

**Updated Statement of Reasons for
Proposed Amendments to
California Code of Regulations, Title 18,
Sections 4022, Inventories of Cigarettes;
4027, Manufacturer’s Monthly Report;
4061, Unused Stamps and Unused Meter Settings;
4065, Unsalable Cigarettes; 4066, Stolen Indicia;
and 4091, Payment by Consumer**

SPECIFIC PURPOSES, PROBLEMS INTENDED TO BE ADDRESSED, NECESSITY,
AND ANTICIPATED BENEFITS

We propose to amend California Code of Regulations, Title 18, sections (Regulations)

- Regulation 4022, *Inventories of Cigarettes*
- Regulation 4027, *Manufacturer’s Monthly Report*
- Regulation 4061, *Unused Stamps and Unused Meter Settings*
- Regulation 4065, *Unsalable Cigarettes*
- Regulation 4066, *Stolen Indicia*
- Regulation 4091, *Payment by Consumer*

The proposed amendments correct outdated information and make these regulations consistent with current reporting practices.

Background

The California Department of Tax and Fee Administration (Department) is responsible for administering and enforcing the Cigarette and Tobacco Products Tax Law (CTPTL) and the California Cigarette and Tobacco Products Licensing Act of 2003 (Licensing Act). The CTPTL (Rev. & Tax. Code (RTC), § 30001 et seq.) imposes taxes and surtaxes on distributors’ distributions of cigarettes and tobacco products in this state. The Licensing Act (Bus. & Prof. Code (BPC), § 22970 et seq.) requires distributors, manufacturers, importers, wholesalers, and retailers of cigarettes and tobacco products to obtain licenses to engage in the sale of cigarettes or tobacco products in this state. (BPC, §§ 22972, 22975, 22979, 22979.21.)

Distributors, Manufacturers, Importers, Wholesalers, and Retailers

As relevant here, the CTPTL provides that the term “distribution” includes “[t]he sale of untaxed cigarettes or tobacco products in this state” and “[t]he placing . . . of untaxed cigarettes or tobacco products . . . in retail stock for the purpose of selling the cigarettes or tobacco products to consumers.” (RTC, § 30008, subds. (a) & (c).) The CTPTL provides that the term “distributor” includes every person who distributes cigarettes or tobacco products, “within the meaning of the term ‘distribution.’” (RTC, § 30011, subds. (a) & (b).) And, it generally provides that “untaxed” cigarettes and tobacco products means cigarettes

and tobacco products that have not been distributed in such a manner as to produce a tax liability under the CTPTL. (RTC, §§ 30005, 30005.5.)

The CTPTL requires distributors to register for a distributor's license (RTC, §§ 30140, 30151) and makes it a crime to engage in business as a distributor without a license. (RTC, § 30149.) The CTPTL requires distributors to purchase tax stamps to pay the taxes imposed on their distributions of cigarettes and affix a tax stamp to each pack of cigarettes before distribution. (RTC, §§ 30161, 30163.) It also requires distributors to file returns reporting the taxes imposed on their distributions of tobacco products and requires distributors to remit payment for those taxes with their returns. (RTC, § 30181, subd. (b).) And, tobacco products are referred to as "tax-paid" after they have been distributed by a licensed distributor who will pay the applicable taxes imposed on the distribution of the tobacco products under the CTPTL.

The CTPTL does not prohibit manufacturers from buying untaxed materials to use to manufacture cigarettes and tobacco products. The CTPTL does provide for manufacturers to sell untaxed cigarettes and tobacco products to licensed distributors (RTC, § 30103), and provides for the original importer (as defined in RTC, § 30019) to sell untaxed cigarettes and tobacco products manufactured outside the United States to a licensed distributor. (RTC, § 30105.) The CTPTL provides that the term "wholesaler" includes any person, other than a licensed distributor, who engages in the business of making sales for resale of tax-paid cigarettes and tobacco products (RTC, § 30016), requires wholesalers to register for a wholesaler's license (RTC, § 30155), and makes it a crime to engage in business as a wholesaler without a license. (RTC, § 30159.) The CTPTL also provides that if any person becomes a distributor without first obtaining a distributor's license, then the taxes and applicable penalties and interest, imposed on the person's distributions of untaxed cigarettes and tobacco products are immediately due and payable (RTC, § 30210), and the taxes, interest, and penalties are subject to being immediately assessed and collected by the seizure and sale of the person's property. (RTC, §§ 30211, 30212.) The CTPTL does not define the term "retailer" and the CTPTL does not apply to a retailer, unless the retailer is also a distributor, manufacturer, importer, or wholesaler.

Taxes and Surtaxes on Distributors' Distributions of Cigarettes and Tobacco Products

RTC section 30101 in the CTPTL imposes a tax upon every distributor of cigarettes and the tax applies to the distribution of each cigarette. The rate of the RTC section 30101 tax was five mills (\$0.005) per cigarette distributed from October 1, 1967, through December 31, 1993, and the rate of the tax has been six mills (\$0.006) per cigarette or \$0.12 per pack (\$0.006 x 20 cigarettes) distributed since January 1, 1994.

In November 1988, California voters passed Proposition 99, known as the "Tobacco and Health Protection Act of 1988" (Prop. 99). Among other things, Prop. 99 imposed a surtax on every distributor of cigarettes at the rate of 12.5 mills (\$0.0125) per cigarette or \$0.25 per pack (\$0.0125 x 20 cigarettes) distributed. Prop. 99 imposed a tax on every distributor of tobacco products, based on the wholesale cost of the products distributed, at a rate equivalent to the combined rate of the taxes imposed on cigarettes by the Prop. 99 surtax and the other provisions of the CTPTL, which only included the RTC section 30101 tax at the time. Prop. 99 also added RTC section 30121, subdivision (b), to the CTPTL to provide that tobacco products "includes, but is not limited to, all forms of cigars, smoking tobacco, chewing

tobacco, snuff, and any other articles or products made of, or containing at least 50 percent, tobacco, but does not include cigarettes.” Prop. 99’s surtax on the distribution of cigarettes and equivalent tax on the distribution of tobacco products are both codified in RTC section 30123 in the CTPTL.

In November 1998, California voters passed Proposition 10, known as “The Children and Families First Act” (Prop. 10). The purpose of Prop. 10 was to create county commissions to provide early childhood medical care and education. Prop. 10 imposed an additional surtax on every distributor of cigarettes at the rate of 25 mills (\$0.025) per cigarette or \$0.50 per pack distributed. Prop. 10 imposed a tax on every distributor of tobacco products (as defined in RTC, § 30131.1, subd. (b), which was identical to RTC, § 30121, subd. (b) quoted above), based on the wholesale cost of the products distributed, at a rate equivalent to the rate of the Prop. 10 surtax on cigarettes. Prop. 10’s surtax on the distribution of cigarettes and equivalent tax on the distribution of tobacco products are both codified in RTC section 30131.2 in the CTPTL.

On November 8, 2016, California voters passed Proposition 56, known as “The California Healthcare, Research and Prevention Tobacco Tax Act of 2016” (Prop. 56), which went into effect on April 1, 2017. As relevant here, Prop. 56 imposed an additional tax on every distributor of cigarettes at the rate of 100 mills (\$0.10) per cigarette or \$2.00 per pack distributed, which increased the combined cigarette tax rate from \$0.87 per pack to \$2.87 per pack. And, Prop. 56 imposed a tax on every distributor of tobacco products based on the wholesale cost of the products, at a rate equivalent to the rate of Prop. 56’s tax on cigarettes. Prop. 56’s tax on the distribution of cigarettes is codified in RTC section 30130.51 in the CTPTL and Prop. 56’s equivalent tax on the distribution of tobacco products is imposed by RTC section 30123 in the CTPTL (discussed above).

Refunds

The CTPTL authorizes the Department to prescribe regulations for issuing refunds or credits to distributors on their purchase of unused cigarette tax stamps. (RTC, § 30176.) Similarly, RTC section 30177 authorizes the Department to prescribe regulations for refunds or credits to distributors on their purchase of cigarette tax stamps that have been affixed to packages of cigarettes that have become unsalable prior to distribution, or that have become unsalable after distribution and have been returned for credit or exchange, and the Department has proof of such return or destruction.

Reports

The Department has broad authority to prescribe reports from licensees to carry out the CTPTL and the Licensing Act. RTC section 30182 authorizes the Department’s prescription of reports from distributors. RTC section 30188 authorizes the Department’s prescription of reports from wholesalers. BPC section 22979.24 authorizes the Department’s prescription of reports from manufacturers and importers. RTC section 30454 provides the Department additional authority to require distributors and other persons to report shipments of cigarettes or tobacco products from a point outside this state to a point within this state.

Cigarette Tax Uniformity Reporting

The Department participates with the Federation of Tax Administrators (FTA). The FTA has a Tobacco Tax Uniformity Project, the mission of which is to provide an opportunity for government and industry to partner for the efficient and effective reporting and remittance of cigarette and tobacco taxes, to minimize cigarette and tobacco tax evasion, and to act as an information resource to stakeholders. The first point in the Tobacco Tax Uniformity Projects plan to combat cigarette and tobacco tax evasion is for all states to adopt and implement uniform reporting guidelines. Beginning with the May 2020 reporting period (due June 25, 2020), tax forms filed by cigarette manufacturers, importers, distributors, and wholesalers were updated to include the FTA uniformity reporting standards.

Payment by Consumer

Excise tax is imposed on the sale or use of untaxed cigarettes and tobacco products in this state. (RTC, § 30008, subs. (a) & (b).) RTC section 30187 provides that a consumer or user of cigarettes or tobacco products whose use of untaxed cigarettes or tobacco products is subject to tax must file a report with the Department if the tax has not been collected from the consumer by a licensed distributor. A consumer most commonly is subject to tax when purchasing cigarettes and tobacco products from an out-of-state seller, but an exemption applies when an individual brings no more than 400 cigarettes into this state for his or her own use. (RTC, § 30106.) The report must contain the amount of cigarettes and tobacco products received by the consumer and any other detail prescribed by the Department. (RTC,

§ 30187.) Additionally, RTC section 6201 provides that use tax is imposed on the storage, use, or consumption in this state to tangible personal property purchased from a retailer for storage, use, or consumption in this state.

Interested Parties Process

Originally, the Department proposed amendments to Regulations 4022, 4027, 4061, 4065, 4066, and 4091 as part of a package of amended CTPTL regulations that also included Regulations 4011, *Distributors Not Engaged in Business in this State*; 4034, *Report of Shipments to Consumers*; and 4063.5, *Exported Tax-Paid Tobacco Products*. An initial discussion paper and proposed amendments were provided to the public and a meeting with interested parties was held on November 1, 2018 to discuss the proposed amendments. The Department received comments related to the proposed amendments to Regulations 4011, 4034, and 4063.5 and decided to postpone those revisions. The Department did not receive any written comments from interested parties related to the amendments proposed for Regulations 4022, 4027, 4061, 4065, 4066, or 4091.

Proposed Amendments

The proposed amendments to Regulation 4022, *Inventories of Cigarettes*; Regulation 4027, *Manufacturer's Monthly Report*; Regulation 4061, *Unused Stamps and Unused Meter Settings*; Regulation 4065, *Unsalable Cigarettes*; Regulation 4066, *Stolen Indicia*; and Regulation 4091, *Payment by Consumer* will correct outdated information and make these regulations consistent with current reporting practices, delete references to specific obsolete tax forms, and replace references from the Board of Equalization to the California Department of Tax and Fee Administration or Department. In lieu of the references to the forms, the

regulations incorporate the forms' reporting requirements. The proposed revisions are as follows:

Regulation 4022, *Inventories of Cigarettes*

Regulation 4022 requires cigarette distributors and wholesalers to file a monthly report that reconciles their inventory of cigarettes. The proposed amendments would clarify that importers are also required to file the monthly report. The proposed amendments would specify that the report is due on the 25th day of each month. Additionally, the proposed amendments update references from the Board of Equalization to the Department. The proposed amendments also remove references to meters and meter impressions, as these technologies are no longer in use. Additionally, staff proposes removing the current subdivision (b) in its entirety as the language is duplicative of the information in renumbered subdivision (a).

The proposed amendments remove references to obsolete forms, BOE 501-CD, *Cigarette Distributor's Tax Report* and BOE 501-CW, *Cigarette Wholesalers Report*, that are no longer in use. Instead, a new subdivision (c) was added that explains the required information to be included in reports submitted by a distributor or importer of cigarettes with respect to disbursements of cigarettes made by the licensee. Subdivision (d) was added and explains the required information in reports submitted by a distributor, importer, or wholesaler of cigarettes with respect to the receipt of cigarettes by the licensee.

Regulation 4027, *Manufacturer's Monthly Report*

Regulation 4027 prescribes the information to be contained in monthly reports required to be filed with the Department by cigarette manufacturers and tobacco products manufacturers or importers. A proposed amendment changes the title of Regulation 4027 to "*Cigarette Manufacturer and Tobacco Products Manufacturer or Importer Monthly Return and Schedules.*" The proposed amendments also add the word "importers" to subdivisions (a) and

(c) as the provisions of Regulation 4027 apply to both manufacturers and importers of tobacco products. Subdivision (a) was also amended to correct the reporting due date from the 20th day of the month to the 25th day of the month. Subdivision (a) was amended to update report information that conforms with FTA uniformity standards and to remove reporting requirements on obsolete forms BOE-501-MC, *Manufacturer's Report of Cigarettes Released from Storage in California or Shipped into California*, and BOE-501-MT, *Manufacturer's Report of Tobacco Products released from Storage in California or Shipped into California*. Revised subdivision (b) and new subdivisions (c) and (d) replace these form references with a list of the reporting information that the Department requires from manufacturers of cigarettes or manufacturers and importers of tobacco products. The proposed amendments update references from the Board of Equalization to the Department throughout the regulation, and references to Revenue and Taxation Code (RTC) sections 30102, 30103, and 30105 were added.

Regulation 4061, *Unused Stamps and Unused Meter Settings*

Regulation 4061 prescribes the process by which a distributor may obtain a refund or credit of unused cigarette tax stamps. The proposed amendments remove references to meters in the title and subdivision (a) since that technology is no longer in use. Subdivision (a) was also

revised to update the instructions for claiming refunds or credits by a distributor of unused stamps returned to the Department. The amendments include deleting instructions for claimants to use form BOE-1024, *Claim for Refund for California Tax Stamps*, and replacing it with a list of the information the Department requires claimants to provide to substantiate a claim for refund. Additionally, the proposed amendments update the language in subdivision (b) to clarify that an “unused stamp” is a tax stamp on a tax stamp roll that has not been affixed to a package of cigarettes. The language in subdivision (c) related to refunds or credits of stamps affixed to packages of cigarettes and their obliteration has been deleted since the regulation only relates to unused stamps; Regulation 4065 prescribes the process for obtaining a refund when tax stamps have been affixed to packs of cigarettes. The proposed amendments update references from the Board of Equalization to the Department throughout the regulation.

Regulation 4065, *Unsalable Cigarettes*

Regulation 4065 prescribes the process by which a distributor may obtain a refund or credit when cigarette tax stamps are affixed to packs of cigarettes that have become unsalable. The unnumbered paragraph of the regulation was revised to be numbered as subdivision (a). New subdivision (a) was amended to remove the reference to meters since that technology is no longer in use, and to update references from the Board of Equalization to the Department. The new subdivision also provides an itemized list of the information claimants must provide to substantiate a claim for refund for cigarettes that have become unsalable.

Subdivision (b) was added to clarify how a Department employee is to confirm that a cigarette tax stamp has been properly made unrecognizable after a refund or credit has been verified as valid. This proposed addition also explains that the Department employee must provide the distributor a certification of the amount of tax stamps that are acceptable to include in their claim.

Subdivision (c) was added to clarify that, before a claim is granted, the distributor must provide a copy of the credit memorandum or affidavit from the manufacturer for the returned stock. These documents must indicate the number of cigarette tax stamps that were affixed to the returned packages of cigarettes.

Subdivision (d) was added to clarify that, in the event cigarettes are not returned to the manufacturer, a distributor shall provide proof of the destruction of cigarettes with tax stamps when they are unfit or unsalable by destroying them in the presence of an employee authorized to witness the destruction.

Regulation 4066, *Stolen Indicia*

Regulation 4066 provides that no refund is available based on a distributor’s assertion that cigarette tax stamps have been lost due to theft or unexplained disappearance. Staff proposes removing references to “meter settings” and “meter impressions” in Regulation 4066, as these technologies are no longer used. The word “unaffixed” was added before “stamps” for clarity.

Regulation 4091, *Payment by Consumer*

Regulation 4091 prescribes the process by which consumers of cigarettes or tobacco products must report and pay tax when the tax is imposed on the consumer, such as when untaxed

cigarettes or tobacco products are shipped to the consumer from an out-of-state retailer. The proposed amendments in subdivision (a) remove reference to form BOE-501-CI, *Cigarette and Tobacco Products Excise Tax Return*, and replace it with a list of the information the Department requires for a submission to be considered a valid return. In subdivision (a) and (b), staff added “cigarette and tobacco products taxes” to clarify the tax for which consumers or users are liable with respect to this regulation. In addition, the proposed amendments update references from the Board of Equalization to the Department throughout the regulation.

Economic Impact Assessment

The proposed amendments to Regulations 4022, 4027, 4061, 4065, 4066, and 4091 impact cigarette and tobacco products manufacturers, importers, distributors, and wholesalers. As of May 12, 2021, the number of active accounts were as follows:

- 761 Cigarette & Tobacco Products Distributor License,
- 27,551 Cigarette & Tobacco Products Retailer License,
- 381 Cigarette & Tobacco Products Wholesaler License,
- 2 Cigarette & Tobacco Transporter Permit,
- 144 Cigarette Distributor/Importer,
- 1 Cigarette Floor Stock Retailer,
- 60 Cigarette Internet Excise Tax,
- 60 Cigarette Internet Use Tax,
- 24 Cigarette Manufacturer,
- 33 Cigarette Manufacturer/Importer License,
- 49 Cigarette Tax Stamp,
- 199 Cigarette Wholesaler,
- 772 Tobacco Products Distributor,
- 209 Tobacco Products Manufacturer/Importer License,
- 189 Tobacco Products Manufacturers/Importer, and
- 322 Tobacco Products Wholesaler accounts.

It should be noted that a person may have more than one account type. There are no comparable Federal regulations. In the absence of Federal regulation, state regulation is needed, and the Department is the state agency responsible for administering state, local, and district sales and use tax. The Department considered whether to begin the formal rulemaking process to adopt the proposed amendments at this time or, alternatively, whether to take no action at this time. No additional alternatives were considered.

The amendments are needed to correct outdated information and make these regulations consistent with current reporting practices. The benefits of the regulatory changes are the result of goals developed by the agency based on broad statutory authority. Although the statewide dollar costs and benefits from these regulatory changes are unknown, the amendments provide clarification and guidance to cigarette and tobacco products manufacturers, importers, distributors, and wholesalers which will assist in their compliance and reporting. The amendments are also consistent with statutory requirements. As such, the Department anticipates that the proposed amendments will have little to no economic impact on businesses. The Department anticipates:

- The estimated impact is below \$10 million.
- No businesses or jobs will be created or eliminated as a result of the regulatory changes.
- The regulatory changes will not affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here.
- The regulatory changes will not directly impact housing costs.
- There are no other benefits of the regulatory changes, including, but not limited to, benefits to the health, safety, and welfare of California residents, worker safety, and the state's environment and quality of life, identified by the Department.

Additionally, there is no estimated change of investment in the state; no incentive for innovation in products, materials, or processes; and no fiscal impact. The regulatory changes do not mandate specific technologies or equipment. The regulatory changes do not affect any local entity or program and do not affect any federally funded state agency or program. The Department will update the versions of Regulations 4022, 4027, 4061, 4065, 4066, and 4091 on its website and incorporate the amendments into industry guidance. The workload associated with these changes is considered routine. Any corresponding cost would be absorbed within the Department's existing budget.

Update to the Statement of Reasons

The Department mailed, published, and posted its notice for the adoption of the proposed amendments to Regulations 4022, 4027, 4061, 4065, 4066, and 4091 on September 24, 2021. The notice explained that November 08, 2021, was the deadline for written comments regarding the adoption of the proposed amendments to Regulations 4022, 4027, 4061, 4065, 4066, and 4091. The notice also explained that the Department had not scheduled a public hearing to discuss the proposed regulatory action, but the Department would hold a public hearing if a written request for a public hearing was received no later than 15 days before the close of the written comment period. No public hearing was requested and no written public comments were received regarding the proposed regulatory action.