

Notice of Changes to the Text of Proposed Regulation 4077, *Tobacco Product Manufacturer*

To Interested Parties,

Notice is hereby given that the California Department of Tax and Fee Administration (CDTFA) made changes to the proposed text of California Code of Regulations, title 18, section (Regulation or Reg.) 4077, *Tobacco Product Manufacturer*, pursuant to Government Code section 11346.8.

Need for the Changes

Public Hearing

On August 16, 2019, the CDTFA issued a notice regarding proposed amendments to Regulation 4076, *Wholesale Cost of Tobacco Products*, and the proposed adoption of new Regulation 4077. On September 16, 2019, the CDTFA received an email regarding proposed Regulation 4077 that Ms. Nancy Farias sent on behalf of the Service Employees International Union (SEIU) Local 1000. In the email, Ms. Farias expressed SEIU Local 1000's opinion that Regulation 4077 "will cause the State of California to lose revenue" because it will allow retailers "to sell nicotine and vape juice separately to a customer, and the tax would only be collected on the nicotine portion of the sale and not the entire product as combined." Ms. Farias expressed SEIU Local 1000's opinion that Regulation 4077 "is a safety hazard to the public" because "nicotine is considered a dangerous chemical" and "not preventing retail store customers from blending the vape juice and nicotine in stores . . . could endanger the purchaser, the employees and other customers." Ms. Farias also requested that the CDTFA conduct a public hearing to discuss proposed Regulation 4077 on behalf of SEIU Local 1000 and attached a safety data sheet to her email, which indicates that nicotine solution is toxic and environmentally damaging. Therefore, the CDTFA held a public hearing to discuss proposed Regulation 4077 on November 21, 2019, in accordance with Government Code section 11346.8, subdivision (a).

Mr. Steven Alari attended the public hearing and made comments on behalf of SEIU Local 1000. Mr. Alari stated that SEIU Local 1000 opposes proposed Regulation 4077 because it encourages customers to blend liquid nicotine with other products in stores to reduce their tax burden. Mr. Alari also stated the blending creates health, safety, and environmental issues, including health and safety issues for CDTFA investigators who have to seize untaxed liquid nicotine, as liquid nicotine is hazardous and he provided the same safety data sheet indicating that nicotine solution is toxic and environmentally damaging. Mr. Alari stated that, for the same reasons, SEIU Local 1000 disagrees with the statement in the CDTFA's initial statement of reasons that proposed Regulation 4077 does not affect the health and welfare of California residents. Mr. Alari also stated that SEIU Local 1000 believes that allowing customers to buy non-nicotine vape juice and liquid nicotine separately will affect jobs by hurting businesses that sell vape juice that is already blended with liquid nicotine.

Mr. Michael Carpenter of Carpenter Sievers also attended the public hearing and provided a November 21, 2019, letter from Ms. Rachel K. Hyde (Hall) that contained comments on behalf of the Premium Cigar Association (PCA). In the letter, Ms. Hyde (Hall) raised the PCA's

concern that proposed Regulation 4077 will “prohibit premium tobacconists from conducting the following historical business practices:

- Pipe tobacco is blended in store from finished tobacco products. Pipe tobacco is removed from the large manufacturer bags and placed into a small, separate container by either the customer or the professional tobacconist.
- Professional tobacconists curate samplers of premium cigars to sell to customers and for charity events.
- Manufacturers in the Dominican Republic, Honduras, and many other countries, produce handcrafted, custom premium cigars specifically for local premium tobacconists to sell. No part of the manufacturing process takes place locally by the in-state entity.”

The PCA also encouraged the CDTFA to consider revising proposed Regulation 4077 so it is more narrowly focused and has less of an impact on premium tobacconists, some of which are small businesses.

Responses to Comments on Behalf of SEIU Local 1000

The CDTFA considered the September 16, 2019, and November 21, 2019, comments on behalf of SEIU Local 1000. The CDTFA agreed that liquid nicotine can be hazardous if mishandled or misused. However, the CDTFA did not agree that proposed Regulation 4077 encourages customers to blend liquid nicotine with other products, will cause the state to lose revenue, will create health, safety, or environmental issues, or hurts businesses that sell vape juice that is already blended with liquid nicotine. This is because it is already common for consumers that use electronic cigarettes to purchase liquid nicotine, a base liquid, such as vape juice, and flavoring and then blend them to make custom liquids for use in their electronic cigarettes. The Cigarette and Tobacco Products Tax Law (Rev. & Tax. Code (RTC), § 30001 et seq.) (CTPTL) does not prohibit licensed retailers from purchasing tax-paid liquid nicotine from licensed distributors and wholesalers and then selling it to their customers at retail and does not currently impose tax on a retailer who merely purchases and resells tax-paid liquid nicotine in that manner. The CTPTL does not prohibit retail customers from purchasing tax-paid liquid nicotine from licensed retailers and separately purchasing non-nicotine vape juice, and then blending the two products for their own use. The CTPTL does not prohibit licensed retailers from allowing their customers to blend liquid nicotine with vape juice on their premises. The CTPTL does not authorize the CDTFA to regulate liquid nicotine due to its health, safety, or environmental effects. Proposed Regulation 4077 merely clarifies that a retailer is not a manufacturer just because the retailer allows its customers to blend liquid nicotine and other products after a sale has been made. Proposed Regulation 4077 does not change the application of tax when a licensed retailer merely purchases tax-paid liquid nicotine from a licensed distributor or wholesaler and resells it at retail, and there is no evidence that the regulation will actually encourage a substantial number of consumers to make custom liquids for use in their electronic cigarettes that would not otherwise do so or have a substantial impact on businesses that sell vape juice that is already blended with liquid nicotine. Also, proposed Regulation 4077 clarifies that retailers are generally required to purchase their tobacco products from licensed distributors and wholesalers and that clarification may reduce the amount of untaxed liquid nicotine CDTFA

investigators seize from retailers in the future. Therefore, the CDTFA did not make any changes to proposed Regulation 4077 in direct response to the comments on behalf of SEIU Local 1000.

However, after considering the comments about blending liquid nicotine and vape juice, the CDTFA realized that “blending” is a term commonly used to refer to the action of making custom liquids for use in electronic cigarettes, and there was an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) with subdivision (b) of proposed Regulation 4077 because it does not refer to blending. Therefore, the CDTFA determined that it was necessary to change the subdivision so it refers to a retailer that “blends” liquid nicotine and other components, rather than a retailer who “prepares” liquid nicotine and other components, and refers to a retailer who allows its customers to “blend” liquid nicotine and other components, rather than a retailer who allows its customers to “prepare” liquid nicotine and other components, for the specific purpose of addressing the issue (or problem) regarding the omission of the term blending. The CDTFA also realized that there was an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) with subdivisions (a) and (b) in proposed Regulation 4077 because, after the prior change, subdivision (b) will provide that a retailer that “mixes, blends, or combines” liquid nicotine and other components is a tobacco product manufacturer, but subdivision (a) does not consistently define the term manufacturer to specifically include a person who “mixes, blends, or combines” a finished tobacco product. Therefore, the CDTFA determined that it was necessary to change subdivision (a) of proposed Regulation 4077 so it provides that a person who “mixes, blends, or combines” a finished tobacco product is a tobacco product manufacturer for the specific purpose of addressing the issue (or problem) by making the terminology used in subdivision (a) consistent with the terminology used in subdivision (b) of the regulation.

Responses to Comments on Behalf of the PCA

The CDTFA considered the November 21, 2019, comments on behalf of the PCA and realized that there was another issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) because subdivision (b) of proposed Regulation 4077 provides guidance to retailers who mix, blend, or combine liquid nicotine with other components and retailers that package liquid nicotine with other items, but proposed Regulation 4077 does not provide sufficient guidance to retailers that mix, blend, or combine other tobacco products, such as pipe tobacco, or retailers that package other tobacco products with other items, such as retailers that package cigars together. Therefore, the CDTFA determined that it was necessary to change the first sentence in subdivision (b) to clarify that a retailer who mixes, blends, or combines “a tobacco product that is not in a form suitable for human consumption, such as” liquid nicotine, and other “ingredients or” components “to make” a tobacco product “that is suitable for human consumption” is a tobacco product manufacturer, for the specific purpose of addressing the issue (or problem) by providing broader guidance to tobacco product retailers about the types of mixing, blending, or combining that will make them tobacco product manufacturers. The CDTFA also determined that it is necessary to add a new subdivision (c) to proposed Regulation 4077 to clarify that a “retailer is not a manufacturer solely because the retailer packages finished tobacco products, such as cigars, together as one unit or because the retailer mixes, blends, or combines finished tobacco products, such as pipe tobacco,” for the specific purpose of addressing the issue (or problem) by providing broader guidance to tobacco product retailers about the types of

packaging and mixing, blending, and combining that they can do without becoming tobacco product manufacturers.

Also, after considering the comments on behalf of the PCA, the CDTFA determined that a retailer can be a tobacco product manufacturer under subdivision (a) of proposed Regulation 4077 if the retailer owns a brand or formula for a premium cigar and contracts with a manufacturer in the Dominican Republic, Honduras, or other country to produce handcrafted cigars to the standard for their brand or formula, even if the manufacturing process takes place outside the country. However, the CDTFA did not agree that this created an issue (or problem) with subdivision (a) of proposed Regulation 4077 because it only makes such a retailer a tobacco product manufacturer that is required to obtain and maintain a valid Cigarette and/or Tobacco Products Manufacturer/Importer's License issued by the CDTFA under Business and Professions Code section 22979, and it will not prohibit such a retailer from continuing the historical practice of contracting with a manufacturer in the Dominican Republic, Honduras, or other country to produce handcrafted cigars to the standard for their brand or formula.

The CDTFA's Other Changes

In addition, the CDTFA determined that there were two more minor issues (or problems within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) with the last sentence in subdivision (b) of proposed Regulation 4077 because the sentence should apply to tobacco products, rather than nicotine products, and the sentence should only apply to retailers that are not licensed manufacturers, importers, or distributors since licensed manufacturers, importers, and distributors are not required to purchase their tobacco products exclusively from licensed distributors and wholesalers. Therefore, the CDTFA determined that it was necessary to make minor changes to the last sentence in subdivision (b) so it refers to "tobacco" products, rather than "nicotine" products, and applies to retailers that are not licensed manufacturers, importers, or distributors for the specific purpose of addressing the issues (or problems). The CDTFA determined that it was necessary to reformat the last sentence in subdivision (b), as subdivision (d), to help clarify that the sentence applies to retailers described in subdivisions (b) and (c). The CDTFA also determined that it was necessary to add a reference to RTC section 30019, which defines "importer," to proposed Regulation 4077's reference note because the reference note already refers to RTC sections 30011 and 30016, which define the terms "distributor" and "wholesaler," respectively.

Text of the Changes

The CDTFA has prepared a revised version of the text of proposed Regulation 4077 with the changes clearly indicated in strikeout and underline format. The CDTFA is also making the revised version of the text of proposed Regulation 4077 available to the public by placing it in the rulemaking file and posting it on the CDTFA's website at www.cdtfa.ca.gov. If you wish to review the rulemaking file, it is available for your inspection at 450 N Street, Sacramento, California, from 8:00 a.m. to 5:00 p.m. Monday through Friday, excluding state holidays.

Contact Persons

Questions regarding the substance of the changes to proposed Regulation 4077 should be directed to Mr. Stephen Smith, Tax Counsel IV, by telephone at (916) 323-3106, by e-mail at Stephen.Smith@cdtfa.ca.gov, or by mail at California Department of Tax and Fee Administration, Attn: Stephen Smith, MIC:82, 450 N Street, PO Box 942879, Sacramento, CA 94279-0082.

Written comments regarding the changes to proposed Regulation 4077 and other inquiries concerning the proposed administrative action should be directed to Ms. Kim DeArte, Regulations Coordinator, by telephone at (916) 309-5227, by fax at (916) 322-2958, by e-mail at CDTFARegulations@cdtfa.ca.gov, or by mail at California Department of Tax and Fee Administration, Attn: Kim DeArte, MIC:50, 450 N Street, PO Box 942879, Sacramento, CA 94279-0050. Ms. DeArte is the designated backup contact person to Mr. Smith.

Written Comments Regarding the Changes

Any interested person may submit written comments regarding the changes to proposed Regulation 4077. The written comment period ends at 11:59 pm (PDT) on May 27, 2020. The CDTFA will consider the statements, arguments, and/or contentions contained in written comments received by Ms. DeArte at the postal address, email address, or fax number provided above, prior to the close of the written comment period, before the CDTFA decides whether to adopt the revised version of the text of proposed Regulation 4077.