

## ATTACHMENT 1 FISCAL IMPACT STATEMENT

### Economic Impact Statement

#### A. FISCAL EFFECT ON PRIVATE SECTOR

2. The Department has made an initial determination that the proposed action would not have a significant, statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.

These regulations would require licensed firearms dealers to collect a Dealer Record of Sale (DROS) fee of \$31.19 from a firearm purchaser or transferee, and remit those monies to the Department. Collection of statutorily authorized fees, and remission of such monies to the Department, is current practice for licensed firearms dealers. Only the dollar amount of the DROS Fee would change due to the proposed action. This dollar amount change would be made automatically within the DROS Entry System (DES), and would have no direct impact on the activity of licensed firearms dealers.

By law, a firearm may not lawfully be sold to a person who resides in a state other than the state in which the seller's licensed premises is located (Pen. Code, § 27585, see also 18 U.S.C. § 922(b)(3); 27 CFR § 478.99(a)). It would be unlawful for a resident of California to purchase a firearm in another state so as to avoid payment of the increased DROS Fee, and to then bring the firearm back to California. Conversely, it is also generally unlawful for a resident of another state to purchase a firearm in California. Due to these restrictions, there is no reason to believe that the fee increase would lead California businesses to compete with businesses in other states.

The proposed action may have an economic impact that *indirectly* affects business, in a potential \$18,616,500 yearly loss in firearms sales statewide. The DROS Fee, paid by a firearm purchaser at the time of a transfer of one or more firearms, will increase from \$19 to \$31.19. Research suggests that a one percent increase in the price of a handgun lowers the quantity demanded by two to three percent (Bice and Hemley, 2002). The \$12.19 fee increase is approximately two percent of the average cost of a handgun (\$500) and may result in a four to six percent decrease in quantity of handguns demanded. According to the Department's DROS records, in 2019 there were 415,025 handguns sold in the State of California. A five percent decrease in demand for handguns would result in 20,751 fewer handguns sold in California each year. Given the average price of a handgun, this amounts to a \$10,375,500 loss in handgun sales statewide.

The Department is not aware of similar research regarding long guns, although it is reasonable, in the absence of information, to estimate that an increase in the price of a long gun would also lower the quantity demanded, and by the same proportion (2-3 percent). The \$12.19 fee increase is one percent of the average price of a long gun (\$1,000), and may result in a two to three percent decrease in quantity of long guns demanded. According to the Department's DROS records, in 2019 there were 329,652

long guns sold in the State of California. A 2.5 percent decrease in demand for long guns would result in 8,241 fewer long guns sold in California each year. Given the average price of a long gun, this amounts to an \$8,241,000 loss in long gun sales statewide.

Combining the estimated loss in handgun and long gun sales, the Department estimates that there will be an indirect economic impact of \$18,616,500 due to these regulations.

3. Licensed firearms dealers charge the DROS Fee to each firearm purchaser at the time of a transaction of one or more firearms. These monies are then remitted to the Department.

As of May 13, 2020, there were 1,675 licensed firearms dealers. This number changes daily, as new licenses are approved and old licenses expire.

Although the Department does not have information regarding the size of licensed firearms dealers, approximately 280 dealers are one of five corporations: Bass Pro Outdoor World, Big 5 Sporting Goods, Dick's Sporting Goods, Sportsman's Warehouse and Turner's Outdoorsman. The remaining businesses have only one, two or (rarely) three locations, and, if set up as corporations, have corporate headquarters in California (i.e., are "independently owned" and not "dominant in its field of operation").

Therefore, using the consolidated small business definition in Government Code section 11346.3, subdivision (b)(4)(B) as a guide, the Department estimates that approximately 1,395 licensed firearms dealers are "small businesses." This is approximately 83 percent of all licensed firearms dealers.

4. It is unlikely that the proposal would create new businesses or eliminate existing businesses within the state.

There are 1,675 licensed firearms dealers in California. If firearm sales are distributed evenly, a five percent decrease in demand for handguns (20,751 fewer, statewide) would result in 12 fewer handguns sold by a particular business, each year, at an average loss of approximately \$6,000. A 2.5 percent decrease in demand for long guns (8,241 fewer, statewide) would result in five fewer long guns sold by a particular business, each year, at an average loss of approximately \$5,000. In total, the Department estimates that the average decrease in revenue may be approximately \$11,000 per licensed firearms dealer.

This indirect economic impact is unlikely to result in the elimination of existing businesses, unless those businesses were already financially precarious. To the contrary, the National Shooting Sports Foundation's most recent *Firearm and Ammunition Industry Economic Impact Report* states that "The economic growth America's firearm and ammunition industry has experienced in recent years has been nothing short of remarkable. Over the past decade, the industry's growth has been driven by an unprecedented number of Americans choosing to exercise their fundamental right to keep and bear arms and purchase a firearm and ammunition." According to the Department's

records, DROS transactions have increased by 60 percent in the past 10 years, from 483,872 in 2009 to 788,254 in 2019.

5. These regulations would affect licensed firearms dealers throughout the state.

6. The Department estimates that the average decrease in revenue may be approximately \$11,000 per licensed firearms dealer. Retail employment in California, such as at a licensed firearms dealer, is likely to be paid at or close to minimum wage. Without considering taxes, benefits, or other variables associated with employment in California, a business that employs a person for 40 hours a week for 52 weeks at the California minimum wage of \$12 per hour would pay \$24,960 to that employee, yearly. If there is an \$11,000 decrease in revenue per licensed firearms dealer, per year, then, disregarding all other variables, the decrease in revenue would be less than half the salary of one full-time employee.

## **B. ESTIMATED COSTS**

1. The DROS Fee is paid by individual firearm purchasers or transferees. The amount paid by an individual is dependent on the number of DROS transactions that the individual initiates. One DROS transaction may include one or more firearms.

## **C. ESTIMATED BENEFITS**

3. This rulemaking protects public safety by providing a consistent revenue stream for the activities of the Department's Bureau of Firearms. The Department anticipates that this rulemaking will result in revenue of \$31,557,356 in Fiscal Year 2020-21, and then \$22,781,488 for Fiscal Year 2021-22 and each year thereafter. Specifically, those activities related to checking the background of potential firearm purchasers serve to protect public safety by ensuring that a person prohibited by state or federal law does not purchase, or maintain possession of, a firearm. The ownership or possession of a firearm by convicted felons, persons found to be a danger to self or others because of a mental illness, persons addicted to the use of narcotics, and other prohibited persons pose a risk of immediate, serious harm to the people of the state of California.

Other activities funded by the DROS Fee, such as the maintenance of the Automated Firearm System (AFS) and certain aspects of the Armed and Prohibited Persons Section (APPS) are directed toward the investigation and prosecution of firearms-related crimes. Addressing these important public safety issues requires a consistent revenue stream that is directly related to the number of firearms sold and possessed in the state. Penal Code section 28233, which this rulemaking implements, structures the DROS Fee in exactly this manner.

## **D. ALTERNATIVES TO THE REGULATION**

3. See response to C. 3, above.

## **Fiscal Impact Statement**

### **B. FISCAL EFFECT ON STATE GOVERNMENT**

4. These regulations would increase revenue that the Department is required to use to fund statutorily mandated programs.

Existing law allows the Department to require a firearms dealer to charge each firearm purchaser a fee, called the DROS Fee, at the time of a transfer of firearms. Until January 1, 2020, the DROS Fee was set at \$19 by CCR, Title 11, section 4001, as authorized by Penal Code sections 28225 and 28230. Revenue from the DROS Fee was used to fund multiple statutorily specified firearms regulatory and enforcement activities.

Assembly Bill (AB) 1669, effective January 1, 2020, effectively changed the authority for the DROS Fee, from Penal Code section 28225 to the newly-added section 28233. This new section authorizes a fee of \$31.19 that which would fund many of the same statutorily specified firearms regulatory and enforcement activities, as had been funded by the previous DROS Fee.

The Department implemented this \$31.19 fee in an emergency rulemaking that went into effect on January 1, 2020. The Department's emergency regulations named this fee the DROS Fee because the old DROS Fee was, for practical purposes, repealed; because the fee in Penal Code section 28233 funds the activities specified by the previous DROS Fee; and because this fee now is the principal fee charged at the time of each DROS transaction. For all practical purposes, the DROS Fee has increased from \$19 to \$31.19.

#### **DROS Fee Revenue**

**Table 1** (below) shows revenue from the DROS Fee, and the projected revenue that the Department anticipates will result from the adoption of these regulations. This table does not include other sources of revenue that are also deposited into the DROS Fund (e.g., the fees authorized by Penal Code sections 23690 and 28300).

The first row shows the total number of actual and projected DROS transactions each year. Firearm sales numbers are relatively stable, but are sensitive to new legislation and anticipated political developments. The Department, without further information regarding future sales, projects that the level of transactions will remain steady in the ongoing years. The projected number of DROS transactions for Fiscal Year 2019-20 and the next two fiscal years approximates an average of the number of DROS transactions in the last two fiscal years.

During the 2019-20 fiscal year, the Department experienced a larger than normal DROS volume. This unanticipated increase in DROS volume is not considered to be reflective of long-term trends.

The second row shows the number of actual and projected *billable* DROS transactions each year. Per Penal Code section 28240, for a transaction of any number of firearms on the same date, only one billable fee may be charged. Because some people purchase multiple firearms in a single transaction, the number of billable DROS transactions are fewer than the total number of DROS transactions.

The third row shows the amount of actual and projected DROS Fee revenue. Through December 31, 2019, the DROS Fee was \$19 per billable DROS transaction. Because the Department lost the authority to charge the \$19 DROS Fee on January 1, 2020, the projection for FY 2019-20 includes half of a year’s worth of billable DROS transactions at the \$19 fee level and half of a year’s worth of billable DROS transactions at the \$31.19 fee level. The revenue estimates for FY 2020-21 and subsequent fiscal years reflect anticipated collections of the \$31.19 fee.

**TABLE 1: REVENUE (Actual and Projected)**

	<b>FY 17-18</b>	<b>FY 18-19</b>	<b>FY 19-20* (Projected)</b>	<b>FY 20-21 (Projected)</b>	<b>FY 21-22 (Projected)</b>
<b>Total DROS Transactions</b>	857,536	789,540	956,551	1,162,963	839,552
<b>Billable DROS Transactions</b>	752,302	683,380	834,703	1,011,778	730,410
<b>Revenue from \$19/\$31.19 DROS Fee</b>	\$14,293,738	\$12,984,220	\$17,740,933	\$31,557,356	\$22,781,488

**\*The Department is still calculating DROS transactions for Fiscal Year 2019-20. The final number may vary by approximately one percent.**

Without the adoption of this regulation, the DROS Fee revenue will drop to \$0 when the emergency action expires.

**DROS Fee Expenditures**

The DROS Fee is deposited in the DROS Fund. The monies are then appropriated by the Legislature for expenditure by the Department.

As authorized by Penal Code section 28233, the DROS Fee will pay for the costs of operating, in whole or in part, the firearms-related programs listed below.

**TABLE 2: PROGRAMS FUNDED BY THE DROS FEE**

<b>Program</b>	<b>Penal Code Statutes Implemented</b>
Automated Firearms Systems Unit*	18100, 30000
Armed & Prohibited Persons Section*	30000
Phone Resolution Unit	28220

Law Enforcement Release Unit*	33850, excepting those activities specified in section 33860
Carry Concealed Weapon Permits Unit*	26175, excepting those activities specified in section 26190
Background Clearance Unit	28220
Training, Information and Compliance Section*	Chapter 2, excepting those activities specified in section 26720
Customer Support Center	28215
Reporting and Quality Assurance Section	28215
Administration and Special Projects Section*	Penal Code, Part 6, Title 4

**NOTE: An asterisk (\*) indicates that the program is not wholly funded through DROS Fee revenue. Certain functions of specified programs are funded through separate fee and General Fund monies, as specified in statute.**

These programs largely concern background checks on potential firearms purchasers or transferees. A firearm dealer must submit to the Department certain identifying information for every potential firearm purchaser or transferee. (Pen. Code, §§ 28100-28490.) As required by Penal Code section 28220, the Department then examines available records to determine whether the potential purchaser or transferee is prohibited by state or federal law from possessing, receiving, owning or purchasing a firearm. If the Department determines that the purchaser is prohibited by state or federal law from possessing, receiving, owning, or purchasing a firearm (e.g., convicted felons; persons found to be a danger to self or others because of a mental illness; persons addicted to the use of narcotics; et cetera), the Department immediately notifies the dealer and the sale is denied.

More specifically, the Background Clearance Unit examines available records concerning the potential purchaser or transferee, and determines whether the individual is prohibited. The Phone Resolution Unit tracks down information that is not immediately available, such as incomplete court records. The Reporting and Quality Assurance Section reviews DROS records and determinations for accuracy. The Customer Support Center answers questions from dealers as to how to complete the Dealer Record of Sale. The Automated Firearms System Unit maintains the Automated Firearms System, a repository of firearm records maintained by the Department. The Armed and Prohibited Persons Section matches records of persons who own or possess a firearm (usually subsequent to a DROS transaction) with evidence that the person may be newly prohibited (e.g., a restraining order). Each of these activities is necessary to the process of ensuring that prohibited persons are not allowed to purchase or possess a firearm.

In recent years, the Department significantly reduced its firearms-related program activities and expenditures in order to operate within the available DROS Fund revenues, which are well below the appropriation levels established by the Legislature for these critical public safety firearms programs. For example, the Bureau of Firearms has maintained only baseline program functionalities with an average personnel vacancy rate of 18 percent over the last three years; has postponed significant facility infrastructure

projects; and has delayed necessary information technology refreshes in order to maintain solvency in the DROS Fund. The Department anticipates that the cost to refresh and rebuild its aging information technology (IT) systems will total approximately \$2,352,000 for planning and other initial costs, and then \$8,275,000 annually for a five-year period.

**Table 3** (below) shows a side-by-side comparison of projected DROS Fund revenues and estimated expenditures by the Department from the DROS Fund. DROS Fee revenue projections for each fiscal year are taken from Table 1.

The second row shows all other sources of revenue that are also deposited into the DROS Fund, such as other fees, transfers and other adjustments. Notably absent is the required repayment of two loans to the DROS Fund from the Firearms Safety and Enforcement Fund, totaling \$5,844,000 which are scheduled to be repaid by FY 2024-25.

The first and second rows, combined, make up the total projected DROS Fund Revenue for Fiscal Years 2020-21 through 2022-23.

Departmental expenditures include its appropriation for salaries and benefits, operating expenses and equipment; a supplemental pension loan repayment of \$666,000; a Pro Rata cost of \$819,000 (which increases to \$1,226,000 in 2020-21), and the anticipated cost to refresh and rebuild legacy firearms IT systems.

The third row shows DROS Fund appropriations, which are expended by the Department for salaries and benefits, operating expenses and equipment. Historically, due to insufficient fee revenues, appropriations from the DROS Fund have exceeded DROS Fund revenues, resulting in an operational deficit. Until now, the shortfall has been offset by spending down the fund balance, shifting Departmental resources from other Departmental priorities, and holding critical positions vacant.

The pension loan repayment is a result of the 2017-18 budget package (Chapter 50 [SB 84, Committee on Budget and Fiscal Review]) was approved as part of the Governor's May Revision proposal. The state borrowed \$6 billion from the Pooled Money Investment Account to make a one-time supplemental payment to the California Public Employees' Retirement System. All funds that make pension payments, including the General Fund and most other state funds, must repay the loan over the next decade. While the General Fund started repaying the loan in 2017-18, other funds (i.e., the DROS Fund) began payments in 2018-19.

The Pro Rata cost is the cost of central service agencies, such as the Department of Finance, the State Treasurer, the State Controller, and the Legislature for providing budgeting, banking, accounting, auditing, payroll, and other services to all state departments. The Pro Rata process apportions the costs of providing central administrative services to all state departments and funding sources that benefit from the services. Amounts apportioned to special funds (i.e. the DROS Fund) for their fair share

of central administrative services costs are transferred from the special funds to the General Fund and the Central Service Cost Recovery Fund.

The Department is currently in the beginning stages of refreshing and rebuilding its firearms information technology (IT) systems. Since 1980, the Department has built and maintained numerous firearms IT systems in order to comply with various legislative mandates. Over the past 40 years, the systems have become outdated, and have effectively reached the end of their life. It is no longer efficient to make modifications to the current systems each year in response to new legislative requirements. In response, the Department has been working towards a system refresh and rebuild, which will modernize its firearms IT systems into one cohesive unit that is adaptable to future needs. This modernization is projected to cost approximately \$40,000,000, and will last at least five years. As the project progresses, the Department will have a better estimate of its expenditures, and can readjust the fee as necessary.

**TABLE 3: EXPENDITURES (Projected)\***

	<b>FY 20-21 (Projected)</b>	<b>FY 21-22 (Projected)</b>	<b>FY 22-23 (Projected)</b>
<b>(+) DROS Fund Revenue from \$19/\$31.19 DROS Fee</b>	\$31,557,356	\$22,781,488	\$22,781,488
<b>(+) DROS Fund Revenue from other sources including transfers &amp; other adjustments</b>	\$5,768,083	\$6,557,485	\$6,557,485
<b>(-) DROS Appropriation</b>	\$27,300,000	\$23,223,000	\$21,697,000
<b>(-) Pension Loan Repayment &amp; Pro Rata</b>	\$1,892,000	\$1,281,000	\$1,281,000
<b>(-) Firearms IT System Modernization</b>	\$2,352,000	\$8,275,000	\$8,275,000
<b>Surplus (Deficit)</b>	\$5,781,439	<b>(\$3,440,027)</b>	<b>(\$1,914,027)</b>

**\* Does not include repayment of \$5,844,000 in loans from the Firearms Safety and Enforcement Fund anticipated to occur in Fiscal Year 2024-25.**

**DROS Fund Deficit**

Although the DROS Fund experienced an unexpected increase in revenue for FY 2020-21, The Department estimates that , with a return to normal firearm sales volume and the addition of the Firearms IT System Modernization costs, the Fund will experience a deficit of \$3,440,027 in FY 2021-22, and \$1,914,027 in FY 2022-23 and thereafter. These estimates do not factor additional chaptered legislation that may further impact the



DROS expenditures, as new and expanded responsibilities are added to the DROS program.

If, instead, the DROS Fee decreases to \$0, due to lack of authority to collect the \$31.19 fee, the Department estimates that the DROS Fund will have a deficit of over \$31,544,000 for FY 2020-21, \$32,779,000 for FY 2021-22, and \$31,253,000 for FY 2022-23 and each fiscal year thereafter (see **Table 4**, below).

**TABLE 4: DEFICIT WITH A \$0 DROS FEE (Projected)**

	<b>FY 20-21 (Projected)</b>	<b>FY 21-22 (Projected)</b>	<b>FY 22-23 (Projected)</b>
<b>Deficit</b>	<b>(\$31,544,000)</b>	<b>(\$32,779,000)</b>	<b>(\$31,253,000)</b>