



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

Date Amended:	04/26/05	Bill No:	SB 421
Tax:	Pseudoephedrine Fee	Author:	Simitian
Related Bills:			

This analysis will only address the bill's provisions that impact the Board.

BILL SUMMARY

Among other things, this bill would require the State Board of Equalization (Board), commencing January 1, 2007, to collect a fee upon the first sale of pseudoephedrine by a manufacturer in this state, as specified.

Summary of Amendments

Since the previous analysis, this bill was amended to authorize the Board to expend the fee revenues in the Illegal Drug Lab Cleanup Subaccount, upon appropriation by the Legislature, for the costs of administering and collecting the fee.

ANALYSIS

Current Law

Under the existing Sales and Use Tax Law, all retail sales are subject to the sales tax unless specifically exempted in the law. Section 6369, for example, provides an exemption for prescription medicines sold or furnished by licensed medical personnel.

Retail sales of controlled substances are currently subject to the tax. Unregistered sellers of methamphetamine and other illicit drugs who fail to collect and remit the sales tax are in violation of the sales tax laws. A number of police departments regularly contact the Board when they make arrests for possession of controlled substances with the intent to sell. In order to levy an assessment, documentation of sales must be available, and assets must be accessible to collect the tax due.

Under Section 11100 of the Health and Safety Code, part of the California Uniform Controlled Substance Act, any manufacturer, wholesaler, retailer, or other person or entity in this state that sells, transfers, or otherwise furnishes pseudoephedrine to any person or entity in this state or any other state is required to submit a report to the Department of Justice of all of those transactions.

Prior to selling, transferring, or otherwise furnishing pseudoephedrine to any person or business entity in this state or any other state, existing law requires:

- A letter of authorization from that person or business entity that includes the currently valid business license number or federal Drug Enforcement Administration registration number, the address of the business, and a full description of how the substance is to be used, and
- Proper identification from the purchaser.

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The reporting requirements, however, do not apply to any sale, transfer, furnishing, or receipt of any product that contains pseudoephedrine and which is lawfully sold, transferred, or furnished over the counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder. This does not apply to preparations in solid or liquid dosage form, except pediatric liquid forms, as defined, containing pseudoephedrine where the individual transaction involves more than three packages or nine grams of pseudoephedrine.

Section 11100 also provides that it is unlawful for any retail distributor to sell in a single transaction more than three packages of a product that he or she knows to contain pseudoephedrine or to knowingly sell more than nine grams of pseudoephedrine, other than pediatric liquids as defined. Except as otherwise provided, the three-package-per-transaction limitation or nine-gram-per-transaction limitation applies to any product that is lawfully sold, transferred, or furnished over-the-counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder, unless otherwise exempted.

Proposed Law

Among other things, this bill would add Section 25354.6 to the Health and Safety Code to require the Board to collect a fee upon the first sale of pseudoephedrine by a manufacturer in this state, commencing January 1, 2007. The Department of Toxic Substances Control (DTSC) would be required to set the amount of a fee at an amount sufficient to fund the annual work plan developed for taking removal or remedial action to clean up drug lab waste, including the estimated costs to complete that work plan. The amount of the fee could not be in an amount more than .00232 cents (\$0.000232) per milligram of pseudoephedrine

The fee revenues would be deposited in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund, to carry out removal and remedial actions to clean up drug lab waste. The Board would also be authorized to expend the fee revenues in the Illegal Drug Cleanup Lab Subaccount, upon appropriation by the Legislature, for the costs of administering and collecting the fee.

In General¹

Methamphetamine, a derivative of amphetamine, is a powerful stimulant that affects the central nervous system. Amphetamines were originally intended for use in nasal decongestants and bronchial inhalers and have limited medical applications, which include the treatment of narcolepsy, weight control, and attention deficit disorder, can be easily manufactured in clandestine laboratories (meth labs) using ingredients purchased in local stores. Over-the-counter cold medicines containing ephedrine or **pseudoephedrine** and other materials are "cooked" in meth labs to make methamphetamine.

The manufacture of methamphetamine has a severe impact on the environment. The production of one pound of methamphetamine releases poisonous gases into the atmosphere and creates 5 to 7 pounds of toxic waste. Many laboratory operators dump the toxic waste down household drains, in fields and yards, or on rural roads.

¹ <http://www.whitehousedrugpolicy.gov/publications/factsht/methamph/>

Meth labs can be portable and so are easily dismantled, stored, or moved. This portability helps methamphetamine manufacturers avoid law enforcement authorities. Meth labs have been found in many different types of locations, including apartments, hotel rooms, rented storage spaces, and trucks.

Background

In 1997, Senate Bill 560 (Hayden) was introduced to impose a 25% sales and use tax on the retail cash sales of chemicals used as reagents to the manufacturing of methamphetamine. The funds collected would have been used primarily for drug rehabilitation programs. That bill advanced all the way to the Assembly Floor, where it failed to receive the necessary two-thirds votes for passage.

In 1999, a proposal identical to Senate Bill 560 was introduced in Assembly Bill 306 (Corbett). That bill died in the Senate Committee on Appropriations.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to revise the funding mechanism to cleanup drug lab waste. The DTSC has completed emergency cleanups of over 15,000 methamphetamine labs in the past 10 years. Under existing law, the "gross removal of an illegal drug lab is the emergency cleanup of hazardous substances posing an immediate threat to public health or safety." The DTSC is responsible for this portion of the cleanup, which is financed by the General Fund.
2. **The April 26, 2005 amendments** authorize the Board to expend the fee revenues in the Illegal Drug Lab Cleanup Subaccount, upon appropriation by the Legislature, for the costs of administering and collecting the fee.

The **April 12, 2005** amendments specify that the fee is imposed upon the first sale of pseudoephedrine by a manufacturer in this state. The introduced version of the bill did not impact the Board.

3. **Manufacturers could avoid this fee.** The imposition of the fee would be upon the first sale of pseudoephedrine by a manufacturer in this state. A manufacturer could simply avoid the proposed fee by selling pseudoephedrine to an out-of-state distributor who would subsequently sell the pseudoephedrine in this state. In such a case, the first sale of pseudoephedrine in this state would be by that distributor and not the manufacturer.

Although this measure provides the basis of the fee, it is not clear on whom the fee is imposed. For example, is the manufacturer, distributor or retailer required to pay the fee, which would be based on the sales in this state by a manufacturer?

4. **Administrative provisions.** In order for the Board to administer the proposed fee under provisions consistent with other Board-administered fees, it is suggested that the following section be added to this bill:

For purposes of this section, the State Board of Equalization may collect the fees pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code).

In addition to the suggested administrative language, the bill should be amended to authorize the payment of refunds on overpayments of the fee. Board staff is willing to work with the author's office in drafting appropriate amendments.

5. **The fee would impact legitimate users.** Assuming that the term "pseudoephedrine" includes nonprescription medicines, such as Sudafed and Sinutab, which contain pseudoephedrine, and assuming that manufacturers increase the selling price of pseudoephedrine products to reimburse themselves for the fee, the proposed fee would fall upon products purchased by legitimate users.
6. **This bill could increase state and local sales and use tax revenues.** In order to be reimbursed for the fee, pseudoephedrine manufacturers may increase the price of pseudoephedrine products, which would be reflected in the retail sales price of pseudoephedrine sold to the ultimate consumer.

Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed pseudoephedrine fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

7. **What are retailers doing to address sales of pseudoephedrine?** To make it more difficult for customers to easily obtain medications containing pseudoephedrine, stores such as Target, Albertson's, Longs Drugs, Wal-Mart, and Sam's Club have or are in the process of moving many nonprescription cold and allergy medications behind pharmacy counters because they include pseudoephedrine. Customers won't need a prescription to purchase medications containing pseudoephedrine product, but will need to ask pharmacists for access to the medication.
8. **Other states' pseudoephedrine legislation.** On April 7, 2004, the Oklahoma Legislature enacted House Bill 2176 (Title 63 O.S. 2-212) – The Pseudoephedrine Control Bill. This legislation did the following:
 - Identified all forms of pseudoephedrine products as a Schedule V controlled substance to be dispensed only through a pharmacy.
 - Limited the amount of solid dose pseudoephedrine that could be sold to an individual (without a prescription) to a total of nine grams per month. Liquid and liquid gel compound products are exempt from the pharmacy sales restrictions.
 - Placed enforcement of the nine gram per month limit upon the pharmacist or pharmacy technician.
 - Required a pharmacist or technician to maintain a written log documenting the date of the transaction, name of the consumer, and the amount of the compound, mixture, or preparation that was sold.
 - Required the consumer to present a photo identification that displays the date of birth of the consumer and sign the written log for the purchase of the compound.
 - Required information to be maintained by the pharmacy and open for inspection by law enforcement.

According to news reports, the state has seen an 80 percent drop in its meth lab seizures in the last year.

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Six states allow only pharmacies to sell drugs with pseudoephedrine, and seven others make retailers lock up the products or sell them from staffed counters. Legislatures in 22 states are considering similar restrictions, including California.

Senate Bill 152 (Speier) would impose additional requirements on the sale by a pharmacist or retail distributor of a product, except as specified, containing any amount of pseudoephedrine or its salts or isomers or the salts of isomers of pseudoephedrine. Effective June 1, 2006, the bill would require the purchaser of the product to present a government-issued photo identification. The bill would also add to these requirements, effective January 1, 2008, a provision that the pharmacist and retail distributor maintain a record of the sales of the product and limit sales to a single purchaser to 3 packages or 9 grams within a 30-day period. Senate Bill 152, however, failed passage out of the Senate Committee on Business, Professions, and Economic Development.

- 9. Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

The *Sinclair Paint* decision ratified the use of fees approved by a majority of the Legislature to address health or other social problems created by the use or production of a particular product. In order to pass judicial scrutiny, the Court suggests that: 1) a fee must not exceed the cost of providing services related to the remediation of the problem created by a particular product; and 2) a reasonable connection must exist between the social problems remedied by a fee and the payer of the fee.

Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the fees imposed are in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a new fee program. These costs would include registering fee payers, developing computer programs, mailing and processing determinations and payments, carrying out compliance and audit efforts to ensure proper reporting, developing regulations, training staff, and answering inquiries from the public. A cost estimate of this workload is pending.

REVENUE ESTIMATE**Background, Methodology, and Assumptions**

The Bureau of Narcotic Enforcement (BNE) conducted a review of the various distributors and manufacturers that provided pseudoephedrine products to the California retail market during calendar year 2004. Total adult and pediatric consumption of over-the-counter (OTC) products (solid and liquid) was provided in a briefing report titled "2004 Pseudoephedrine OTCs and Methamphetamine Related Issues." For pills and liquid capsules, the actual pills and caps pseudoephedrine consumption data was provided in pounds (lbs). The liquid data was only provided in gallons and, for the purpose of this estimate, had to be converted to pounds.

The report indicated 1.9 billion pills (199,180 lbs of pseudoephedrine) and 209 million liquid caps (16,019 lbs of pseudoephedrine) for adults, totaling 215,199 lbs of pseudoephedrine. Since the liquid data was in gallons (259,336 gallons), we converted gallons to equivalent pounds by extrapolating it from the data provided. We estimated the 259,336 gallons would yield 12,167 lbs of pseudoephedrine. The total quantity of adult pseudoephedrine amounts to 227,336 pounds (215,199 + 12,167). Each pound of pseudoephedrine is equivalent to 453,592 milligrams. Therefore, total pounds converts to 103.1 billion milligrams (227,336 lbs × 453,592 = 103.1 billion milligrams) of adult pseudoephedrine. For pediatrics (solid and liquid), total milligrams was estimated to be 584 million milligrams. Total pseudoephedrine consumption is estimated to be 103.7 billion milligrams (103.1 billion + .584 billion).

Revenue Summary

Based on the proposed maximum fee of \$0.000232 per milligram of pseudoephedrine, an estimated \$24 million in fee revenues could be generated annually (\$0.000232 × 103.7 billion milligrams = \$24 million) for deposit in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund.

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