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5/6/15 #8**ISSUE 4: CIGARETTE TAX AND LICENSING PROGRAMS**

The Legislative Analyst's Office will present an overview of Cigarette Tax and Licensing Program as well as their recommendations for the program.

**BACKGROUND**

The Subcommittee has discussed the issue of the Cigarette Tax and Licensing program at its May 21, 2014, and March 10, 2015, hearings. These hearings have focused on the administrative costs related to the General Fund and three special funds - the Breast Cancer fund, Prop 99, and Prop 10 - to fund the Cigarette and Tobacco Compliance Fund, created under AB 71 (Chapter 890, Statutes of 2003) and the role of the BOE to administer and collect the tax imposed on tobacco products in California.

Due to concerns about the administrative fees of the BOE and the timing of when those concerns came through the budget process, the Subcommittee adopted supplemental reporting language that required BOE to submit a report on the administrative costs of the cigarette and tobacco excise tax and licensing programs, hold a stakeholder meeting, and submit a report on alternative approaches for funding the licensing program. The intent of the supplemental reporting language was to gather information so that the Legislature could evaluate the proposal with the most information possible.

The BOE's report on the funding options yielded 11 proposals that fall under three categories: proposals to raise revenue to pay for licensing program costs, proposals to reduce licensing program administrative costs, and proposal to change the allocation of administrative costs.

As a result, at its March 10, 2015, hearing, the Subcommittee still had additional questions about how to address the issue of administrative costs. The LAO began working on a report that would provide recommendations on how to address the licensing fee.

**LAO RECOMMENDATIONS****Summary of their recommendations**

**Tobacco excise Taxes and Licensing.** California imposes excise taxes on cigarettes and on other tobacco products such as cigars and chewing tobacco. Most revenue from these taxes goes to special funds established by ballot measures. The state also licenses tobacco sellers and distributors.

**State Administrative Costs.** The BOE administers the cigarette and tobacco excise tax and licensing programs. Recently, there has been considerable legislative interest in these programs' costs. The Legislature faces two key decisions: how to pay for BOE's cigarette and tobacco programs, and how much to spend on them.

**Recommendation.** The LAO recommends that the state use excise tax revenue to pay for excise tax administration but not for the cigarette and tobacco licensing program. To address the current imbalance between the licensing program's costs and revenue, the LAO further recommends that the Legislature do the following:

- Temporarily increase fees on tobacco retailers, wholesalers, and distributors
- Direct BOE and The California Department of Justice (DOJ) to explore options to reduce the program's costs by promoting electronic filing of schedules and tax returns.

<b>STAFF COMMENTS</b>
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The issue of the administrative costs will continue unless the Legislature takes steps to address them now. There are many things to consider in this discussion, including the natural decline of revenue from cigarette tax since less people are paying into the program, and ensuring additional oversight to create program efficiencies while balancing enforcement responsibilities under the master settlement agreement. The timing for addressing the administrative costs is very important. There are likely to be future ballot measures to increase the tax as well as new products such as e-cigarettes that may play a future role in the tax. The goal is to ensure that the appropriate level of funding is returning to the special funds rather than being diverted to administrative costs.

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**Staff Recommendation: Hold Open**

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**Agenda Item 8**  
**May 6, 2015**

**DATE:** April 27, 2015

**TO:** Children and Families Commission of Orange County

**FROM:** Christina Altmayer, Executive Director 

**SUBJECT:** Board of Equalization Administrative Fees

**ACTION:** Receive report on Legislative Strategies and the Board of Equalization's Increasing Administrative Fees

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**SUMMARY:**

The Children and Families Commission of Orange County, in partnership with the First 5 Association and First 5 LA, has been leading statewide efforts to address the rising administrative fees associated with the Board of Equalization's (BOE) monitoring and collection of Proposition 10 tobacco taxes. The BOE administrative costs charged to the Children and Families Trust Fund have increased by 600 percent statewide in the past 10 years at the same time that tobacco tax revenue has decreased by nearly 30 percent. For the fiscal year ended June 30, 2014, the BOE charges were \$16.6 million, a cost of over \$1 million to the Children and Families Commission of Orange County. A fact sheet on the increased BOE administrative costs is included as Attachment 1.

In May 2014, the State Assembly Budget Subcommittee, Chaired by Assemblyman Tom Daly directed a review of the BOE's tobacco tax program and required the BOE to submit a report to the Legislature by April 1, 2015 including at least three alternative approaches for future funding of the tobacco tax program. The BOE submitted the report on March 9, 2015 and the Assembly Budget Subcommittee No. 4 on State Administration and Assembly Revenue and Taxation Committee held a joint committee hearing on this matter on April 10, 2015. This agenda item provides an update on the recent legislative support as well as an update on a proposed tobacco tax measure.

**DISCUSSION:****Board of Equalization Alternatives Report**

The Supplemental Report of the FY 2014/15 State Budget required the BOE to convene a stakeholder meeting to discuss potential approaches for future funding of the Cigarette and Tobacco Products License Program and then to submit a report to the Joint Legislative Budget Committee and related subcommittees by April 1, 2015. The stakeholder meeting was held in November 2014 and Orange County Commission's Executive Director provided written and verbal comments at the meeting. The report was issued on March 9, 2015 and summarized 11 different proposals which were submitted through the stakeholder process. In general, the proposals focused on increasing reliance on general fund revenue, increasing or adjusting the current licensing fees, and/or taxing electronic cigarettes through expanding the definition of tobacco products in statute.

**Assembly Joint Hearing**

The State Assembly held a joint hearing of two committees on March 10, 2015 (Budget Subcommittee No. 4 and Revenue and Taxation) to hear from the Board of Equalization regarding

the costs of the tobacco licensing program. The purpose of the hearing was to review the report on the program which was developed by the BOE. The State Legislative Analyst Office (LAO) provided an overview of the BOE programs and was requested to provide their analysis on this issue.

### **Legislative Analyst Office Report on Cigarette and Licensing Programs**

On April 22, 2015 the LAO issued a report for the 2015-16 Budget, Cigarette Tax and Licensing Programs, included as Attachment 2. The report noted how representatives from Proposition 10 have brought this issue to the Legislature's attention and documented how licensing fee revenue has been insufficient to support the licensing program expenditures, resulting in the increased demand on Proposition 10 and other special funds, as noted below:

*“In 2006-07, the Legislature approved a budget proposal to begin charging the four funds that receive cigarette and tobacco excise tax revenue for part of the costs of administering the licensing program. As a result of this change, these funds have had reduced resources for programmatic purposes. Today, these funds pay about four-fifths of the licensing program costs.”*

To address the licensing revenue disparity, the LAO Report makes three recommendations:

1. Tobacco (excise) tax revenue should be used for administration and discontinue the practice of charging funds received from the tobacco excise tax revenues for licensing programs costs.
2. Temporarily increase the fees charged for the cigarette and tobacco licensing program with the goal of using fee revenues to pay for all licensing program costs.
3. Implement the fee increase on a temporary basis, expiring after four years. A fixed expiration date would provide an opportunity for the Legislature to reassess fee revenues as well as explore options for reducing program costs.

The LAO report identifies approximately \$9 million in Licensing Program costs that would no longer be charged to Proposition 10 funds; potentially resulting in annual savings to the Orange County Commission estimated at \$250,000 annually. The total charge to Proposition 10 funds includes the Licensing Program (\$9.9 million annually) and the Tobacco Tax Program (\$24.9 million annually). While the LAO proposal would be a positive step forward, it does not fully address the rising administrative fees. The Commission in partnership with the First 5 Association is working to ensure that any remedy on the charges takes a comprehensive assessment of all charges to the tobacco special funds and consider all charges related to licensing and enforcement, including \$8 million for the stamp system which is included in the Tobacco Tax Program.

### **New Tobacco Taxes – Senate Bill 591/Assembly Bill 1396**

Proposed Senate Bill 591 (Pan - D) would impose an additional \$2 per pack excise tax of each 20 count pack of cigarettes sold and distributed in California on or after January 1, 2016. Revenue generated would be deposited into the California Tobacco Tax Act Fund, and allocated into three accounts for tobacco prevention and education, disease related health care and tobacco law enforcement. This bill passed the Senate Governance and Finance Committee on April 22, 2015 and is pending in the Senate Health Committee.

The related proposed Assembly Bill 1396 (Bonta - D) allocates the revenue generated by SB 591 and is contingent on passage of SB 591. Assembly Bill 1396 requires that no more than two-percent of

the funds be used for administrative costs and contains a back-fill provision to off-set potential losses to Proposition 10 funds.

It is anticipated that should the Legislature not meet the required two-thirds votes that are needed for approval that it would be proposed as a ballot initiative in November 2016.

The Orange County Commission Executive Director continues to work with representatives from First 5 LA, First 5 Association, and other Executive Directors to develop a legislative advocacy strategy to resolve this issue during the current legislative session. Curt Pringle and Associates has provided valuable support on this matter and will continue to provide guidance and assistance, particularly in outreaching to the Orange County delegation. The Commission Executive Director will provide further updates at the May meeting.

**STRATEGIC PLAN & FISCAL SUMMARY:**

No funding action is proposed for this item.

**PRIOR COMMISSION ACTIONS:**

- February 2014 - Approved Proposed Legislative Strategy to Address Board of Equalization Administrative Fees
- December 2013 – Executive Officer’s Report
- February 2013 - First 5 California/Board of Equalization Administrative Fees

**RECOMMENDED ACTION:**

Receive report on Legislative Strategies and the Board of Equalization’s increasing administrative fees; and provide direction to the Commission Executive Director on recommend alternatives.

**ATTACHMENTS:**

1. Children’s Programs Depleted to Support Tobacco Enforcement
2. Cigarette Tax and Licensing Programs – Legislative Analyst’s Office

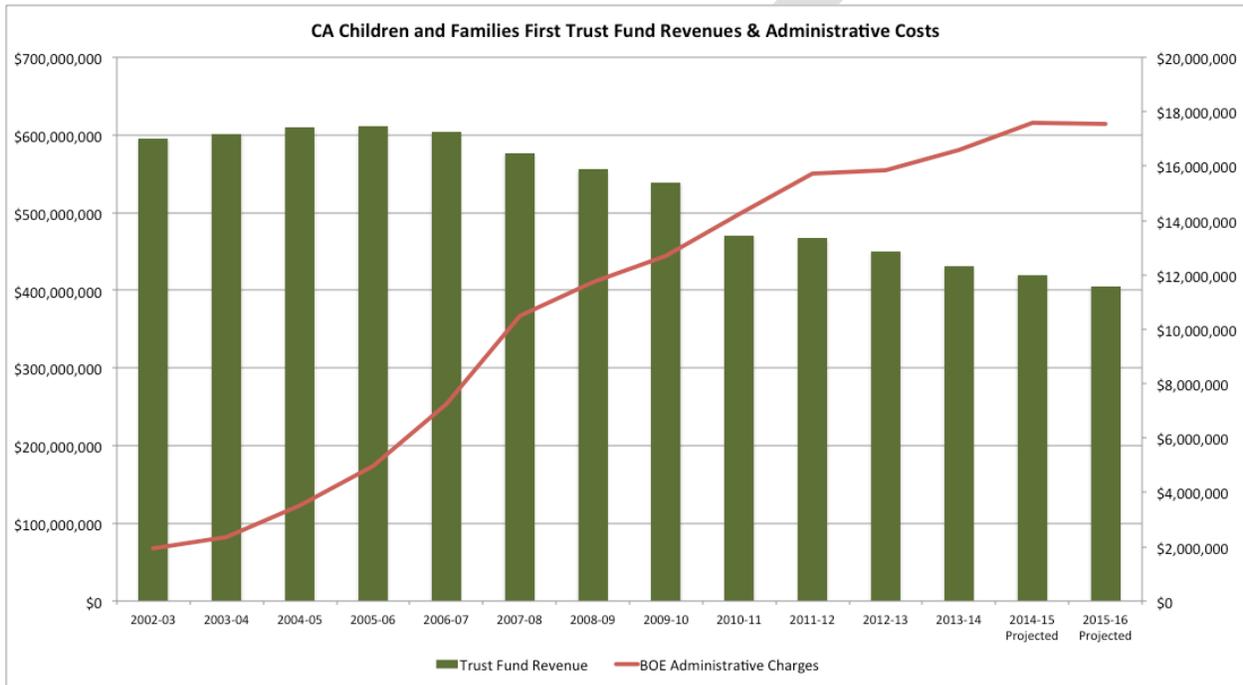
**Contact:** Christina Altmayer



## Children’s Programs Depleted to Support Tobacco Enforcement

### Voter Intent

When Proposition 10 was approved by the voters in 1998 it allowed for the Board of Equalization to reimburse for “expenses incurred in the administration and collection of taxes”. At the time of passage, the LAO estimated that the BOE would incur annual administration costs of about \$800,000 in 1998/99 which would decline by 2000 to approximately \$600,000 annually thereafter. In 1998/99, First 5 funds were charged \$568,000 against tobacco revenue of \$562 million. In FY 2013/14 First 5 funds were \$16.6 charged against revenue of \$461 million.



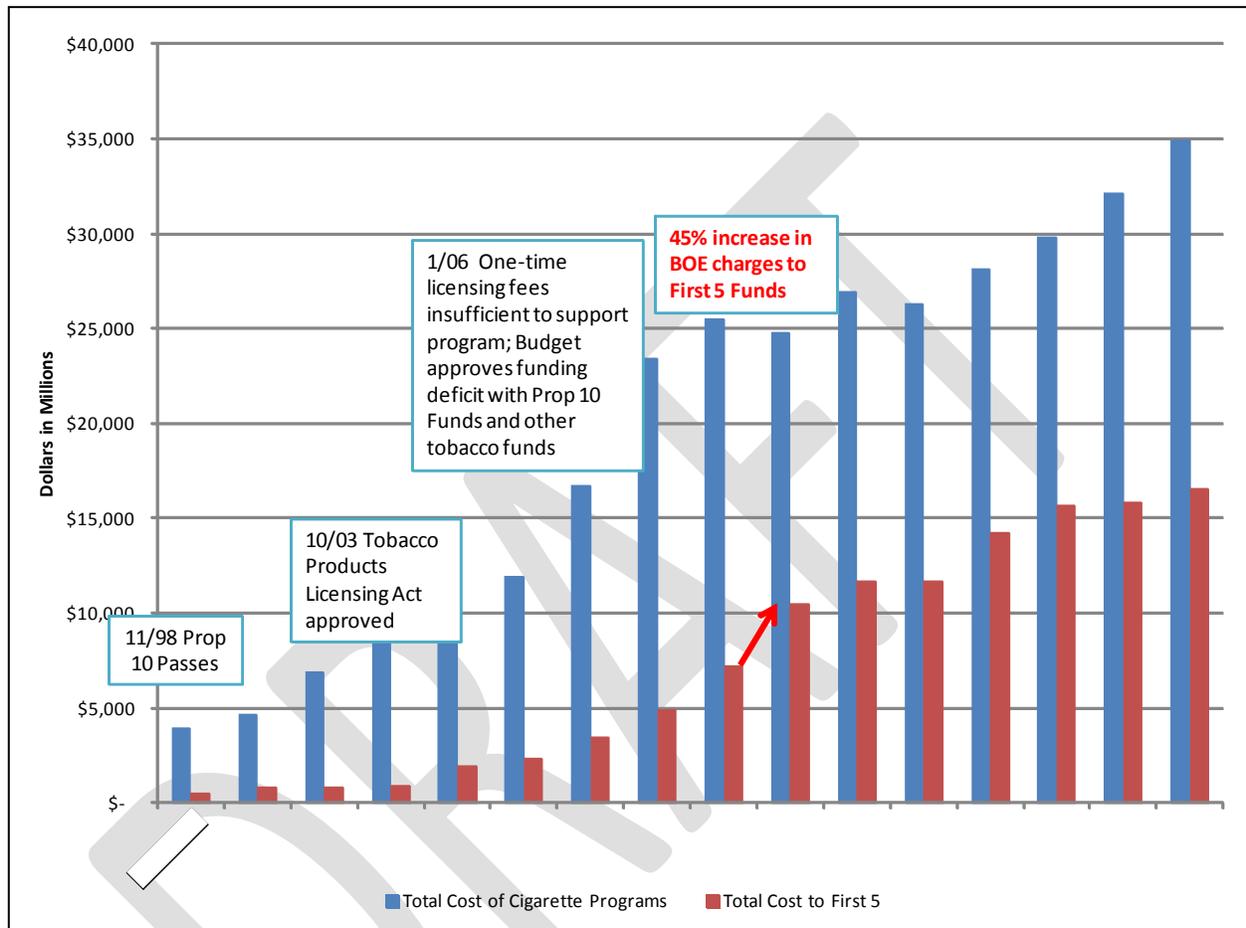
### Tobacco Enforcement Efforts

In October 2003, AB71 (Jerome Horton), was authorized requiring distributors, wholesalers and retailers of cigarette and tobacco products to be licensed by the State Board of Equalization and created one-time licensing fees. Funds resulting from the licensing fees would be used to support statewide enforcement efforts. By fiscal year 2005/06, the BOE began to project the deficit as one-time licensing fee revenue was being to be depleted and insufficient to support ongoing enforcement operations.

On January 2, 2006, a budget change was approved allowing the BOE to now charge First 5 Funds, Prop 99 and Breast Cancer funds for the deficit created by the loss in licensing revenue on an ongoing basis. As a result, there was a 45% increase in BOE charges to First 5 funds from FY 2006/07 to FY 2007/08. One of the most significant factors driving this increase in the BOE licensing stamp system which costs the BOE \$10 million annually in contract costs. The system supports enforcement and compliance with terms of the Master Settlement Agreement. No administrative fees are charged against the MSA.

### Continued Increases Projected

BOE fees are likely to increase over time based on historical trends, BOE staff projections due to filling vacancies, and the impact of any future tobacco taxes. BOE staff has indicated that any new tax would result in a significant increase in BOE tobacco tax collection, with Proposition 10 taking the majority share.



### Need for Relief

To ensure the protection of Proposition 10 funds for the intended purpose of supporting young children’s healthy development, we urge actions in the FY 2015/16 Budget process:

- A one-percent (1%) maximum on the amount BOE can charge Proposition 10 revenue for reimbursement of tobacco tax collection and administration. Proposition 10 County Commissions throughout the state must abide by similar caps on administrative expenses, such as a 10% ceiling on administrative expenses of their total budget.
- Eliminating any “enforcement” costs as eligible expenses to be paid by Proposition 10 funds. This would be consistent with the language of the voter- approved Proposition 10 legislation that allows for BOE reimbursement for “administration and collection” of tobacco taxes.



## The 2015-16 Budget:

# Cigarette Tax and Licensing Programs

MAC TAYLOR • LEGISLATIVE ANALYST • APRIL 22, 2015

## Summary

**Tobacco Excise Taxes and Licensing.** California imposes excise taxes on cigarettes and on other tobacco products such as cigars and chewing tobacco. Most revenue from these taxes goes to special funds established by ballot measures. The state also licenses tobacco sellers and distributors.

**State Administrative Costs.** The State Board of Equalization (BOE) administers the cigarette and tobacco excise tax and licensing programs. Recently, there has been considerable legislative interest in these programs' costs. The Legislature faces two key decisions: (1) how to pay for BOE's cigarette and tobacco programs, and (2) how much to spend on them.

**Recommendations.** We recommend that the state use excise tax revenue to pay for excise tax administration but not for the cigarette and tobacco licensing program. To address the current imbalance between the licensing program's costs and revenue, we further recommend the Legislature (1) temporarily increase fees on tobacco retailers, wholesalers, and distributors, and (2) direct BOE and the California Department of Justice (DOJ) to explore options to reduce the program's costs by promoting electronic filing of schedules and tax returns.

## Background

Cigarettes, along with other tobacco products such as cigars and chewing tobacco, are subject to various federal, state, and local taxes and fees. In California, in addition to sales taxes, the state imposes "excise" taxes on each pack of cigarettes and on each dollar of tobacco products. California also levies licensing fees on businesses that sell or distribute tobacco. The BOE administers these tobacco excise tax and licensing programs.

## State Imposes Excise Tax on Distributors

Under the state's Cigarette and Tobacco Products Tax Program, BOE administers and collects California's excise taxes on tobacco products. The state levies these taxes on distributors who supply cigarettes or other tobacco products to wholesalers or retailers. In the case of cigarettes, distributors pay this tax by buying tax stamps with a face value equivalent to the cigarette excise tax rate of 87 cents per pack. To comply with the excise

tax, distributors must affix one of these stamps to each pack that they distribute to wholesalers or retailers. In the case of other tobacco products, distributors pay a tax equivalent to roughly 29 percent of the products' wholesale price. BOE adjusts this rate each year based on price changes.

**Most Cigarette and Tobacco Excise Tax Revenue Goes to Special Funds.** Figure 1 shows the distribution of tobacco excise tax revenues in 2013-14. The state's General Fund received \$90 million of these revenues. The rest was allocated to special funds to support specific programs as follows:

- \$460 million for childhood development programs pursuant to Proposition 10, approved by voters in 1998.
- \$270 million for tobacco education and prevention, tobacco-related disease research, health care for low-income persons, environmental protection, and recreation programs pursuant to Proposition 99, approved by voters in 1988.

- \$20 million for breast cancer-related research and breast cancer screening for uninsured women pursuant to Chapter 661, Statutes of 1993 (AB 2055, Friedman).

**Each Fund Pays Share of Cost for Tax**

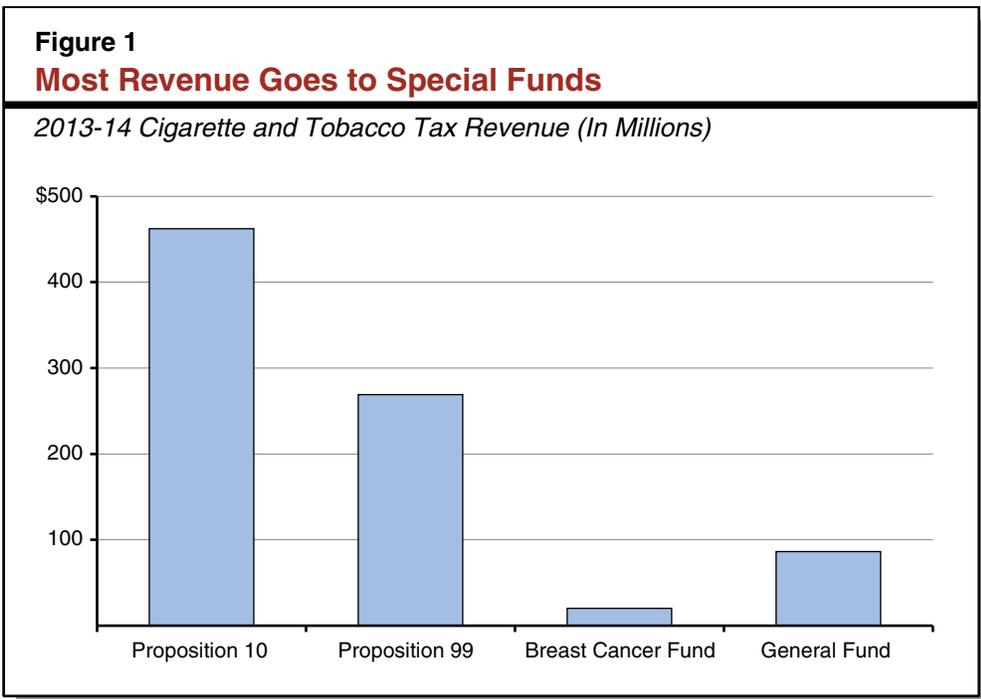
**Administration.** BOE spreads the cost of administering the excise tax across each of the funds receiving revenue from this source, with each fund paying a share of costs that is roughly in proportion to its share of total excise tax revenue. The 2015-16 Governor's Budget proposes spending \$25 million on BOE excise tax administration and continuing to apportion these costs across the four funds that receive the excise tax revenue.

**State Licenses Retailers, Wholesalers, and Distributors**

**California Entered Master Settlement**

**Agreement.** In the 1990s, many states sued tobacco companies for damages related to the effects of smoking. In 1998, 46 states—including California—and the four largest cigarette manufacturers settled these lawsuits with a "Master Settlement Agreement"

(MSA). As described in the nearby box, the MSA imposes a variety of obligations on participating tobacco companies, including a requirement to make annual payments to each settling state. Annual MSA payments to California's state and local governments total hundreds of millions of dollars.



***Licensing Program Supports Activities Related to MSA.*** Under the MSA, states must maintain accurate records of cigarette sales and must “diligently enforce” various payment requirements related to those sales, including the payment of state excise taxes. To fulfill California’s obligations under the MSA, the Legislature created new programs administered by BOE and DOJ, including a new Cigarette and Tobacco Products

Licensing Program (Chapter 890, Statutes of 2003 [AB 71, Horton]). Under this program, BOE registers several types of businesses involved in the sale or distribution of cigarettes and tobacco products. To register, cigarette and tobacco retailers pay a one-time licensing fee of \$100. Distributors and wholesalers pay an annual licensing fee of \$1,000. Once licensed, businesses are subject to recordkeeping and inspection requirements.

### **The Tobacco Master Settlement Agreement**

***Agreement Created Ongoing Revenue Stream.*** California and 45 other states entered a Master Settlement Agreement (MSA) with the four largest cigarette manufacturers in 1998. (Since then, many other manufacturers have become “participating manufacturers” by agreeing to the terms of the MSA.) Under the MSA, participating manufacturers make payments to California totaling hundreds of millions of dollars annually. One-half of this money goes to local governments while the other half goes to the state. In the past, the state borrowed against its share of this payment stream in order to balance the budget. The state’s share of settlement revenue currently is dedicated to repaying this debt.

***Revenue Depends on Enforcement.*** Although many tobacco manufacturers have decided to participate in the MSA, some have not. Under the MSA, each state must (1) pass laws requiring these non-participating manufacturers to make certain payments to the state based on their cigarette sales and (2) “diligently enforce” these payment requirements by tracking all cigarettes sold in the state. If a state does not fulfill these obligations, participating manufacturers can seek to lower their payments through arbitration. To fulfill California’s obligations under the MSA, the Legislature created new programs administered by the State Board of Equalization (BOE) and the Department of Justice, including BOE’s Cigarette and Tobacco Licensing Program.

***Recent Arbitration Reduced Payments to Some States.*** In recent years, participating cigarette manufacturers have argued that their payments to some states—including California—should be smaller because the states did not diligently enforce the MSA’s provisions related to non-participating manufacturers. Under the MSA, a federal arbitration panel is responsible for resolving these types of disagreements. Many states, including California, settled this dispute prior to arbitration. Under this settlement, the tobacco manufacturers made the disputed payments, but the states provided the manufacturers with some credits against their future payments. Fifteen states chose to proceed with arbitration instead of settling. In 2013, the arbitration panel ruled that nine of those fifteen states had enforced their laws diligently and were entitled to the money that the tobacco companies had withheld. However, the panel found that six states had not enforced their laws diligently, and it reduced payments to those states accordingly. This arbitration applied to payments for the 2003 sales year; later years are still in dispute.

**Licensing Program Expenditures Exceed Fee Revenue**

As shown in Figure 2, licensing fees generated \$18 million for the state licensing program in 2003-04. This initial influx of revenue was more than sufficient to pay the program’s costs in 2003-04. In subsequent years, however, fee revenue typically has been one-tenth of this initial level, and expenditures have consistently exceeded revenue. From 2005-06 to 2013-14, annual expenditures averaged \$7 million more than annual fee revenue.

**2006-07 Budget Shifted Funding.** In 2006-07, the Legislature approved a budget proposal to begin charging the four funds that receive cigarette and tobacco excise tax revenue for part of the costs of administering the licensing program. As a result of this change, these funds have had reduced resources for programmatic purposes. Today, these funds pay about four-fifths of the licensing program’s costs, and the rest is paid from licensing fees.

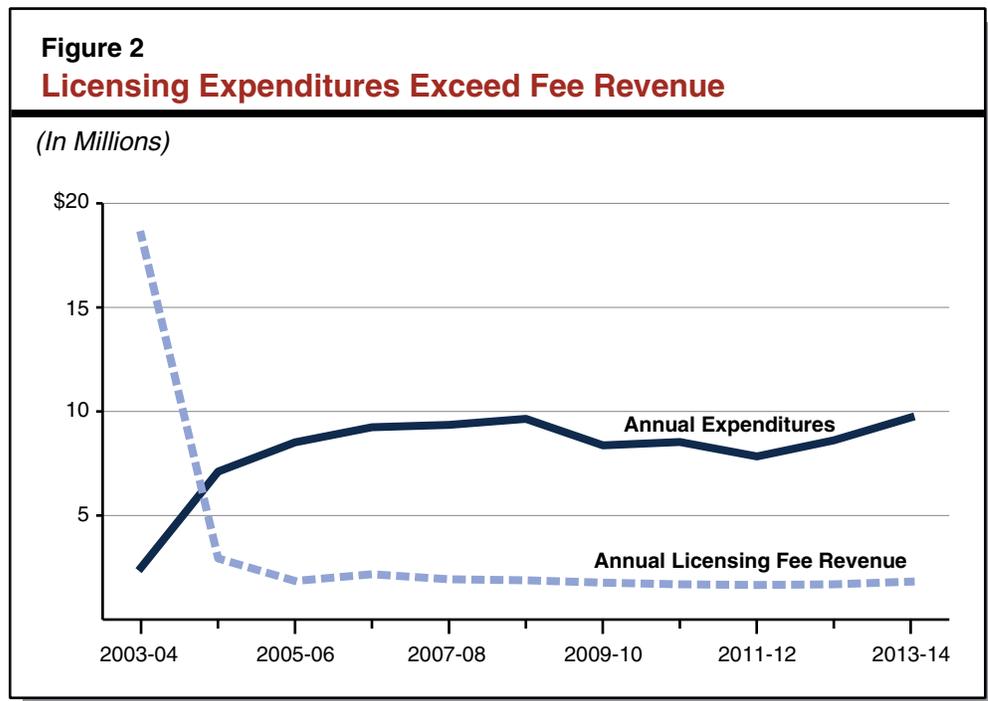
**Legislature Required Report on Funding Options**

In 2014, representatives from Proposition 10 programs expressed concerns about the costs and funding of BOE’s cigarette and tobacco programs, particularly the licensing program. Specifically, they expressed concern that administrative costs of the licensing program were being supported by excise tax funds, resulting in reduced

programmatic funds for special and General Fund programs. In response to these concerns, the Legislature approved supplemental reporting language (SRL) requiring BOE to:

- Submit a report on the administrative costs of the cigarette and tobacco excise tax and licensing programs.
- Hold a stakeholder meeting.
- Submit a report on alternative approaches for funding the licensing program.

**BOE’s Report on Funding Options.** The report BOE submitted in response to the SRL describes 11 options, listed in Figure 3, that focus on the licensing program. (Although the SRL did not require BOE to report on tax administration, stakeholders have also raised concerns in that area.) The report does not make a recommendation. Six of the options included in the report raise revenue to pay for licensing program administrative costs, thereby reducing the costs paid with excise tax revenue. For example, one option replaces the current one-time retailer



licensing fee with a recurring fee. Four of the options reduce administrative costs—such as by requiring licensees to file schedules and returns electronically. One option does not raise additional revenue or decrease costs, but shifts greater responsibility for paying for this program’s costs to the General Fund.

## Analysis

The Legislature faces two key decisions regarding BOE’s cigarette and tobacco programs: (1) how to pay for them, and (2) how much to spend on them.

### Funding Sources for BOE’s Cigarette and Tobacco Programs

**Reasonable for Excise Taxes to Pay for Excise Tax Administration.** California has many revenue sources that are shared by multiple funds or entities, including the sales tax. When multiple entities or funds share revenues, it is common for the cost of tax administration to be split across all beneficiaries in direct proportion to the revenues they receive. The current system of cost allocation for the cigarette and tobacco excise tax program appears to be consistent with this practice and consistent with the provisions of Propositions 99 and 10.

**Use Licensing Fees to Pay for Licensing Program.** In general, we think it is preferable to pay for the licensing program with licensing fees. Using cigarette and tobacco excise tax revenue for this

purpose appears somewhat inconsistent with the provisions of Propositions 99 and 10. Specifically, these measures provide that their funds are to be used for specific programmatic purposes, with a portion of the revenues set aside for tax administration and collection. (We note that the tobacco licensing program did not exist at the time voters approved Propositions 99 and 10.)

### Expenditures on BOE’s Cigarette and Tobacco Programs

#### *Potential Efficiencies in Licensing Program.*

As noted above, there is currently a significant operating deficit in the licensing program. Closing this gap primarily through reduced spending, however, would be risky. This is because the Legislature created the licensing program to comply with the MSA requirement for diligent enforcement of tobacco laws, and states found not to be diligent have had their revenues reduced. There are ways, though, to reduce administrative

**Figure 3**

### Proposals Listed in BOE’s Supplemental Report

#### Proposals to Raise Revenue to Pay for Licensing Program Costs

- Institute a recurring fee at the retail level to increase the share of costs covered by the licensing fees.
- Increase the taxes assessed on cigarettes and tobacco products by an unspecified amount.
- Reevaluate the cigarette stamp discount in order to increase revenue.
- Increase penalties and fines to mitigate the shortfall of the licensing program.
- Tax electronic cigarettes, dissolvable tobacco, and other recently developed products by expanding the definition of “tobacco products.”
- Increase collection efforts related to tax due on out-of-state cigars shipped into California by unregistered distributors.

#### Proposals to Reduce Licensing Program Administrative Costs

- Reduce spending and cap administrative costs on the cigarette and tobacco products licensing program.
- Allow cigarette and tobacco retailer licenses to be issued in perpetuity.
- Require cigarette and tobacco products licensees to file electronically.
- Create efficiencies between state and local agencies in order to reduce the duplication of efforts.

#### Proposal to Change Allocation of Administrative Costs

- Pay for the cigarette and tobacco products licensing program with funds from the General Fund.

BOE = Board of Equalization.

costs without sacrificing program effectiveness. For example, the stakeholder proposal related to electronic filing of schedules and tax returns identifies a likely administrative efficiency. As described above, the MSA requires the state to keep accurate records of cigarette sales. With hundreds of millions of packs of cigarettes sold in California each year, managing these records is costly. Cigarette distributors, wholesalers, and retailers often submit schedules and returns on paper, increasing the cost of entering and verifying data. If the state received more of these records in electronic form, it could potentially achieve similar outcomes with lower state administrative costs. We note, however, that requiring electronic filing could be costly for some businesses, at least initially.

## Recommendations

### **Use Excise Tax Revenue to Fund Tax Administration, Not Licensing Costs**

As described above, using cigarette and tobacco excise tax revenue to pay for excise tax administration is reasonable and is authorized under Propositions 99 and 10. Most revenue from cigarette and tobacco excise taxes goes to special funds created by ballot measures. These ballot measures specify that the funds are available for programmatic purposes and for the cost of tax administration and collection. These ballot measures do not explicitly authorize the use of these funds to administer a licensing program. Consequently, we recommend that the Legislature direct the administration to discontinue the practice of charging funds receiving tobacco excise tax revenues for licensing program costs.

### **Temporarily Increase Amount and Frequency of License Fees**

We recommend that the Legislature temporarily increase the fees charged for the

cigarette and tobacco licensing program with the goal of using fee revenues to pay for all licensing program costs. For example, we estimate that the following changes in the fee structure would generate sufficient revenue for this purpose: (1) replace the current \$100 one-time fee for retailers of cigarettes and tobacco products with an annual fee of \$250, and (2) increase the annual fee paid by wholesalers and distributors from \$1,000 to \$1,250.

We recommend that the Legislature implement the fee increases on a temporary basis, expiring after about four years. A fixed expiration date would provide an opportunity for the Legislature to reassess whether fee revenues line up with ongoing program costs. If electronic filing or other efficiencies reduced state administrative costs, the Legislature could reduce the fees. Alternatively, if the fees generated less revenue than needed, the Legislature could evaluate whether additional cost containment measures were needed or further fee increases were warranted. Any shortfall in funding over the next four years could be addressed by directing the administration to use the balance of the licensing fee fund (estimated to be \$8.6 million in 2014-15).

### **Direct BOE and DOJ to Develop Electronic Filing Proposal**

As described above, BOE's cigarette and tobacco programs are data-intensive, so increasing the rate of electronic filing likely would reduce state administrative costs. We recommend that the Legislature adopt budget bill language requiring BOE and DOJ to develop and report on at least one proposal for a statutory change related to electronic filing. Such a report should address:

- How the proposal would affect each department's ongoing administrative costs.

## 2015-16 BUDGET

- Whether to require electronic filing or to provide an incentive. For example, the state could charge a higher fee for licensees that submit information on paper and a lower fee for licensees that submit information electronically.
- Whether to extend this requirement or incentive to all licensees, or to apply it only to certain types of businesses, such as wholesalers and distributors.

### **LAO Publications**

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This brief was prepared by Seth Kerstein and reviewed by Marianne O'Malley. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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