



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

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| Date Introduced: | 02/26/09 | Bill No: | AB 689 |
| Tax: | Cigarette and Tobacco Products | Author: | Calderon |
| Related Bills: | AB 89 (Torlakson) SB 600 (Padilla) | | |

BILL SUMMARY

This bill would change the definition of tobacco products to include all products and articles made of, or containing tobacco, except cigarettes.

ANALYSIS

CURRENT LAW

Tobacco products are defined in Revenue and Taxation Code Sections 30121 and 30131.1 to include cigars, smoking tobacco, chewing tobacco, snuff, and other products containing at least 50 percent tobacco. Section 30123 (Proposition 99) imposes a tax on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 (Proposition 10) imposes an additional tax on tobacco products based on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the 50-cent per pack tax on cigarettes also imposed by Section 30131.2. The tobacco products tax rate is determined annually by the Board and based on the March 1 wholesale cost of cigarettes. Currently, the surcharge rate for fiscal year 2008-09 is 45.13 percent.

The Proposition 99 tobacco products surtax imposed under Section 30123 is deposited into the Cigarette and Tobacco Products Surtax Fund (including any revenues that result from an indirect increase in the other tobacco products tax triggered by a cigarette tax increase), while the Proposition 10 surtax imposed under Section 30131.2 is deposited into the CCF Trust Fund.

PROPOSED LAW

This bill would amend Sections 30121 (Proposition 99) and 30131.1 (Proposition 10) to define tobacco products to include, but not be limited to, all forms of cigars, smoking tobacco, chewing tobacco, snuff, and any other articles or products made of, or containing tobacco, but does not include cigarettes.

This provision would be operative January 1, 2010.

BACKGROUND

Proposition 99, approved by voters in November 1988 and effective January 1, 1989, imposed a surtax of 25 cents per package of 20 cigarettes, and also created an equivalent tax on other tobacco products. Proceeds from the taxes provide funding for health education, disease research, hospital care, fire prevention, and environmental conservation.

Proposition 10, approved by voters in November 1998 and effective January 1, 1999, imposed an additional surtax of 50 cents per package of 20 cigarettes. The measure

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also imposed an additional excise tax on the distribution of other tobacco products equivalent to the additional cigarette tax and imposed an equivalent compensating floor stock tax. The revenues from the additional tax are deposited into the CCF Trust Fund and are used to fund early childhood development programs, and to offset any revenue losses to certain Proposition 99 programs as a result of the additional tax imposed by Proposition 10.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the California Distributors Association and is intended to create a bright line for purposes of imposing the tobacco products tax to all products containing tobacco.
2. **How does the Board currently administer the 50% threshold for other tobacco products?** Tobacco products that are cigars, smoking tobacco, chewing tobacco, or snuff are subject to the state excise tax on tobacco products regardless of the percent of tobacco contained in the specified products. However, any other articles or products made of, or containing tobacco, not including cigarettes, must contain at least 50% tobacco to be subject to the state excise tax.
3. **Types of products that may be taxed if this bill is enacted.** Currently, the Board would expect that tobacco wraps, also known as blunts or blunt wraps, that contain less than 50% tobacco would be affected by the proposed change. There may be other tobacco products for which the Board is not currently aware or that are not yet available in California that may be subject to the state's excise tax as a result of this measure.
4. **Is California the only state with a 50% tobacco content threshold?** A brief review of New York, Oregon, Texas, and Illinois indicates that these other states do not have a 50% tobacco content threshold, or any other specified percent of tobacco content, that applies to determining if tobacco products are subject to their state's excise tax:
 - New York defines "tobacco products" as "any cigar or tobacco, other than cigarettes, intended for consumption by smoking, chewing, or snuff." http://www.tax.state.ny.us/pdf/memos/cigarette/m09_1m.pdf
 - Oregon defines "tobacco products" to mean "cigars, cheroots, stogies, periques, granulated, plug cut, crimp cut, ready rubbed and other smoking tobacco, snuff, snuff flour, cavendish, plug and twist tobacco; fine cut and other chewing tobaccos, shorts, refuse scraps, clippings, cuttings and sweepings of tobacco and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or smoking in a pipe or otherwise, or both for chewing and smoking, but shall not include cigarettes as defined in ORS 323.010(1)." (ORS 323.500) <http://www.oregon.gov/DOR/TOB/IC-105-404.shtml>.
 - Texas defines "tobacco product" as follows: (a) a cigar; (b) smoking tobacco, including granulated, plug-cut, crimp-cut, ready-rubbed, and any form of tobacco suitable for smoking in a pipe or as a cigarette; (c) chewing tobacco, including Cavendish, Twist, plug, scrap, and any kind of tobacco suitable for chewing; (d) snuff or other preparations of pulverized tobacco; or (e) an article or product that is made of tobacco or a tobacco substitute and that is not a cigarette. <http://www.statutes.legis.state.tx.us/ViewChapter.aspx?key=tx.155>.

- Illinois defines “tobacco products,” excluding cigarettes, to include cigars; cheroots; stogies; periques; granulated, plug-cut, crimp-cut, ready-rubbed and other smoking tobacco; snuff or snuff flour; cavendish; plug and twist tobacco; fine-cut and other chewing tobaccos; refuse scraps, clippings, cuttings and sweepings of tobacco; and other kinds and forms of tobacco suitable for chewing or smoking. [35 ILCS 143/ Tobacco Products Tax Act of 1995.](#)

The Board is not aware of another state that has a 50% tobacco content threshold.

5. **The intent of the 50% threshold in Proposition 99 is unclear to the Board.** Since this was a voter initiative and not a legislative act, the Board did not participate in the drafting of the initiative, therefore the original intent of the 50% threshold is not clear to the Board.
6. **Would there be an effect on the Cigarette and Tobacco Products Licensing Act?** Currently, the Board administers the Cigarette and Tobacco Products Licensing Act of 2003, which established a statewide licensing program under Division 8.6 (commencing with Section 22970) of the Business and Professions Code. The Act imposed licensing requirements on all retailers, wholesalers, distributors, importers and manufacturers of cigarettes and tobacco products and all manufacturers and importers of cigarettes. In general, the Board believes that those currently licensed with the Board would not be materially affected by this measure. There may, however, be a small, but unknown, amount of persons that are not currently licensed to sell tobacco products under the Licensing Act that may be affected by this provision.
7. **Related legislation.** AB 89 (Torlakson) imposes an additional excise tax on cigarettes of \$2.10 per package of 20. The proceeds would fund various education, health, and research programs.

SB 600 (Padilla) imposes an additional excise tax on cigarettes of seventy-five mills per cigarette (\$0.075), or \$1.50 per package of 20 and would be annually adjusted for inflation. Funds would be deposited in the Tobacco Tax and Health Protection Fund and the General Fund.

COST ESTIMATE

With respect to excise taxes and the Licensing Act, the Board would incur some costs for revising publications, identifying and notifying affected retailers, answering questions from the public, carrying out compliance and audit activities, performing inspection of retail licensee locations, and other functions related to the Licensing Act. A detailed cost estimate is pending, however, these costs may be insignificant (below \$10,000).

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Tobacco products containing less than 50 percent tobacco are thought to be an extremely small part of total sales of these items. One of the few products that could become taxable under this criterion is called a “blunt wrap.” These are cigarette wrappers or papers typically made of, or containing tobacco. They are intended to be used as wrappers for making roll-your-own cigarettes. Some blunt wraps contain less than 50 percent tobacco and some do not.

The federal government taxes cigarette papers and tubes, and the federal tax rates on them increased earlier this year as a part of legislation funding the Children’s’ Health

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Insurance Program (CHIP). According to documents from the U.S. Congress Joint Committee on Taxation (JCT), under CHIP revenues for cigarette papers and tubes increased by less than \$500,000 per year.¹ Since we do not know the precise JCT revenue figure, we will assume the upper end figure of \$500,000 in our calculations.

Based on our knowledge of sales of major California tobacco products, we estimate that the CHIP tax increase averaged about 10 percent of wholesale sales of tobacco products.² If we assume this percentage for cigarette papers and tubes, U.S. wholesale costs of cigarette papers and tubes are estimated to be less than \$5 million ($\$500,000 / 0.10 = \$5,000,000$).

Blunt wraps containing less than 50 percent tobacco are only a portion of all cigarette wrappers, papers, and tubes sold, and therefore only a portion of the \$5 million estimated U.S. wholesale sales. We have no market share information for blunt wraps. We researched Internet websites to assist us in making an assumption of the market share of sales receipts of blunt wraps containing less than 50 percent tobacco of all cigarette wrappers, papers, and tubes.

Our research revealed that there are three general categories of cigarette wrappers, papers and tubes. These are: (1) blunt wraps made of or containing tobacco, (2) cigarette papers not containing tobacco, and (3) cigarette tubes not containing tobacco. We found that prices of blunt wraps are typically 30 to 50 times higher than cigarette papers or tubes not containing tobacco. For example, on one website blunt wraps typically sold for prices of about \$0.65 each. The same website featured cigarette papers (not containing tobacco) costing close to two cents per paper. Cigarette tubes (not containing tobacco) cost about one cent each. Since the unit prices of blunt wraps containing tobacco are so much higher than cigarette papers or tubes not containing tobacco, it appears that the dollar volume of blunt wraps could be 30 to 50 times the unit volume. Therefore, an extremely small part of the market for cigarette papers and tubes could account for significantly more sales receipts than their unit volumes would suggest.

For revenue estimation purposes, we assume that half of the estimated \$5 million in U.S. sales of cigarette papers and tubes is from sales of blunt wraps that contain less than 50 percent tobacco. This assumption implies an estimated U.S. wholesale market volume of about \$2.5 million for blunt wraps.

From a publication, we obtained that published tobacco products revenues and volume by state, we estimate that California accounts for about 10 percent of the U.S. roll-your-own (RYO) tobacco market.³ Assuming that preferences of California RYO smokers for blunt wraps are similar to those of the nation as a whole, this implies wholesale sales of about \$250,000 of blunt wraps in California. This is about 0.1 percent of the estimated \$168 million wholesale sales of all tobacco products in California.

¹ *Estimated Revenue Effects Of The Internal Revenue Code Provisions Of H.R. 2, The "Children's Health Insurance Program Reauthorization Act Of 2009," As Passed By The House Of Representatives January 14, 2009, JCX-4-09; Modeling The Federal Revenue Effects Of Proposed Changes In Cigarette Excise Taxes, JCX-101-07, October 19, 2007.*

² Calculations are based on data found in *Tax Burden on Tobacco: 2005*, GuerillaEconomics, LLC and Orzechowski and Walker, April 2007.

³ *Tax Burden on Tobacco: 2005*, GuerillaEconomics, LLC and Orzechowski and Walker, April 2007. Volumes of the "other products" category (tobacco products excluding chewing tobacco, moist snuff, and cigars) for California were about 10 percent of U.S. volume in 2005.

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On April 15, 2009 the Board set the fiscal year 2009-10 tobacco products tax rate at 41.11 percent. At this rate, we estimate that sales of blunt wraps would increase tobacco products revenues by about \$100,000 per year (250,000 x 0.4111 = \$102,775).

In addition to blunt wraps, there may be other tobacco products that could be categorized as having less than 50 percent tobacco. Likely sales of these products are unknown. Under this bill, tobacco products revenues would increase beyond \$100,000 to the extent that sales are made of these products.

REVENUE SUMMARY

We estimate that tobacco products revenues will increase by about \$100,000 per year. To the extent that new dissolvable tobacco products are sold, revenue gains would be higher by an unknown amount.

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