Measure of Tax for Tobacco Products Under Proposition 99

The rate of the tobacco products tax is required by Revenue & Taxation Code Section 30123 to be "based on the wholesale cost of these products … which is equivalent to the combined rate of tax imposed on cigarettes … " . Since the calculated wholesale cost of cigarettes does not include the cost of incoming freight charges, the wholesale cost of tobacco products should also exclude freight. 4/20/89.
Gary Jugum has asked me to respond to your memorandum of March 30, 1989 regarding the above referenced matter.

Passage of Proposition 99 at the last election resulted in the addition to the Revenue and Taxation Code of Article 2 (commencing with section 30121) entitled “Cigarette and Tobacco Products Surtax”. Section 30123 (a) imposes a tax upon the distribution of cigarettes at the rate of $0.0125 per cigarette in addition to the tax already imposed by the Cigarette Tax Law. The total tax upon distribution of cigarettes, as of January 1, 1989 (the effective date of Proposition 99), is $0.0175 per cigarette. Section 30123 (b) imposes a tax upon the distribution of tobacco products “based on the wholesale cost of these products, at a tax rate as determined annually by the State Board of Equalization, which is equivalent to the combined rate of tax imposed on cigarettes…” Prior to passage of Proposition 99, distribution of tobacco products had not been subject to a tax. Section 30126 provides that the “annual determination required of the State Board of Equalization pursuant to subdivision (b) of section 30123 shall be made based on the wholesale cost of tobacco products as of March 1, and shall be effective during the state’s next fiscal year.”

The major difficulty in determining the measure of tax for tobacco products is in meeting the statutory requirement that the rate be equivalent to that imposed on cigarettes. The rate of tax imposed on cigarettes is calculated on a per-cigarette basis and is not directly transferrable to tobacco products such as snuff, chewing tobacco, etc. Your memo suggests a methodology for converting the rate imposed on cigarettes to an equivalent rate to be imposed on tobacco products.

As I understand it, you have calculated the weighted-average wholesale cost of one cigarette as $0.042. You reach this figure by averaging the manufacturers’ list cigarette prices per 1,000 cigarettes as of December 1987, adding the wholesale markup; and then dividing by 1,000. Thus, the tax on one cigarette is equivalent to a tax of $0.0175 on a wholesale price of $0.042. Next, you calculated the ratio of tax to wholesale cost (.0175 divided by .042) as 41.67 percent. Thus, the tax on cigarette is 41.61 percent of wholesale cost. This rate is expressed in a form which is applicable to tobacco products as well as to cigarette.

The question you have asked concerns the definition of “wholesale cost of tobacco products.” You have been asked by distributors whether incoming freight charges are includable as a part of the wholesale cost of tobacco products against which the tax rate is to be applied. As you point out, it would be inappropriate to include transportation charges on the tobacco
products side of the equation when they were not included on the cigarette side. The purpose of the equation, or formula, is simply to find a common denominator. Applicable to both cigarettes and tobacco products. You have found that “wholesale cost” constitutes a practical common denominator. Since “wholesale cost” of cigarette does not include freight, “wholesale cost” of tobacco products should not include freight.

In conclusion, an operative definition of “wholesale cost” which excludes freight charges complies with the statutory requirements, as long as it is applied uniformly to both cigarettes and tobacco products. Distributors of tobacco products should be advised to calculate tax as 41.67 percent of wholesale cost excluding freight.

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