<input type="checkbox"/> Print Only
<input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))		<input type="checkbox"/> Other (Specify) _____	
4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)			
5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)			
<input checked="" type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))	<input type="checkbox"/> Effective on filing with Secretary of State	<input type="checkbox"/> §100 Changes Without Regulatory Effect	<input type="checkbox"/> Effective other (Specify) _____
6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY			
<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660)	<input type="checkbox"/> Fair Political Practices Commission	<input type="checkbox"/> State Fire Marshal	
<input type="checkbox"/> Other (Specify) _____			
7. CONTACT PERSON Richard E. Bennion		TELEPHONE NUMBER (916) 445-2130	FAX NUMBER (Optional) (916) 324-3984
		E-MAIL ADDRESS (Optional) rbennion@boe.ca.gov	

8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE <i>Joann Richmond</i>	DATE June 13, 2016
TYPED NAME AND TITLE OF SIGNATORY Joann Richmond, Chief, Board Proceedings Division	

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED**JUL 27 2016**

Office of Administrative Law

Final Text of
California Code of Regulations, Title 18, Section 4076,
Wholesale Cost of Tobacco Products

(A new regulation to be added to the California Code of Regulations)

4076. Wholesale Cost of Tobacco Products.

(a) Definitions.

(1) Arm's-length transaction. An "arm's-length" transaction means a sale entered into in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction.

(2) Discounts or trade allowances. "Discounts or trade allowances" are price reductions, or allowances of any kind, whether stated or unstated, and include, without limitation, any price reduction applied to a supplier's price list. The discounts may be for prompt payment, payment in cash, bulk purchases, related-party transactions, or "preferred-customer" status.

(3) Finished tobacco products; finished condition. "Finished tobacco products" and tobacco products in "finished condition" are tobacco products that will not be subject to any additional processing before first distribution in the state.

(b) Wholesale cost.

(1) If finished tobacco products are purchased by a distributor from a supplier in an arm's-length transaction, the "wholesale cost" of the tobacco product is the amount paid for the tobacco product, including any federal excise tax, but excluding any transportation charges for shipment originating within the United States. Discounts and trade allowances must be added back when determining "wholesale cost."

(2) If a manufacturer or an importer is also the distributor, the wholesale cost of tobacco includes all manufacturing costs, the cost of raw materials (including waste materials not incorporated into the finished tobacco product) prior to any discounts or trade allowances, the cost of labor, any direct (including freight-in) and indirect overhead costs, and any federal excise and/or U.S. Customs taxes paid. Wholesale cost includes all freight or transportation charges for shipment of materials and/or unfinished product from the supplier to the manufacturer concurrently licensed as a distributor, but excludes domestic freight or transportation charges for shipment of finished tobacco products as defined in subdivision (a)(3).

(3) If tobacco product costs include express, implicit, or unstated discounts or trade allowances, the correct wholesale costs to be reported by the distributor may be determined using any of the methods provided in subdivision (c).

(4) If tobacco products are not purchased in an arm's-length transaction, the correct wholesale costs to be reported by the distributor may be determined using any of the methods provided in subdivision (c).

(c) Alternative methods of estimating or calculating wholesale cost.

The following resources or methods may be used.

(1) A publicly or commercially available price list that the distributor used to determine the prices of tobacco products sold to customers in arm's-length transactions during the time period at issue, less an estimate based on best available information of the distributor's or a similarly situated distributor's profit.

(2) If a publicly or commercially available price list is not available, industry data from the time period to be estimated or calculated that provides reasonable evidence of typical tobacco product costs during such time period, including, but not limited to:

(A) Evidence reasonably indicative of the typical costs of the same or similar tobacco products for similarly situated distributors, with appropriate adjustments to such costs as indicated by all the facts and circumstances.

(B) All the direct and indirect costs that the supplier paid or incurred with respect to acquisition, production, marketing, and sale of the tobacco products sold by the supplier to the distributor, with appropriate adjustments to such costs as indicated by all the facts and circumstances, plus a reasonable estimate of the supplier's profit.

(C) The price of the same or similar tobacco products as reflected in a supplier's price list, with appropriate adjustments to such price as indicated by all the facts and circumstances.

(D) The retail price of the same or similar tobacco products as reflected in a retailer's price list, with appropriate adjustments to such price as indicated by all the facts and circumstances, less reasonable estimates of the retailer's and distributor's profits.

(E) Additional methods not mentioned above, with Board approval.

(d) Sales not made at arm's-length.

(1) Presumption. Sales, purchases, and transfers of tobacco products are rebuttably presumed to not be at arm's-length if they are between related parties such as: relatives (by blood or marriage, which relationships include, but are not limited to, spouses, parents, domestic partners, children and siblings); partners or a partnership and its partners; a limited liability company or association and its members; commonly controlled corporations; a corporation and its shareholders; or persons, as defined in Revenue and Taxation Code section 30010, and entities under their control or between commonly controlled entities.

(2) Rebuttal of presumption. If the Board determines that a sale, purchase, or transfer of tobacco products was between related parties, the distributor may rebut the presumption that the sale, purchase, or transfer was not at arm's-length by showing that the price, terms, and conditions of the transaction were substantially equivalent to those that would have been negotiated between unrelated parties.

(e) Examples of estimating or calculating the wholesale cost of tobacco:

(1) Example 1: Distributor B produces handmade cigars. B's tobacco product costs include: all manufacturing costs, the cost of raw materials (including waste materials not incorporated into the final product), the cost of labor, any direct and indirect overhead costs, and any federal excise and/or U.S. Customs taxes paid. The cost does not include freight or transportation charges for shipment from the supplier to the distributor.

(2) Example 2: Distributor C purchases tobacco products from a subsidiary corporation in which it owns or controls more than 50 percent of the voting stock. Due to this corporate relationship between seller and buyer, the Board presumes that the sale and purchase were not at arm's-length, and the presumption is not rebutted by C. In the absence of an arm's-length transaction, the methods discussed in subdivision (c) may be used to determine the correct wholesale cost.

(3) Example 3: Distributor D acquires tobacco product free of charge and reports no wholesale cost for the product on its Tobacco Products Distributor Tax Return. However, D acquired such tobacco product at a 100 percent discount or trade allowance. In the absence of an arm's-length transaction, the methods discussed in subdivision (c) may be used to determine the correct wholesale cost.

(4) Example 4: Distributor E, with a tobacco products importers license, acquires tobacco products or finished tobacco products from a supplier outside the United States. E's tobacco product costs include, in addition to all other production or acquisition costs, the costs of all U.S. Customs fees and federal excise taxes paid or incurred by E with respect to such tobacco products.

(5) Example 5: Distributor F receives three tobacco products packaged as one unit, as a "three for the price of two" promotional package, labeled with a single UPC barcode. As the products are packaged together as one inseparable unit, tax is based on the total package price.

(6) Example 6: Distributor G receives 2 units, to sell as a "buy one, get one free" promotion. Each unit is separately packaged and each unit is labeled with a UPC barcode. Because one unit is being provided for free, tax would apply to the wholesale cost of each separate unit as calculated by a method discussed in subdivision (c).

(7) Example 7: Distributor H receives a three percent discount for paying their supplier within 10 days of receipt of their items. To calculate the wholesale cost, Distributor H must add the three percent discount to the price paid for the products.

(f) Rate Setting. The Board's annual determination of the rate of tax that applies to other tobacco products shall be made based on the wholesale cost of tobacco products as of March 1 of the current calendar year and shall be effective during the next fiscal year, beginning July 1.

Note: Authority cited: Section 30451, Revenue and Taxation Code. Reference: Sections 30008, 30010, 30011, 30017, 30105, 30121, 30123, 30126, 30131.1, 30131.2, 30131.5, 30201, and 30221, Revenue and Taxation Code.