

Date of Hearing: April 6, 2016

ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION

Adam Gray, Chair

AB 1901 (Quirk) – As Amended March 14, 2016

**SUBJECT:** Taxation: cigarettes: unaffixed stamps

**SUMMARY:** Extends the penalties for possessing, selling, or buying false or fraudulent cigarette tax stamps to “unaffixed stamps”. Specifically, **this bill:**

- 1) Imposes a fine of up to \$5,000, or imprisonment not to exceed one year in county jail, or both, for possessing, selling, or buying unaffixed stamps in a quantity less than 2,000.
- 2) Imposes a fine of up to \$50,000, or imprisonment not to exceed one year in county jail, or both, for possessing, selling, or buying unaffixed stamps in a quantity of 2,000 or greater.
- 3) Defines “unaffixed stamps” as stamps for which the tax has previously been paid by a licensed distributor and previously affixed to a package.
- 4) Clarifies that “unaffixed stamps” do not include any unused and unapplied rolls of stamps or loose stamps acquired from the board or its authorized agent and in the possession of a licensed distributor.
- 5) Requires the Board of Equalization (BOE) to destroy any stamps seized under this section.

**EXISTING LAW:**

- 1) The California Cigarette and Tobacco Products Licensing Act (Act) of 2003 provides for the licensure, by BOE, of manufacturers, distributors, wholesalers, importers, and retailers of cigarette or tobacco products that are engaged in business in California and prohibits retailers, manufacturers, distributors, and wholesalers from distributing or selling those cigarette and tobacco products unless they are in compliance with those licensure requirements.
- 2) The Cigarette and Tobacco Products Tax Law (Law) imposes a tax on the distribution of tobacco products and on the distribution of cigarettes, which are paid through the use of stamps or meter impressions that are required to be affixed to each package of cigarettes sold. The Law requires that certain cigarette and tobacco products be forfeited to the state under specified circumstances, upon seizure by BOE.
- 3) Defines “Stamps and meter impressions” as indicia of payment of tax, and include, but are not limited to, stamps, meter impressions, or any other indicia developed using current technology.
- 4) Requires the BOE to prescribe and approve the types of stamps and meter impressions, and the methods of applying stamps and meter impressions to packages of cigarettes.
- 5) Imposes a fine of up to \$5,000, or imprisonment not to exceed one year in county jail, or both, for possessing, selling, or buying false or fraudulent cigarette tax stamps or meter impressions in a quantity less than 2,000.

- 6) Imposes a fine of up to \$50,000, or imprisonment not to exceed one year in county jail, or both, for possessing, selling, or buying false or fraudulent cigarette tax stamps or meter impressions in a quantity of 2,000 or greater.
- 7) Requires the destruction by the State Board of Equalization of any stamps seized.
- 8) Requires any fines assessed to be deposited in the Cigarette and Tobacco Products Compliance Fund, amounts in which are available for specified expenditure upon appropriation by the Legislature.

**FISCAL EFFECT:** Unknown

**COMMENTS:**

Purpose of the Bill: According to the author, under existing law, cigarette distributors are required to pay an 87-cents excise tax on each pack of cigarettes by purchasing a tax stamp which is affixed on each pack of cigarettes prior to distribution. The BOE's inspection teams have recently identified cigarette tax evasion schemes where used tax stamps were re-used and affixed to another cigarette pack to evade the 87-cents per cigarette pack excise tax. BOE inspectors have also found large collections of used stamps that are intended for reuse. Current law is ambiguous whether BOE inspection teams have the authority to seize and destroy the collection of used stamps, even though it is clear that the used stamps have been collected for the purpose of re-using the stamp to evade the stamp tax.

AB 1901 clarifies that it is a misdemeanor for anyone to possess, buy, sell, or offer to buy or sell any used cigarette tax stamps. It also authorizes the BOE to seize and destroy used cigarette tax stamps aggregated for reuse purposes. Unlike postage stamps or trading cards that are collectibles with value, cigarette tax stamp collections have value solely related to tax evasion. During one enforcement operation alone, BOE staff found a storage unit containing nearly 206,000 unaffixed, used stamps with a tax value of about \$179,000 placed on transfer sheets and prepared for affixation to cigarette packs.

The author states that AB 1901 serves to combat this tax evasion scheme, minimize tax evasion opportunities, and assist in making the marketplace fair and equitable for those that are legitimately paying the excise tax.

Background: Cigarettes are subject to both the cigarette tax and the cigarette and tobacco products surtax, collectively referred to as taxes. The taxes are assessed on each cigarette distributed in California. The current tax rate is \$0.0435 cents per cigarette, which is \$0.87 per pack of twenty 20 cigarettes. Distributors pay the taxes by purchasing cigarette tax stamps from the BOE. Distributors are required to affix the tax stamp to each package of cigarettes before distribution. Distributors pass the excise taxes on to their customer, and the taxes become part of the retail selling price of the cigarettes. The cost of the cigarette tax stamp includes both taxes.

Other forms of tobacco products are taxed at the same rate, but in a different manner. Under current law, "tobacco products" include, but are not limited to, all forms of cigars (except "little cigars"), smoking tobacco, chewing tobacco and snuff, and any other articles or products made of or containing at least 50 percent tobacco. The tax, which is a component of the cigarette and tobacco products surtax, is paid by tobacco products distributors. The tobacco products tax is

imposed upon the first distribution of tobacco products at a rate determined annually by the BOE. The tobacco products tax rate is equivalent to the combined rate of the taxes applied to cigarettes. The rate is applied to the wholesale cost of the tobacco products.

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.

Tax Evasion Schemes: The BOE's Investigation Division actively investigates and makes seizures of unstamped or counterfeit stamped cigarettes and imports of domestic labeled cigarettes or export type cigarettes stamped in violation of the law. According to a BOE report in 2014, they estimate that cigarette and tobacco products excise tax revenue evasion was about \$214 million in fiscal year 2012-13. This estimate is comprised of \$198 million by retailers who purchase and sell untaxed cigarettes and tobacco products and \$16 million in casual evasion by consumers. These estimates include all forms of tax evasion schemes, including the use of unaffixed stamps.

Cigarette and tobacco product tax evasion schemes can be perpetrated in several ways. The most commonly known scheme is what is punishable under current law—affixing fraudulent stamps or meter impressions on non-MSA compliant and/or out-of-state diverted cigarettes and reselling them on the black market. As stated above, the BOE's inspection teams have recently identified cigarette tax evasion schemes where used tax stamps were re-used (aka “unaffixed” stamps) and affixed to a different cigarette pack. Rather than using fraudulent stamps, perpetrators—often

actual retailers—collect the removed cellophane wrapper on a legal pack of cigarettes containing a legitimate stamp, and give them to people known as “aggregators.” The aggregators then remove the stamps from the wrapper and affix them to non-MSA compliant or out-of-state diverted cigarettes, thus evading the \$0.87 California tax. Current law does not account for and, thus, does not punish the use, collection or sell of re-used stamps. The picture below is from an undisclosed retailer who was collecting stamps for an “unnafixed stamp” tax evasion scheme.



Cigarette and Tobacco Products Taxes Revenues: The revenues from excise taxes on cigarettes and tobacco products are deposited into four funds, which are all affected by tax evasion schemes. 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.

Double referral: Should AB 1901 pass the Assembly Committee on Governmental Organization on Wednesday, April 6, 2016, this bill will be referred to the Assembly Committee on Revenue and Taxation for further consideration.

Prior/Related legislation: 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).

ABX2-11 (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).

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.

624 (Padilla, Chapter 653, Statutes of 2007. Increases the civil penalties under the Stop Tobacco Access to Kids Enforcement (STAKE) Act and expands the role of agencies that are permitted to carry out investigations of illegal tobacco sales to minors under the STAKE Act from the Department of Public Health to include the Attorney General and other state and local agencies.

AB 71 (Jerome Horton, Chapter 890, Statutes of 2003. Enacted the Cigarette and Tobacco Products Licensing Act of 2003. This bill was a comprehensive attempt to reduce illegal sales of cigarette and other tobacco products within California. This bill created a statewide licensing program for retailers, enhancing the powers of BOE's tobacco compliance and enforcement division, expanding DOJ's tobacco compliance and enforcement responsibilities, and enacting and increasing criminal and civil penalties for sales of counterfeit cigarettes and other tobacco products.

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

California State Board of Equalization (Sponsor)  
American Cancer Society-Cancer Action Network  
The American Lung Association in California  
California Distributors Association  
Fiona Ma, Chairwoman, California State Board of Equalization

### **Opposition**

None on file

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