



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

DRAFT

Date Amended:	06/07/06	Bill No:	AB 71
Tax:	Drug Manufacturer Fee	Author:	Chan and Frommer
Related Bills:			

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

BILL SUMMARY

This bill would require the Board of Equalization (Board) to annually assess and collect a fee on manufacturers of drugs sold in the state.

ANALYSIS

Current Law

Under existing law, a state and local sales and use tax is imposed on the sale or use of tangible personal property in this state, including prescription drugs, unless specifically exempted in the law. Section 6369, for example, provides an exemption for prescription medicines sold or furnished under specified conditions.

Currently, the total combined sales and use tax rate is between 7.25 and 8.75 percent, depending on the location in which the merchandise is sold. The Board does not collect any additional taxes or fees on the prescription drugs.

Proposed Law

This bill would add Article 7 (commencing with Section 111657) to Chapter 6 of Part 5 of Division 104 to the Health and Safety Code to enact the Drug Safety and Effectiveness Program.

Among other things, this bill would request the University of California to establish a program to evaluate the safety and effectiveness of prescription drugs in the state that would have the following components:

- A determination of the classes of drugs that are advertised to consumers, marketed to physicians, or both, in the state.
- An Internet Web site that would report information on the safety and effectiveness of brand name and generic drugs in the classes, as identified, including, when available, direct comparisons of relative safety and effectiveness, and differential safety and effectiveness of specific drugs according to age, gender, race, or ethnicity.

This bill would also impose a fee on manufacturers of drugs sold in the state. The specific fee to be assessed on a drug manufacturer would be established by the University of California, to the maximum extent practicable, on the basis of a drug manufacturer's market share of the total amount of drugs sold in the state. A fee would not be assessed on a drug manufacturer that could demonstrate, as determined by the University of California, that it does not manufacture drugs that have described characteristics.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

The fee would be assessed and collected annually by the Board in accordance with Part 22 (commencing with Section 43001) of Division 2 of the Revenue and Taxation Code (Hazardous Substances Tax Law).

The fees collected would be deposited in the Drug Safety Watch and Effectiveness Program Fund, which this bill would establish in the State Treasury. Moneys in the fund would be expended, upon appropriation by the Legislature, for the purposes of the Drug Safety and Effectiveness Program, including the costs of the Board or collection and administration of fees. All interest earned on the moneys deposited into the Drug Safety Watch and Effectiveness Program Fund (Fund) would be retained in the Fund.

This bill would become effective January 1, 2007.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to provide consumers more information on the safety and effectiveness of prescription drugs they are taking and thereby encourage them to discuss such information with their physicians.
2. **Could the state require out-of-state retailers to remit a drug fee?** Various Supreme Court cases have focused on states' ability to impose the use tax on out-of-state firms making sales to in-state customers. In 1967 the Supreme Court ruled in *National Bellas Hess, Inc. v. Illinois Department of Revenue* (1967) 386 U.S. 753, that a firm that has no link to a state except mailing catalogs to state residents and filling their orders by mail cannot be subject to that state's sales or use tax. The Court ruled that these mail order firms lacked substantial physical presence, or nexus, required by the Due Process Clause and the Commerce Clause of the United States Constitution.

In the 1977 case of *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274 the Court articulated that, in order to survive a Commerce Clause challenge, a tax must satisfy a four part test: 1) it must be applied to an activity with a substantial nexus with the taxing State, 2) it must be fairly apportioned, 3) it does not discriminate against interstate commerce, and 4) it must be fairly related to the services provided by the State.

North Dakota enacted anti-National Bellas Hess legislation with the expressed purpose of creating nexus with mail order firms selling to consumers in the state, in an attempt to compel out-of-state retailers to collect the use tax on mail order sales and test the continuing validity of the National Bellas Hess decision. The statute was challenged, and in 1992 the Supreme Court issued a ruling in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298. The Court in *Quill* applied the Complete Auto Transit analysis and held that satisfying due process concerns does not require a physical presence, but rather requires only minimum contacts with the taxing state. Thus when a mail-order business purposefully directs its activities at residents of the taxing state, the Due Process Clause does not prohibit the state's requiring the retailer to collect the state's use tax. However, the Court held further that physical presence in the state was required for a business to have a "substantial nexus" with the taxing state for purposes of the Commerce Clause. The Court therefore affirmed that in order to survive a Commerce Clause challenge, a retailer must have a physical presence in the taxing state before that state can require the retailer to collect its use tax.

Based on the above cases, it is questionable whether the state could require an out-of-state manufacturer of drugs, who has no physical presence in California, to remit a fee.

3. **Administrative provisions.** This bill would require the Board to collect the drug manufacturer fee pursuant to the Hazardous Substances Tax Law. However, the bill should be amended to specify that the Board is authorized to collect the drug manufacturer fee pursuant to the Fee Collection Procedures Law. The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund, and appeals provisions, as well as providing the Board the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

In addition to the suggested administrative language, the bill should be amended to specify that the University of California shall provide to the Board the name and address of the feepayer and the amount of the fee, specify a due date for the fee, and authorize the payment of refunds on overpayments of the fee.

The following language is suggested:

111657.1. (c) The fee shall be assessed and collected annually by the State Board of Equalization ~~in accordance with Part 22 (commencing with Section 43001) of Division 2 of the Revenue and Taxation Code.~~

(1) For purposes of this section, the State Board of Equalization shall collect the drug manufacturer fee pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). The State Board of Equalization may prescribe, adopt, and enforce regulations to carry out this article, including, but not limited to, provisions governing collections, reporting, refunds, and appeals.

(2) The University of California shall provide to the State Board of Equalization the name and address of each person or entity who is liable for a fee or expense, the amount of the fee or expense, and the due date.

(d) The fees collected shall be deposited in the Drug Safety Watch and Effectiveness Program Fund, which is hereby established in the State Treasury. Moneys in the fund shall be expended, upon appropriation by the Legislature, for the purposes of this article, including the payment of refunds of the manufacturer drug fee imposed pursuant to this section, to reimburse administrative costs of the State Board of Equalization for collection and administration of the fees. All interest earned on the moneys that have been deposited into the Drug Safety Watch and Effectiveness Program Fund shall be retained in the fund.

(ed) The fees collected pursuant to this section and the earnings therefrom shall be used solely for the purposes of implementing this article. The University of California shall not collect fees pursuant to this section in excess of the amount reasonably anticipated by the University of California to fully implement this article. The University of California shall not spend more than it collects from the fees, and the earnings thereon, in implementing this article.

4. **Petitions for redetermination and claims for refund.** It is suggested that, for purposes of the drug manufacturer fee, the University of California handle the petitions for redetermination and approve the claims for refund based upon the grounds that the University of California improperly or erroneously calculated the amount of the fee or identified the wrong feepayer. It would be difficult for Board staff to resolve feepayer protests and claims based on actions of another agency, and doing so could result in a significant number of additional appeals conferences and Board hearings. Accordingly, the following language is suggested:

111657.1. (c) (3) No petition for redetermination of fees determined by the University of California pursuant to Section 111657.1 shall be accepted or considered by the State Board of Equalization if the petition is founded upon the grounds that the University of California has improperly or erroneously calculated the amount of the fee or has incorrectly determined that the person is subject to the fee. Any appeal of a determination based on the grounds that the amount of the fee was improperly or erroneously calculated or that the person is not responsible for the fee shall be accepted by the State Board of Equalization and forwarded to the University of California for consideration and decision.

(4) No claim for refund of fees paid pursuant to Section 111657.1 shall be accepted or considered by the State Board of Equalization if the claim is founded upon the grounds that the University of California has improperly or erroneously calculated the amount of the fee or has incorrectly determined that the person is subject to the fee. Any claim for refund based on the grounds that the amount of the fee was improperly or erroneously calculated or that the person is not responsible for the fee shall be accepted by the State Board of Equalization and forwarded to the University of California for consideration and decision.

5. **This bill should contain a specific appropriation to the Board.** This bill proposes a fee to be imposed on or after January 1, 2007, which is in the middle of the state's fiscal year. In order to begin to develop computer programs and to hire appropriate staff, an adequate appropriation would be required to cover the Board's administrative start-up costs that would not be identified in the Board's 2006-07 budget.
6. **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.

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 notifying feepayers, developing forms and publications, computer programming, mailing and processing determinations and payments, training staff, and answering inquiries from the public. A cost estimate of this workload is pending.

REVENUE ESTIMATE

This measure does not specify the amount of the proposed fee. Accordingly, a revenue estimate could not be prepared.

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