

4-17-1989

# Proposition 99 and the Tax on Other Tobacco Products

Joint Legislative Budget Committee

Follow this and additional works at: [http://digitalcommons.law.ggu.edu/caldocs\\_joint\\_committees](http://digitalcommons.law.ggu.edu/caldocs_joint_committees)



Part of the [Legislation Commons](#), and the [Taxation-State and Local Commons](#)

---

## Recommended Citation

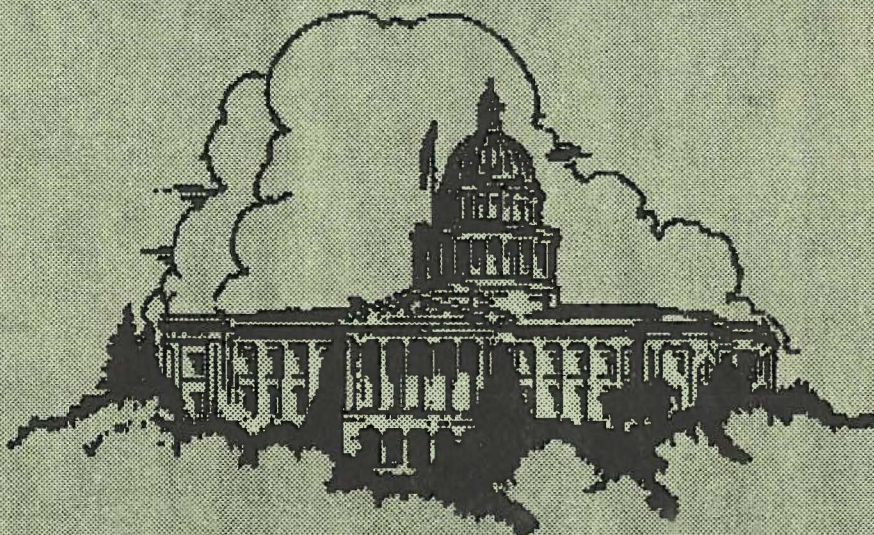
Joint Legislative Budget Committee, "Proposition 99 and the Tax on Other Tobacco Products" (1989). *California Joint Committees*. Paper 21.

[http://digitalcommons.law.ggu.edu/caldocs\\_joint\\_committees/21](http://digitalcommons.law.ggu.edu/caldocs_joint_committees/21)

This Committee Report is brought to you for free and open access by the California Documents at GGU Law Digital Commons. It has been accepted for inclusion in California Joint Committees by an authorized administrator of GGU Law Digital Commons. For more information, please contact [jfischer@ggu.edu](mailto:jfischer@ggu.edu).

**CALIFORNIA LEGISLATURE  
JOINT LEGISLATIVE BUDGET COMMITTEE**

**SENATOR WILLIAM CAMPBELL, CHAIRMAN**



**PROPOSITION 99 and the  
TAX on other TOBACCO PRODUCTS**

**A Report on the  
Hearing of April 10, 1989**

**by the**

**Joint Legislative Budget Committee  
Prepared April 17, 1989**

**John Vasconcellos  
Vice Chairman**

**DEPOSITORY**

**JUN 14 1989**

**RECEIVED**

**SENATE MEMBERS**

**Alfred E. Alquist  
Robert G. Beverly  
Bill Greene  
Milton Marks  
Joseph Montoya  
Nicholas C. Petris**

**ASSEMBLY MEMBERS**

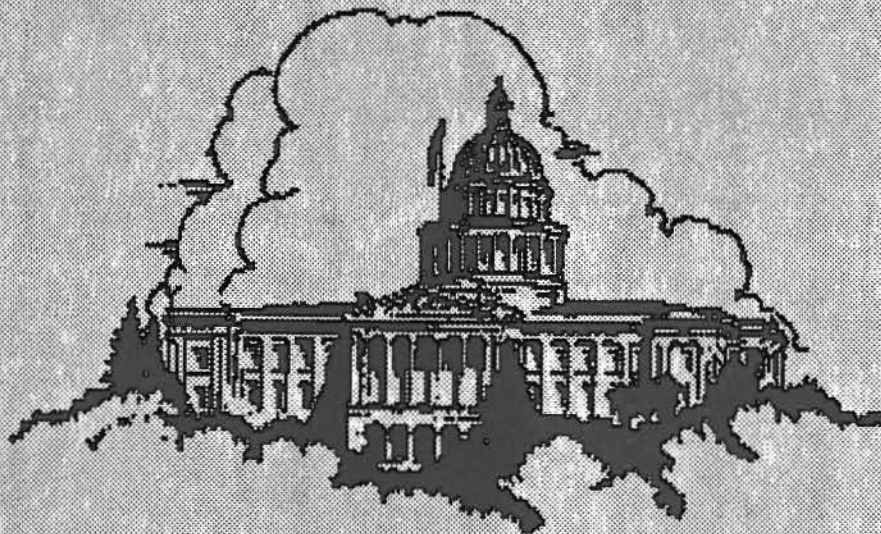
**William Baker  
John Burton  
Robert Campbell  
Frank Hill  
Pat Nolan  
Maxine Waters**

**Thomas A. Burns, Staff Director**

**KFC  
22  
L500  
B83  
1989  
no. 3**

**CALIFORNIA LEGISLATURE  
JOINT LEGISLATIVE BUDGET COMMITTEE**

**SENATOR WILLIAM CAMPBELL, CHAIRMAN**



**PROPOSITION 99 and the  
TAX on other TOBACCO PRODUCTS**

**A Report on the  
Hearing of April 10, 1989**

**by the**

**Joint Legislative Budget Committee  
Prepared April 17, 1989**

**John Vasconcellos  
Vice Chairman**

**SENATE MEMBERS**

**Alfred E. Alquist  
Robert G. Beverly  
Bill Greene  
Milton Marks  
Joseph Montoya  
Nicholas C. Petris**

**ASSEMBLY MEMBERS**

**William Baker  
John Burton  
Robert Campbell  
Frank Hill  
Pat Nolan  
Maxine Waters**

**Thomas A. Burns, Staff Director**

**LAW LIBRARY  
JUL 12 1989  
GOLDEN GATE UNIVERSITY**

KFC  
22  
1500  
B83  
1989  
no. 3

**CALIFORNIA LEGISLATURE**  
**JOINT**  
**LEGISLATIVE BUDGET COMMITTEE**

**INTRODUCTION**

**April 17, 1989**

The Joint Legislative Budget Committee held a public hearing on April 10, 1989, in Room 2040 at the State Capitol in Sacramento to study the issue of Proposition 99 and the tax on other tobacco products. This report represents the outgrowth of that discussion. Contained within are:

- 1) a report on the proposition and its impact on other tobacco products;
- 2) a copy of the transcript of the proceedings of the Board of Equalization with regard to the proposition;
- 3) a copy of the Committee agenda for the hearing; and,
- 4) a copy of the transcript of the hearing.

**WILLIAM CAMPBELL**  
Chairman

## TABLE of CONTENTS

<b>SUBJECT</b>	<b>PAGE</b>
1) Introduction. . . . .	i
2) Table of Contents/ List of Illustrations. . . . .	ii
3) Report on Proposition 99 and the Tax on Other Tobacco Products. . . . .	1
4) <u>Appendix I</u> : Transcript of Public Hearing by the State Board of Equalization (November 30, 1988). . . . .	A-1
5) <u>Appendix II</u> : Agenda of Committee Public Hearing (April 10, 1989). . . . .	A-40
6) <u>Appendix III</u> : Transcript of Committee Public Hearing (April 10, 1989). . . . .	A-42

## LIST of ILLUSTRATIONS

1) Illustration No. 1/ State Cigarette Excise Tax Rates. . . . .	3
2) Illustration No. 2/ Comparison of New Tax Rates on Other Tobacco Products. . . . .	6
3) Illustration No. 3/ Out-of-State Direct Mail Tobacco Products' Advertisement. . . . .	7

**REPORT ON PROPOSITION 99 AND THE TAX ON OTHER TOBACCO  
PRODUCTS**

Report on Proposition 99 and the Tax on Other Tobacco Products

I. BACKGROUND

The Revenue and Taxation Code imposes a state excise tax upon distributors of cigarettes which is based on a per cigarette levy. The state sales and use tax is then imposed on the wholesale cost of cigarettes plus the excise rate. Prior to the passage of Proposition 99 by the voters in November of 1988, this tax rate was five mills (\$0.005) per cigarette or--since cigarettes are sold in packages of 20--10 cents per pack. The excise rate had been at this level since 1967.

After administrative costs, the proceeds from this 10 cent tax are distributed so that 70 percent goes to the General Fund of the State Treasury and the remaining 30 percent goes as a subvention to local government.

Proposition 99 added to this excise tax in several ways:

- 1) A surtax on the cigarette excise tax was imposed at twelve and one-half mills (\$0.0125) per cigarette, or 25 cents per pack, all to total to a new per pack excise rate of 35 cents. The first 10 cents of this new 35 cent rate continues to be distributed as it was previously.
- 2) A definition was added to the tax code to define "tobacco products," which were cited as cigars, pipe tobacco, chewing tobacco, snuff and any other product not a cigarette and containing at least 50 percent tobacco.
- 3) A tax was imposed on the newly-defined tobacco products "based on the wholesale cost of these products, at a rate, as determined annually by the State Board of Equalization, which is equivalent to the combined rate of tax imposed on cigarettes...(e.g., the new 35 cent rate.)" (Revenue and Taxation Code Section 30123(b).)
- 4) Revenue generated from the new tax increases in Items 1 and 3 above were defined as outside the Gann appropriation limit and, therefore, could be expended independent of limit restrictions according to specific guidelines set out in the Proposition.
- 5) Revenue generated from the new increases may be used to supplement current services but not fund existing service levels.

For tobacco products, this tax is new, as these products were not levied an excise tax prior to Proposition 99.

The Legislative Analyst, in projecting the effect this measure would have on revenue, forecast that in 1989-90 (a year during which the new rate would apply only for 6 months) \$300 million would be generated and in 1989-90 \$600 million would be collected. Also, the Analyst pointed out that the trend in cigarette and tobacco consumption has declined every year from the year previous during this decade because of declining per capita numbers of smokers or tobacco users. As this is an inelastic tax--e.g., one that is a fixed cent levy, revenue yields will decline when adjusted for inflation.

The Analyst speculated that the new surtax would increase the average price of a pack of cigarettes by slightly more than 20 percent and, because of this price jump, consumption would decrease by anywhere from one percent to 8 percent. So, the Analyst believed--absent the direct revenue yield from the surtax--that there would be two counterbalancing effects on the General Fund and local government revenues: 1) the sales tax yield would increase as the tax is levied on the total price of a product, which in this case would include the additional 25 cent tax, and 2)

the total price of a product, which in this case would include the additional 25 cent tax, and 2) the revenue yield formerly realized when there was only a 10 cent rate would decrease as some portion of consumers would cut down on their purchase of cigarettes and tobacco products because of the increased cost. Quoting literature in the field, the Analyst noted that studies show that for each one percent decline in consumption there is a corresponding \$6 million decline in revenues. So, if consumption declined by as much as 10 percent, the revenue loss could be \$60 million.

What the Analyst did not speculate on was whether or not those consumers who had been formerly purchasing cigars, snuff and other tobacco products without any excise tax would continue to purchase from in-state vendors a product with a substantial markup as a result of the Proposition.

## II. DETERMINATION OF THE TAX ON TOBACCO PRODUCTS

As mandated by the provisions of Proposition 99, the Board of Equalization, deliberating on the rate of excise tax to be imposed on tobacco products, concluded in its November 30, 1988 meeting that a single ad valorem tax (a tax applied to the market value of the item) rate would be the most equitable. The Board reached this conclusion after considering the following:

- 1) The difficulty in application of an equivalent tax for both cigarettes and tobacco products is that the former is uniform and it is easy to set a standard rate whereas the latter comes in many sizes and different packaging. As an example, cigars are sold individually while snuff is sold by the package.
- 2) The Board staff interpreted the definition of "tobacco products" to include all tobacco products as one.
- 3) The Board staff interpreted the language of the Proposition to call for only one excise tax rate, not several rates based either on the size, packaging of the product, or the wholesale price of the product.
- 4) An ad valorem tax rate is currently used by 28 of the 30 states that have an excise tax on cigarettes or tobacco products (See Illustration No. 1.) The Board staff perceived that the ad valorem approach would be the least confusing to distributors and consumers, and would be easier to administer.

With these considerations, the Board staff recommended a tobacco products' tax rate (X) set according to the tax rate on one cigarette (C) divided by the weighted average wholesale cost of one cigarette (W). So, the formula for the calculation as presented to the Board was:

$$X = \frac{C(\text{Tax rate on one cigarette})}{W(\text{Weighted average wholesale cost of one cigarette})}$$

The staff determined that the weighted average wholesale cost per cigarette was 4.2 cents. The tax rate after Proposition 99 is 1.75 cents. So, the staff concluded that the tax rate on tobacco products should be 1.75 cents divided by 4.2 cents, or 41.67 percent. It further recommended to the Board that this rate would apply--in accordance with the provisions of Proposition 99--to the period from January 1, 1989 through June 30, 1989.

The tobacco products industry protested the recommendation of the Board staff, maintaining that the staff should have based the suggested rate for tobacco products on the tax per cigarette



**ILLUSTRATION NO. 1**  
*State Cigarette Excise Tax Rates*



SOURCE: Tobacco Institute

(Effective January 1, 1989)

April 17, 1989

Page Three

against the average per unit cost of tobacco products, such as an individual cigar. The industry maintained that, if this approach were used, the tax rate on tobacco products would only be 18 percent. Because this 42 percent increase, the industry maintained that out-of-state vendors would be able to gain unfair market advantage by advertising through direct mail that an out-of-state purchase would avoid this recent hike. There would be lost sales to California small business and lost sales and excise tax revenue to the state treasury.

Proposition 99 advocates maintained that the intent of the initiative was to impose the same effective tax rate on cigarettes as imposed on cigars, snuff and other tobacco products, producing the same unit tax revenue.

The Board adopted the recommendation of its staff at its November meeting.

### III. PUBLIC HEARING BY COMMITTEE (April 10, 1989)

On April 10, 1989, a public hearing on the issue of Proposition 99 and the tax on other tobacco products by the Joint Legislative Budget Committee was held. The Committee sought to investigate the equity and legality of the decision by the Board on the tax rate on tobacco products, as well as to consider the effect that the Board's action might have on revenue projections and the sale of such products.

Mr. Dell Anderson, Administrator of Excise Taxes for the Board of Equalization, defended the action of the Board, stating that the weight-to-value method of computation the Board adopted was the most equitable and in line with the proposition intent.

Mr. Cory Brown, a Proposition 99 advocate, spoke in support of the Board's action, outlining that the Proposition 99 coalition had the following goals:

- 1) To raise the price of tobacco so that the cost hike would drive down demand as a matter of public policy;
- 2) To establish a tax on other tobacco products that were not formerly taxed and a tax that was equitable with the one on cigarettes; and,
- 3) To raise funding for programs with a high public policy profile, such as those that teach children not to smoke, provide health care to individuals who cannot afford it and so on.

Mr. Brown maintained that the Board's determination on the tax rate for tobacco products was in concert with the goals of the coalition, adding that the tax was not onerous in that rates in other states range from 5 to 65 percent and that the new California rate of 42 percent was well within that span.

As alluded to above, the Office of the Legislative Analyst is required to provide a fiscal analysis of all ballot propositions. When the Analyst did their review of the provisions of Proposition 99, they interpreted the language of the proposition in the same manner as the Board of Equalization. This interpretation led to an estimated total income from the new tax of \$600 million. Of this amount, \$31 million was from the new tax on other tobacco products.

Addressing these projections, Mr. Rabovsky, a representative from the Analyst's Office, noted that their estimates of revenue had some uncertainties in them. According to Mr. Rabovsky, there is no way to accurately forecast what impact the 41.67 percent price increase will have on consumer demand. The office also was not sure of the number of cigars previously purchased in California. The Analyst used California's share of the national cigarette market in building its revenue projections. If the tobacco industry figures were used instead the estimated revenues

would decline by approximately \$7 million.

Nevertheless, although in disagreement with the position of his office, Mr. Rabovsky indicated that the position of the tobacco industry with regard to the imposition of a tax rate on other tobacco products was plausible and that he could understand the reasoning behind the approach.

Mr. John Parker, Chairman of the Board for the California Association of Tobacco and Candy Distributors, reiterated the industry's position. Arguing that the language in Revenue and Tax Code Section 30123(b) refers to the wholesale cost of each individual item not to the cost of all items, Mr. Parker noted some unique problems with the way the Board chose to implement the language in Section 30123(b).

Using a copy of Illustration No. 2, it was shown that the tax on a pack of 20 cigarettes which sell for \$2.63 per pack is \$0.35 while the tax on a single cigar which sells for \$2.81 is \$1.17. According to Mr. Parker, the tax on little cigars varies dramatically depending on whether the cigar is considered a "cigarette" or a "cigar". The tax on 20 little cigars sole in a carton is \$1.27 while the tax on 20 cigarettes sold in a tin is \$0.35. The only difference between the two, stated Mr. Parker, is that cigarettes are produced at a rate of 3 pounds per thousand cigarettes while the cigars are produced at a rate of more than 3 pounds per thousand.

According to Mr. Parker, one of the primary concerns expressed by the tobacco industry with a tax of 41.67 percent was that people would start to purchase cigars and pipe tobacco outside of California. Illustration No. 3 represents a copy of an advertisement which is being distributed by direct mail throughout California. Mr. Parker pointed out that the first line of the ad reads: "With the new California 41 percent tobacco tax, mail ordering your tobacco products has, obviously, become very attractive from a cost standpoint."

Two small business tobacco shop owners, Ms. Barbara Morphy and Ms. Linda Squires said their cigar and pipe tobacco business was down 30 to 40 percent since the passage of the proposition. When pressed on where these customers have gone, the owners speculated that 90 percent have started using mail orders for their tobacco products.

In concluding the hearing, the Committee asked Mr. David Doerr, a tax consultant with the California Taxpayers' Association, to comment on tax policy. Mr. Doerr noted that the manner by which the tax has been implemented means that the cigarette manufacturers will decide the amount of tax paid for other tobacco products. According to Mr. Doerr, this occurs because, as the wholesale price of cigarettes rises, the tax on other tobacco products will decline.

#### IV. CONCLUSIONS BY THE COMMITTEE

After reviewing all of the comments and testimony presented, the following conclusions were drawn by the Committee:

The language pertaining to a tax on other tobacco products contained in Proposition 99 is not clear. Because of this ambiguity in the language of the proposition, both the interpretation of such language by the tobacco industry and the Board of Equalization are plausible.

The tax rate of 41.67 percent may be causing California taxpayers to move their purchases of cigars and pipe tobacco out of state. Business in tobacco shops is down 30 to 40 percent. Much of this business appears to be going out of state.

ILLUSTRATION NO. 2
















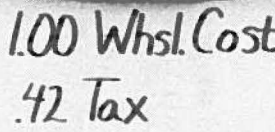



CIGARS	LITTLE CIGARS	PIPE TOBACCO	SNUFF & CHEWING TOBACCO	CIGARETTES
 2.81 Whsl Cost 1.17 Tax	 20 Little Cigars 3.04 Whsl Cost 1.27 Tax	 3.20 Whsl Cost 1.33 Tax	 1.18 Whsl. Cost .49 Tax	 2.63 Whsl Cost .35 Tax
 2.20 Whsl Cost .93 Tax	 20 "Cigarettes" 2.39 Whsl. Cost .35 Tax	 1.99 Whsl. Cost .83 Tax	 1.16 Whsl. Cost .49 Tax	 1.93 Whsl. Cost .35 Tax
 1.30 Whsl. Cost .55 Tax	 1.54 Whsl Cost .64 Tax	 1.00 Whsl. Cost .42 Tax	 20's .89 Whsl. Cost .35 Tax	
 1.16 Whsl. Cost .48 Tax	 1.10 Whsl. Cost .46 Tax	 1.00 Whsl. Cost .42 Tax	 25's .91 Whsl. Cost .35 Tax	
			 1.06 Whsl. Cost .44 Tax	 20's Value Price .65 Whsl. Cost .35 Tax

ILLUSTRATION NO. 3



DEAR CALIFORNIA CUSTOMER,

WITH THE NEW CALIFORNIA 41% TOBACCO TAX, MAIL ORDERING YOUR TOBACCO PRODUCTS HAS, OBVIOUSLY, BECOME VERY ATTRACTIVE FROM A COST STANDPOINT. WHILE BUYING THESE PRODUCTS LOCALLY MAY BE MORE "CONVENIENT", WE AT IRC, AFTER 132 YEARS OF TRYING, KNOW WE CAN ASSIST WITH YOUR SMOKING NEEDS.

THE ONE "THING" THAT HAS NOT CHANGED IS OUR PHILOSOPHY OF 1857 "CUSTOMER SERVICE FIRST". WE STILL CATER TO OUR CUSTOMERS, BY MAIL, BY PHONE, AND IN THE STORE, AS WE ALWAYS HAVE. FOR EXAMPLE:

ORDERS SHIPPED SAME DAY RECEIVED.

WE SHIP ANYWHERE.

WE GUARANTEE FRESHNESS OF OUR TOBACCO AND CIGARS.

IF WE DON'T CARRY YOUR FAVORITE BRAND WE WILL GET IT FOR YOU.

EASY, FAST RETURN POLICY, IF NOT COMPLETELY HAPPY WITH YOUR PURCHASE.

WE ACCEPT ALL MAJOR CREDIT CARDS.

PLUS MANY MORE SERVICES. INCLUDING, FREE 800 CALLING, FREE GIFT WRAPPING, PLUS, PLUS.

AS YOU SEE WE AT IRC ARE JUST WAITING TO SHOW YOU HOW GOOD WE REALLY ARE. IF YOU HAVE NOT RECEIVED OUR 1989 MAILING (ABOUT MID NOV.) JUST CALL 1 800 621-1457, AND IT WILL BE IN THE MAIL IN MINUTES. WE LOOK FORWARD TO THE OPPORTUNITY OF SERVING YOU WITH THE FINEST TOBACCOS, CIGARS, AND PIPES IN THE UNITED STATES.

P.S. ENCLOSED ARE A FEW OF OUR CURRENT SPECIALS.

CORDIALLY

THE IWAN RIES FAMILY.

**Iwan Ries & Co.**  
19 South Wabash (Second Floor)  
Chicago II 60603-3182 • (312) 372-1306



**ORDER TOLL FREE**  
24 HOURS A DAY, 7 DAYS A WEEK  
1-800-621-1457 (Illinois Only: 1-800-972-1087)

The Board of Equalization should reexamine its methodology for determination of a tax rate on other tobacco products.

A tax rate calculated on the average wholsale price per unit of other tobacco products is a proper method of taxing these products and is in compliance with the provisions of Revenue and Taxation Code Section 30123 (b).

**APPENDIX I:**

**Transcript of Public Hearing by the State Board of Equalization  
(November 30, 1988)**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION**

**1020 N Street, Room 102**

**Sacramento, California**

**REPORTER'S TRANSCRIPT**

**NOVEMBER 30, 1988**

**CONSIDERATION OF MATTERS  
CONCERNING IMPLEMENTATION OF  
PROPOSITION 99**

**Reporter: Bob Barnes  
Hearing Reporter**



P R E S E N T

For the Board  
of Equalization:

ERNEST J. DRONENBURG, JR.  
Chairman

PAUL CARPENTER  
Vice Chairman

CONWAY H. COLLIS  
Member

JOHN DAVIES  
Appearing for Gray Davis,  
State Controller (per  
Government Code Section 7.9)

CINDY RAMBO  
Executive Director

JANICE MASTERTON  
Assistant to Executive  
Director

For Board of  
Equalization Staff:

JUDY AGAN  
Assistant Executive Director,  
Business Taxes

E. V. ANDERSON  
Chief, Excise Taxes

Speakers:

CAROLYN MARTIN  
and  
TONY NAJERA  
American Lung Association

DAVID DOERR  
California Taxpayer's  
Association

JOHN PARKER  
Phillips and King Cigar Company

DENNIS LOPER  
Smokeless Tobacco Council

--oOo--

1 MR. DRONENBURG: The next item we're going to talk  
2 about is tobacco rates for other tobacco products, item 26.

3 MS. AGAN: Yes. Mr. Chairman, Members of the Board,  
4 the staff is prepared to make a recommendation to the Board  
5 at this time.

6 We are recommending that we use an approach of ad  
7 valorem tax and based upon a formula we would recommend at  
8 this time that we establish the rate at 41.67 percent.

9 I do understand there are a number of speakers here  
10 today who would like to address the issue both for and against  
11 our recommendation.

12 (Senator Carpenter joined the hearing in progress.)

13 MR. DRONENBURG: Okay. We will try to give some  
14 coherent order. We are going to treat this like the  
15 Legislature does in that we will have those that are  
16 proponents and then those that are opponents. So if all the  
17 proponents could come forward. If I have to tell you which  
18 class you're in, you're in trouble.

19 MR. DAVIES: You do have to explain it to me. Are you  
20 talking about proponents of the initiative or this regulation?

21 MR. DRONENBURG: I don't know.

22 MS. MARTIN: This regulation and the initiative.

23 MR. DRONENBURG: They obviously know where they are.

24 MS. MARTIN: My name is Carolyn Martin and I'm a  
25 volunteer on the Board of the American Lung Association of  
26 California. We appreciate the opportunity to testify  
27 today about the tax rates for tobacco products other  
28 than cigarettes.

1           When we participated in writing the Tobacco Tax and  
2 Health Protection Initiative, we deliberately chose clear,  
3 simple language so that the goals would be evident to the  
4 voters. They certainly understood those goals and voted  
5 overwhelmingly for Prop. 99 despite efforts by the tobacco  
6 industry to mislead them.

7           Prop. 99 increased the California tax on cigarettes  
8 from 10 cents a pack to 35 cents and imposed a tax on tobacco  
9 products which is defined very specifically in the initiative.  
10 The specific language that sets your responsibility today is  
11 as follows.

12           The act adds to the Revenue and Tax Code Section 30123,  
13 subsection (b), and states, "There shall be imposed upon every  
14 distributor a tax upon the distribution of tobacco products,  
15 based on the wholesale cost of these products, at a tax rate,  
16 as determined annually by the State Board of Equalization,  
17 which is equivalent to the combined rate of tax imposed on  
18 cigarettes by subsection (a) and the other provisions of  
19 this part."

20           The Act is clear and straightforward --

21           MR. DRONENBURG: Wait. Could you keep reading? Do you  
22 have the rest of that paragraph?

23           MS. MARTIN: Subsection (a)?

24           MR. DRONENBURG: You just read (a). Read (b).

25           MS. MARTIN: Okay. I'm coming to it. It's in here.  
26 Okay. The act is clear and straightforward in its intent.  
27 Based on the wholesale cost, the tax on tobacco products  
28 is to produce a tax revenue equivalent to that produced

1 from cigarettes.

2 For example, if a package of cigarettes wholesales for  
3 a dollar then the effective applicable tax rate on cigarettes  
4 is 35 percent. Then the tax rate on tobacco products should  
5 be that same percentage of value.

6 MR. DRONENBURG: What if that package of cigarettes  
7 was \$4. What's the tax rate on that \$4 package?

8 MS. MARTIN: Four times 35, whatever that is.

9 MR. DRONENBURG: No. No. The \$4 package would have a  
10 35 cent tax.

11 MS. MARTIN: No. It's an equation. So it would be  
12 the equivalent.

13 MR. DRONENBURG: No. But the tax as it actually is  
14 applied would be 35 cents for that \$4 pack. Are you aware  
15 of that? Dunhill cigarettes cost \$4. How much tax --

16 MS. MARTIN: The way the initiative is read, it was  
17 written tax per cigarette. Okay. So the 25 cents is based  
18 on the average number of cigarettes per the average pack.

19 And this is just an example to say that if the  
20 wholesale price of any cigarette package was a dollar then  
21 the wholesale price of an equivalent dollar spent on tobacco,  
22 snuff or something like that should be the same kind of tax.  
23 It should be in proportion.

24 MR. DRONENBURG: I know. You used a dollar and you  
25 used 35. I'm saying if that dollar had been \$4, it still  
26 would have been 35. It would have been a much different  
27 rate, isn't that correct?

28 MS. MARTIN: No, I don't think so. Let me finish this.

1 MR. DRONENBURG: Keep reading. I'll explain to you  
2 later.

3 MS. MARTIN: I'm a history teacher unfortunately,  
4 not a math teacher. Okay. For example, if a package of  
5 cigarettes wholesales for a dollar then the effective  
6 applicable tax rate on cigarettes is 35 percent.  
7 Therefore the tax rate on tobacco products would have the  
8 same percentage of value.

9 The sale of a dollar of cigarettes and the sale of  
10 a dollar of tobacco products should produce the same tax  
11 revenue. Therefore if you sell \$4 of cigarettes, you should  
12 produce the same tax revenue if you sell \$4 of cigars.

13 Is that --

14 MR. DRONENBURG: That's what you'd like.

15 MS. MARTIN: Um-hmm (affirmative).

16 MR. DRONENBURG: Okay.

17 MS. MARTIN: The phrase in subparagraph (b) -- here we  
18 go -- Section 20123 of the code, based on the wholesale cost  
19 of these products, states the clear intent of the initiative  
20 is to use the same percentage of value formula that is used in  
21 28 of the 30 states with a tobacco products tax.

22 MR. DRONENBURG: That's a -- did you prepare this or  
23 are you reading it?

24 MS. MARTIN: I read -- I certainly know the initiative  
25 because I helped write that, and I read the background  
26 material.

27 MR. DRONENBURG: Do you understand what you just said  
28 about 28 of 40 states?

1 MS. MARTIN: 28 of 30 states use this value formula.

2 MR. DRONENBURG: But that's not correct.

3 MS. MARTIN: The same percentage. I'm willing to  
4 be corrected.

5 MR. DRONENBURG: Okay. Good. All right. Continue.  
6 I'll try not to interrupt you.

7 MS. MARTIN: That's all right. The California  
8 electorate overwhelmingly rejected the deceptive and false  
9 arguments of the tobacco industry against increasing the  
10 California tax on cigarettes and other tobacco products when  
11 it approved Prop. 99.

12 The voters of California discarded their deceptive  
13 advertising and they handed the tobacco companies a major  
14 defeat. The industry's now attempting to subvert the clear  
15 intent of the initiative language by urging the State Board  
16 of Equalization to adopt formulas for taxing tobacco products  
17 that are not consistent with the initiative's language.

18 We urge you to adopt a fair and equitable tax rate  
19 that carries out the precise intent of the initiative.  
20 The language in the initiative is not ambiguous.

21 By adopting the percentage of value formula for taxing  
22 tobacco products, you will honorably fulfill the electorate's  
23 decision in November.

24 MR. DRONENBURG: All right. I don't know. Why don't  
25 we hear from the next representative?

26 SENATOR CARPENTER: So basically you are asking us to  
27 lower our staff's recommendation.

28 MS. MARTIN: Certainly not.

1           SENATOR CARPENTER: Isn't that what your formula does?

2           MS. MARTIN: What we're really saying is that we want  
3 it based on percentage of value and -- sorry. We want it  
4 based on the fact that the cost for tobacco products is  
5 equivalent to the increased tax and the taxes people pay  
6 on cigarettes. You shouldn't pay less, because you are  
7 smoking cigars, in taxes. You should pay the same.

8           MR. DRONENBURG: The same.

9           MS. MARTIN: The same percentage.

10          MR. DRONENBURG: Let's use two things. Unfortunately,  
11 I don't think what you would like is what we can do because  
12 we are mixing apples and oranges.

13           But let's use your two examples, the \$1 with 35 cents.  
14 Okay. Now a \$4 package of Dunhill cigarettes, expensive  
15 cigarettes, how much tax is paid on those?

16          MR. COLLIS: It doesn't matter. The initiative doesn't  
17 speak to that.

18          MS. MARTIN: It doesn't speak to that.

19          MR. DRONENBURG: We used it in our example.

20          MS. MARTIN: I'm using it as an example.

21 The initiative says that it will be an equivalent value,  
22 equivalent cost.

23          MR. DRONENBURG: You said, okay, the cost of a Dunhill  
24 cigarette's equivalent value is taxed at a rate one-quarter  
25 of that of a \$1 cigarette, under the current example, because  
26 it's not a percentage tax. It's a tax based on a unit not a  
27 tax based on an ad valorem or value.

28          There are two different taxes. They can't be the same.

1 The \$4 package of Dunhill cigarettes will pay 35 cents for  
2 a tax. That's just the facts because we only tax per  
3 10 cigarettes.

4 All right. And you could pay \$4 for a package of  
5 chewing tobacco and under your formula, you'd be paying five  
6 times as much in taxes.

7 MR. COLLIS: You are making this far more complicated  
8 than the initiative made it. Our staff has provided us  
9 with --

10 MR. DRONENBURG: Wait a minute.

11 MR. COLLIS: Let me finish my --

12 MR. DRONENBURG: First you've made a statement I'm  
13 making it more complicated. I'm laying out the facts and  
14 explaining it to the lady who obviously is coming with good  
15 intentions but does not understand the mathematics of what  
16 she's proposing.

17 MR. DRONENBURG: I think actually her confusion is  
18 that she's familiar with the initiative and what it says.

19 MS. MARTIN: That's right.

20 MR. COLLIS: And she's trying to somehow equate what  
21 the initiative says with this exotic, complicated formula that  
22 you're attempting to apply. That's the confusion.

23 MR. DRONENBURG: What exotic formula? I took her words  
24 and told her what the consequences were. That's all.

25 MR. COLLIS: Let me finish my statement.

26 MR. DRONENBURG: You said I made an exotic formula.

27 MR. COLLIS: Our staff has provided us with the average  
28 wholesale price of a package of cigarettes. They have also



1 told us what the percentage of tax would be under Prop. 99 on  
2 that package of cigarettes, the average cost the wholesale  
3 package of cigarettes.

4 They have told us that that is 41.67 percent.  
5 The initiative could not be clearer in terms of saying  
6 that you apply that 41.67 percent against the cost of the  
7 wholesale cost of nontobacco products. Now it just does  
8 not seem very complicated.

9 MR. DRONENBURG: Well, it doesn't seem really  
10 complicated to me either and that's because I don't get tied  
11 up in dramatic formulas. I read -- and she only read half of  
12 a sentence.

13 But section (b) of 30. -- I mean 30123 states, "There  
14 shall be imposed upon every distributor a tax upon the  
15 distribution of tobacco products --" now this is not the end  
16 of the sentence. It's simply a comma -- "based on the  
17 wholesale cost of these products..." That's very simple.  
18 It's referring back --

19 MR. COLLIS: So far we're in agreement. Keep going.

20 MR. DRONENBURG: "...the wholesale cost of those  
21 products..."

22 MR. COLLIS: We agree so far.

23 MR. DRONENBURG: "...at a tax rate, comma, as  
24 determined annually by the State Board of Equalization  
25 equivalent to the combination --"

26 MR. COLLIS: "...combined rate of tax imposed on  
27 cigarettes under subdivision (a)," and our staff told us  
28 the combined rate of tax imposed on cigarettes under

1 subdivision (a) is 41.67 percent. Now what is complicated  
2 about that?

3 MR. DRONENBURG: You are not basing that combined rate  
4 on the tobacco products. It's right in that sentence.  
5 You are basing it on the cigarette wholesale rate not tobacco  
6 with the wholesale rate.

7 MR. COLLIS: Because the initiative told us to base it  
8 on the rate of tax applied against cigarettes. It says  
9 "...which is equivalent to the combined rate of tax imposed on  
10 cigarettes by subdivision (a)..." Our staff has told us that  
11 that rate is 41.67 percent.

12 MR. DRONENBURG: That rate that they told you --

13 MR. COLLIS: You must agree with me.

14 MR. DRONENBURG: That rate they've told you about is  
15 their computed rate. The rate is 35 cents on 20 --

16 MS. MARTIN: Wait.

17 MR. DRONENBURG: The rate is right above here, .0125,  
18 in the Constitution and you take that times 20 and you get to  
19 the 35. That's the rate that should be equivalent to.

20 It doesn't talk about how to compute that rate.  
21 It only says it should be based on the wholesale distribution  
22 cost of tobacco.

23 MR. COLLIS: They have told us what the average  
24 wholesale cost of a package of cigarettes is.

25 MR. DRONENBURG: It doesn't talk -- this talks about  
26 rate of tax imposed on cigarettes and subdivision (a) and that  
27 up above is 1. -- .0125 for each cigarette.

28 MR. COLLIS: For each cigarettes distributed, that's

1 right. The average price of each cigarette is 4.2 cents.

2 MR. DRONENBURG: It doesn't talk about average price  
3 of cigarettes up there. It talks about down here using, for  
4 the basis of the computation, tobacco products.

5 MS. MARTIN: It says it has to be equivalent to the  
6 combined rate of tax imposed on cigarettes.

7 MR. DRONENBURG: Okay. The combined rate of tax  
8 imposed on cigarettes.

9 MS. MARTIN: Um-hmm (affirmative). So it must be an  
10 equation.

11 MR. DRONENBURG: All right. But it doesn't say we use  
12 the cigarettes. It says right here to use the tobacco  
13 products as the basis.

14 MR. COLLIS: Can I ask something? How much did the  
15 tobacco industry spend in fighting Proposition 99, do you  
16 happen to know?

17 MS. MARTIN: 20 million or more.

18 MR. COLLIS: 20 million or more. After an expenditure  
19 of 20 million or more, taxpayers didn't buy the kind of  
20 nonsensical arguments that you're presenting today. I don't  
21 see why we ought to buy them.

22 SENATOR CARPENTER: Mr. Chairman, I find all of these  
23 arguments fascinating and I'd love to hear the next witness.

24 MR. DRONENBURG: Yes. All right. Next witness.

25 MS. MARTIN: Thank you.

26 MR. NAJERA: My name is Tony Najera. I also represent  
27 the American Lung Association. But I'm also here to speak on  
28 behalf of the Coalition for a Healthy California who were the

1 sponsors of Prop. 99.

2 And we urge you to adopt the staff's -- we support the  
3 recommendation that you -- that's been presented to you today.  
4 I think it said it best.

5 MR. DRONENBURG: All right. Is there anybody else who  
6 wants to speak? Okay. Anybody else that wants to comment on  
7 the regulation?

8 SENATOR CARPENTER: Mr. Chairman, is it true that the  
9 tax rate goes up at the rate of one percent a minute?

10 MR. LOPER: This will be quick.

11 MR. DRONENBURG: All right. Could you introduce  
12 yourself for the record?

13 MR. DOERR: Mr. Chairman, Members -- is this on?

14 MR. DRONENBURG: I don't think so. No, it's not.

15 MR. DOERR: Mr. Chairman, Members, my name David Doerr  
16 and I am the Chief Tax Consultant for the California  
17 Taxpayer's Association and I want to discuss the problems  
18 inherent in implementing the tobacco tax portion of  
19 Proposition 99.

20 In a sense, this takes me back to the days when I  
21 worked for the Legislature and had the responsibility of  
22 implementing several other tax initiatives in terms of doing  
23 the preparatory work, principally Props. 13 and 4.

24 And I think the thing we find in most initiatives is  
25 that they're really not as clearly written as we would like.  
26 And so that leaves room for interpretation, disagreement and  
27 that's what we have today. We have two interpretations  
28 reading the same language.

1           And so in those situations, we have to make judgments.  
2 One of the things that was difficult in implementing Prop. 13  
3 and Prop. 4 was the lack of precision, the difficulties we  
4 found in drafting the language.

5           And what happened in many cases with those initiatives  
6 was we received after-the-fact intent statements from the  
7 authors which attempted to fill in after the fact which  
8 probably should have done before the fact.

9           I think this issue came to a head in the Supreme Court  
10 decision shortly after passage of 13 where the Supreme Court  
11 directly addressed the issue by Mr. Jarvis who attempted to  
12 state his intent of what he intended the language to do and  
13 the Supreme Court said that that was not persuasive in terms  
14 of deciding what, in fact, the measure actually provides.

15           So we tend to read this measure in that same light.  
16 What does it say and how should it work? That's what I  
17 propose to address to you today.

18           We've proposed a simple formula that meets the test  
19 which has been described. I think we all know what the  
20 tests are. They've just been read.

21           You are to create a tobacco tax rate equivalent to  
22 the cigarette tax rate using the wholesale price of tobacco  
23 products. That's all that it says. It doesn't go beyond  
24 that.

25           MR. DRONENBURG: Do you agree with that, Mr. Collis?

26           MR. DOERR: That's what it says.

27           MR. COLLIS: So far as I understand that, I agree.

28           MR. DRONENBURG: That's all I was just saying,

1 Mr. Collis. Maybe he says it more artfully. But that's  
2 exactly what I said.

3 MR. DOERR: We come to a different conclusion than the  
4 staff. We've used a different formula and our formula is a  
5 simple one, we think. We divide the per unit cigarette tax  
6 rate by the average per unit wholesale price of all tobacco  
7 products.

8 MR. COLLIS: Say that once more please.

9 MR. DOERR: Divide the per unit cigarette tax rate  
10 by the per unit wholesale price of all tobacco products.  
11 We've used the average cigarette tax rate and used the  
12 wholesale price of tobacco products.

13 MR. DRONENBURG: Do you agree with that?

14 MR. DOERR: That's called for in the initiative.

15 MR. COLLIS: Did you include in that the cigarettes?

16 MR. DOERR: The cigarette tax rate --

17 MR. COLLIS: When you say all tobacco products --

18 MR. DOERR: Other than cigarettes.

19 MR. COLLIS: You were on other than cigarettes.

20 MR. DOERR: Right. The average wholesale price.

21 MR. DRONENBURG: Do you agree with that?

22 MR. DOERR: Now --

23 MR. COLLIS: So far, he and the prior witness said  
24 the same thing.

25 MR. DRONENBURG: They had exactly the opposite --

26 MR. COLLIS: No. So far --

27 MR. DOERR: I had trouble understanding --

28 MR. DRONENBURG: Wait a minute. Maybe we can solve --

1 solve this whole issue if we get Mr. Collis to vote.

2 I'd be glad to support --

3 MR. COLLIS: I will certainly vote for those aspects  
4 of this statement and the prior statements that are the same.

5 MR. DRONENBURG: You said they're both the same.  
6 Let's just have Mr. Doerr design a motion. I'll move it.

7 MR. COLLIS: The package of cigarettes, if it is  
8 selling for an average price of -- which apparently it does --  
9 of 84 cents, the tax imposed by Proposition 99 is something  
10 over a third of that value, is that accurate?

11 MR. DOERR: No.

12 MR. COLLIS: Okay. I thought --

13 MR. DOERR: Okay.

14 MR. COLLIS: No. Well, I assume if you say that --  
15 can't you answer it in the way I proposed? I want the  
16 formula proposed by 99.

17 MR. DOERR: What we just heard was a rate of  
18 41 percent.

19 MR. COLLIS: Right.

20 MR. DOERR: Our formula produced a rate of 18.98  
21 percent. So we've taken --

22 MR. COLLIS: A rate of what, 15 --

23 MR. DOERR: 18.98 percent.

24 MR. COLLIS: 18.98?

25 MR. DOERR: Correct. So there is -- it's a substantial  
26 difference.

27 MR. COLLIS: I thought the language of Prop. 99 was  
28 that the tax on a pack of cigarettes was being increased

1 from 10 to 35 cents.

2 MR. DOERR: That's correct.

3 MR. COLLIS: That was public understanding.

4 MR. DOERR: That's correct.

5 MR. COLLIS: And so under any formula, when you  
6 take 35 cents of a package of cigarettes that is selling for  
7 a dollar --

8 MR. DRONENBURG: How about the \$4 package, Mr. Collis?

9 MR. COLLIS: Let me finish.

10 MR. DRONENBURG: How about the \$4 package?

11 MR. COLLIS: If the package is selling for a dollar,  
12 it's been raised to 35 cents. That's about a third of the  
13 price, isn't that about right? That's just common sense,  
14 isn't it? It's right in there somewhere.

15 MR. DOERR: Yeah. You're in the ballpark.

16 MR. LOPER: But that's an average price, is that  
17 correct? We're talking about \$4 cigarettes, 60-cent  
18 cigarettes, per pack.

19 What you then apply is a rate of 41 percent because  
20 you take average price. But what you do is you -- when you  
21 apply it to other tobacco products, you apply that to a  
22 dollar can of Skoal or a \$5 cigar.

23 MR. COLLIS: That 41 percent, we're in agreement --

24 MR. LOPER: Wait. This is -- but what you have done  
25 on one is you have used an average price and on the other  
26 you're using an individual price.

27 So what you do is you weight one side and you unweight  
28 the other so therefore it's not an equivalent tax. It's over



1 an equivalent tax because 41 percent is an average price.  
2 But the staff did not recommend an average price for other  
3 tobacco products. They took a specific price.

4 MR. COLLIS: If we used the formula you are using --  
5 let's apply it to cigarettes for a minute because we have  
6 some agreement in that area.

7 If we applied it to a dollar pack of -- package of  
8 cigarettes, the tax under Prop. 99 would not be raised from  
9 10 to 35 cents. It would be raised from 10 to 18 cents.  
10 That isn't what people voted on.

11 MR. LOPER: But what we're saying is don't use average  
12 price for one and not the other. What I am saying is if you  
13 want to take a specific percentage formula and apply it to  
14 each individual price then you are talking equivalency.

15 You are taking the average price in cigarettes, but  
16 then in other tobacco products you have no average price.  
17 You apply it to that wholesale price.

18 MR. COLLIS: You are trying to do through the back  
19 door what your 20 million couldn't do through the front door.

20 MR. DRONENBURG: Mr. Collis, get away from the campaign  
21 rhetoric and think about the issues.

22 MR. LOPER: The tobacco distributors are, in fact, the  
23 taxpayer. If you read the law, it says the distributor is.  
24 That has nothing do with so-called manufactures in the tobacco  
25 industry. Let's be very straight.

26 There was not \$20 million spent by distributors.  
27 If that's what you feel then you're obviously -- you are  
28 wrong. The tobacco distributors are the taxpayer. We are

1 representing the taxpayer.

2 MR. DOERR: Anyway, getting back to --

3 MR. DRONENBURG: Don't confuse the substance.

4 We've got to get more rhetoric for the press.

5 MR. DOERR: The formula -- we're trying to use the  
6 language in the initiative to establish the formula which is  
7 basically a cigarette tax rate which is a per unit rate and  
8 wholesale price of tobacco products, put those two together  
9 and that's what our formula does.

10 There is nothing in the Constitution that says anything  
11 about the wholesale price of cigarettes. But if that's what  
12 had been wanted, it should have been drafted in.

13 It gets back to the original point these things are  
14 never clear. There are chasms of room for implementation.  
15 And so we're looking at strictly at the way it reads.

16 Now if we go to the other approach, we think there is  
17 very serious problems with the number the staff came up with.  
18 First of all, on the point that somehow this is equivalent  
19 to the way it was established in all the other states which  
20 tax tobacco products, we have a chart here for your viewing  
21 which shows that if we used the staff formula to try to come  
22 up with a tobacco product rate, what that would be versus  
23 what the actual tobacco tax rate is in the other states, and  
24 it doesn't match in any of the states. It comes close in a  
25 couple but it doesn't seem to match at all.

26 But the biggest problem if this was just a revenue  
27 issue --

28 MR. COLLIS: Let me check that statement. Miss Agan,

1 you indicated that the formula staff has proposed is same  
2 formula that's use utilized in 28 of the other 30 states that  
3 have taxes on other --

4 MS. AGAN: Not the same formula per se. It's the same  
5 method of applying the tax. In other words, this is an ad  
6 valorem tax.

7 MR. DOERR: Which is what the chart --

8 MR. COLLIS: What do you mean the same method?

9 MS. AGAN: It's on the value. And the formula takes  
10 into consideration the tax rate per cigarettes and that then  
11 is divided by the weighted average of the wholesale cost of  
12 one cigarette and that wholesale price is established as of  
13 March 1st per the language in the initiative.

14 MR. COLLIS: Okay.

15 MR. DRONENBURG: Not a formula. It's just a tax  
16 method.

17 MR. DOERR: Using percentage of value.

18 MR. DRONENBURG: Method of taxing. Ad valorem.

19 MR. DOERR: That's the way they arrive --

20 MR. DRONENBURG: Not even close.

21 MR. COLLIS: Why is the taxpayer's association here?

22 MR. DOERR: Well, as I was about to say, if this was a  
23 revenue matter, we probably wouldn't be here.

24 MR. COLLIS: Did you all take a position, incidentally,  
25 on 99?

26 MR. DOERR: Yes, we did. We opposed 99 and not on the  
27 revenue basis but on a number of what we think are fundamental  
28 issues with regard to earmarking of revenues, of the integrity

1 of tax administration, integrity of the legislative process,  
2 a whole series of issues.

3 But on this issue as we -- 99 has passed. We're now  
4 trying to figure out how to best implement it. And we accept  
5 the decision of the voters. This is what they want. But what  
6 is the proper method of implementation?

7 As I said, if this was a revenue matter, we probably  
8 wouldn't be here. I would put money on the table right now  
9 that --

10 SENATOR CARPENTER: Don't do that.

11 MR. DRONENBURG: At what rate?

12 MR. DOERR: -- the high tax alternative that's been  
13 developed by the staff will not produce much more, if any,  
14 revenue than the rate that we call the moderate rate.

15 MR. DRONENBURG: That's because of the declining value  
16 of -- I mean the increasing value of cigarettes.

17 MR. DOERR: I'll tell you why it won't. This is what  
18 we're concerned about. Our concern is about the integrity  
19 of tax administration in California and about California's  
20 business climate and this is what we see are the major  
21 issues here.

22 This high tax rate, as stated, will produce a rate of  
23 about 41 percent. Now, when this issue came up in the  
24 Legislature for all the years that I was a consultant on the  
25 Assembly Revenue and Taxation Committee, we were told by the  
26 Board of Equalization staff that it was impossible to  
27 effectively administer a tobacco products tax and I always  
28 recommended when this issue came up the Board tells us they

1 can't effectively administer it. There are all these problems  
2 in administration.

3 I agreed with the Board's staff then. I still do on  
4 the question of effective administering. I don't think it can  
5 be effectively administered.

6 With this high tax alternative, you have these real  
7 problems. What's going to happen is taxpayers are simply  
8 going to order boxes of cigars and tins by mail. It's very  
9 easy. In fact, it will be --

10 MR. COLLIS: But, Mr. Doerr, that is exactly -- that  
11 is precisely the argument that was made by the tobacco  
12 companies in trying to beat 99. The argument that they made  
13 was if you raise the tax, it is going to create, they were  
14 asserting, a black market.

15 MR. DOERR: I'm not asserting black market.

16 MR. COLLIS: They were asserting that people would  
17 utilize other means of obtaining their tobacco products.  
18 And now what your coming in here and saying is that if we  
19 apply the tax that's mandated by 99, people are going to  
20 find other means to obtain their tobacco products. It's the  
21 same argument that was rejected by the voters.

22 MR. DOERR: What we're trying to decide is, one, what  
23 is the tax mandated by 99? I'm suggesting a moderate rate as  
24 opposed to staff's high rate, and I think you can read 99 to  
25 impose a moderate rate. That's the issue.

26 What are the problems of the high tax rate? First of  
27 all, the mail order problem. That's why you are not going to  
28 get the revenue amounts our tax rate produces.

1 MR. COLLIS: Can you read 99 to come up with the rate  
2 the staff does?

3 MR. DOERR: I can't read 99 to do that but I understand  
4 how they got there. They've read into 99 wholesale price  
5 of cigarettes. It's not written there. Maybe it's assumed.  
6 It's certainly not written. Wholesale price of cigarettes is  
7 not there. But I understand how they got to that rate.

8 But it will lead -- I don't think there is any question  
9 about it. People clip out these little coupons and send in  
10 for a box of cigars or package of smokeless tobacco by mail.

11 So what this does -- and one of the reasons is people  
12 like to feel they can outwit the tax administrators.  
13 It's part our culture unfortunately but that's there.

14 So what it does is it tends to undermine the integrity  
15 of the tax process. It undermines the integrity of tax  
16 administration and it's bad because it breeds lack of  
17 confidence in your tax structure and our tax process.

18 And that's not what we want to see established is a  
19 feeling that it's a good idea to try and get around the tax  
20 laws. And, you know, to have this thing initiated and spread,  
21 we might be doing more harm to the entire tax structure.

22 MR. COLLIS: That's an argument against any high tax  
23 state and the way -- the logical extension of what you suggest  
24 is either -- is not to have taxes and there wouldn't be any  
25 cheating at all against them.

26 MR. DOERR: I understand. In certain taxes there are  
27 more avenues for enforcement.

28 MR. COLLIS: Mr. Doerr, let me ask you what this means.

1 The line which was equivalent to the combined rate of tax  
2 imposed on cigarettes by subdivision (a).

3 MR. DOERR: That's the cigarette tax rate of .0175.

4 MR. COLLIS: Combined rate of tax imposed  
5 on cigarettes.

6 MR. DOERR: .0175 per cigarette.

7 MR. DRONENBURG: It refers right back to the other  
8 paragraph.

9 MR. DOERR: That is what it says.

10 MR. DRONENBURG: And the combined rate -- to be any  
11 combined rate --

12 MR. DOERR: Combined rate of 10 cents plus the  
13 25 cents. It would be 35 cents.

14 MR. COLLIS: It would be impossible to find -- to find  
15 a combined rate if you don't put them together and come up  
16 with an average. There would be no such thing as a combined  
17 rate. The words would be meaningless.

18 MR. DOERR: A 25 cent add by the initiative.

19 MR. COLLIS: You are trying to take out -- the words  
20 "combined rate" in this initiative.

21 MR. DOERR: Combining the two. In any event, the  
22 next point, in addition to, we think, undermining the  
23 integrity of the tax structure and destroying taxpayer  
24 confidence in tax administration which we think is very  
25 undesirable, we think that it is harmful to the business  
26 climate as well and what we're going to do is we'll be  
27 exporting business.

28 California's merchants are hurt. Merchants in other

1 states selling these products benefit. This is not in the  
2 interest of California. It's not in the interest of good  
3 tax administration, good tax policy.

4 We think that you can read the initiative to use the  
5 formula we've suggested. We are not arguing they shouldn't  
6 pay tax. We're saying a very significant tax increase is  
7 certainly appropriate which is approximately 19 percent.  
8 That's a significant, significant tax increase.

9 (Mr. Davies left the hearing room.)

10 MR. DOERR: Now remember -- back to my original  
11 point -- the staff of your Board has always said you cannot  
12 administer this tax effectively. They have always said that.

13 It's not -- there is not the same federal controls on  
14 shipments of tobacco products as there are on cigarettes.  
15 You have a basic difference in the product. This is what  
16 leads to this problem of --

17 SENATOR CARPENTER: But, Mr. Doerr, the administration  
18 is a problem and it's a problem without regard to what the  
19 rate is.

20 MR. DOERR: A high tax rate makes it more likely for  
21 people to say it's worth my while to go out-of-state than a  
22 moderate tax rate. That's the point, senator.

23 SENATOR CARPENTER: The same initiative will spread  
24 throughout the country like wildfire. I suspect we'll have  
25 very similar tax rates on cigarettes in other states as well.  
26 So your arguments may have temporal truth but only temporal.

27 MR. DOERR: In any event, that completes my remarks.  
28 I thank you.



1 MR. PARKER: Mr. Chairman, my name is John Parker.  
2 I'm owner of Phillips and King Cigar Company. We're a  
3 distributor primarily of cigars and pipe tobacco.  
4 I'm also president of the California Association of  
5 Tobacco Distributors.

6 First, I'd like to say our company is a small family  
7 business. We do approximately 5-1/2 to six million dollars  
8 in the western states and we're not one of the giant  
9 businesses of the tobacco business. We're a California  
10 corporation. And we're, like I said, a small family business.

11 I'm here also to question the rationale of the staff's  
12 proposed 40-plus percent tax on other tobacco products as an  
13 equivalent tax. It's my belief Section 30123(b) is specific  
14 in that the tax is based on the wholesale cost of the products  
15 I sell divided into the cigarette tax rate.

16 I also think it's important to discuss the impact of  
17 the exorbitant tax rate suggested by the Board, the impact on  
18 my business and retailers I sell.

19 My customers currently can buy all the products I sell  
20 here in California from other distributors outside the State  
21 of California and their customers, the consumers, can also buy  
22 these products outside of the state through mail-order houses.

23 Both of these avenues would not produce the revenue  
24 that is contemplated to be produced by these taxes. I believe  
25 that the revenue derived from this tax may be insignificant  
26 in the total revenue but it would be devastating, this rate,  
27 to our small businesses.

28 As an example, I currently sell high-grade cigars at

1 wholesale for approximately \$4.50 per cigar. At the proposed  
2 tax rate, they would add \$1.79 to make the cigar wholesale  
3 at \$6.29.

4 MR. COLLIS: What cigar sales are \$4.50?

5 MR. PARKER: Monte Cruz, individual, an imported cigar.

6 MR. COLLIS: I'm familiar with it.

7 MR. PARKER: Okay. That's at wholesale.

8 MR. PARKER: A box of 10 of these cigars can be  
9 purchased from a mail-order house in the East, J&R, for  
10 \$49.95. It's a savings to the consumer of \$12.95 even if  
11 he pays the shipping of \$2 per order. Now that \$2 would be  
12 if he ordered one box or if he bought 10 boxes.

13 (Mr. Davies rejoined the hearing in progress.)

14 MR. PARKER: It's also likely that many smoke shops,  
15 retailers that I deal with, would buy from out-of-state  
16 wholesalers or the mail-orders houses. They will buy at  
17 reduced rates because they will not be paying the tax to  
18 those out-of-state wholesalers.

19 And it's our feeling that they will pay perhaps part  
20 of -- pay maybe none of the tax collected and -- pay maybe  
21 none of the tax showing these sales as items other than  
22 tobacco, perhaps gifts or something.

23 On the cigarette end of it -- a better example of  
24 the inequity of the tax is you have pipe tobacco.  
25 We wholesale for \$10.75 for a four-ounce tin. A four-ounce  
26 tin of tobacco is approximately the same use per unit for  
27 the number of smokes as a pack of cigarettes.

28 The tax on a pack of cigarettes, one pack of

1 cigarettes, B. A. Rothman's, high-grade cigarettes at \$1.44  
2 per pack, or generic cigarettes at 60 cents per pack would  
3 still be 35 cents. On the pipe tobacco, the tax would  
4 be \$5.06.

5 In other words, 35 cents on a pack of cigarettes and  
6 \$5.06 on a tin of tobacco that would give the same amount of  
7 smokes, if you will. We don't understand the staff calling  
8 these taxes equivalent.

9 Further, the cheapest pipe tobacco available at  
10 \$2.10 for a four-ounce tin would be taxed at a rate of  
11 83 cents which is still higher than the staff proposed  
12 equivalent rate. Those are our problems.

13 MR. LOPER: Finally, Mr. Chairman, Members, very  
14 simply, we believe that we've all read 30123(b). It says  
15 based on the cost of these products.

16 Now the only difference in the formula staff proposes  
17 and the formula we're proposing is that we say the rate that  
18 you multiply is a combined rate of .0175 which is the  
19 tax rate. That's the combined tax rate.

20 They want to do it on an the average cost of  
21 cigarettes, on the sale of tobacco products. We're saying  
22 you do it on the full cost of sale of tobacco products.  
23 The full cost of tobacco products are higher than the average  
24 cost of cigarettes.

25 If you apply their rate, it's not equivalent.  
26 What they're applying is a rate that's weighted. They tell  
27 us we should not weight our rate. We should do it  
28 individually per cigar or per can of snuff.

1 But they weighted their rate. They took the average  
2 cost of cigarettes. We're saying if you are going to weight  
3 it on one end, you weight it on the other end, which is  
4 average cost of other tobacco products as the section says.

5 It says based on the wholesale cost of these products  
6 at a rate determined by the Board to give a rate equivalent  
7 to the combined rate. The combined rate is .0175. That's the  
8 tax rate.

9 MR. DRONENBURG: Mr. -- could you explain to  
10 Mr. Collis? This is very confusing because he obviously  
11 doesn't understand the combined rate.

12 Explain to him maybe that Section 30123(a) has to  
13 be combined with another part of the Constitution to get a  
14 combined rate of 35 percent that is only equivalent to  
15 25 percent which is the addition to the --

16 MR. LOPER: The combined rate is the 10 cents and the  
17 25 cents. The initial 10 cents is --

18 MR. DRONENBURG: Why is that?

19 MR. LOPER: In the Rev. and Tax Code --

20 MR. DOERR: 1967.

21 MR. DRONENBURG: So when it talks about combined rate  
22 as mentioned above, it's talking about combining the rate that  
23 this is with the rate that's already in the code.

24 MR. LOPER: Exactly. That comes up to the rate of  
25 .0175 which is 35 cents per pack of cigarettes. We're saying  
26 you take the combined rate .0175 and you apply it to the  
27 average cost of the wholesale tobacco products as the statute  
28 states.

1 MR. DRONENBURG: Okay.

2 MR. COLLIS: I do understand that's your position  
3 and yours, Mr. Dronenburg.

4 MR. DRONENBURG: I asked Mr. Anderson. Mr. Anderson,  
5 as you read Section 3.123, what is it talking about there?  
6 What is the rate that is developed in the first part?

7 MR. COLLIS: Mr. Dronenburg --

8 MR. DRONENBURG: I have a question of the staff.

9 MR. COLLIS: I know you do. We can go around in  
10 circles on this issue from now until doomsday.

11 The fact is --

12 MR. DRONENBURG: I'd just like to get the record  
13 complete.

14 MR. COLLIS: The fact is I believe that Prop. 99 is  
15 very clear. It calls for applying the tax rate of tobacco  
16 products other than cigarettes based on the tax rate on one  
17 cigarette divided by the average wholesale cost of a  
18 cigarette.

19 MR. DRONENBURG: It doesn't say that. It doesn't say  
20 the average cost of wholesale cigarette.

21 MR. COLLIS: 41.67 percent of the wholesale cost of  
22 other tobacco products.

23 MR. DRONENBURG: Mr. Anderson, where does it say in  
24 this amendment that we use average cost of cigarettes?

25 MR. ANDERSON: It does not say that specifically.  
26 It also does not say we use average price of --

27 MR. DRONENBURG: Would you read section (b) to me  
28 that says --

1 MR. COLLIS: I thought you wanted him to answer  
2 your question.

3 MR. DRONENBURG: He answered the first part.  
4 Then he elaborated.

5 MR. COLLIS: You just don't want elaboration.

6 MR. DRONENBURG: I want him to read instead of  
7 telling me.

8 MR. ANDERSON: You want me to read the whole section?

9 MR. DRONENBURG: Read 30123(b).

10 MR. ANDERSON: It says there shall be imposed a tax  
11 upon the distribution of tobacco products based on the  
12 wholesale cost of these products.

13 MR. DRONENBURG: What does that mean?

14 MR. ANDERSON: At a rate --

15 MR. DRONENBURG: What is --

16 MR. ANDERSON: Let me finish.

17 MR. DRONENBURG: I want you to stop there and tell me  
18 what the wholesale price is.

19 MR. COLLIS: Mr. Dronenburg, you voted on the whole  
20 thing, not just the part you --

21 MR. DRONENBURG: I just want to understand his logic.  
22 This is the man who constructed this formula. I want to  
23 understand his logic.

24 MR. ANDERSON: It specifically says the wholesale cost  
25 of these products.

26 MR. DRONENBURG: Which are tobacco products.

27 MR. ANDERSON: Tobacco products other than cigarettes.  
28 Then it goes on to say at a tax rate as determined annually

1 by the State Board of Equalization which is equivalent to the  
2 combined rate of tax imposed on cigarettes by subdivision (a)  
3 and other provisions of this part.

4 Now how we went about computing this basis, we  
5 followed the theory that equivalent did not mean what the  
6 theory behind their formula says.

7 And the theory behind their formula is saying that a  
8 cigar is equivalent to a cigarette. And I just don't think  
9 that's what the initiative intended. So the only logical  
10 reading of the section is to take the wholesale cost of both  
11 products and make the computation.

12 MR. DRONENBURG: Let's take and use -- the proof of  
13 the pudding is in the eating. In your formula, these are  
14 simple mathematical things. I've done it right in front  
15 of me so I'm not -- based on your formula, a \$4 pack of  
16 cigarettes would pay how much tax?

17 MR. ANDERSON: About nine percent.

18 MR. DRONENBURG: Nine percent or 35 cents based on  
19 your formula.

20 MR. ANDERSON: That's correct.

21 MR. DRONENBURG: Based on your formula, how much would  
22 a \$4 cigar pay?

23 MR. ANDERSON: About a \$1.80.

24 MR. DRONENBURG: That's equivalent?

25 MR. ANDERSON: Well, let's put it the other way.

26 MR. DRONENBURG: No. I didn't ask you that. I asked  
27 you a question, sir. That's equivalent? Do you say that's  
28 equivalent?

1 MR. ANDERSON: I think so, yes.

2 MR. DRONENBURG: You are saying -- gee, wait a minute.  
3 Talk about a maximum tax generator. This man should get the  
4 award of the year for the man who can get the most tax.

5 I understand that's what you are looking to do is  
6 generate the most tax possible. I'm looking for the proper  
7 interpretation of what the statutes says though, and  
8 equivalent in this statute was not trying to get the most tax.  
9 It was trying to get tax comparable or equal to.

10 MR. ANDERSON: That's really the question.

11 MR. DRONENBURG: And you are saying that's equal?

12 MR. ANDERSON: You are telling me that a tax --

13 MR. DRONENBURG: Let's take their formula.

14 Their formula -- their formula says 17 percent. Take that  
15 times that same \$4. What would that equal?

16 MR. ANDERSON: I don't have a calculator.

17 MR. DRONENBURG: 68 cents. Which to you is more  
18 equivalent to 35 cents, the 68 cents or the \$1.64?

19 MR. ANDERSON: You have taken the extremes.

20 MR. DRONENBURG: Which one is equal?

21 MR. ANDERSON: From a percentage standpoint, neither  
22 of them are equal. There are problems no matter --

23 MR. DRONENBURG: We're talking about extremes.

24 This is what the initiative's trying to do is trying to tax  
25 things equally, tobacco products and cigarettes.

26 SENATOR CARPENTER: Mr. Chairman --

27 MR. ANDERSON: Using their formula, what you are saying  
28 is tax of 1.75 cents on a product that costs an average of



1 four cents is also equal to the tax on --

2 MR. DRONENBURG: Average of four cents.

3 MR. ANDERSON: They've computed in their formula the  
4 average cost, wholesale cost, of a cigar is 21 cents.

5 MR. DRONENBURG: Average.

6 MR. ANDERSON: You are saying 1.7 cents on 21 cents  
7 is equivalent to 1.75 cents on four cents -- 4.2 cents.  
8 That is -- that's not equivalent either. It's also  
9 equivalent average cost per cigarettes too. We're weighting  
10 it the same way he weighted it.

11 There are other problems with their formula. It is  
12 not a weighted average.

13 MR. DRONENBURG: It seems like to me it gets a better  
14 answer than your formula, if we're trying to get equal not  
15 greater.

16 Mr. Collis wants to raise taxes. He wants to raise  
17 as much tax as possible. That's what he's saying here.  
18 I'm saying that the constitutional amendment says let's try  
19 to keep it equal.

20 MR. ANDERSON: I think the role of the Chairman and  
21 the Board is to decide what equivalent means, and either  
22 formula will give an equivalency rate. But one of them  
23 produces a ridiculous result.

24 SENATOR CARPENTER: Would you recognize me when you're  
25 through with your language?

26 MR. DRONENBURG: Mr. Carpenter.

27 SENATOR CARPENTER: Mr. Anderson, would you justify  
28 for us the outcome that you have? Would you tell us what

1 your reasoning and what your rationale was, and I would like  
2 you to do so, if you could, without any interruptions from me.

3 MR. ANDERSON: And any of the other Board Members?

4 SENATOR CARPENTER: I didn't say that.

5 MR. ANDERSON: The simple rationale was the only simple  
6 way of reading it was to come up with the average price of  
7 cigarettes and apply what -- compute what the percentage rate  
8 there was and apply that same percentage rate to tobacco  
9 products other than cigarettes.

10 There are other ways that we could do that that would  
11 produce the same amount of tax. One of them is not the method  
12 presented by the opponents to this.

13 We could then also take the average price of tobacco  
14 products for each one of these and come up with the same rate  
15 and then apply it on a stick basis.

16 But I don't think that's what the proposition states.  
17 We felt the only way to read it was to come up with the  
18 average price of a pack of cigarettes and compute what the  
19 tax rate of that pack was and apply that same rate to  
20 tobacco products.

21 SENATOR CARPENTER: That's what you did.

22 MR. ANDERSON: That's what we did.

23 SENATOR CARPENTER: You recognize, of course, that  
24 nothing you might have done would have found universal  
25 acceptance.

26 MR. ANDERSON: Absolutely, nor be 100 percent correct.

27 SENATOR CARPENTER: Right, because there are different  
28 ways of perceiving the variables involved. You had a very

1 difficult task and I'm not sure if you were right or if you  
2 were wrong but I think you met that task head-on and --

3 MR. ANDERSON: Thank you. We did try to apply the  
4 simplest rules.

5 SENATOR CARPENTER: Sure.

6 MR. COLLIS: Mr. Chairman --

7 MR. DRONENBURG: Mr. Anderson, did you find anywhere  
8 in here that talked about the wholesale cost of cigarettes?

9 MR. ANDERSON: No.

10 MR. DRONENBURG: Does it mention wholesale cost of  
11 tobacco products in this section we're talking about?

12 MR. ANDERSON: Yes, it does.

13 MR. DRONENBURG: Yet you ignored the wholesale cost  
14 of tobacco products but you picked up the wholesale cost of  
15 cigarettes.

16 MR. ANDERSON: Well, no, we did not ignore --

17 MR. DRONENBURG: Thank you. Did it figure in your  
18 formula?

19 MR. ANDERSON: That's what we're applying the rate to.

20 MR. DRONENBURG: You are applying the rate but to  
21 develop the equivalency, you ignored it.

22 MR. ANDERSON: The equivalency doesn't say it has to  
23 be based on the wholesale price of tobacco products only.  
24 It just says an equivalent rate to the combined tax on  
25 cigarettes --

26 MR. COLLIS: Does it apply to the retail cost,  
27 Mr. Dronenburg?

28 MR. DRONENBURG: No. The equivalent rate of the

1 combined tax on my \$4 example says his rate is way off the  
2 mark. It's not half as close as the rate proposed by the  
3 taxpayer.

4 MR. COLLIS: Mr. Chairman, would you entertain a  
5 motion at this point?

6 MR. DRONENBURG: Is there anyone else who wishes to  
7 speak on this issue? Hearing no other speakers, are there  
8 any other issues that deal with this regulation, excluding  
9 the rate computation, that should be addressed? All right.

10 MR. COLLIS: I move the tax rate applying to tobacco  
11 products other than cigarettes be set at a tax rate of one  
12 cigarette divided by the average wholesale cost of cigarettes.  
13 That ends up being 41.67 percent.

14 MR. DRONENBURG: Is that right from your news release  
15 or is that something that you understand?

16 MR. COLLIS: Would you like to make the motion for me,  
17 Mr. Dronenburg? Let me finish it. That rate ends up being  
18 41.67 percent of the wholesale cost of other tobacco products.  
19 I move that the Board adopt that percentage.

20 MR. DRONENBURG: Is there a second?

21 MR. DAVIES: I have a question. Is that the same as  
22 the staff recommendation in terms of per pack versus per  
23 cigarette? I assume it works out to be the same.

24 MR. ANDERSON: That is the staff recommendation.

25 MR. DAVIES: That's the methodology you recommend  
26 and have used?

27 MR. ANDERSON: Yes.

28 MR. DAVIES: I second.

1 MR. DRONENBURG: Wait a minute. He said and have used.  
2 How -- you've never used --

3 MR. ANDERSON: In coming up with the rate.

4 MR. DRONENBURG: This rate, this ad valorem, this type  
5 of percentage has never been used in California before.

6 MR. ANDERSON: I understand what he meant was that  
7 that's the method we used to compute the rate.

8 MR. DRONENBURG: There is a second. Any discussion  
9 of the motion? Hearing no discussion, Mr. Davies, your vote.

10 MR. DAVIES: Aye.

11 MR. DRONENBURG: Mr. Collis.

12 MR. COLLIS: Aye.

13 MR. DRONENBURG: Mr. Dronenburg, no. Mr. Carpenter.

14 SENATOR CARPENTER: Aye.

15 MR. DRONENBURG: All right. The motion passes.

16 --oOo--  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**APPENDIX II:**

**Agenda of Committee Public Hearing  
(April 10, 1989)**

CHAIRMAN  
WILLIAM CAMPBELL

VICE CHAIRMAN  
JOHN VASCONCELLOS

# California Legislature

## Joint Legislative Budget Committee

### SENATE

ALFRED E. ALQUIST  
ROBERT G. BEVERLY  
BILL GREENE  
MILTON MARKS  
JOSEPH MONTOYA  
NICHOLAS C. PETRIS

### ASSEMBLY

WILLIAM BAKER  
JOHN BURTON  
ROBERT CAMPBELL  
ROBERT C. FRAZEE  
WILLIAM LEONARD  
MAXINE WATERS

### AGENDA

Proposition 99 and the Tax on Other Tobacco Products

Monday, April 10, 1989

Room 2040, 3:00 p.m.

1. Mr. S. V. "Del" Anderson, Administrator of Excise Tax for Board of Equalization
2. Mr. Cory Brown, Coalition for a Healthy California  
Mr. Tony Majeria, American Lung Association
3. Mr. Dan Rabovsky, Legislative Analyst
4. Mr. John Parker, Chairman of the Board, California Association of Tobacco and Candy Distributors
5. Ms. Barbara Morphy, owner  
The Tobacco Loft, located in Concord and Pleasanton
6. Ms. Linda Squires, owner  
Pipe of Squires, located in Santa Rosa
7. Mr. David Doerr, tax consultant, California Taxpayer's Association

**APPENDIX III:**

**Transcript of Committee Public Hearing  
(April 10, 1989)**



1 HEARING

2  
3 JOINT LEGISLATIVE BUDGET COMMITTEE

4  
5 STATE OF CALIFORNIA

6  
7  
8 PROPOSITION 99 AND TAX ON OTHER TOBACCO PRODUCTS

9  
10  
11  
12 STATE CAPITOL

13 ROOM 2040

14 SACRAMENTO, CALIFORNIA

15  
16  
17  
18  
19 MONDAY, APRIL 10, 1989

20 3:05 P.M.

21  
22  
23  
24  
25 Reported by:

26  
27 Evelyn Mizak  
28 Shorthand Reporter



I N D E XPage

1  
2  
3 Proceedings

1

4 Opening Statement by CHAIRMAN CAMPBELL

1

5 Witnesses:

6 S. V. "DELL" ANDERSON, Administrator of  
Excise Tax, Board of Equalization

2

7 CORY BROWN  
8 Coalition for a Healthy California

13

9 TONY NAJERA  
American Lung Association

20

10 DAN RABOVSKY  
11 Legislative Analyst

21

12 JOHN PARKER, Chairman of the Board  
California Association of Tobacco & Candy Distributors

24

13 BARBARA MORPHY, Owner  
14 The Tobacco Loft, Concord and Pleasanton

35

15 LINDA SQUIRES, Owner  
Pipe of Squires, Santa Rosa

38

16 DAVID DOERR, Tax Consultant  
17 California Taxpayers' Association

41

18 Adjournment

47

19 Certificate of Reporter

48

20

21

22

23

24

25

26

27

28

P R O C E E D I N G S

--oo0oo--

1  
2  
3 CHAIRMAN CAMPBELL: Good afternoon and welcome to the  
4 fourth hearing of the Joint Legislative Budget Committee this  
5 session.

6 With me today are the Chairman of the Senate Finance  
7 Committee and Budget and Fiscal Review Committee, the very  
8 distinguished Senator Al Alquist. Also the Vice Chairman of the  
9 Senate Committee on Appropriations and a Member of this  
10 Committee, Senator Bob Beverly.

11 Today's hearing is to review the Board of Equalization's  
12 decision to interpret the provisions of Prop. 99 in a manner  
13 which imposes a 41.67 percent tax rate on other tobacco products.  
14 Other tobacco products are cigars, pipe tobacco, snuff, and  
15 chewing tobacco.

16 We've invited the Board of Equalization to tell us their  
17 thought process for imposing a 42 percent tax hike on other  
18 tobacco products. We've also invited persons representing the  
19 proponents of Proposition 99 to comment on their intent in  
20 drafting the proposition. The Legislative Analyst will be asked  
21 to testify what assumption they used in developing the revenue  
22 numbers used in the ballot arguments.

23 One of the key issues which the Board must address is  
24 whether the tax on tobacco products is so high they have driven  
25 persons who purchase these products out of state. In the packets  
26 before the Committee is a copy of an ad which is being circulated  
27 throughout the state informing purchasers of cigars and pipe  
28

1 tobacco that they can avoid the tax by purchasing these products  
2 outside the State of California. If in fact this is occurring,  
3 then the Board has managed to drive business out of California.  
4 We will have three witnesses to comment on this aspect of the  
5 problem.

6 I hope, at the end of the hearing, to entertain a motion  
7 on the sense of the Committee on this issue. Is the current tax  
8 too high, and if so, at what level should the tax rate be set?  
9 The findings of this Committee will be used to develop amendments  
10 to SJR 29, which is currently in Senate Revenue and Taxation  
11 awaiting hearing.

12 Our first witness this afternoon is Mr. Dell Anderson.  
13 Mr. Anderson is the Administrator of the Excise Tax for the Board  
14 of Equalization. He and his staff developed the staff  
15 recommendations for the Board to consider when the tax rate was  
16 set.

17 Mr. Anderson, you may stand there; you may sit down  
18 there if you'd like; wherever it's most comfortable for you.

19 MR. ANDERSON: First of all, I'll address how we made  
20 the computations, which is a very simple, forward method. Then  
21 I'll talk a little bit about why we used this method rather than  
22 others that were considered by the Board.

23 On the chart here, you will see a computation. It in  
24 effect shows the various components of what we used in making the  
25 computation: "C" being the tax rate on cigarettes under the  
26 increased rate of 1.75 cents per cigarette; "W" being weighted  
27 average wholesale cost of one cigarette, which we computed on  
28

1 March 1st of last year's cost, which is 4.2 cents per cigarette.  
2 The formula then being: C divided by W, comes out with a tax  
3 rate, which is the tax rate then to be applied to the wholesale  
4 cost of tobacco products.

5 Now, this is the method that the staff recommended to  
6 the Board.

7 CHAIRMAN CAMPBELL: Proposition 99 called for a 25 cent  
8 increase on a package of cigarettes.

9 MR. ANDERSON: Yes, that's correct.

10 CHAIRMAN CAMPBELL: What was the tax prior to that?

11 MR. ANDERSON: The tax prior to that was 10 cents on a  
12 pack of 20 cigarettes, although in the law it specified on a per  
13 cigarette basis.

14 CHAIRMAN CAMPBELL: That portion of the tax did, the 10  
15 cents?

16 MR. ANDERSON: Even in the Proposition it talks about a  
17 per cigarette basis, but it does equate to a 10 cent per pack of  
18 20 cigarettes previously, with a 25 cent increase, which is a  
19 total of 35 cents per pack of 20 cigarettes, if you want to talk  
20 about packs rather than a per cigarette --

21 SENATOR ALQUIST: Mr. Chairman.

22 CHAIRMAN CAMPBELL: Senator Alquist.

23 SENATOR ALQUIST: What is the percentage of that tax  
24 against the average price of a pack of cigarettes?

25 MR. ANDERSON: That's what the computation here does.  
26 It's based on -- it would be the same thing if we took it by the  
27 pack or by the cigarette. This computation is on a per cigarette  
28 basis. The average wholesale cost of a cigarette is 4.2 cents.

1           CHAIRMAN CAMPBELL: Do all cigarette packs have 20  
2 cigarettes in them?

3           MR. ANDERSON: No, they do not. There are some that are  
4 in packs of 25. We do have some in 10. There are some of your  
5 foreign cigarettes that are in odd sizes.

6           CHAIRMAN CAMPBELL: So what happens to a pack of 25?

7           MR. ANDERSON: It has the same equivalent, because the  
8 tax is on a per cigarette basis.

9           CHAIRMAN CAMPBELL: So it's not a 25 cent increase for a  
10 pack of 25 cigarettes?

11          MR. ANDERSON: No, it is not. It would be the  
12 equivalent of 25.

13          CHAIRMAN CAMPBELL: How do you work that out in a  
14 machine?

15          MR. ANDERSON: It -- they --

16          CHAIRMAN CAMPBELL: I don't want to joke too much about  
17 this.

18          MR. ANDERSON: So, the basis here, as you asked, is the  
19 percentage on the average wholesale cost of cigarettes, the tax  
20 rate current is 41.67 percent. That's basically the reason we  
21 went this route.

22          The Proposition called for equivalent tax, including the  
23 old tax and the increase, on other tobacco products. Now, in  
24 some of the information here of the tobacco products, they're  
25 defined by various things. Actually, the law says tobacco  
26 products are all tobacco products other than cigarettes, so there  
27 may be some tobacco products that we haven't defined by talking  
28 about snuff, chewing tobacco, pipe tobacco and cigars.

1           The Board had several proposals made to it of methods to  
2 make this computation.

3           SENATOR ALQUIST: Let me ask one more question.

4           How did you decide to use the wholesale price rather  
5 than the retail price or the cost of manufacture?

6           MR. ANDERSON: Basically the Proposition says that the  
7 tax will be imposed on the wholesale cost of tobacco products.

8           SENATOR ALQUIST: It did say that?

9           MR. ANDERSON: Yes, it's very specific in specifying  
10 that it would be on the wholesale price of tobacco products.

11           CHAIRMAN CAMPBELL: Now, do all packs of cigarettes cost  
12 the same?

13           MR. ANDERSON: No, they do not.

14           CHAIRMAN CAMPBELL: Give me a variable.

15           MR. ANDERSON: In the package that I presented to you,  
16 there is a chart in there that shows how we computed it. If you  
17 look in the first section, go back to Exhibit C. I think you're  
18 looking at it on the back there.

19           So, the prices -- this information was taken from the  
20 tobacco industry. We did not develop this. Those are basically  
21 the prices. They range -- most of them fall into approximately  
22 two different categories: 39.15 cents; \$39.15 for a carton --  
23 or, I guess that's per 100.

24           CHAIRMAN CAMPBELL: Let me ask you, a pack of Dunhills,  
25 what would a pack of Dunhills go for?

26           MR. ANDERSON: I can't answer that specifically.

27  
28



1           CHAIRMAN CAMPBELL: What's the average pack of  
2 cigarettes today, if I were to go out and buy a package of  
3 Marlboros?

4           MR. ANDERSON: At the retail level?

5           CHAIRMAN CAMPBELL: Yes.

6           MR. ANDERSON: Uh --

7           CHAIRMAN CAMPBELL: Is it a dollar a pack now? Is it 50  
8 or 75 cents?

9           MR. ANDERSON: Of course, the price you're going to be  
10 paying for it --

11          CHAIRMAN CAMPBELL: Do we have smokers in the crowd?

12          FROM THE AUDIENCE: It's \$1.70 to \$2.00 now.

13          MR. ANDERSON: And that would include the tax, because  
14 the price you're going to see on there is going to include the  
15 tax.

16          CHAIRMAN CAMPBELL: What if you liked a different type,  
17 and you smoked Dunhills. What do they run?

18          MR. ANDERSON: Does anybody have --

19          FROM THE AUDIENCE: About 4.47-48.

20          CHAIRMAN CAMPBELL: What do they pay? What's their tax  
21 increase?

22          MR. ANDERSON: It's 35 cents for a pack of twenty.

23          No matter how you make this computation, unless you can  
24 come up with a unit idea in the other tobacco products, you're  
25 going to have some inconsistencies in applying the tax rate.

26          I think that was recognized in the wordage of the  
27 Proposition. That's why it was worded in a way that this tax  
28

1 rate would be on the wholesale value rather than on a unit, as  
2 the cigarette tax is.

3 Now, there is a problem equating a -- coming up with an  
4 equivalent tax where one is on a per unit value, and the other  
5 one is -- or a per unit item -- and the other one is on a  
6 wholesale value.

7 CHAIRMAN CAMPBELL: The campaigns all said it was a 25  
8 cent tax on a pack of cigarettes. That's basically, as I recall,  
9 what the campaign literature on behalf of this indicated.

10 MR. ANDERSON: Well, I think that any of the literature  
11 that I saw also talked about the tobacco products, but it's a  
12 minor portion of it.

13 CHAIRMAN CAMPBELL: We know that it extends to products.

14 MR. ANDERSON: Right.

15 CHAIRMAN CAMPBELL: We're just saying that a pack of  
16 cigarettes that cost a \$1.70 or \$4, they're going to pay 35 cents  
17 now. They're going to pay 25 cents more than they paid before --

18 MR. ANDERSON: That's correct.

19 CHAIRMAN CAMPBELL: -- the impact of that resolution.

20 I'd like to introduce the Chairman of the Assembly Ways  
21 and Means Committee and Vice Chairman of this Joint Legislative  
22 Budget Committee, John Vasconcellos, who has just joined us.

23 So, the per pack cigarettes, no matter what the cost, is  
24 a 25 percent increase?

25 MR. ANDERSON: It's a 25 cent increase, not a 25 percent  
26 increase.

27 CHAIRMAN CAMPBELL: Excuse me.  
28

1 MR. ANDERSON: It's actually a 250 percent increase.

2 CHAIRMAN CAMPBELL: We know it's a large increase.

3 MR. ANDERSON: And as I pointed out in the computation,  
4 that does come to almost a 42 cent -- percentage of the wholesale  
5 value of cigarettes. So that's the rate on cigarettes today, is  
6 41.67 percent of wholesale cost, taken on an average.

7 CHAIRMAN CAMPBELL: On a regular price of cigarettes.

8 MR. ANDERSON: Taken on the --

9 CHAIRMAN CAMPBELL: Not Dunhills.

10 MR. ANDERSON: Dunhill represents such a minor  
11 percentage of the total universe of cigarettes.

12 CHAIRMAN CAMPBELL: We're talking about what the cost of  
13 a pack is. No matter if it's \$10 a pack, there's still going to  
14 be a 25 cent increase per pack?

15 MR. ANDERSON: That's correct.

16 I'm not sure that I'm here to defend the fairness of  
17 Proposition 99, just what it says.

18 CHAIRMAN CAMPBELL: That's what we're talking about  
19 today.

20 MR. ANDERSON: The Board entertained other ways of  
21 making the computation. The staff looked at several different  
22 ways of making this computation, one of which could easily be  
23 considered. If you want to tax on an equivalent basis, let's  
24 just plain and simply take the amount of tobacco in cigarettes  
25 and equate that to the amount of tobacco in other tobacco  
26 products and tax it on that basis.

1 We didn't really decide that this was an equivalent  
 2 basis, but that would have amounted to about a 206 percent  
 3 tobacco products rate on other tobacco products at the wholesale  
 4 value. We dismissed that as not being the equivalency factor  
 5 that they were talking about in Proposition 99.

6 We looked at two proposals by the tobacco industry, one  
 7 by the cigar people, that talked about equating -- taking one  
 8 cigar as being the same as one cigarette, and therefore, you'd  
 9 get the same amount of tax as on one cigarette.

10 CHAIRMAN CAMPBELL: Do cigars come in boxes also? Can I  
 11 buy a pack of cigars, like five?

12 MR. ANDERSON: You can buy a box of cigars in fives and  
 13 thirties and very different --

14 CHAIRMAN CAMPBELL: Is it like a package of cigarettes?

15 MR. ANDERSON: They don't --

16 CHAIRMAN CAMPBELL: Do you tax the 25 cents on the  
 17 package of cigars, or do you tax each cigar individually?

18 MR. ANDERSON: We dismissed the idea of a pack or a  
 19 cigar as being equivalent to a cigarette or a pack, the same as  
 20 we did using it just on the strict tobacco content basis.

21 The smokeless tobacco industry presented a proposal to  
 22 us to consider an ounce of tobacco product being the unit at  
 23 which you would tax, so that one ounce would then be equivalent  
 24 to one cigarette as far as the amount of tax that you would take  
 25 in.

26 The only problem with that is that if you wanted to  
 27 compute it on that basis, you're talking about approximately 34  
 28 cigarettes before you'd end up having an ounce of tobacco.

1           One proposal that was presented to us was to take the --  
2 what is it called -- the weight-to-value method, which, after  
3 making several computations, we determined that using that method  
4 would come out with precisely the same tax rate as we have  
5 computed here. If you considered trying to equate the value of  
6 an ounce of tobacco product of any type with an ounce of tobacco  
7 in cigarettes, then you'd end up with approximately the same  
8 percentage rate as you'd come up with here.

9           The problem with that is that you'd have to do it on an  
10 overall basis for all tobacco products, otherwise you'd have  
11 varying different rates. We felt the Proposition called for a  
12 tobacco products rate, not numerous tobacco products rates.

13           So basically, after considering all of the different  
14 proposals, the Board did adopt the method that we have computed  
15 here.

16           We -- in the package that I gave to you, you do have a  
17 letter there from Lloyd Connelly, who was one of the principal  
18 proponents of the Proposition. It's attached to the letter  
19 rather than the big package that you have there. This was  
20 written to the Board prior to their hearing, urging the Board  
21 that they consider equivalency to mean what was intended in the  
22 drafting, and he uses an example in there. If you use his  
23 example, he specifically states that if you had a dollar  
24 wholesale value of cigarettes, and a 35 cent rate per pack, you'd  
25 end up with a 35 percent. That is precisely the formula we used  
26 here, the difference being that wholesale value of a pack of  
27 cigarettes is not a dollar; it's 84 cents. Therefore, you'd end  
28 up with 41.67 percent.

1 Now, the way the Proposition is laid out, each year that  
2 computation will be recomputed, and the rate on tobacco products,  
3 as long as cigarettes continue to go the way they are with their  
4 wholesale costs going up, the percentage rate on tobacco products  
5 will go down each year with that computation based on the  
6 March 1st data each year.

7 So basically that's the methodology [sic] that we used.  
8 The Board felt that that was in keeping with the wording of  
9 Proposition 99 and adopted that rate.

10 If you have any other questions, I'd be glad to  
11 entertain them at this time.

12 ASSEMBLYMAN VASCONCELLOS: Any questions? Senator  
13 Beverly.

14 SENATOR BEVERLY: Are you acquainted with the prevailing  
15 practice in other states?

16 MR. ANDERSON: Yes, I am.

17 SENATOR BEVERLY: What is generally the practice in  
18 states that have a similar levy?

19 MR. ANDERSON: It ranges substantially, but in the  
20 package we gave to you, we also have some sheets that show that.  
21 If you look in there on Exhibit A in the first section, it will  
22 show --

23 SENATOR BEVERLY: Exhibit A?

24 MR. ANDERSON: Yes, it shows there the cigarette tax  
25 rate in each of the states. It shows it converted to an ad  
26 valorem tax rate, and it shows what the tobacco products rate is  
27 in those various states.

28

1 Now, just to give you kind of a quick synopsis of them,  
2 there are twelve of those states that the tobacco products rate  
3 is within 5 percent of an ad valorem rate as computed on  
4 cigarettes, if you follow the same methology as we do.

5 There are another sixteen states that range beyond that:  
6 seven of them being more than 5 percent higher, and there's nine  
7 of them that would -- excuse me, it's the other way around. Nine  
8 of them would have a higher rate on tobacco products than they do  
9 on cigarettes on an ad valorem basis, and seven of them would be  
10 less than. So obviously, they have not all used the same  
11 methology in coming up with that.

12 And most of them, as near as we're aware of, those rates  
13 are specified in the law. It's not an interpretation or  
14 computation that they make. That tobacco products rate is  
15 specified in the law. And obviously, some of them used different  
16 methods in coming up with what that tobacco tax rate is.

17 But at least in looking at that, that means that 21 of  
18 28 states that have a tobacco products tax are within 5 percent  
19 of the ad valorem rate if you compute it on cigarettes or higher,  
20 with only 7 of them being lower.

21 ASSEMBLYMAN VASCONCELLOS: Say that last part again?

22 MR. ANDERSON: That would equate to 21 of the 28 states  
23 that have a tobacco products rate with either have a rate on  
24 tobacco products other than cigarettes that would be within 5  
25 percent of an ad valorem if you computed it on the cigarettes or  
26 higher, with only 7 of them having a lower tobacco products rate  
27 than on the cigarettes.

28

1 SENATOR BEVERLY: May I pursue this?

2 Let's take Washington State. That 64.9 percent tobacco  
3 rate is, what, 65 cents on a dollar cigar?

4 MR. ANDERSON: That's correct. It's based on the  
5 wholesale value, same as California.

6 SENATOR BEVERLY: And 35 percent --

7 MR. ANDERSON: On their cigarettes. So, that's  
8 obviously one of those that has a higher rate on the tobacco  
9 products than they do on the cigarettes.

10 SENATOR BEVERLY: Thank you.

11 ASSEMBLYMAN VASCONCELLOS: Any other questions or  
12 comments?

13 Thank you.

14 Next is Cory Brown and Tony Najera. Cory Brown, for the  
15 Coalition for a Healthy California.

16 MR. BROWN: Thank you, Mr. Chairman, Members of the  
17 Committee.

18 My name is Cory Brown. I'm General Counsel for the  
19 Planning and Conservation League, also the spokesperson for the  
20 Coalition for a Healthy California, which drafted and ran the  
21 campaign in favor of Proposition 99, the tobacco tax initiative.

22 We felt that Proposition 99 was the most important  
23 measure ever considered by the voters to protect human life.

24 Some of the statistics that underscore why we wrote  
25 Proposition 99 include the fact that 30,000 Californians die  
26 prematurely each year because of tobacco-related diseases. When  
27 you look at who's learning to smoke, 90 percent of smokers start  
28



1 by the time they're 19; 60 percent by the time they're 14.  
2 Additionally, studies by the Congressional Office of Technology  
3 Assessment indicate that cigarettes cost society \$2.17 cents per  
4 pack in terms of lost wages, lost economic benefits, health care,  
5 programs, and costs like that. Only a fraction of that's  
6 recovered by the cost of taxes imposed upon cigarettes.

7 We looked at those tremendous costs of tobacco products  
8 -- cigarettes, cigars, chewing tobacco and others -- imposed upon  
9 society. We decided that we wanted to save lives in several  
10 important ways. Our goals in designing Proposition 99 were  
11 several-fold.

12 The first was to raise the price of tobacco so that  
13 price elasticity would drive down demand. Studies have shown  
14 that's especially true amongst school children, those children  
15 who are the primary people who are beginning to smoke. The  
16 higher the price goes, the less children beginning to smoke. We  
17 felt that was very important.

18 Secondly, we wanted to establish proportionate tax on  
19 tobacco products other than cigarettes that weren't formerly  
20 taxed -- cigars, chewing tobacco, snuff, and things like that,  
21 that also have adverse health consequences.

22 Third, we wanted to raise funding for priority programs,  
23 teaching children not to smoke, providing health care for people  
24 who can't afford it, for environmental protection programs and  
25 others, as a way of helping the Legislature and the Governor meet  
26 many of your priority social programs and environmental programs  
27 that have been badly underfunded.

28

1 We felt that the Board of Equalization decision fully  
2 implements Proposition 99 in this context as we intended it to be  
3 envisioned, and we fully support their decision.

4 I'd like to outline a little bit of what Proposition 99  
5 says in terms of the tax on noncigarette tobacco products, then  
6 review the very curious proposals that the tobacco company has  
7 presented and that are at issue at this hearing as well.

8 Section 30123(b) of Proposition 99, and I read from the  
9 initiative, states that the tax on noncigarette tobacco products  
10 shall be established at a rate:

11 "... which is equivalent to the  
12 combined rate of tax imposed on  
13 cigarettes ...."

14 And in 30126, it goes on to say it:

15 "... shall be based on the wholesale  
16 cost of tobacco products ...."

17 and "tobacco products" referring to the noncigarette products,  
18 and that the rate shall be determined by the Board of  
19 Equalization.

20 One thing that's interesting to note is, in 30123(b) it  
21 says "at a rate". Not to establish several or differential  
22 rates, but to establish a single rate, which is clearly our  
23 intent.

24 But the Board of Equalization clearly carried out the  
25 intent of the drafters and the voters in terms of the formula  
26 they drafted. They simply took that amount of tax that's levied  
27 on cigarettes against its wholesale cost in terms of percentage,  
28

1 and applied that percentage against the dollar value of the  
2 wholesale cost of the noncigarette tobacco products. That's as  
3 we intended it. It's a simple formula, and it helps accomplish  
4 each of the goals that we had achieved.

5 We want to commend the Board of Equalization for seeing  
6 through the other proposals and clearly carrying out the  
7 implementation of the Act.

8 In response to Senator Alquist's question about what do  
9 other states use, 28 of 30 states do use an ad valorem tax, and  
10 that's what we're supporting there. The rate in other states  
11 ranges from 5 percent to about 65 percent. In California, it  
12 would be about 41 percent. So clearly, this isn't anything  
13 unusual in terms of what the Board of Equalization is doing in  
14 terms of establishing this tax rate.

15 You'll hear before you other proposals that are being  
16 proposed by the tobacco industry. The tobacco industry spent \$22  
17 million on what was considered to be one of the most misleading  
18 campaigns voters have ever seen. They argued that the passage of  
19 Proposition 99 would lead to all kinds of strange things, like  
20 gangs taking over, cigarette running, and things like that. They  
21 lost, clearly, by a strong voter mandate, despite their \$22  
22 million.

23 The voters didn't buy their smoke screen. We certainly  
24 hope the Legislature won't, either, and that the Legislature will  
25 reject the tobacco industry's efforts to weaken Proposition 99,  
26 the tobacco tax initiative.

27  
28

1           In terms of the Smokeless Tobacco Council's proposal,  
2 they have come up with some strange concoction of weight-to-  
3 value method. It's one of the most convoluted, complicated  
4 formulas I've ever seen. As an attorney, it's one of the most  
5 twisted legal reasonings I've seen in terms of actually coming up  
6 with a way that -- of suggesting that Proposition 99 should be  
7 implemented.

8           The clear terms in Proposition 99 say "based upon  
9 wholesale cost." There's no reference in terms of the weight of  
10 the product, in terms of how the tax is applied. How the  
11 Smokeless Tobacco Council reads that things should be based on  
12 weight, when the clear statute says based upon the wholesale  
13 cost, is clearly beyond us. We believe that their proposal is  
14 clearly contrary to the intent.

15           For those of you who are concerned about funding  
16 important programs that teach children not to smoke, taking care  
17 of health concerns for those who can't afford it, under the  
18 Smokeless Tobacco proposal, the amount of revenues that would be  
19 generated from these products would decline from about \$30  
20 million under the Board of Equalization's method, to about \$12  
21 million per year.

22           Clearly, the intent of Prop. 99 was to increase funding  
23 -- increase the cost of these products to discourage children to  
24 smoke. In looking at the intent, the Board of Equalization  
25 raises the cost higher to discourage more children from using the  
26 products.

1           Secondly, the intent was to raise money for priority  
2 programs. Again, the Board of Equalization's method furthers  
3 that goal more.

4           So, we have both furtherance of the purposes of  
5 Prop. 99, as well as the clear letter of the law in terms of the  
6 Board of Equalization is right, the Smokeless Tobacco Council is  
7 wrong.

8           Furthermore, the Cigar Association argues in their  
9 papers that you can't apply the weight method to cigars. So, if  
10 you adopted that method, it just wouldn't work in terms of a  
11 system, as the Cigar Association discusses. And we get back to  
12 the language of Proposition 99, it says "at a rate," not at  
13 several rates. It says "at a rate."

14           Smokeless Tobacco is both impractical in terms of how it  
15 applies as being a single rate to all types of tobacco products.  
16 It violates the clear letter of the law, and it violates what the  
17 goals of the statute are.

18           The cigar companies are proposing that you compare one  
19 cigar to one cigarette. Now, I think that is also a very strange  
20 way of doing it, because we didn't say in the initiative look at  
21 this on a per unit basis. Again, we said look at the wholesale  
22 cost of cigars, snuff, chewing tobacco, and other forms of  
23 noncigarette tobacco products, in terms of how the tax should be  
24 applied. So again, we have a clear violation in terms of what  
25 the letter of the law says.

26           Secondly, in terms of discouraging children from  
27 smoking, the amount of tax would be far lower under the cigar  
28 industry's proposal. Again, that violates that intent.

1 Third, in terms of revenues, again, in terms of meeting  
2 the social program needs, the cigar industry's proposal wouldn't  
3 raise the \$30 million per year that the Board of Equalization's  
4 formula would raise. It would raise about \$5 million per year.

5 So, what we're seeing are two industries that are  
6 promoting very self-serving interests and trying to deny our  
7 school systems funds that are needed to teach children not to  
8 smoke, the funds we need to provide health care for people who  
9 can't afford it, and the funds we need to protect our environment  
10 and expand our parks.

11 Furthermore, the Smokeless Tobacco Council argues that  
12 the cigar industry's proposal wouldn't work with respect to  
13 smokeless tobacco because how do you measure a unit of snuff, how  
14 do you measure a unit of chewing tobacco; it's different. And  
15 again, that brings us back to the language of the Act that says  
16 that it's one tax rate. It says "at a tax rate."

17 In review, we strongly support the Board of  
18 Equalization's actions. It's the formula we envisioned when we  
19 wrote Proposition 99. It's the formula that's required by the  
20 Act itself because it states wholesale costs, and it says "at a  
21 rate," which means one tax equation. It also is the formula that  
22 best promotes the purposes of the Act: raising the tax high  
23 enough to discourage children from using these dangerous  
24 products; secondly, raising the funds for the priority health  
25 care, education, and environmental programs which you, the  
26 Legislature, have articulated the need for funding for.

1           In conclusion, the Coalition for a Healthy California  
2 strongly urges the Legislature to see through the smoke screen  
3 established by -- put out there by the self-serving tobacco  
4 industry, to protect children, and vote against their proposals.

5           I'd be happy to open up to any questions.

6           ASSEMBLYMAN VASCONCELLOS: Any questions?

7           Thanks, Cory.

8           MR. BROWN: Thank you.

9           ASSEMBLYMAN VASCONCELLOS: Tony.

10          MR. NAJERA: Mr. Chairman, Members of the Committee, my  
11 name is Tony Najera. I represent the American Lung Association  
12 of California.

13          Rather than reiterating what Mr. Cory Brown just  
14 articulated, which I brought my testimony, it covers exactly the  
15 same points that he did.

16          So, to save some time, I would just say thank you for  
17 the opportunity for allowing us to appear before this body. And  
18 as one of the major sponsors of Prop. 99, we're really here to  
19 support the recommendations as determined by the Board of  
20 Equalization.

21          The Coalition feels the way the Board of Equalization  
22 levied the tax really, truly implements the intent of Prop. 99.  
23 We feel that the Act is clear and straightforward in its intent,  
24 as stated in Section 30123(b). We intended to raise the price,  
25 to decrease consumption of tobacco products. That is very true.

26          The Board has been given the authority and the  
27 responsibility to determine this tax rate on an annual basis,  
28

1 and we ask that you consider upholding not only the Board's  
2 decision on the tax levied, but the voters' mandate in carrying  
3 out the intent of Prop. 99.

4 Thank you.

5 ASSEMBLYMAN VASCONCELLOS: Thank you.

6 Next, Dan Rabovsky, Legislative Analyst.

7 You did an analysis prior to the measure on the ballot  
8 with respect to what it would cost and/or render in the way of  
9 proceeds. Advise us as to what you depended upon, what you said,  
10 how you calculated it, what your assumptions were.

11 MR. RABOVSKY: Mr. Chairman, Dan Rabovsky for the  
12 Analyst's Office.

13 As you just said, we did an analysis of Proposition 99  
14 for the ballot pamphlet that was distributed to the voters.

15 Our estimate, our fiscal estimate in that ballot  
16 pamphlet included \$31 million in 1989-90 from the new tax on the  
17 other tobacco products. That is, the noncigarette tobacco  
18 products. Our total estimate was about 600 million. That's on  
19 an annual basis in 1989-90. So, the other tobacco products  
20 revenue was a small percentage of the total Prop. 99 revenue.  
21 It's about 5 percent.

22 In preparing our ballot estimate, we read Proposition 99  
23 with respect to the other tobacco products tax in exactly the  
24 same way that the Board of Equalization read it in making their  
25 adoption. In other words, we presumed that what Proposition 99  
26 meant was that you take the 35 cent tax rate, combined tax rate  
27 on cigarettes; you divide that by the average wholesale price of  
28



1 a pack of cigarettes; get a tax rate, which is a dollar value  
2 type of tax rate, and then apply that to the wholesale price of  
3 other tobacco products. So, we interpreted it in the same way  
4 that the Board did in making our estimate.

5 Our methodology was to estimate the dollar value at  
6 wholesale of tobacco products, using national data and estimates  
7 of California's proportion of national sales. We reduced those  
8 dollar sales by about 17½ percent to reflect the fact that, with  
9 the price increase due to the tax, one would expect sales to  
10 decline somewhat.

11 We assumed a price elasticity that would result in that  
12 17.5 percent reduction. This was essentially based on data that  
13 came out of academic studies for cigarettes. We didn't have a  
14 separate one for other tobacco products, and we simply assumed  
15 the same effect for other tobacco products as for cigarettes.

16 Then we applied the tax rate, which we had estimated at  
17 about 43.9 percent -- a little bit higher than what the BOE  
18 actually came out with -- to this reduced amount of sales, and we  
19 got a revenue of about \$31 million.

20 ASSEMBLYMAN VASCONCELLOS: For the other tobacco  
21 products?

22 MR. RABOVSKY: For other tobacco products. That was  
23 part of the \$600 million overall estimate.

24 Now, of course, our estimate had some uncertainties in  
25 it. One is, what will be the reaction to those higher prices?  
26 As I said, we assumed that a reaction similar to cigarettes, and  
27 if course, even the cigarette reaction is open to some  
28 uncertainty. We will find out over time how close we were.

1 California's share of the market for other tobacco  
2 products was also an uncertainty. We did not have very good data  
3 for that. We assumed that California's share of the cigarette  
4 market is proportional to our population; that is, our population  
5 proportion to national population.

6 We understand from the cigar industry now that that may  
7 have overestimated the revenue from cigars; that Californians may  
8 actually smoke fewer cigars in relation to our population than  
9 the nationwide average. If the tobacco industry figures are  
10 correct for our proportion, that would reduce our estimate  
11 probably on the order of \$7 million. That is, from the 31 or so,  
12 it would bring it down to about 25.

13 Generally over all, there's probably more of a downside  
14 risk in our estimate than an upside risk; that is, for any major  
15 change. In other words, if we were off by very much, we probably  
16 overestimated rather than underestimated, we feel. But we won't  
17 really know for a while, until initial effects of the Proposition  
18 have worn off and the market settles down, probably.

19 ASSEMBLYMAN BAKER: Is your office following that actual  
20 revenue?

21 MR. RABOVSKY: We are following the revenue, but again,  
22 I think it's a little too early to tell what the permanent  
23 reaction is going to be.

24 ASSEMBLYMAN VASCONCELLOS: Any questions or comments?

25 ASSEMBLYMAN BURTON: Is there any doubt in your mind  
26 about what the proper formula should be?

27  
28

1 MR. RABOVSKY: I think that when we saw the tobacco  
2 industry proposals that were presented to the Board of  
3 Equalization, at first we were rather surprised by that  
4 interpretation.

5 In talking with them, we can understand how one can read  
6 the words in the Proposition the way that they read them. It is  
7 not the way that we read them. And to us, it seemed to make  
8 sense; it seemed to be consistent with the rest of the  
9 Proposition, that one would place an equal financial burden on  
10 other tobacco products as is being placed on cigarettes. I can  
11 understand how the industry, perhaps, can read the words that  
12 way, however.

13 In other words, they're saying --

14 ASSEMBLYMAN BURTON: Of course.

15 MR. RABOVSKY: But the way we interpreted it was the  
16 same way the Board interpreted it.

17 ASSEMBLYMAN BURTON: The tobacco industry's got a great  
18 way of interpreting it.

19 ASSEMBLYMAN BAKER: States are split.

20 ASSEMBLYMAN VASCONCELLOS: Any other questions or  
21 comments?

22 Thank you.

23 John Parker, Chairman of the Board, California  
24 Association of Tobacco and Candy Distributors.

25 MR. PARKER: Mr. Chairman, gentlemen, my name is John  
26 Parker. I am the Chairman of the Board of the California  
27 Association of Tobacco and Candy Distributors.

28

1           If you'd indulge me a moment, I'd like to reread the  
2 section of the Proposition which states, 30123(b):

3           "There shall be imposed upon every  
4 distributor a tax upon the distri-  
5 bution of tobacco products based  
6 on the wholesale cost of these  
7 products at a tax rate as determined  
8 annually by the State Board of  
9 Equalization which is equivalent  
10 to the combined rate of tax imposed  
11 on cigarettes by subdivision (a)  
12 and the other provisions of this  
13 part."

14           What I contend is that the State Board of Equalization  
15 took the average cost of a pack of cigarettes and divided it into  
16 the tax rate, which they -- we have heard today. What this  
17 method does not take into account, as the initiative directs, is  
18 the average wholesale cost of other tobacco products -- the  
19 operative word being the "average" -- as they have with the  
20 cigarettes, the average wholesale cost of other tobacco products,  
21 which is what we've tried to do here, to show you that various  
22 tobacco products, starting with cigars at a wholesale cost of  
23 \$2.81, the tax rate is \$1.17. Down here, at the other end, is a  
24 normal domestic pack of cigarettes, which is what they used the  
25 rate 89 cents wholesale cost, 35 cent tax.

26           Another glaring example are on these little cigars, this  
27 by law in California is taxed as a cigarette, 20 cigarettes, 35  
28

1 cents tax. This cigar, by definition in California, because it  
2 weighs more than 3 pounds per thousand, not much bigger than this  
3 one, is \$3.04 wholesale cost, but the tax is \$1.27.

4 ASSEMBLYMAN VASCONCELLOS: That distinction's been on  
5 some long-standing; I assume?

6 MR. PARKER: That's correct. It's not -- cigarettes are  
7 -- it's determined by weight, unless they're paper-covered rolls.  
8 If they're a small cigar, that's determined by weight.

9 ASSEMBLYMAN VASCONCELLOS: The definitions are one which  
10 have been long since --

11 MR. PARKER: That's correct.

12 ASSEMBLYMAN VASCONCELLOS: -- agreed to and in practice?

13 MR. PARKER: That's correct, yes.

14 ASSEMBLYMAN BAKER: Were they always taxed differently,  
15 the little cigars and the big cigars?

16 MR. PARKER: Yes, they were. It is my belief that since  
17 the cigarette tax was imposed by the State, that the definition  
18 of 3 pounds per thousand, under being cigarettes, over being  
19 cigars.

20 It goes down the line on the cigars. Pipe tobacco is  
21 the same way. Again, \$3.20 wholesale cost on pipe tobacco, the  
22 tax is \$1.33; down the line to wholesale cost of \$1.10, 46 cents.  
23 Which brings us down here, again, the average price was used and  
24 they came up with, in March of last year, I believe, 86 cents per  
25 pack; it's now 89 cents per pack of cigarettes, 35 cent tax.

26 You have a cigarette here, like the Dunhill you were  
27 alluding to, \$2.63 wholesale cost, still 35 cents tax. This pack

28

1 runs \$1.93, 35 cents. Down to the value-priced, the generics if  
2 you will, 65 cents wholesale cost, 35 cents tax.

3 ASSEMBLYMAN BURTON: What's in the aspirin box?

4 MR. PARKER: This box?

5 ASSEMBLYMAN BURTON: Yes.

6 MR. PARKER: That's chewing tobacco. This is Skoal wet  
7 chew; this is little pellets of chew; and that's your Red Man,  
8 your normal chewing tobacco, and then plug tobacco.

9 But all up and down the line, we contend that the  
10 average, just like they did with cigarettes, that an average  
11 should have been taken on other tobacco products, and in fact, an  
12 average was come up with with information received from the  
13 various industry councils. I believe you have this; I believe  
14 it's in your package. The tax rate of .0175, which is the tax on  
15 one stick or one cigarette, would be divided by the average cost  
16 of other tobacco products, which turns out to be 92 cents -- or  
17 .092, which leaves a tax rate of 18.98 on the other tobacco  
18 products. This is the formula that we have come up with that  
19 uses the average wholesale cost of other tobacco products.

20 The other problem that we have in this state on the  
21 other tobacco products with this 41 percent tax is not the fact  
22 that the consumption is going to be greatly reduced by the  
23 consumer, particularly, but that this tax is going to encourage  
24 people -- no, it's not going to encourage them to smoke -- it's  
25 going to encourage mail order houses outside the state to start  
26 flooding the state with advertising, such as I have here. I  
27 believe you have this in your package. The first paragraph, if I  
28 may read it, blatantly says:

1 "With the new California 41 percent  
2 tobacco tax, mail ordering your  
3 tobacco products has, obviously,  
4 become very attractive from a cost  
5 standpoint."

6 These people have found that if they offer for sale in California  
7 the same products that a consumer was buying in December at a  
8 substantially lower price, that the consumer will not quit  
9 smoking but will go outside the state to purchase his tobacco  
10 products at a much lower price, thus cheating the State of  
11 California out of whatever tax rate is determined.

12 SENATOR BEVERLY: May I ask a question on that point.

13 ASSEMBLYMAN VASCONCELLOS: Yes, go right ahead.

14 SENATOR BEVERLY: I can't go to Nevada and buy an  
15 automobile and bring it back to California and escape the tax.

16 MR. PARKER: That's correct.

17 SENATOR BEVERLY: That's a sales and a use tax, or  
18 whatever I get taxed; on or the other.

19 But I can escape it in the tobacco products?

20 MR. PARKER: Certainly.

21 SENATOR BEVERLY: I can do business with old Nate  
22 Sherman in New York?

23 MR. PARKER: That's correct. And probably get three or  
24 four --

25 SENATOR BEVERLY: Why is that? Because of the language  
26 of the taxing statute?

1 MR. PARKER: It's because there is no checks and  
2 balances, number one. And number two, I don't believe that it is  
3 illegal at this time to have this kind of a solicitation sent  
4 into the state. I'm not sure that it's -- I'm honestly --

5 SENATOR BEVERLY: Maybe the Board of Equalization could  
6 comment on that point.

7 MR. ANDERSON: You cannot bring tobacco products into  
8 the state without owing the tax. The problem is one of policing.  
9 It's illegal to bring tobacco products into the state without  
10 paying the tax on it, just as an automobile. The difference  
11 being that you have to register an automobile with DMV; you don't  
12 have to register the cigar.

13 That is, we have a way of finding out all of the  
14 registered --

15 SENATOR BEVERLY: We're going to register fire arms and  
16 cars, but not cigars, please.

17 (Laughter.)

18 SENATOR BEVERLY: But as far as you're concerned, the  
19 law requires a tax to be paid on it.

20 MR. ANDERSON: That is correct.

21 SENATOR BEVERLY: Just as if it were a use tax.

22 MR. ANDERSON: Everyone who mail orders stuff into the  
23 state for their own consumption owes the tax.

24 SENATOR BEVERLY: Do some out of state suppliers levy a  
25 tax and pay it to California?

26 MR. ANDERSON: No, they do not.

27  
28



1 ASSEMBLYMAN VASCONCELLOS: What's the practice with  
2 other mail order items on which there is a sales tax? Let's get  
3 out of the tobacco area.

4 Come forward.

5 ASSEMBLYMAN CAMPBELL: Mr. Chairman, someone carried a  
6 bill a couple of years ago to put a tax on some mail order stuff.  
7 I'm not too sure where it went, but --

8 ASSEMBLYMAN VASCONCELLOS: What is the status of mail  
9 order sales for clothes, appliances, whatever else?

10 MR. ANDERSON: That comes under the sales tax law, and  
11 it's -- I don't have all the answers as to how it applies. I  
12 know that it applies.

13 The problem is one of getting the out-of-state mail  
14 order houses to give us the information so that we can go after  
15 those people. Many of them, under the sales tax law, voluntarily  
16 register with the Board of Equalization, collect that use tax  
17 from the person mail ordering it into the state.

18 ASSEMBLYMAN VASCONCELLOS: Is there any state law that  
19 prohibits someone from mailing without registering?

20 MR. ANDERSON: No, there is not.

21 ASSEMBLYMAN VASCONCELLOS: Could there be?

22 MR. ANDERSON: You get into the interstate commerce  
23 problem of --

24 ASSEMBLYMAN VASCONCELLOS: It doesn't prohibit mailing.  
25 It just prohibits them without registering.

26 MR. ANDERSON: No, there is no law that would prohibit  
27 them from registering.

28

1 ASSEMBLYMAN VASCONCELLOS: Has there been a  
2 constitutional opinion rendered on the constitutionality of the  
3 law?

4 MR. ANDERSON: Under the sales tax law there's several  
5 court cases. I'm not prepared to respond to those.

6 ASSEMBLYMAN VASCONCELLOS: It seems to me we may need to  
7 find that out. We may need to have a law that says if any  
8 out-of-state mail order house fails to register, then we can  
9 proceed from that to make the tax, however it is, conform so the  
10 people in the state are not disadvantaged.

11 MR. ANDERSON: That would definitely help the policing  
12 of the tobacco products law.

13 ASSEMBLYMAN BURTON: There has been introduced in the  
14 Congress by Jack Brooks, who's the Chairman of the House  
15 Committee on Judiciary, a bill of nationwide application that  
16 would require all of this mail order business now to include the  
17 tax and forward it to the states. I think there's like about  
18 20-something states are really losing a lot of money under this  
19 so-called, not just tobacco, but the mail order stuff. And  
20 naturally, the mail order companies are sending to all of their  
21 customers, you know, "Fight this legislation; it's going to  
22 increase the cost."

23 But basically what they are is a bunch of cheats. I  
24 don't know the chance of legislation passing in Washington, but I  
25 know that the Governor here and many of our colleagues that are  
26 so strong on law and order would probably support legislation  
27 that would, you know, fulfill this requirement, and also help the  
28 state treasuries, and stop the chiselers.

1 We stopped the welfare chiselers under Ronald Reagan.  
2 Let it be said we stopped the tobacco tax chiselers under George  
3 Deukmejian.

4 MR. PARKER: Thank you.

5 We understand that the State Board prefers a percent  
6 that is the same for all products because it's the easiest to  
7 administer. And we believe that one rate may not be accurate for  
8 various products such as these.

9 If it is necessary for ease of administration, I believe  
10 that shouldn't the rate at least relate to other tobacco  
11 products. To be more consistent with what we actually believe,  
12 the formula, as I stated, is the tax rate of 1.0175 [sic],  
13 divided by the average cost of all the other tobacco products.

14 That's the main thrust.

15 ASSEMBLYMAN VASCONCELLOS: Tell me how you got to that?

16 MR. PARKER: The .0175, that is the tax rate on one  
17 cigarette; .0175 cents per cigarette, times 20 is your 35 cents.

18 So, we believe that if we take -- using that formula, if  
19 we take the average cost per other tobacco products, which we  
20 have determined to be .092 cents, divide that into the rate of  
21 .0175, it comes out with a more equitable rate of 18.98 percent.

22 ASSEMBLYMAN VASCONCELLOS: My math isn't following  
23 yours.

24 I used to smoke before I quit, and I won't say why I  
25 quit right now.

26 There were 20 cigarettes to the usual pack.

27 MR. PARKER: Yes, sir.

28

1 ASSEMBLYMAN VASCONCELLOS: If there's 35 cents tax rate  
2 that's like 2 cents a cigarette.

3 MR. PARKER: Right, it's .0175; one-and-three-quarters  
4 cents per cigarette is the tax.

5 ASSEMBLYMAN VASCONCELLOS: But there was a rate,  
6 one-and-three-quarter cents, and the cigarette still costs about  
7 4 cents apiece.

8 MR. PARKER: Right.

9 ASSEMBLYMAN VASCONCELLOS: On a 40 percent rate for one  
10 cigarette.

11 MR. PARKER: Right, that's true, but that's using the  
12 average price -- that's true, and -- but the way the Board came  
13 up with the rate was the 1.75 -- or, 0175 times the average price  
14 of cigarettes.

15 ASSEMBLYMAN VASCONCELLOS: As opposed to the average  
16 price of a cigarette? It would be the same.

17 MR. PARKER: It would be the same, but the rate on the  
18 other tobacco products should be based on an average, not on the  
19 wholesale cost.

20 ASSEMBLYMAN VASCONCELLOS: How would you devise an  
21 average between snuff and cigars, or a fancy cigar?

22 ASSEMBLYMAN CAMPBELL: Break it down to a dollar, and so  
23 much percentage per dollar.

24 MR. PARKER: From information gathered from the  
25 industries, just like the State Board did with cigarettes.  
26 Information which we have already -- that has been determined,  
27 that we can come up with those numbers.

28

1 ASSEMBLYMAN VASCONCELLOS: Okay.

2 MR. PARKER: Other than what I showed you on the flyer  
3 there, that's all I have to say. If there are any other  
4 questions?

5 ASSEMBLYMAN VASCONCELLOS: Mr. Burton.

6 ASSEMBLYMAN BURTON: You made the argument before the  
7 Board of Equalization; right?

8 MR. PARKER: That's correct. We have brought this point  
9 before the Board.

10 ASSEMBLYMAN BURTON: And the Board of Equalization has  
11 consistently, in the minds of some, been the champion of the  
12 taxpayer; right?

13 MR. PARKER: Perhaps.

14 ASSEMBLYMAN BURTON: Historically. And yet, they, in  
15 their infinite wisdom, found that this was a consistent way of  
16 doing it; right?

17 MR. PARKER: Uh-huh.

18 ASSEMBLYMAN BURTON: And you're asking us to  
19 second-guess those constitutionally-elected experts.

20 MR. PARKER: That is correct.

21 SENATOR BEVERLY: On that point, is there litigation  
22 pending on this issue? You objected to the Board's method and  
23 levy.

24 MR. PARKER: There is no litigation at this time.

25 SENATOR BEVERLY: Nothing in court at this point?

26 MR. PARKER: That's correct.  
27  
28

1 ASSEMBLYMAN VASCONCELLOS: Questions or comments? Mr.  
2 Baker.

3 ASSEMBLYMAN BAKER: I think what he's saying is that,  
4 regardless of the price of a pack of cigarettes, you get charged  
5 35 cents, but then the other products all get tagged 41 percent  
6 of the cost.

7 I think what he's saying is that there has to be a  
8 little equity here.

9 I didn't support the law. I think it stabs the lower  
10 middle-class, the people who are stupid enough to smoke.

11 I don't know how I can help. The Board of  
12 Equalization's empowered to tax these things. It is patently an  
13 avaricious tax. It's too high, and it was intended to be that,  
14 and apparently the people were fooled in voting for it.

15 MR. PARKER: Thank you.

16 ASSEMBLYMAN VASCONCELLOS: Next, Barbara Morphy, owner  
17 of The Tobacco Loft in Concord and Pleasanton.

18 MS. MORPHY: I'm here to also give you some insight on  
19 how this tax has affected the small retailer, and I'm just one of  
20 them.

21 Our shops, we're a small, family-owned business. Since  
22 Prop. 99 has passed and been in effect, our business has been  
23 down between 30 and 40 percent in the premium cigar and the  
24 hand-blended tobacco -- tobacco blends for the discriminating  
25 pipe smoker, is what I'm trying to say.

26 Our business is not based on cigarettes. Our business  
27 is based on the new dad that wants to celebrate the birth of his  
28 child, or someone who wants to read a book and smoke a pipe.

1           This is serious because we -- I'm well aware of other  
2 retailers who have gone out of business because of this tax. And  
3 I want to be in business next year. Our five children want us to  
4 be in business next year.

5           CHAIRMAN CAMPBELL: Ms. Morphy, let me ask you a  
6 question.

7           You've lost customers.

8           MS. MORPHY: Yes.

9           CHAIRMAN CAMPBELL: Where have they gone?

10          MS. MORPHY: We know now -- there was talk before about  
11 this tax designed to reduce tobacco consumption. Yes, however,  
12 our 30-40 percent, it's not that people have stopped smoking.  
13 They definitely are sending for their products in mail order,  
14 out-of-state mail order.

15          Our business is like friends, but, you know, you can  
16 only have friendship go so far. They've come in; they've told  
17 us. A lot of them were aware of this mail order business going  
18 on before, but they liked to come in and socialize and purchase  
19 their products from us.

20          But now, when the \$2 cigar is now \$3, that's pretty hard  
21 to overlook. So, we know they are still getting their products,  
22 just not from anybody here in the State of California.

23          CHAIRMAN CAMPBELL: You're saying your business is down  
24 40-50 percent.

25          MS. MORPHY: It's down 30-40.

26          CHAIRMAN CAMPBELL: And what percent of that 30-40 in  
27 your judgment now purchases out-of-state?  
28

1 MS. MORPHY: Oh, I could easily say safely 28 percent  
2 that I'm really well aware of.

3 ASSEMBLYMAN VASCONCELLOS: Just to be clear, you don't  
4 mean 28 percent of --

5 MS. MORPHY: Twenty-eight --

6 ASSEMBLYMAN VASCONCELLOS: You mean 28 percent of the  
7 30-40?

8 MS. MORPHY: Yes, for sure.

9 CHAIRMAN CAMPBELL: And the other 73 percent, or 72  
10 percent --

11 MS. MORPHY: I don't know. People move, or they may go  
12 to Walgreen's.

13 ASSEMBLYMAN VASCONCELLOS: Just the way you expressed  
14 it, you mean of the 30 percent that's gone --

15 MS. MORPHY: Yes.

16 ASSEMBLYMAN VASCONCELLOS: -- all of them, but for a  
17 small bit, you think has gone out of state?

18 MS. MORPHY: Oh, definitely.

19 ASSEMBLYMAN VASCONCELLOS: So that's not 28 percent of  
20 the total --

21 CHAIRMAN CAMPBELL: I see; I misinterpreted that.

22 ASSEMBLYMAN BAKER: Mr. Chairman, wouldn't it be a safe  
23 assumption that when prices go up, the quantity goes down, and  
24 they've shifted downward into other products that are cheaper?

25 MS. MORPHY: Are you talking to me?

26 ASSEMBLYMAN BAKER: Yes.

27

28



1 MS. MORPHY: Twice a year, basically, there are normal  
2 manufacturer's increases that happen in the cigar business.

3 ASSEMBLYMAN BAKER: But they're not 41 percent  
4 increases.

5 MS. MORPHY: No, never. A nickel a cigar, maybe.

6 ASSEMBLYMAN BAKER: But don't you find a down scaling  
7 when prices go up radically like that, that people to avoid that  
8 won't quit smoking, but they'll shift to a cheaper product?

9 MS. MORPHY: They get angry. That's when they turn to  
10 mail order. I think a few may have turned to Walgreen's or  
11 Payless instead of the premium.

12 ASSEMBLYMAN BAKER: Or cigarettes.

13 MS. MORPHY: Perhaps.

14 CHAIRMAN CAMPBELL: Is there still a good 5 cent cigar?

15 MS. MORPHY: No. Those days are gone.

16 CHAIRMAN CAMPBELL: How many units do you own? Do you  
17 just own one store?

18 MS. MORPHY: We have two stores, 35 miles apart, so  
19 you're talking about two areas of customers.

20 CHAIRMAN CAMPBELL: Any other questions of Ms. Morphy?

21 Then Ms. Linda Squires. You're located in Santa Rosa,  
22 Pipe of Squires.

23 MS. SQUIRES: Hello there. I'm Linda Squires, the Pipe  
24 Squires, and I'm an independent retailer of one store, a chain of  
25 one link.

26 I'm also the president of a group of retailers, just  
27 like myself, all across the country. Barbara happens to be in  
28

1 our group. We have somebody in Baltimore, and nobody in  
2 Washington State. And I have talked to many of them. And so I  
3 come here with a great feeling of a lot of other small retailers  
4 in addition to myself that have all suffered an immediate loss of  
5 30 percent at an average of our business.

6 And I must say, first of all, our customer is not a  
7 child. Our customer is an adult, primarily male, who is -- if  
8 he's going to be smoking premium cigars that retail from \$2-5 a  
9 cigar, he knows what he wants, and he knows where to get them,  
10 and he is somebody who is intelligent enough to locate an  
11 alternative source of purchasing those products.

12 Since these aggressive mail order people from  
13 out-of-state have already broken into our market via direct  
14 mailing, one person in a big company called J.R. in New Jersey  
15 has actually sent catalogues to our customers, and these prices  
16 represent approximately 60 percent decrease. I mean, a 60  
17 percent less, you know, the price is lower than what we can  
18 offer.

19 We are losing our business to out-of-state people.  
20 There is no question --

21 CHAIRMAN CAMPBELL: What is your business now? How many  
22 stores do you have?

23 MS. SQUIRES: We have one location.

24 CHAIRMAN CAMPBELL: And how much is your business?

25 MS. SQUIRES: Thirty percent is my average for the first  
26 quarter of the year.

1           These people have not quit smoking. These people are  
2 purchasing their cigars from out-of-state. Purchasing them from  
3 New Jersey.

4           They're not mentioning to the State Board of  
5 Equalization or to the State of California Legislature that  
6 they're purchasing these cigars from out-of-state, and they have  
7 no intention of telling them. They don't have to park these in  
8 their driveway, and they're gone before anybody can come up to  
9 their house. And the money is just gone.

10           It is my understanding, whatever the purposes that the  
11 writers of Proposition 99 intended, they did specify a particular  
12 tax for cigarettes. They also specified that the State Board of  
13 Equalization should determine the tax rate. The poor State Board  
14 of Equalization did not write this law, yet they had to come up  
15 with this figure.

16           What we're saying, what we're asking you is to please  
17 ask the State Board of Equalization to relook at this to a lower,  
18 more equitable rate, because, as the months progress, we are  
19 going to experience an irreversible loss of business; that a  
20 lesser rate, a more equitable rate, will allow us to continue to  
21 keep the business in the State of California.

22           That's really why we're here, is to ask your help into  
23 talking to the State Board and seeing if there might not be an  
24 alternative method of looking at this tax.

25           The industry, of course, came up with something that  
26 sounds very fair and very sensible to me, and that is a tax rate  
27 based -- divided by the average cost of other tobacco products,  
28

1 as opposed to the average cost of cigarettes, which would bring  
2 that to approximately 18 percent. And I think that Barbara and I  
3 will still be in business next year if it was a lower rate.

4 We're asking your help, really. And we thank you for  
5 letting us come.

6 CHAIRMAN CAMPBELL: Any questions by Committee Members?

7 All right, thank you very much for your testimonies. We  
8 appreciate your being here.

9 David Doerr, tax consultant for the California  
10 Taxpayers' Association.

11 MR. DOERR: Good afternoon, Senator, Members.

12 I have several points that I'd like to make on this  
13 issue.

14 First, before I begin, I think I want to clear up a  
15 misconception that was left in answer to Senator Beverly's  
16 question about what happens when you buy a cigar in Nevada.

17 There is no tobacco products tax, use tax, so to speak.  
18 In other words, if you bought the cigar in Nevada, you wouldn't  
19 have to come in and pay a 41 percent of the wholesale price tax.  
20 The only tax that would be required is just the sales tax portion  
21 where there is a sales and use tax. So, if you bought the cigar  
22 for a dollar, it would be six cents.

23 CHAIRMAN CAMPBELL: So you'd have to pay the sales tax.

24 MR. DOERR: Yes, but the sales tax allows a credit for  
25 the sales tax you pay in Nevada. So, if Nevada's tax is 5 cents,  
26 then what you owe California is 1 cent. That's how it works.  
27  
28

1           SENATOR BEVERLY: I did not understand the answer that  
2 way. I'm glad you clarified.

3           MR. DOERR: There's no tobacco tax.

4           CHAIRMAN CAMPBELL: If I bought tobacco products and had  
5 them mailed in, I don't pay this tobacco tax on that; is that  
6 correct?

7           MR. DOERR: That's right. You'd owe a sales tax.

8           CHAIRMAN CAMPBELL: But I would have to pay the sales  
9 tax.

10          MR. DOERR: If they knew about it.

11          CHAIRMAN CAMPBELL: Is the sales tax on top of the  
12 cigarette tax or the tobacco tax?

13          MR. DOERR: Yes, it is.

14          CHAIRMAN CAMPBELL: So you have a double taxation.

15          MR. DOERR: That was going to be another point.

16                 In talking about when you buy out-of-state, you're  
17 saving the 41 cents. You're really saving more because you're  
18 saving the 41 cents, then you're saving the sales tax, which is 6  
19 cents, and then you're saving the sales tax on the 41 cents. So,  
20 it comes pretty close to 50 cents, and that assumes that you  
21 don't tell them that you've ordered this by mail and pay the  
22 sales tax portion voluntarily.

23          SENATOR BEVERLY: May I ask the Board of Equalization  
24 representative.

25                 Do you agree with what he just said?

26          MR. ANDERSON: No, I do not. Let me just explain.  
27  
28

1 Proposition 99 implemented a tax on tobacco products, in  
2 our opinion -- the Board of Equalization's opinion-- in the same  
3 manner as the cigarette tax applies.

4 Because it didn't change all the cigarette statutes,  
5 it's now somewhat unclear as to which of those statutes literally  
6 apply to tobacco products other than cigarettes, and which ones  
7 only apply cigarettes.

8 So we have proposed a bill to the Legislature to clarify  
9 that ambiguity.

10 MR. DOERR: That bill, however, has not passed.

11 MR. ANDERSON: However, from my interpretation of the  
12 law, I do feel that there is a tax on all distributors in  
13 California, which is clear in the Proposition.

14 SENATOR BEVERLY: So that issue is in some dispute?

15 MR. DOERR: They have a bill in to try and change it,  
16 but the bill hasn't passed.

17 MR. ANDERSON: My interpretation of the law, and the  
18 legal staff's interpretation of the law, at this point would be  
19 that a distributor, as mentioned in Proposition 99, is not  
20 defined. It's only defined in the cigarette tax law. And that  
21 distributor is defined as someone who consumes cigarettes that  
22 have not been previously taxed.

23 If you apply that same definition to a distributor of  
24 tobacco products, then they would owe a use tax on those tobacco  
25 products that they consumed that have not been previously taxed.

26 But there is some --

27 MR. DOERR: It hasn't been passed yet.

28

1 CHAIRMAN CAMPBELL: David, do you agree or disagree?

2 MR. DOERR: Well, the point is that the law applies to  
3 cigarettes, but the changes they're proposing to make it apply to  
4 tobacco products hasn't passed. It's in a bill that has moved  
5 through its first committee, but the way we have current law is,  
6 there's no -- nobody owes it until they change the law.

7 MR. ANDERSON: It's a matter of difference of opinion.

8 He's correct, there is definitely unclarity in the law.  
9 We would pursue it the way I said that we interpret it, but to  
10 make sure that we don't lose that interpretation, we're asking  
11 the Legislature to clarify that ambiguity.

12 MR. DOERR: Point number two is that we agree with the  
13 folks that come up here and told you that they disagree with the  
14 Board of Equalization's administration and the formula that they  
15 have come up with.

16 This really goes back to a point I wanted to make. You  
17 have to go on what the law says. The law does not refer to the  
18 wholesale price of cigarettes. It only refers to the wholesale  
19 price of tobacco products.

20 So, we think the correct interpretation is to use the  
21 wholesale price of tobacco products, and you would then divide  
22 that into the per unit cigarette tax rate.

23 This is similar to what we did when we had Prop. 13,  
24 which was a similar initiative that was poorly drafted, so there  
25 were a lot of questions about implementation. What you really  
26 had to do was follow the law as it read, and that's the way we  
27 tried to implement that, and not what the proponents thought they  
28 said they were doing after the fact.

1           So, the Legislature has consistently, in my view,  
2 followed the letter of the law rather than the after-the-fact  
3 statement: this is what we intended.

4           You may remember in 1978, we had a substantial amount of  
5 testimony on what as intended, but it didn't square with what was  
6 written in the Proposition. We think this is the same kind of  
7 situation. You have to follow the law.

8           The third point, this is bad tax policy. First of all,  
9 you shouldn't opt for the high rate, because what you're doing is  
10 OD-ing on a tax that's regressive, that's not elastic. This is  
11 going to cause you problems down the line, because you're going  
12 to fund programs that grow, and the tax revenue's not going to  
13 grow. So, you just build a hole by what I would say is OD-ing on  
14 an inelastic tax.

15           Finally, this is the only tax in the State of California  
16 where the tax rate will be changed by the pricing action of  
17 private industry. We don't have that on any other tax. That's  
18 why I say it's not good tax policy. The tax rate changes because  
19 of the action of a private, nongovernmental party.

20           ASSEMBLYMAN VASCONCELLOS: By which action? On the  
21 price of cigarettes?

22           MR. DOERR: Yes. They can adjust the wholesale price of  
23 cigarettes and drive the tax rate down, if they want to. I mean,  
24 that's not really good tax policy to set your tax system up that  
25 way.

26           Finally --  
27  
28



1 ASSEMBLYMAN BAKER: What would the alternative be, Dave?  
2 To tax it on a real price of all products?

3 MR. DOERR: Normally you specify the rate you want to  
4 tax it by, and that's what these folks should have put in that  
5 Constitutional Amendment. Whatever rate they thought was fair  
6 should have been put in the Constitution. But it wasn't done  
7 that way.

8 ASSEMBLYMAN BAKER: If they put a 41 percent rate, it  
9 wouldn't have passed.

10 MR. DOERR: Probably not.

11 The third point, and this goes to the business climate  
12 argument that you've been hearing from the witnesses, that there  
13 is substantial opportunity for out-of-state mail order sales.  
14 Other areas where you could avoid these taxes is by going  
15 out-of-state yourself, as Senator Beverly said, buying them at  
16 military installations or Indian reservations, perhaps, or from  
17 just bootleggers that we're probably going to see increase.

18 But anyway, there's a substantial possibility for  
19 getting these products a lot cheaper than you can buying through  
20 a legitimate retailer. And what happens to the business climate  
21 is, it's their business. So, not only are you not going to  
22 collect all the money that we think we're going to get because  
23 the price goes up and the people go out-of-state, then you have  
24 less tax collections than if the price was low and the people are  
25 buying in-state. Not only that, the state loses income tax  
26 revenue from these people; they lose sales tax revenues from the  
27 foregone sales of tobacco products that are being bought

28

1 out-of-state and the Board can't collect. These people, then,  
2 with less income don't buy products from other merchants, and so  
3 you have a sales tax drain there. And so it goes on and on.

4 So, you have kind of a multiplier effect in terms of a  
5 negative cycle by setting a rate so high that it hurts the  
6 business climate and forces people to buy out-of-state. There's  
7 more than just the direct amount of tobacco tax revenue involved  
8 here. It's the amount foregone on all these other taxes.

9 So, we think that you'd have a more realistic tax,  
10 probably generate close to the amount of revenue you're  
11 generating now, if not more, if you did interpret the amendment  
12 the way it appears to be written, rather than the way the Board  
13 of Equalization's interpreted it.

14 Thank you very much.

15 CHAIRMAN CAMPBELL: Is there anybody who would like to  
16 offer additional testimony to the Committee this afternoon?

17 If not, thank you all very much. I appreciate your  
18 being here.

19 This meeting is adjourned.

20 (Thereupon this hearing of the  
21 Joint Legislative Budget Committee  
22 was adjourned at approximately  
23 4:17 P.M.)

24 ---oo0oo---

Handwritten text at the top left, possibly a date or reference number.

Handwritten text below the first line, possibly a name or title.

Faint horizontal line of text or a separator line near the bottom of the page.