

Memorandum

To: Mr. Monte Williams
Administrator, Excise Taxes Division

Date: February 7, 1996

From: Mary C. Armstrong
Assistant Chief Counsel

Subject: **Legal Interpretation for Annotation Letter to**

You have requested our advice regarding the following:

What is a retailer's tax obligation under the Cigarette and Tobacco Products Tax for the sale of cigars made by hand in the retailer's/distributor's establishment and how would the tax base be calculated on these cigars.

The Cigarette and Tobacco Products Tax is imposed on a distributor's sale of tobacco products based on the wholesale cost of the product. Section 30017 of the Cigarette and Tobacco Products Tax Law defines wholesale cost as "...the cost of tobacco products to the distributor prior to any discounts or trade allowances." The wholesale cost of purchasing pre-made cigars imported from outside the state includes the material used to manufacture the cigar, the labor and overhead costs in the manufacturing process and a manufacturer's markup.

In the example you provided, when a retailer purchases raw goods at wholesale and manufactures the cigars on the retailers premise, the retailer is selling the cigar as the finished product. As such, a tax base must be determined to reflect not only the cost of the raw goods but also what would be considered labor, overhead, and markup. We are of the opinion that the method to use to arrive at a wholesale cost of the cigar would be to determine the wholesale cost of a cigar of similar quality that is available for purchase at the wholesale level. This figure could then be used as the fair market value of the cigars being hand made at the retailer's premise.

If you have further questions concerning this matter, we will be happy to discuss them with you.

MCA:ph
cc: Bill Kimsey
Frank Love
Jim Van Gundy
Stella Levy



FILE
TOBACCO-LEGAL

Memorandum

To : Ms. Mary Armstrong
Assistant Chief Counsel,
Special Taxes and Administration MIC: 82

Date : December 26, 1995

From : Monte Williams, Administrator
Excise Taxes Division MIC: 56

Subject : Legal Interpretation For Annotation

Attached is a copy of a request from the _____, Inc. for an opinion on the imposition of the Tobacco Products Tax. The primary question posed is what is the retailer/distributor's tax obligation under the Tobacco Products Tax Law for the sale of cigars made by hand in his establishment. A secondary question is how the tax base would be calculated. Attached is a copy of our proposed letter.

We are sending this information in accordance with the procedures set forth in Mr. Sorensen's memorandum of September 6, 1995. Please review our proposed response and prepare a legal opinion on this subject which can be cited as an annotation. We will await your response before sending the letter to the taxpayer.

If you have any further questions, please phone me at 327-3276.



WPK:jvg

Attachments

cc: Bill Kimsey
Frank Love
Jim Van Gundy

July 15, 1995

Mr. Monte Williams
Administrator, Excise Taxes Division
State Board of Equalization
Sacramento, CA 94279-0001
FAX: (916) 323-9297

Dear Monte:

I am seeking your opinion as to what the tax requirements and obligations would be for a California retailer of cigars who also employs on his premises a person or persons making cigars by hand. In addition to selling those cigars which he imports direct from out-of-state sources, the retailer would also be selling the cigars which his employee makes by hand on the retailer's premises. Past experience has indicated that consumers are fascinated with watching the handrolling of a cigar, an activity which usually creates an instant demand for that cigar.

Under the "Cigarette and Tobacco Product Tax Law", it is obvious that the retailer would be required to apply for a distributor's license, file monthly returns and pay the California tobacco products tax for those cigars which he imports direct from out of state.

However, having read the tax law, I am unclear as to what the retailer's tax obligation is for the sale of cigars made by hand in his establishment or how the tax base (i.e. wholesale cost) would be calculated. We would appreciate your opinion on these issues.

We look forward to your response to this letter at your earliest convenience. Could you also send me a copy of California's "Cigarette and Tobacco Product Tax Law"? I don't have a good copy.

Best wishes and thank you.

Sincerely,

President



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

150 N Street, Sacramento, California
P.O. Box 942879, MIC:56, Sacramento, CA 94279-0056)
Telephone: (916) 322-1960
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JOHAN KLEHS
First District, Hayward

DEAN ANDAL
Second District, Stockton

ERNEST J. DRONENBURG, JR.
Third District, San Diego

BRAD SHERMAN
Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

BURTON W. OLIVER
Executive Director

February 20, 1996

Dear .

Your July 15, 1995 letter to Mr. Monte Williams has been referred to me for response. We asked our legal department to review your letter and we have incorporated their input into our response. In your letter, you requested our opinion as to what a retailer's tax obligation is for the sale of cigars made by hand in the retailer's establishment, and how the tax base would be calculated.

The Cigarette and Tobacco Products Tax is imposed on a distributor's sale of tobacco products based on the wholesale cost of the product. Section 30017 of the Cigarette and Tobacco Products Tax Law defines wholesale cost as "...the cost of tobacco products to the distributor prior to any discounts or trade allowances." The wholesale cost of purchasing pre-made cigars imported from outside the state includes the material used to manufacture the cigar, the labor and overhead costs in the manufacturing process and a manufacturer's markup.

In the example you provided, when a retailer purchases the raw goods at wholesale and manufactures the cigars on the retailer's premise, the retailer is selling the cigar as the finished product. As such, a tax base must be determined to reflect not only the cost of the raw goods, but also what would be considered labor, overhead, and markup. We are of the opinion that the method to use to arrive at a wholesale cost of the cigar would be to determine the wholesale cost of a cigar of similar quality that is available for purchase at the wholesale level. This figure could then be used as the fair market value of the cigars being hand made at the retailer's premise.

I hope the above information adequately addresses your concerns. As requested in your letter, enclosed are Pamphlets 4 and 15, Cigarette and Tobacco Products Tax Law and Regulations. If you have any further questions regarding this matter, you may contact me at the number listed above.

Sincerely,

William P. Kimsey
Principal Auditor
Excise Taxes Division

WPK:mg

Enclosures

cc: Mr. Monte Williams

Memorandum

To : Mr. Monte Williams
Excise Tax Unit

Date : April 20, 1989
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APR 21 1989

EXCISE TAX

From : Stella Levy
Tax Counsel

(916) 327-3400
ATSS 467-3400

Subject: Measure of Tax for Tobacco Products Under Proposition 99

Gary Jugum has asked me to respond to your memorandum of March 30, 1989 regarding the above referenced matter.

Passage of Proposition 99 at the last election resulted in the addition to the Revenue and Taxation Code of Article 2 (commencing with section 30121) entitled "Cigarette and Tobacco Products Surtax". Section 30123(a) imposes a tax upon the distribution of cigarettes at the rate of \$0.0125 per cigarette in addition to the tax already imposed by the Cigarette Tax Law. The total tax upon distribution of cigarettes, as of January 1, 1989 (the effective date of Proposition 99), is \$0.0175 per cigarette. Section 30123(b) imposes a tax upon the distribution of tobacco products "based on the wholesale cost of these products, at a tax rate as determined annually by the State Board of Equalization, which is equivalent to the combined rate of tax imposed on cigarettes..." Prior to passage of Proposition 99, distribution of tobacco products had not been subject to a tax. Section 30126 provides that the "annual determination required of the State Board of Equalization pursuant to subdivision (b) of section 30123 shall be made based on the wholesale cost of tobacco products as of March 1, and shall be effective during the state's next fiscal year."

The major difficulty in determining the measure of tax for tobacco products is in meeting the statutory requirement that the rate be equivalent to that imposed on cigarettes. The rate of tax imposed on cigarettes is calculated on a per-cigarette basis and is not directly transferrable to tobacco products such as snuff, chewing tobacco, etc. Your memo suggests a methodology for converting the rate imposed on cigarettes to an equivalent rate to be imposed on tobacco products.

As I understand it, you have calculated the weighted-average wholesale cost of one cigarette as \$0.042. You reach this figure by averaging the manufacturers' list cigarette

Mr. Monte Williams
Excise Tax Unit

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April 20, 1989

prices per 1,000 cigarettes as of December 1987, adding the wholesale markup, and then dividing by 1,000. Thus, the tax on one cigarette is equivalent to a tax of \$0.0175 on a wholesale price of \$0.042. Next, you calculated the ratio of tax to wholesale cost (.0175 divided by .042) as 41.67 percent. Thus, the tax rate on cigarettes is 41.67 percent of wholesale cost. This rate is expressed in a form which is applicable to tobacco products as well as to cigarettes.

The question you have asked concerns the definition of "wholesale cost of tobacco products." You have been asked by distributors whether incoming freight charges are includable as a part of the wholesale cost of tobacco products against which the tax rate is to be applied. As you point out, it would be inappropriate to include transportation charges on the tobacco products side of the equation when they were not included on the cigarette side. The purpose of the equation, or formula, is simply to find a common denominator applicable to both cigarettes and tobacco products. You have found that "wholesale cost" constitutes a practical common denominator. Since "wholesale cost" of cigarettes does not include freight, "wholesale cost" of tobacco products should also not include freight.

In conclusion, an operative definition of "wholesale cost" which excludes freight charges complies with the statutory requirements, as long as it is applied uniformly to both cigarettes and tobacco products. Distributors of tobacco products should be advised to calculate tax as 41.67 percent of wholesale cost excluding freight.

Stella Levy

SCL/smt:1337C

cc: Gary J. Jugum
Donald J. Hennessy
E. L. Sorensen, Jr.