January 5, 2021
Report 2019-046

FACT SHEET

Elaine M. Howle *State Auditor*

CONTACT: *Margarita Fernández* | *(916) 445-0255 x 343* | *MargaritaF@auditor.ca.gov*

Proposition 56 Tobacco Tax

State Agencies' Weak Administration Reduced Revenue by Millions of Dollars and Led to the Improper Use and Inadequate Disclosure of Funds

Background

To reduce tobacco use and fund public health programs, in 2016 voters chose to increase taxes on tobacco products when they passed Propositions 56, which created the California Healthcare, Research and Prevention Tobacco Tax Act of 2016. This tax, which took effect in April 2017, generated an average of more than $1.3 billion in revenue in each of the two following fiscal years. Responsible for overseeing entities involved in the sale of cigarettes and other tobacco products, the California Department of Tax and Fee Administration (CDTFA) determines and collects taxes on these tobacco products. This money is allocated to seven state agencies—as specified in the law—to be used for specific purposes. Our office is required to conduct a biennial independent audit of the agencies receiving Proposition 56 tax revenue.

Key Findings

- The CDTFA used inaccurate information to calculate the tax rate for certain tobacco products in fiscal year 2018–19, causing the State to lose millions in additional revenue that could have been used to reduce tobacco use.
  - » The State lost $1.3 million because CDTFA used the highest-priced class of cigarettes to calculate the wholesale cost of cigarettes.
  - » The State lost an additional $5 million because CDTFA used a wholesale markup rate in calculating the tax rate for other tobacco products for more than ten years that it could not support, and it is currently higher than warranted.
- Some of the agencies that receive Proposition 56 tax revenue have not established adequate safeguards to ensure they properly award and monitor the use of those funds.
  - » Nine of the 10 grants we reviewed at the Department of Justice included activities that did not comply with the law.
  - » The Department of Health Care Services awarded tens of millions of dollars to repay student loans of physicians and dentists who practice in areas that do not have provider shortages.
- Four of the six agencies we reviewed failed to adequately disclose the amount of funds they received or how they used those funds.

Key Recommendations

- CDTFA should include certain classes of cigarettes in determining the wholesale price of cigarettes and determine the current wholesale markup rate to use when calculating the tax rate for other tobacco products.
- Justice should implement a formal grant application review process that ensures it awards funds only for allowable purposes.
- Health Care Services should amend its application selection process to require that all participants practice in geographic areas that have shortages of such health professionals.
- Agencies that receive Proposition 56 funds should provide the public with complete information for past fiscal years and within six months of the end of future fiscal years.

In Fiscal Year 2018–19, CDTFA Could Have Collected Millions in Additional Revenue

	Wholesale Markup Used by CDTFA	Estimate of Actual Wholesale Markup
Cigarette Markup Rate	6 Percent	4 Percent
Other Tobacco Product Tax Rate	62.8 Percent	64 Percent
Other Tobacco Product Sales	× $411.9 Million	× $411.9 Million
Other Tobacco Product Tax Revenue	$258.6 Million	$263.6 Million
Difference		$5 Million