

[Assembly Bill 2243](#) (Wood)

Date: Introduced

Program: Medical Cannabis Tax

Sponsor: Author

Revenue and Taxation Code Part 13.5 (commencing with Section 31001) of Division 2

Effective January 1, 2017 but operative date dependent on funding

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Summary: Imposes upon cultivators a per-ounce medical cannabis tax to be collected by a distributor on the sale of all distributed medical cannabis flowers, medical cannabis leaves, and immature medical cannabis plants.

Purpose: To provide funding to address the impacts of illegal cannabis cultivation.

Fiscal Impact Summary: Annual revenue of \$77 million.

Existing Law: Federal Law. Existing federal law prohibits the manufacture, possession, sale, or distribution of marijuana.¹ Congress enacted the Controlled Substances Act (CSA)² as part of the Comprehensive Drug Abuse Prevention and Control Act of 1970. The CSA establishes five “schedules” of certain drugs and other substances designated “controlled substances.”³ For a drug or other substance to be designated as a schedule I controlled substance, it must be found that the substance “has a high potential for abuse,” has “no currently accepted medical use in treatment in the United States,” and “lack accepted safety for use of the drug or other substance under medical supervision.”⁴ Federal law lists marijuana as a schedule I controlled substance, deemed to have no accepted medical use.⁵

California’s Medical Marijuana Program. Under existing law, the California Uniform Controlled Substances Act⁶ prohibits, except as authorized by law, the possession, cultivation, transportation, and sale of marijuana and derivatives of marijuana. Existing law authorizes, under The Compassionate Use Act of 1996 (Proposition 215 of 1996), a patient or the patient’s primary caregiver to cultivate or possess marijuana for the patient’s medical use when recommended by a physician, as specified.⁷

California’s Sales and Use Tax Law.⁸ Existing law imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use or other consumption in this state of tangible personal property purchased from a retailer, except where the law specifies an exclusion or exemption. Nothing in the Sales and Use Tax Law exempts or excludes the sale of illegal substances. Therefore, under the law, sales and use tax apply to retail sales of marijuana, including medical marijuana, to the same extent as any other retail sale of tangible personal property.

There is no specific exemption or exclusion for marijuana or medical marijuana. For patient treatment, RTC Section 6369 exempts from the sales and use tax retail sales of medicines, as defined, when the medicines sold or furnished are:

- prescribed by an authorized person and dispensed on a prescription filled by a pharmacist,
- furnished by a licensed physician to his or her own patient, or
- furnished by a health facility for treatment pursuant to a licensed physician’s order, or sold to a licensed physician.

¹ 21 U.S.C. § 841 et seq.

² 21 U.S.C. § 801 et seq.

³ 21 U.S.C. §§802(6), 812(a).

⁴ 21 U.S.C. § 812 (b)(1).

⁵ 21 U.S.C. § 812:Schedule I(c)(10).

⁶ Division 10 (commencing with Section 11000) of the Health and Safety Code (HSC).

⁷ HSC Section 11362.5.

⁸ Part 1 of Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).

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The sale of medical marijuana, however, is generally not made under conditions that would satisfy the elements of RTC section 6369.

Proposed Law: This bill adds Part 13.5 (commencing with Section 31001) to Division 2 of the RTC, known as the Medical Cannabis Tax Law (MCTL). The MCTL imposes a tax upon each licensed cultivator at a specified rate per ounce on the sale of all cannabis flowers (\$9.25 per ounce), leaves (\$2.75 per ounce), and immature plants (\$1.25 per plant). A licensed distributor must collect the tax from each licensed cultivator at the time of the sale.

A licensed distributor must separately state the amount of tax on the purchase order provided to the licensed medical cannabis cultivator at the time of sale.

Exemption. The bill exempts sales that the United States Constitution or laws or the California Constitution prohibit from taxation. The MCTL requires the BOE to prescribe the manner by which to claim the exemption.

Tax Liability. A licensed cultivator is liable for tax until paid to the state. However, a licensed cultivator's payment to a licensed distributor relieves the cultivator from further liability. Any tax collected from a licensed cultivator that is not remitted to the BOE constitutes a debt owed to the state by the licensed distributor. Nothing in the MCTL imposes any obligation upon a licensed distributor to take any legal action to enforce the collection of the tax.

Any unreturned amounts the licensed distributor represents and collects as the tax owed by the licensed cultivator that are not actually owed constitute a distributor's debt to the state.

Rate Adjustment. The MCTL requires the Legislative Analyst's Office (LAO) to regularly review the established tax levels at least every other year, beginning in 2018. The LAO must make recommendations to the Legislature, as appropriate, regarding adjustments that would further the goal of addressing public safety and the environmental impacts caused by the proliferation of cannabis cultivation.

Administration. This bill requires the BOE to administer and collect the tax pursuant to the Fee Collection Procedures Law (FCPL).⁹ For purposes of the MCTL, the bill clarifies the terms "fee" and "feepayer" as follows:

- "Fee" includes the medical cannabis tax; and
- "Feepayer" includes a person required to pay the medical cannabis tax.

The FCPL generally provides for the BOE's administration of fee programs. Among other things, the FCPL provides for collection, reporting, return, refund, and appeals procedures, as well as the BOE's authority to adopt regulations related to the FCPL's administration and enforcement.

The MCTL specifically authorizes the BOE to prescribe and adopt tax administration and enforcement regulations including, but not limited to, collections, reporting, refunds, and appeals.

Reporting and Payment. The medical cannabis tax is due and payable to the BOE quarterly on or before the last day of the month following each calendar quarter. In addition, a return for the preceding calendar quarter must be filed with the BOE. (The BOE may, however, require tax payments and the filing of returns for periods other than the period or periods specified in the tax and fee laws administered under the FCPL.)¹⁰

An electronic tax return would be authenticated in a form or pursuant to a method as the BOE may prescribe.

⁹ Part 30 (commencing with Section 55001) of Division 2 of the RTC.

¹⁰ RTC Section 55041.1.

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Definitions. The MCTL defines the following terms:

- “Licensed cultivator” means a person that is licensed as a cultivator under the Medical Marijuana Regulation and Safety Act (MMRSA).
- “Distribution” has the same meaning as that term is defined in the MMRSA.
- “Licensed distributor” means “distributor” as defined in the MMRSA.
- “Sale” means the transfer of title or possession for consideration in any manner or by any means whatever.

Deposit of Revenues. The BOE must deposit all revenues, less refunds and BOE reimbursement for expenses incurred in the administration of the medical cannabis tax, into the Cannabis Production and Environment Mitigation Fund, which this bill creates in the State Treasury. All moneys deposited into the fund are continuously appropriated as follows:

- 30% to an unspecified agency for disbursement to local law enforcement-related activities pertaining to illegal cannabis cultivation.
- 30% to the Natural Resources Agency to fund a competitive grant program for environmental cleanup restoration and protection of public and private lands that have been damaged from illegal cannabis cultivation.
- 30% to the multiagency task force, the Department of Fish and Wildlife, and the State Water Resources Control Board, to address the environmental impacts of cannabis cultivation on public and private lands in California and other state enforcement-related activities from illegal cannabis cultivation.
- 10% to the Bureau of Medical Marijuana Regulation, and other state agencies or departments that the bureau determines appropriate, to conduct ongoing studies of areas that may create challenges to compliance with the MMRSA.

Report. The BOE must submit a report to the Legislature on the total amount of revenue collected over the two-year time period from the operative date of the medical cannabis tax. The report is due on or before the last day of the month commencing 180 days after the two-year period from the tax operative date.

Operative Date and Funding. The MCTL becomes operative on or after the first day of the first calendar quarter commencing more than 270 days after adequate funding has been received by the BOE to implement and administer the MCTL. The MCTL requires the BOE to post a notice on its Internet Website when this condition has been satisfied.

The MCTL requires a General Fund or special fund loan to fund the BOE’s MCTL regulatory activity establishment and support. The loan would be repaid by the BOE from the initial proceeds from taxes collected pursuant to this part or any rule or regulation adopted pursuant to this part, no later than six months after the MCTL’s operative date.

This bill becomes effective January 1, 2017, but operative on or after the first day of the first calendar quarter commencing more than 270 days after the BOE’s receipt of adequate funding.

Background: Medical Marijuana Sellers – Sales Tax. In 1996, California voters passed Proposition 215, also known as the Compassionate Use Act of 1996, which allows patients and their primary caregivers to cultivate or possess marijuana for personal medical treatment with the recommendation of a physician, as specified.

In 2003, [Senate Bill 420](#) (Ch. 875, Stats. 2003, Vasconcellos) established statewide guidelines for Proposition 215 enforcement. In particular, SB 420 allows nonprofit distribution in certain cases for patient cultivation cooperatives, small-scale caregiver gardens, and dispensing collectives. However, despite the fact that numerous medical marijuana dispensaries currently do business in California, the sale of medical cannabis is illegal under federal law.

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On August 29, 2013, the U.S. Department of Justice issued guidance to federal prosecutors regarding cannabis enforcement under the CSA (referred to as the [Cole Memo](#)).¹¹ The Cole Memo reiterated the Department's commitment to enforcing the CSA consistent with Congress' determination that cannabis is a dangerous drug that serves as a significant source of revenue to large-scale criminal enterprises, gangs, and cartels. In furtherance of those objectives, the Cole Memo instructed the Department attorneys and law enforcement to focus on the following eight priorities in enforcing the CSA against cannabis-related conduct:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

Under the Cole Memo, marijuana-related conduct that implicates one or more of these enforcement priorities should be the primary question when considering CSA prosecution. Although the guidance was issued in response to recent marijuana legalization initiatives in certain states, it applies to all Department marijuana enforcement nationwide.

Operative December 16, 2014, Public Law 113-235¹² prohibits the United States Department of Justice from using funds to prevent specified states, including California, from implementing laws that authorize the use, distribution, possession, or cultivation of medical marijuana.

Because the sale of medical marijuana¹³ is taxable, the BOE issues seller's permits to those medical marijuana sellers and will issue seller's permits to any other sellers making unlawful sales.

In 2007, the BOE mailed a special notice to California sellers of medical marijuana to clarify the application of tax to medical marijuana sales and the requirement that they must hold a seller's permit.

Medical Marijuana Regulation and Safety Act. In 2015, the Legislature enacted the MMRSA, a package of legislation that establishes a comprehensive licensing and regulatory framework for medical marijuana, including cultivation, manufacturing, transportation, distribution, sale, and product. The MMRSA consists of three bills: [SB 643](#) (Ch. 719, McGuire), [AB 243](#) (Ch. 688, Wood), and [AB 266](#) (Ch. 689, Bonta).

Among its provisions, the MMRSA establishes the Bureau of Medical Marijuana Regulation (Bureau) within the Department of Consumer Affairs to oversee and enforce the state's medical marijuana regulations, in collaboration with the California Department of Public Health and the CDFR. Additionally, it establishes categories of licenses for various medical marijuana activities, such as cultivation, manufacturing, distribution, transportation, and sale.

¹¹ <http://medicalmarijuana.procon.org/sourcefiles/cole-DOJ-memo-aug-2013.pdf>

¹² [H.R. 83](#) / Public Law 113-235, Consolidated and Further Continuing Appropriations Act, 2015, (Dec. 16, 2014; 128 Stat. 2130; 701 pages).

¹³ All retail sales, including illegal sales, are subject to tax unless otherwise exempt.

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AB 266 also added RTC Section 31020 to require the BOE, in consultation with the CDFA, to adopt a system to report commercial cannabis and cannabis product movement throughout the distribution chain (track and trace). The adopted system must employ secure packaging and provide information to the BOE. Section 31020 also requires the system to capture, at a minimum, all of the following:

- The amount of tax due by the designated entity;
- The name, address, and license number of the designated entity that remitted the tax;
- The name, address, and license number of the succeeding entity receiving the product;
- The transaction date; and
- Any other information the BOE deems necessary for marijuana and marijuana taxation and regulation.

Commentary:

1. **Proposed tax is complicated.** This bill proposes a complicated tax scheme that departs from other distributor-level tax structures administered by the BOE. In general, BOE-administered taxes and fees require either: (1) the tax be reported and paid by the person upon whom the tax is imposed, or (2) the tax be reported and paid by the seller required to collect the tax from the purchaser upon whom the tax is imposed. In contrast, this proposed tax requires the purchaser (licensed distributor) to collect the medical cannabis tax from the seller. The MCTL requires a licensed distributor to issue a purchase order to document the tax imposed. However, a purchase order is simply a merchandise order and not documentation of a sale or distribution. This method could be problematic when the distributor does not purchase the quantity specified on the purchase order. Further, it is unclear how a distributor, who makes the payment rather than receives a payment, can collect the tax. Does the distributor “short” his or her payment to the cultivator by the tax amount?

BOE staff suggests imposing the tax on the “first sale” or “distribution” of flowers, leaves, and immature plants in this state. The taxpayer in this case would be defined as the person who makes the first sale or distribution of cannabis flowers, leaves, and immature plants in this state. A sale from a cultivator to a distributor would be excluded from the definition of sale or distribution thus imposing the tax on the distributor’s sale or distribution. This mechanism closely follows the imposition of the cigarette and tobacco products tax. In addition to the suggested revisions to the proposed tax, BOE staff also suggests revising the MCTL’s definitions to conform to the imposition and collection change.

BOE staff is available to draft appropriate amendments to assist the author.

2. **Lack of license should not exclude tax liability.** This bill imposes the medical cannabis tax upon a cultivator. The bill defines licensed cultivator to mean: *a person that is **licensed** as a cultivator under the MMRSA*. The bill requires tax collection by a **licensed** distributor. Does a cultivator or distributor escape the tax if they do not comply with the MMRSA’s licensing requirements?
3. **Do cultivators always sell to distributors?** Under the MMRSA, BPC Section 19326 specifies certain restrictions on medical cannabis. For example, the statute requires a licensed cultivator or licensed manufacturer “to send” all medical cannabis to a distributor for quality assurance, inspection, and batch testing prior to distribution to a dispensary. Accordingly, the MMRSA allows a cultivator to sell medical cannabis directly to a manufacturer. That manufacturer must send the finished product to a distributor prior to distribution to a dispensary. Since the MMRSA does not require a cultivator to sell to a distributor, how would the tax be imposed and collected if a cultivator sells directly to a manufacturer or if the cultivator “sends” (does not sell) the medical cannabis to the distributor for testing?

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- 4. Proposed tax is subject to sales tax.** The total retail sales price of tangible personal property is subject to the sales or use tax, unless specifically exempted or excluded by law.

To be reimbursed for the proposed new tax, a distributor would likely incorporate the additional tax into the sales price of the medical cannabis. The sales tax applies to the entire sales price of medical cannabis, including any increase in the retail sales price to the consumer due to the prior imposition of the medical cannabis tax. The Revenue Estimate discusses the impact on state and local sales and use tax revenues.

- 5. Future track and trace tax program.** The bill requires a licensed distributor to collect and remit the tax and a return to the BOE quarterly. The bill does not specifically allow tax payment through the use of stamps, other markings capable of encrypting certain tax information, or track and trace technology.

BOE staff suggests amending the bill to provide the BOE authority to prescribe by regulation a method and manner for the medical cannabis tax payment. This suggestion builds upon existing requirements for the BOE to adopt a track and trace system (RTC Section 31020) and for the CDFA to establish a unique identifier program (BPC Section 19335).

- 6. Suggested technical amendments.** The BOE staff recommends the following amendments:
- The bill specifies two distinct points of tax imposition: sale and distribution. The bill should specify only one point of taxation to eliminate confusion.
 - The bill should require licensed distributors to file electronic returns, consistent with other BOE-administered tax programs.
 - The bill should allow licensed distributors to remit the medical cannabis tax by means other than an electronic funds transfer (EFT) when they are unable to obtain a bank account. Under the law,¹⁴ certain reporting requirements are imposed on tax and feepayers that have substantial tax or fee liabilities. Specifically, tax and feepayers with monthly tax liabilities that average \$20,000 or more must remit their tax and fee payments via an EFT under BOE-prescribed procedures.
- 7. Related legislation.** [SB 987](#) (McGuire) imposes a 15% tax on medical marijuana purchased from a retailer of medical marijuana, beginning January 1, 2018.

Administrative Costs: BOE administrative costs related to this bill are substantial. These costs include: taxpayer identification, notification, and registration; regulation development; manual and publication revisions; tax return design; computer programming; return, payment, and refund claim processing; audit and collection tasks; staff training; and public inquiry responses. A detailed cost estimate is pending. As a point of reference, costs estimated for a similar measure (AB 243, amended August 17, 2015) were estimated to be \$705,000 for FY 2015-16, \$3.9 million for FY 2016-17, \$3.6 million for FY 2017-18, \$3.7 million for FY 2018-19 and ongoing.

Revenue Impact:

Background, Methodology, and Assumptions. Given the infancy of this market, identifying reliable data is challenging; however, staff developed detailed assumptions, sources, and calculations that are shown in the Medical Marijuana Spending and Supply Sources table (page 9).

Major assumptions are:

- 100% compliance (See Qualifying Remarks).
- \$220 per ounce is a typical price of medical cannabis (Line 3).
- \$1.3 billion is a reasonable estimate of the value of medical cannabis sales in 2014 (Line 6).

¹⁴ RTC Section 55050.

- 95% of medical cannabis is grown in California, and 5% is imported. This postulation is founded on discussions with BOE staff who have worked with local city and county officials and have interviewed growers and industry representatives (Line 10).
- Of total plant material, staff assumes 72% is flowers and 28% is leaves and stems (Lines 12 and 13).
- 40% of medical cannabis plants are grown indoors and 60% are grown outdoors (Lines 16 and 17).
- Based on discussions with BOE staff, average yield is two ounces of usable product per plant for indoor grows and 96 ounces per plant for outdoor grows. (Lines 18 and 19).
- Extrapolating federal data on total U.S. recreational and medical cannabis prevalence rates, staff assumes the value of California medical cannabis sales will increase in the range of five to six percent per year from 2015 through 2019.¹⁵ This implies growth of 30% from 2015 to 2019.
- About 5% of immature plants are sold to cultivators (Line 23). This percentage is relatively small because the vast majority of cultivators grow their own immature plants without a sales transaction taking place.

Furthermore, staff assumes the tax on medical cannabis plants will be passed on to consumers, and the medical cannabis dispensaries will comply with California’s tax laws.

Revenue Summary. Annual revenues for this measure are estimated to be about \$77 million. Revenues for flowers, leaves, and immature plants are shown in the table below.

	Estimated 2019		
	Amounts (Millions)	Tax Rates	Revenues (\$Millions)
California-Grown Medical Flowers (Million Ounces)	7.43	\$9.25	68.73
California-Grown Medical Leaves and Stems (Million)	2.89	\$2.75	7.95
Immature plants distributed (Million Plants)	0.1	\$1.25	0.10
Total			\$76.8

Related sales tax impacts are \$6.3 million, broken out as follows:

	Fiscal Year 2018- 19	
	Rates	Revenue
State General Fund	3.94%	\$3.0
Local Revenue Fund 2011	1.06%	\$0.8
Local Revenue Fund 1991	0.50%	\$0.4
Public Safety Fund	0.50%	\$0.4
Local Cities and Counties	1.25%	\$1.0
Special District Taxes	0.96%	\$0.7
Statewide Average Rate	8.21%	\$6.3

¹⁵ Percentages vary for each year. They are based on statistical relationships using U.S. data from 2002 through 2014 from the following publication: *Behavioral health trends in the United States: Results from the 2014 National Survey on Drug Use and Health*, Center for Behavioral Health Statistics and Quality, HHS Publication No. SMA 15-4927, NSDUH Series H-50. Retrieved from <http://www.samhsa.gov/data/>

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Qualifying Remarks. Even though 100% compliance was used, staff notes that less than complete compliance would lower these revenue estimates. Extrapolating Colorado's data based on a 2014 Congressional Research Service report implies that a 60% compliance rate would be a reasonable expectation.¹⁶ If compliance were 60%, total excise tax revenues would be \$46.1 million, and related sales and use tax revenues would be \$3.8 million.

These estimates are highly uncertain and vary greatly depending on staff assumptions. Furthermore, staff continues to research the medical cannabis industry in California, and these estimates are subject to change to the extent that more accurate data is obtained.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

¹⁶ *Federal Proposals to Tax Marijuana: An Economic Analysis*, Congressional Research Service, 2014.

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Medical Marijuana Spending and Supply Sources		
Line No.		Source
	<u>Total Marijuana Spending</u>	
1	Total U.S. Marijuana Spending in 2014 (\$ Millions)	\$47,489 <i>What America's Users Spend on Illegal Drugs: 2000-2010, Office of National Drug Control Policy, 2014; projected to 2014 using trend analysis by BOE staff</i>
2	Total U.S. Marijuana Spending in 2014 (Million Ounces)	216 <i>What America's Users Spend on Illegal Drugs: 2000-2010; projected to 2014 using trend analysis by BOE staff</i>
3	Implied Average Price per Ounce	\$220 Line 1 / Line 2
4	Assumed California Percentage	13.9% <i>The Effect of Medical Marijuana Laws on Marijuana, Alcohol, and Hard Drug Use, National Bureau of Economic Research, Working Paper 20085, 2014; applied by BOE staff to CA population percentage of U.S.</i>
5	Total CA Marijuana Spending in 2014 (\$ Millions)	\$6,610 Line 1 x Line 4
6	<u>Medical Marijuana Spending (\$Millions)</u>	\$1,323 <i>The State of Legal Marijuana Markets, 3rd edition, 2015, Arcview Market Research</i>
7	Medical Ounces (millions)	6.01 Line 6 / Line 3
8	CA Medical Percentage of CA Total Marijuana Spending	20% Line 6 / Line 5
9	<u>Supply Sources</u>	
10	California-Grown Percentage	95% BOE staff and industry representatives
11	California-Grown Medical Flowers (Million Ounces)	5.71 Line 7 x Line 10
12	Flower Percentage	72% <i>Oregon Cannabis Tax Revenue Estimate, July 22, 2014</i>
13	Leaves Percentage	28%
14	California-Grown Medical Leaves and Stems (Million Ounces)	7.93 Implied by Line 12
15	California-Grown Medical Leaves and Stems (Million Ounces)	2.22 Line 13 x Line 14
16	Indoor Percentage	40% <i>Government Income Projections for California's Cannabis Industry, Full Circle Cannabis Consultations, 2013</i>
17	Outdoor Percentage	60%
18	Indoor Yield per Plant (Ounces)	2 BOE staff and industry representatives
19	Outdoor Yield per Plant (Ounces)	96 BOE staff and industry representatives
20	Number of Indoor Plants	1,142,417 (Line 11 x Line 16) / Line 18
21	Number of Outdoor Plants	35,701 (Line 11 x Line 17) / Line 19
22	Total Number of Plants	1,178,117 Line 20 + Line 21
23		
	Percentage of immature plants distributed	5% BOE staff and industry representatives
24	Immature plants distributed	58,906 Line 22 x Line 23

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