

Date of Hearing: April 20, 2016

ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION

Adam Gray, Chair

AB 2770 (Nazarian) – As Introduced February 19, 2016

SUBJECT: Cigarette and tobacco product licensing: fees and funding

SUMMARY: Updates the Cigarette and Tobacco Products Licensing Program under the Board of Equalization (BOE) by increasing licensing, distributor, and wholesaler fees. Specifically, **this bill:**

- 1) Increases, beginning January 1, 2017, the current one-time retailer license fee of \$100 per location to \$265 per location and imposes a \$265 fee for the annual renewal of a tobacco retailer license.
- 2) Increases, beginning January 1, 2017, the annual distributor and wholesaler licensing fee from \$1,000 to \$1,200.
- 3) Requires BOE to report back to the Legislature no later than January 1, 2020, regarding the adequacy of funding for the Cigarette and Tobacco Products Licensing Act of 2003. Requires the report to include data and recommendations about whether the annual licensing fee funding levels are set at an appropriate level to maintain an effective enforcement program.

EXISTING LAW:

- 1) The California Cigarette and Tobacco Products Licensing Act (Act) of 2003 (AB 71, Horton, Statutes of 2003), created a comprehensive regulatory scheme governing the distribution and sale of cigarettes and tobacco products in this state, and requires the Board of Equalization (BOE) to license manufacturers, importers, distributors, wholesalers, and retailers of cigarettes and tobacco products.
- 2) Requires retailers to maintain a license to engage in the sale of cigarettes and tobacco products that is valid for a 12-month period and must be renewed annually. A one-time fee of \$100 is required for each retail location, along with a fee of the same amount if the licensee fails to renew the license and the license has to be reinstated.
- 3) Requires distributors and wholesalers of cigarette and tobacco products to pay an annual license fee of \$1,000. Cigarette manufacturers and importers are likewise required to obtain and maintain a license to engage in the sale of cigarettes, and were required to pay by AB 71 a one-time fee in the amount of one cent (\$0.01) per package of cigarettes manufactured or imported by the manufacturer or the importer and shipped into this state during the 2001 calendar year, as was reported to BOE (manufacturers and importers that have operated in the state after January 1, 2004, are required to pay a one-time fee commensurate with their respective market share of cigarettes manufactured or imported, and sold in this state during the next calendar year as estimated by BOE). Manufacturers or importers of chewing tobacco or snuff were subsequently required to obtain and maintain a license under the Act to engage in the sale of tobacco products (AB 1749, Horton, Statutes of 2006), and required to pay a one-time license fee of \$10,000. In addition, every manufacturer or importer of

tobacco products, excluding chewing tobacco or snuff, are required to submit with each application a one-time license fee of two thousand dollars (\$2,000). The one-time license fee for a manufacturer or importer of tobacco products is limited to ten thousand dollars (\$10,000).

- 4) Requires that all moneys collected pursuant to the Act (license fees, penalties and fines) be deposited into the Cigarette and Tobacco Products Compliance Fund, and are available for expenditure upon appropriation by the Legislature solely for administering the Act.
- 5) Provides that all revenues and expenses generated by AB 71 with respect to the taxes imposed under the Cigarette and Tobacco Products Tax Law are to be allocated in the same manner as those revenues and expenses are allocated under existing law. This allows for the reimbursement of the BOE for expenses incurred in the administration and collection of tobacco taxes.
- 6) Imposes an excise tax of \$0.87 cents per pack of 20 cigarettes. An excise on other tobacco products is calculated by the BOE based on the wholesale price of cigarettes. Revenues from the tax on cigarettes and other tobacco products are distributed as follows: \$0.10 cents to the General Fund (GF); \$0.50 cents of the per pack tax and an equivalent rate levied on non-cigarette tobacco products to the California Children and Families First Trust Fund (Prop. 10); \$0.25 of the per pack tax and an equivalent rate levied on non-cigarette tobacco products to the Cigarette and Tobacco Products Surtax Fund (Prop. 99); and \$0.02 cents to the Breast Cancer Fund.
- 7) Establishes the Stop Tobacco Access to Kids Enforcement (STAKE) Act, which charges the Department of Public Health (DPH) with developing a program to reduce the availability of tobacco products to persons under 18 years of age and specifies that various agencies, including, but not limited to, DPH, the Attorney General, or local law enforcement agencies may enforce the STAKE Act. Requires DPH, after a third, fourth, or fifth violation, to notify the Board of Equalization (BOE) of the violation and for the BOE to then assess an additional civil penalty and to suspend or revoke the sellers' license for a specific amount of time, based on the number of violations in a given period.

FISCAL EFFECT: According to a Senate Appropriations analysis of ABX2-11 (Nazarian) (identical bill to AB 2770), the bills will have:

- Unknown administrative costs for the BOE to make required computer system changes and notify retailers. Previously, the BOE indicated a January 1, 2017 operative date would allow them to make the necessary changes within existing resources without delaying other projects.
- Ongoing annual revenue increases of \$11.1 million per year from increased licensing fees on tobacco retailers and on distributors and wholesalers.

COMMENTS:

Purpose of the bill: According to the author, AB 71 was intended to reduce illegal sales of cigarette and other tobacco products within the State. However, the one-time licensing fee is not adequate to cover costs associated with maintaining a viable enforcement program. Inadequate funding of this program can lead to lack of field enforcement or a reduction in compliance staff, which leads to further decrease in funding. Field enforcement is crucial to help maintain MSA compliance and enforce the STAKE Act. AB 2770 benefits businesses as it stops violators from circumventing the law and competing with legitimate businesses. The goal of the licensing program is to decrease untaxed tobacco distributions and reduce illegal sales of cigarettes and tobacco products. Furthermore, AB 2770 protects the viability of tobacco health and education programs by ensuring that the licensing program is funded by the licensing fee revenue. AB 2770 will eliminate the need to divert tobacco excise taxes, from their intended purpose, to instead pay for the deficit in the tobacco licensing program.

Background: Master Settlement Agreement (MSA) is an accord reached in November 1998 between the state Attorneys General of forty-six states (including California), five U.S. territories, the District of Columbia and the five largest tobacco companies in America concerning the advertising, marketing and promotion of tobacco products. In addition to requiring the tobacco industry to pay the settling states approximately \$10 billion annually for the indefinite future, the MSA also set standards for, and imposed restrictions on, the sale and marketing of cigarettes by participating cigarette manufacturers.

Under the MSA states must pass laws requiring non-participating manufacturers to make payments to the state based on their cigarette sales, and to diligently enforce the payments requirements by tracking all cigarettes sold in the state. To fulfill California's obligations under the MSA, the Legislature created new programs administered by the BOE and the Department of Justice, including BOE's cigarette and Tobacco Licensing Program.

BOE Licensing Act: In 2003, AB 71 (J. Horton, Chapter 890) enacted the Cigarette and Tobacco Products Licensing Act (Licensing Act), which established a statewide licensure program administered by BOE to help stem the tide of untaxed distributions and illegal sales of cigarettes and tobacco products. Prior to the bill, BOE's Investigations Division had been encountering a large number of cigarettes and tobacco product distributors who were unlicensed. The purpose for being unlicensed is to conceal the nature of their business and to evade the tax. These unlicensed distributors normally maintain minimal assets and are typically transient, which hinders BOE's ability to collect the taxes due and payable.

The Act requires every retailer, distributor, wholesaler, manufacturer and importer to obtain and maintain a license to engage in the sale of cigarettes or tobacco products. Currently, BOE has approximately 38,000 retailers and 1,000 distributors and wholesalers licensed to engage in the sale of cigarettes and tobacco products in California. A distributor and wholesaler license is valid for a calendar year upon payment of a fee of \$1,000 per location, unless surrendered, suspended, or revoked prior to the end of the calendar year, and may be renewed each year upon payment of such fee.

Violations of the Act include, in part, the following: 1) Possession, storing, owning, or has made sales of an unstamped package of cigarettes bearing a counterfeit California tax stamp or tobacco products on which tax is due but has not been paid; 2) Sales of cigarettes or tobacco products to

any distributor, wholesaler, importer, retailer, or any other person who is not licensed or whose license has been suspended or revoked; 3) Retailer and wholesaler purchases of cigarette or tobacco products from any person who is not licensed or whose license has been suspended or revoked; 4) Distributor purchases of cigarettes or tobacco products from any person who is required to be licensed pursuant to the Act but who is not licensed or whose license has been suspended or revoked; 5) Failure to maintain records or make such records available to BOE and law enforcement agency, as specified; 6) A person or entity that engages in the business of selling cigarettes or tobacco products in this state without a license or after a license has been suspended or revoked; and 7) Failure to allow an inspection.

Cigarette and Tobacco Products Taxes Revenues: The revenues from excise taxes on cigarettes and tobacco products are deposited into four funds. The allocation of funds is as follows: of the total eighty-seven cents (\$0.87) tax per package of twenty (20) cigarettes, ten cents (\$0.10) is deposited into the Cigarette Tax Fund, and two cents (\$0.02) goes into the Breast Cancer Fund. Twenty-five cents (\$0.25) is deposited into the Cigarette and Tobacco Products Surtax Fund and may only be used for the following purposes:

- Tobacco-related health education programs and disease research.
- Medical and hospital care and treatment of patients who cannot afford those services, and for whom payment will not be made by any private coverage or federal program.
- Programs for fire prevention; environmental conservation; protection, restoration, enhancement, and maintenance of fish, waterfowl, and wildlife habitat areas; and enhancement of state and local parks and recreation.

Fifty cents (\$0.50) is deposited into the California Children and Families Trust Fund and is used for programs that encourage proper childhood development, including the development of professional and parental education and training, informed selection of childcare, development and education of childcare providers, and research into the best practices and standards for all programs and services relating to early childhood development.

According to the BOE, in fiscal year 2014/2015, California received \$835 million from taxes on cigarettes and other tobacco products. These funds were allocated as follows:

- Cigarette Tax Fund - \$86 million
- Cigarette and Tobacco Products Surtax Fund - \$268 million
- Breast Cancer Fund - \$20 million
- California Children and Families Trust Fund - \$461 million

State Auditor Report: In March 2016, the California State Auditor released a report concerning the costs of the Cigarette and Tobacco Products Tax Program (tax program) and the Cigarette and Tobacco Products Licensing Program (licensing program) administered by the BOE.

The report concludes that although the board's enforcement efforts are effective and properly funded, other funding options and cost saving measures exist for the licensing program. In 2004 the board implemented the licensing program and began licensing all entities involved in the sale of cigarette and

tobacco products in California, with a goal to inspect annually 10,000 of these licensees. In 2005 the board's tax program put into use an encrypted cigarette tax stamp. According to the BOE's most recent estimate, in fiscal year 2012–13 the BOE's three-part approach to enforcing compliance with California's cigarette and tobacco products excise tax laws—licensing, inspections, and an encrypted cigarette tax stamp—prevented the loss of \$91 million in tobacco tax revenue.

The report found since fiscal year 2006–07, license fees have not covered all of the licensing program's costs. For example, in fiscal year 2014–15 licensing fees contributed only \$1.8 million of the \$9.8 million needed to administer the program. To make up the program's \$8.0 million shortfall, the board uses money from the four funds that receive cigarette and tobacco products taxes (see above). Although it is legally permissible to use excise taxes to fund the licensing program, the board has accumulated an excess amount of unspent license fees that it could use to offset the shortfall.

The report makes several recommendations for handling the \$8.0 million shortfall, including, encouraging the Legislature to pass legislation to implement a funding model that will include a license fee increase or a combination of license fee increases, continued use of money from the Cigarette Tax Fund, and a cigarette tax increase.

BOE Report: In 2014 representatives from Proposition 10 programs expressed concern about the administrative costs and funding of BOE's Cigarette and Tobacco Program resulting in reduced funds for other special programs, and the Legislature required BOE to report back with other funding options. Some BOE's proposals include:

- Instituting a recurring fee at the retail level to increase the share of costs covered by the licensing fees;
- Increasing the taxes assessed on cigarettes and tobacco products by an unspecified amount;
- Tax electronic cigarettes, dissolvable tobacco, and other recently developed products by expanding the definition of tobacco product;
- Paying for the cigarette and tobacco products licensing program with funds from the GF; and,
- Reduce spending and cap administrative costs on the cigarette and tobacco products licensing program.

The LAO brief notes that closing the funding gap through reduced spending would be risky because the Legislature created the licensing program to comply with the MSA requirement for diligent enforcement of tobacco laws, and states found not to be diligent have had their revenues reduced.

Policy consideration: ABX2-11 (Nazarian) – Identical bill to AB 2770 – was one of a package of tobacco reform bills that were introduced during the 2015/2016 Second Extraordinary Session. There were five other bills in the package (see Prior/Related Legislation) that ultimately passed both the Senate and the Assembly. ABX2-11 and the companion bills were ordered to engrossing and enrolling on March 10 and 16, 2016, and have not yet been sent to the Governor for signature. AB 2770 is a precaution in the event the Governor does not sign ABX2-

11, and will continue to move should a veto occur. *The committee may wish to consider whether AB 2770 is necessary, if yes, the Committee may further consider whether the same precautionary measures be taken for the other five Second Extraordinary Session bills.*

Staff Note: ABX2-11 requires the BOE to report back to the Legislature no later than January 1, 2019, regarding the adequacy of funding for their programs. AB 2770 requires the BOE to report back by 2020 – other than this minor difference, ABX2-11 is identical.

Related/Prior Legislation: ABX2-11 (Nazarian) of 2015/2016 Second Extraordinary Session. Revises the Cigarette and Tobacco Products Licensing Act of 2003 to change the retailer license fee from a \$100 one-time fee to a \$265 annual fee, and increase the distributor and wholesaler license fee from \$1,000 to \$1,200. (3/16/16 – Ordered to Engrossing and Enrolling).

SBX2-5 (Leno) of 2015/2016 Second Extraordinary Session. Expands the definition of tobacco products to include e-cigarettes and extends current restrictions and prohibitions against the use of tobacco products to e-cigarettes. The bill also establishes an annual e-cigarette retailer licensing fee of \$265 per location. (3/10/16 – Ordered to Engrossing and Enrolling).

ABX2-7 (Stone) of 2015/2016 Second Extraordinary Session. Prohibits smoking in owner-operated businesses and removes some exemptions in existing law that allows tobacco smoking in certain workplaces: Hotel/motel lobbies, meeting & banquet rooms, warehouses, break rooms, businesses with 5 or less employees. (3/16/16 – Ordered to Engrossing and Enrolling).

SBX2-7 (Hernandez) of 2015/2016 Second Extraordinary Session. Increases the minimum legal age to purchase or consume tobacco from 18 to 21, conforms existing law regarding purchasing, selling, and enforcement of tobacco and tobacco products to reflect the new age limit, and deletes existing penalties applicable when a person under 18 years of age purchases tobacco. (3/10/16 – Ordered to Engrossing and Enrolling).

ABX2-9 (Thurmond and Nazarian) of 2015/2016 Second Extraordinary Session. Clarifies charter school eligibility for tobacco use prevention program (TUPE) funds; require the California State Department of Education to require all school districts, charter schools, and county offices of education receiving TUPE funds to adopt and enforce a tobacco-free campus policy; prohibit the use of tobacco and nicotine products in any county office of education, charter school, or school district-owned or leased building, on school or district property, and in school or district vehicles; and, require all schools, districts, and offices of education to post a sign reading "Tobacco use is prohibited" at all entrances. (3/16/16 – Ordered to Engrossing and Enrolling).

ABX2-10 (Bloom) of 2015/2016 Second Extraordinary Session. Allows counties to impose a tax on the privilege of distributing cigarettes and tobacco products. (3/16/16 – Ordered to Engrossing and Enrolling).

AB 2496 (Nava), Chapter 265, Statutes of 2010. Amends the California Cigarette and Tobacco Products Licensing Act of 2003 in governing the financial and other obligations of non-participating tobacco manufacturers (NPMs) as part of its diligence obligation.

AB 2733 (Ruskin), Chapter 607, Statutes of 2010. Amends the Licensing Act to prohibit a licensee whose license has been suspended or revoked from giving cigarette and tobacco

products away or displaying those products during the period of license suspension or revocation, as specified.

SB 625 (Padilla), Chapter 654, Statutes of 2007, establishes a \$100 reinstatement fee upon retailers that engage in the sale of cigarettes and tobacco products in this state but fail to renew the necessary licenses.

AB 71 (Horton), Chapter 890, Statutes of 2003, enacts the Cigarette and Tobacco Products Licensing Act of 2003, which imposes licensing requirements on tobacco manufacturers, wholesalers, retailers and importers; requires manufacturers to pay a one-time fee; and, imposes additional civil and criminal penalties on individuals and businesses who violate tobacco-related, anti-contraband laws, and laws prohibiting tobacco-related sales to minors.

REGISTERED SUPPORT / OPPOSITION:

Support

First 5 California

Opposition

None on file

Analysis Prepared by: Kenton Stanhope / G.O. / (916) 319-2531