

State of California Department of Justice  
Bureau of Firearms

# Standardized Regulatory Impact Assessment: New Dealer Record of Sale (DROS) Fee

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## **Section 1 Introduction**

Among other responsibilities, the California Department of Justice (“the Department”) performs regulatory and enforcement activities related to the sale, purchase, possession, loan, or transfer of firearms pursuant to any provision listed in Penal Code section 16580. These regulatory and enforcement activities have primarily been funded by a fee that is paid at the initiation of a purchase or transfer of one or more firearms through a licensed firearms dealer. Licensed firearms dealers are required by law to complete a Dealer Record of Sale (DROS) for each sale or transfer of a firearm. Because the fee that funds the Department’s firearms-related regulatory and enforcement activities is the principal fee charged at the time of each DROS transaction, the Department has labeled this fee the “DROS Fee.”

Until January 1, 2020, the DROS Fee was primarily authorized by Penal Code section 28225, which allowed the fee to be set at any amount not to exceed \$14, except that the fee may have been increased at a rate not to exceed any increase in the California Consumer Price Index. In 2004 the Department raised the fee to \$19 by promulgating Title 11, section 4001 of the California Code of Regulations (CCR) (Section 4001), pursuant to the conditions of the authorizing statute.

Assembly Bill (AB) 1669 (Stats 2019, ch. 736), effective January 1, 2020, decreased the fee authorized by Penal Code section 28225 to a maximum of \$1, and removed the authority to use that \$1 fee to fund regulatory and enforcement activities related to the sale, purchase, possession, loan or transfer of firearms. AB 1669 added a new section to the Penal Code, section 28233, which authorizes a new \$31.19 fee to offset the reasonable costs of firearms-related regulatory and enforcement activities related to the sale, purchase, manufacturing, lawful or unlawful possession, loan, or transfer of firearms pursuant to any provision listed in Section 16580. In effect, the Legislature replaced the previous DROS Fee with a new \$31.19 DROS Fee.<sup>1</sup>

The Department implemented this new \$31.19 fee by amending Section 4001 in an emergency rulemaking that went into effect on January 1, 2020. This rulemaking proposes to make permanent, with changes, that emergency regulation.

### **Section 1.1 Major Regulation Determination**

Any proposed rulemaking action adopting, amending or repealing a regulation subject to review by the Office of Administrative Law is determined to be a “major” regulation if it has an economic impact on California business enterprises and individuals in an amount exceeding fifty

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<sup>1</sup> Imposition of this new \$31.19 DROS Fee was left to the discretion of the Department, but that discretion was not extended to setting the fee below \$31.19.

million dollars (\$50,000,000) in any 12-month period between the date the major regulation is estimated to be filed with the Secretary of State through 12 months after the major regulation is estimated to be fully implemented (as estimated by the agency).

The Department estimates that the proposed regulation will be filed and become fully implemented on January 1, 2022. The 12-month period in which the economic impact of the proposed regulation may result in an economic impact in an amount exceeding fifty million dollars (\$50,000,000) is defined as January 2022 – December 2022.

The Department estimates that the collection of the new \$31.19 DROS Fee may result in a combined direct, indirect and induced economic impact of \$109,645,866 in the 12 months after the major regulation is estimated to be fully implemented.

## **Section 1.2**

### **Methods by Which the Department Sought Public Input**

As part of the rulemaking process, and in keeping with state law, the Department directly sought public input from stakeholders who have requested to be kept informed of the Department's firearms-related regulations, and through the general solicitation of public comments, pursuant to the emergency rulemaking process in December 2019, a re-adoption of the emergency rulemaking in October 2020, a 45-day Certificate of Compliance public comment period in January 2021, and a second emergency re-adoption in May 2021. The Department received a total of 20 comments during these comment periods.

## **Section 2 Economic Impact of the Proposed Regulation**

### **Section 2.1 Economic Impact Method and Approach**

The direct economic impact of the proposed regulation is the total amount of fees anticipated to be collected in the 12 months after the major regulation is estimated to be fully implemented. Additionally, due to the price elasticity of demand, the Department anticipates a possible decrease in demand for handguns<sup>2</sup> as the price of each handgun purchased in California would effectively increase by \$31.19 over the baseline.

The Department used the 2021 Regional Input-Output Modeling System (RIMS II) to objectively assess the potential indirect or induced economic impacts of the proposed fee. The RIMS II uses multipliers to estimate the spin-off activity generated in other parts of the economy resulting from direct changes in the various industries. The RIMS II multipliers used in this analysis estimate the possible indirect and induced effects of the proposed regulatory effect on retail firearms sales, approximated in the RIMS II as “general merchandise.”

### **Section 2.2 Description of Regulatory Baseline**

The Department compared regulatory alternatives with a baseline that reflects the anticipated behavior of individuals and businesses in the absence of the proposed major regulation. Typically, when a state agency proposes an increase to a regulatory fee, the baseline is the existing regulatory fee. But when authorizing a new \$31.19 DROS Fee in Penal Code section 28233, AB 1669 removed the authority to implement the \$19 DROS Fee from Penal Code section 28225. Therefore, in the absence of the proposed regulation implementing the \$31.19 DROS Fee, the Department would no longer collect the \$19 DROS Fee.

The baseline against which the Department has compared the economic impact of this proposal is \$0.00.

### **Section 2.3 Categories of Individuals and Business Enterprises Affected**

Proposed Section 4001 would impose a fee that is paid at the initiation of a purchase of one or more firearms through a licensed firearms dealer. The specific categories of individuals and business enterprises affected by the proposed major regulation include firearm purchasers, who would pay the DROS Fee, and licensed firearms dealers, who would collect the DROS Fee and

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<sup>2</sup> As discussed in section 2.5.2, the Department is able to project the economic impact on handgun sales, but lacks any basis to extend its projection to all firearm sales.

remit it to the Department. Per Penal Code section 28200, “purchaser” means the purchaser or transferee of a firearm or the person being loaned a firearm. The term “purchaser” is used in this manner throughout this document.

The proposed regulation would impose the DROS Fee on all firearm purchasers equally. This equality of treatment may result in a disparate impact, as purchasers with lower incomes may experience more of an impact on their disposable income due to the \$31.19 fee, while purchasers with higher incomes may experience less of an impact.

The proposed regulation would be collected by all licensed firearms dealers equally. However, as discussed in Section 2.5.2, the \$31.19 increase in the price of a handgun may lead to a decrease in sales. The Department’s equality of treatment may result in a disparate impact, as smaller firearms dealers may experience a higher proportional impact on their profits due to the \$31.19 fee, while larger firearms dealers may experience less of an impact. According to the Department’s records, as of May 12, 2021 there were 1,640 licensed firearms dealers in California. This number changes daily, as new licenses are approved and old licenses expire. Although the Department does not have direct information regarding the business 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 1,360 licensed firearms dealers are “small businesses.” This is approximately 83 percent of all licensed firearms dealers that may experience an impact that, due to the potential price elasticity of demand, is relatively larger than that experienced by the 280 larger firearms dealers.

## **Section 2.4**

### **Impacts on California Consumers: Firearm Purchasers**

The direct economic impact of the proposed fee is equal to the amount of fee revenue the Department expects to collect. Table 1 shows revenue the Department has previously collected from the DROS Fee, for context, and the projected revenue that the Department anticipates will result from the adoption of the new fee.

As discussed above, the 12-month period in which the Department has determined that the proposed regulation may result in an economic impact in an amount exceeding fifty million dollars (\$50,000,000) is defined as January 2022 – December 2022. However, for budgetary purposes, the Department regularly projects the number of DROS transactions in fiscal years, not calendar years. To provide a more sensitive projection of DROS transaction trends, the Department produces these projections in half-year periods, and then aggregates the half-year projections to produce projections for each fiscal year.

The first row of Table 1 shows the total number of actual and projected DROS transactions each fiscal year through fiscal year 2022-23. The Department's projection for the current fiscal year, fiscal year 2020-21, was developed using the number of actual DROS transactions from July 2020 through April 2021.<sup>3</sup> According to the Department's records, there were a total of 1,057,687 DROS transactions during that period. The average number of DROS transactions each month was 105,769 ( $1,057,687/10$  months = 105,769 per month). Assuming there will be an additional 100,000 (rounded from 105,769) DROS transactions in each of the remaining two months of fiscal year 2020-21, the Department projects a total of 1,257,768 DROS transactions ( $1,057,687 + 200,000$ ) in fiscal year 2020-21.

In order to project DROS totals for fiscal year 2021-22, the Department used the same average of approximately 100,000 DROS transactions per month for July through December 2021, for a total of 600,000. The Department based its projections for January 2022 through June 2022 on a separate set of variables. By January 2022, the Department anticipates that the factors that resulted in the increase in firearm sales in calendar years 2020 and 2021 will begin to abate, and the anticipated number of DROS transactions will revert to the mean. For the months of January through June 2022, the Department projects that the number of DROS transactions will approximate the average number of monthly DROS transactions during the period of January through June in each of calendar years 2017, 2018 and 2019. (The Department excluded calendar year 2020 in this calculation due to the extraordinary increase in DROS transactions in that year.) The average number of monthly DROS transactions in the period of January through June of each of calendar years 2017, 2018 and 2019 was approximately 70,000 DROS transactions each month. For the period of January through June of calendar year 2022 – the second half of fiscal year 2021-22 – the Department projects a total of 420,000 DROS transactions. The total number of DROS transactions projected for fiscal year 2021-22 is 1,020,000 ( $600,000 + 420,000$ ).

In order to project DROS totals for fiscal year 2022-23, the Department employed a similar calculation. For the months of July through December 2022, the Department calculated the average number of monthly DROS transactions during the period of July through December in each of calendar years 2017, 2018 and 2019. The average number of monthly DROS transactions in the period of July through December of each of calendar years 2017, 2018 and 2019 was approximately 67,000 DROS transactions each month. For the period of July through December of calendar year 2022 – the first half of fiscal year 2022-23 – the Department projects a total of 402,000 DROS transactions. As with fiscal year 2021-22, for the months of January through June 2023, the Department projects that the number of DROS transactions will approximate the average number of monthly DROS transactions during the period of January through June in each of calendar years 2017, 2018 and 2019 (420,000). The total number of DROS transactions projected for fiscal year 2022-23 would thus be 822,000 ( $402,000 + 420,000$ ). However, the Department anticipates an increase of approximately 10 percent over the historical numbers to account for statewide elections, responses to state and national firearms legislation, social unrest and a continuation of the effects of the pandemic. The Department's final projection for fiscal year 2022-23 is 904,200 DROS transactions.

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<sup>3</sup> This Standard Regulatory Impact Analysis was drafted in May 2021.

The second row of Table 1 shows the number of actual and projected billable DROS transactions each fiscal year. Per Penal Code section 28240, for a single 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. Billable DROS transactions have been approximately 87 percent of total DROS transactions over the last 3 years, and this percentage has been applied to the projected total DROS transactions to estimate billable DROS transactions in fiscal year 2020-21 and each fiscal year thereafter.

The third row of Table 1 shows the amount of actual and projected DROS Fee revenue, calculated by multiplying the number of billable DROS by the DROS Fee actually or projected to be in effect at that time. For fiscal years 2017-18 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, and an emergency regulation implementing the new \$31.19 DROS Fee was implemented on that date, the projection for FY 2019-20 includes half of a year's worth of billable DROS transactions at the \$19 fee level (July 1 – December 31, 2019) and half of a year's worth of billable DROS transactions at the \$31.19 fee level (January 1, 2020 – June 30, 2020). 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</b> | <b>FY 20-21<br/>Projected</b> | <b>FY 21-22<br/>Projected</b> | <b>FY 22-23<br/>Projected</b> |
|------------------------------------|-----------------|-----------------|-----------------|-------------------------------|-------------------------------|-------------------------------|
| Total DROS Transactions            | 857,536         | 789,540         | 956,551         | 1,257,687                     | 1,020,000                     | 904,200                       |
| Billable DROS Transactions         | 752,302         | 683,380         | 834,691         | 1,094,188                     | 887,400                       | 786,654                       |
| Revenue from \$19/\$31.19 DROS Fee | \$14,293,738    | \$12,984,220    | \$17,740,933    | \$34,127,724                  | \$27,678,006                  | \$24,535,738                  |

The 12-month period in which the economic impact of the proposed regulation could potentially exceed \$50 million is defined as January 2022 – December 2022. By adding the number of projected DROS transactions in the second half of fiscal year 2021-22 (420,000 DROS transactions) with those in the first half of fiscal year 2022-23 (402,000 x 10% = 442,200 DROS transactions), the Department projects that for calendar year 2022, there will be 862,200 total DROS transactions. If the number of billable DROS transactions continues to be 87 percent of total DROS transactions, the Department estimates that there will be 750,114 billable DROS transactions in calendar year 2022. At \$31.19 each, the Department anticipates collecting a revenue of \$23,396,056 in the 12 months following the date the Department anticipates the regulation will be fully implemented.

This anticipated revenue to the Department of \$23,396,056 is a direct economic loss by firearms purchasers.

The potential loss of over \$23 million by firearms purchasers would likely have indirect and induced impacts on the broader economy, as firearms purchasers might have expended those funds elsewhere throughout the state. The Department used the RIMS II to objectively assess the potential indirect and induced economic impacts of the proposed fee. The RIMS II uses multipliers to estimate this spin-off activity generated in other parts of the economy resulting from direct changes in the affected industry. The Department used the RIMS II multiplier of 2.011 for the Final-demand Output of economic impacts to general merchandise stores (the closest approximation of retail firearms dealers) to estimate that the potential direct, indirect and induced impact of this potential loss of funds to firearm purchasers due to the collection of the fee would be \$47,049,469.

## **Section 2.5**

### **Impacts on California Businesses: Licensed Firearms Dealers**

The proposed regulation would require licensed firearms dealers to collect a \$31.19 DROS Fee at the initiation of a purchase of one or more firearms, and remit those monies to the Department. The Department has determined that the proposed fee may have an economic impact on those licensed firearms dealers.

#### **Section 2.5.1**

##### **Compliance Costs for Dealers**

Proposed Section 4001 would require licensed firearms dealers to collect a DROS Fee of \$31.19 from each firearm purchaser, 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), the electronic system through which firearm purchaser information is communicated to the Department, and the means by which fees are remitted. A change in the amount of the DROS Fee collected via DES would have no direct impact on the activity of licensed firearms dealers.

#### **Section 2.5.2**

##### **Price Elasticity of Demand for Handguns**

The proposed action may have an economic impact that indirectly affects business, in a potential \$31,127,000 (\$31 million) 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, would be increased to \$31.19, from a baseline of \$0. An often-cited article 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). This is an example of the price elasticity of demand, which Bice and Hemley explain thus:

The law of demand implies an inverse relationship between the price of new handguns and the quantity of handguns demanded. Thus, an increase in the relative price of handguns is predicted to decrease the quantity demanded, *ceteris paribus* (p. 253).

The Department estimates the average price of a handgun to be approximately \$500 (Aught 2013, Sportsman's Outdoor Superstore 2020, Willis 2018). The new \$31.19 fee is approximately six percent of the average cost of a handgun (\$500) and may result in a 15 percent decrease in quantity of handguns demanded. This relationship was observed in the market for handguns specifically. The Department's DROS records differentiate between long guns (e.g., shotguns, rifles, etc.) and handguns. According to the Department's DROS records, in calendar year 2019 there were 415,025 handguns sold in the State of California. A 15 percent decrease in demand for handguns would result in 62,254 fewer handguns sold in California each year. Given the average price of a handgun, this amounts to a \$31,127,000 loss in handgun sales statewide.

The price elasticity of demand for handguns observed by Bice and Hemley did not extend to long guns (rifles and shotguns). As Bice and Hemley note, self-protection is an important motivation for both handgun and shotgun purchases, and the two may be viewed by consumers as substitutes (p. 253). By contrast, during the timeframe analyzed by Bice and Hemley, rifles were used for self-protection relatively rarely (see Kleck and Gertz 1995, p. 185). Because the markets for handguns and long guns are not necessarily similar, and because the article cited above regarding the price elasticity of demand does not extend to long guns, the Department has determined that it lacks sufficient evidence to extend the observed price elasticity of demand for handguns to long guns.

The potential loss of \$31 million to licensed firearms dealers statewide due to lost handgun sales would likely have additional indirect and induced impacts on the broader economy, as firearms dealers might have expended that lost revenue throughout the state. The Department used the RIMS II multiplier of 2.011 for the Final-demand Output multiplier for general merchandise stores to estimate that the total direct, indirect and induced impact of this potential loss of sales would be \$62,596,397.

The Department has reason to believe that this estimate reflects a potential maximum impact of the new \$31.19 DROS Fee to the economy due to decreased handgun sales, but that the actual impact would be significantly less. In the absence of other evidence, the Department presents the abovementioned economic impact as the best possible estimate at this time.

### **Section 2.5.3**

#### **Uncertainty Regarding the Price Elasticity of Demand for Handguns**

The Department has reason to doubt that the economic model presented by Bice and Hemley accurately represents the price elasticity of demand for handguns. The Department was unable to find other economic analyses of the price elasticity of demand for firearms, a dearth of economic analysis that Bice and Hemley acknowledge (p. 251). Moreover, the sales data analyzed by Bice and Hemley is now 30 years old (1961-1994). According to a PEW Research Center survey in 2013, during the 20 years immediately following the data that Bice and Hemley cite, there was a significant shift in the reasons why Americans report owning a firearm (Goo 2013). From 1999 to 2013, “hunting” decreased from 49 to 32 percent, while “protection” increased from 26 to 48 percent. This time period roughly coincides with the “explosive growth in popularity of AR-15s,” a type of long gun (Haar 2013) and the “militarization” of the firearms market (Violence Policy Center 2011). The market for handguns has changed significantly since the data analyzed by Bice and Hemley, and the Department lacks confidence that the relationship of price and demand for handguns in their article reflects current market forces. More recent analysis by the RAND Corporation on the effect of taxation on demand for firearms suggests that “research has faced insufficient variation to empirically estimate the price responsiveness of participants in gun markets.” (Smart 2021).

The Department’s experience with implementing the new DROS Fee provides further basis for questioning the effect described by Bice and Hemley. The Department implemented the \$31.19 DROS Fee, via emergency action, on January 1, 2020. Rather than a decrease in sales, over the subsequent 12 months the Department recorded an increase in DROS transactions of 58 percent over the number of transactions in 2019, one of the sharpest increases on record (from 783,860 in 2019 to 1,238,061 in 2020). It is possible that, without the \$31.19 DROS Fee, DROS transactions would have increased even more sharply. However, news accounts of the change in firearms sales do not mention a possible 15 percent decrease in sales, which should have been noticeable. Instead, news accounts of the increase in firearms purchased in 2020 mention the COVID-19 pandemic; the quadrennial presidential election; and widespread protests regarding social justice and dissatisfaction with government (Cabanatuan 2020; Linthicum 2020; see also Kravitz-Wirtz 2020). But the Department has found no evidence to support the conclusion of a possible decrease in sales of handguns, especially considering the magnitude predicted by the economic model of Bice and Hemley.

Although the Department has reason to doubt the precise relationship between price and the demand for handguns found by Bice and Hemley, it is likely that there is some effect of price on demand. In the absence of any other basis for making this calculation, the Department has included the estimate generated by following Bice and Hemley’s model in its calculation, as a potential maximum limit of the indirect economic impact of the proposed regulation on firearm sales.

### **Section 3**

#### **Changes to California Businesses Due to Implementation of the DROS Fee**

#### **Section 3.1**

##### **Creation or Elimination of Jobs within the State**

Due to the price elasticity of demand, the Department anticipates that the proposed fee may result in a loss of firearm sales by licensed firearms dealers in California of approximately \$31,127,000. With a RIMS II multiplier for the Final-demand employment for general merchandise stores of 18.1076 jobs per million dollars, the Department anticipates a possible elimination of 564 jobs in the first year of full implementation.

The Department does not anticipate that any jobs will be created due to this regulation being implemented.

#### **Section 3.2**

##### **Competitive Advantages or Disadvantages to California Businesses**

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. (18 U.S.C. § 922(b)(3) and 27 CFR § 478.99(a)); see also Pen. Code, § 27585). It would be unlawful for a resident of California to purchase a firearm in another state 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 statutory constraints, the Department does not anticipate that the new fee will put California businesses at a competitive disadvantage compared to businesses in other states.

#### **Section 3.3**

##### **Creation of New Businesses or the Elimination of Existing Businesses**

Due to the price elasticity of demand, the Department anticipates that the proposed fee may result in a loss of firearm sales by licensed firearms dealers in California of approximately \$31,127,000. However, the Department does not anticipate that this potential loss of sales will result in the elimination of existing businesses in the state.

The firearm industry trade association, the National Shooting Sports Foundation, releases a yearly *Firearm and Ammunition Industry Economic Impact Report (Economic Impact Report)*. The *Economic Impact Report* for 2021 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." According to the Department's records, DROS transactions have increased by 62 percent in the past 10 years, from 483,872 in 2009 to 783,860 in 2019. In 2020 alone, there was an increase of 58 percent

over the previous year (from 783,860 in 2019 to 1,238,061 in 2020) although the Department does not anticipate that this increase in sales will extend beyond that fiscal year. Due to these factors, the Department does not anticipate that the new fee will lead to the elimination of existing businesses.

The Department does not anticipate the creation of businesses due to the proposed fee.

### **Section 3.4 Increase or Decrease of Investment in the State**

Due to the price elasticity of demand, the Department anticipates that the proposed fee may result in a loss of firearm sales by licensed firearms dealers in California of approximately \$31,127,000. With a RIMS II multiplier for the Final-demand Value Added for general merchandise stores of 1.2237, the Department anticipates a possible decrease in investment in the state of \$38,090,110 in the first year of full implementation.

The Department does not anticipate an increase in investment due to the proposed fee.

### **Section 3.5 Incentives for Innovation in Products, Materials or Processes**

The Department does not anticipate that the new fee will result in incentives for innovation in products, materials, or processes.

## **Section 4**

### **Fiscal Impact to Local and State Government**

The Department has determined that the proposed fee would have a fiscal impact on state and local government.

#### **4.1**

##### **Fiscal Impact on Local Government**

The proposed fee does not mandate a new program or higher level of service on any local government. Also, the proposed fee does not apply to local government purchases of firearms for law enforcement purposes.

However, due to the price elasticity of demand, the Department anticipates that the proposed fee may result in a loss of firearm sales by licensed firearms dealers in California of approximately \$31,127,000. Local sales taxes, which vary by locality, would be affected by the decrease in firearm sales in those localities. The state imposes a mandatory local rate of 1.25 percent, and many local governments impose an additional rate from 0.15 percent to 3 percent. The Department estimates the average additional amount of sales tax in all cities in California is approximately 1 percent, for a total of 2.25 percent in sales taxes remitted to local governments. A statewide decrease in retail firearm sales of \$31,127,000 would result in \$700,358 less in sales tax revenue remitted to local governments in the first year of full implementation of the proposed regulation.

#### **4.2**

##### **Fiscal Impact on State Government**

The Department has determined that the proposed fee would have a fiscal impact on state government.

Due to the price elasticity of demand, the Department anticipates that the proposed fee may result in a loss of firearm sales by licensed firearms dealers in California of approximately \$31,127,000. The base state sales tax is 6 percent. Due to the potential decrease of retail firearm sales, the Department anticipates a decrease in state sales tax collected, in the amount of \$1,867,620 in the first year of full implementation of the proposed regulation.

The Department projects that the proposed fee will also have a direct impact on revenue collected and deposited into the Dealers' Record of Sale Special Account of the General Fund ("DRoS Fund"). These monies are appropriated by the Legislature for expenditure by the Department as specified by the authorizing statute.

## DROS Fee Expenditures

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 Team*              | 18100, 30000   |
| Armed & Prohibited Persons Unit*              | 30000  |
| Phone Resolution Team                         | 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  |
| Quality Assurance Unit                        | 28215  |
| Administration and Special Projects Unit*     | 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. A firearm dealer must submit to the Department certain identifying information for every potential firearm purchaser. (Pen. Code, §§ 28100-28490.) As required by Penal Code section 28220, the Department then examines available records to determine whether the potential purchaser 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; etc.), the Department immediately notifies the dealer and the sale is denied.

More specifically, in the Bureau of Firearms, the Background Clearance Unit examines available records concerning the potential purchaser, and determines whether the individual is prohibited. The Phone Resolution Team pursues information that is not immediately available, such as incomplete court records. The Quality Assurance Unit reviews DROS records and firearm background determinations for accuracy. The Customer Support Center answers questions from dealers regarding the completion of the Dealer Record of Sale. The Automated Firearms System Team maintains the Automated Firearms System, a repository of firearm records maintained by the Department. The Armed and Prohibited Persons Unit 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 regulatory and enforcement activities and expenditures in order to operate within the available DROS Fee 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 the Department has delayed necessary firearms-related information technology (IT) refreshes in order to maintain solvency in the DROS Fund. Although the Department is in the early stages of its anticipated Firearms Modernization Project, the Department projects that the cost to refresh and rebuild its aging IT systems will total \$2,352,000 for the initial assessment and planning, and then \$8,275,000 annually for a five-year period.

**Table 3** shows a side-by-side comparison of projected DROS Fee revenues and estimated expenditures by the Department from the DROS Fund. As noted above, although a sharp increase in firearm sales in the year 2020 has led to greater than anticipated revenue for fiscal year 2020-21, the Department does not anticipate that this increase in sales will extend beyond that fiscal year.

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 fiscal year 2024-25.

The first and second rows, combined, make up the total projected DROS Fee 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 estimated cost of the initial assessment and planning phase of the Firearms Modernization Project.

The third row shows anticipated DROS Fund appropriations, per the 2021-22 Governor's Budget, 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]), which 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 in the process of planning and analyzing the necessary efforts for the Firearms Modernization Project. 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 to address these needs through a proposed system refresh and rebuild, to modernize its firearms IT systems into one cohesive unit that will be adaptable to future needs. This modernization is projected to cost approximately \$43,727,000, and is anticipated to last at least five years.

**TABLE 3: EXPENDITURES (Projected) with a \$31.19 DROS Fee\***

|   | <b>FY 20-21<br/>(Projected)</b> | <b>FY 21-22<br/>(Projected)</b> | <b>FY 22-23<br/>(Projected)</b> |
|---|---------------------------------|---------------------------------|---------------------------------|
| <b>(+) DROS Fund Revenue from \$31.19 DROS Fee</b>  | \$34,127,724                    | \$27,678,006                    | \$24,535,738                    |
| <b>(+) DROS Fund Revenue from other sources including transfers &amp; other adjustments</b> | \$6,074,502                     | \$6,257,746                     | \$6,507,721                     |
| <b>(-) DROS Appropriation</b>   | <b>(\$25,721,000)</b>           | <b>(\$24,350,000)</b>           | <b>(\$23,688,000)</b>           |
| <b>(-) Pension Loan Repayment &amp; Pro Rata</b>  | <b>(\$1,892,000)</b>            | <b>(\$1,281,000)</b>            | <b>(\$1,281,000)</b>            |
| <b>(-) Firearms IT System Modernization</b>   | <b>(\$2,352,000)</b>            | <b>(\$8,275,000)</b>            | <b>(\$8,275,000)</b>            |
| <b>Surplus (Deficit)</b>  | \$10,237,226                    | \$29,752                        | <b>(\$2,200,541)</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.**

Historically, due to insufficient fee revenues, appropriations from the DROS Fund have exceeded DROS Fund revenues, resulting in an operational deficit. To compensate for this deficit, the Department has borrowed \$5,844,000 in loans from the Firearms Safety and Enforcement Fund. The extraordinary increase in firearm sales in fiscal year 2020-21, the effects of which are projected to carry into fiscal year 2021-22, has resulted in a significant but temporary increase in DROS Fee revenue. For fiscal years 2020-21 and 2021-22, the Department will allow for the Dealers' Record of Sale (DROS) Special Account of the General

Fund (DROS Fund) to accumulate sufficient funds to repay the loan to the Firearms Safety and Enforcement Fund and to build a reserve for economic uncertainties created by fluctuations in DROS volume.

The Department has experienced a higher than anticipated number of DROS transactions the past several months. DROS fund revenue is projected to significantly exceed expenditures in fiscal year 2020-21. But the Department anticipates that the number of DROS transactions will level off in future years. The Department projects that billable DROS transactions will decrease 19 percent in fiscal year 2021-22, and a further 11 percent in fiscal year 2022-23. To the extent funding is available, the Department will seek to fill all of its current vacant positions, and will submit a request for spending authority to hire additional staff.

## **Section 5**

### **Benefits of the Proposed Regulation**

The Department anticipates the following benefits due to the proposed regulation.

#### **Section 5.1**

##### **Fiscal Impact to State Government Attributable to the Proposed Regulation**

The Department anticipates collecting revenue in the amount of \$23,396,056 in the 12 months following the date the Department anticipates the regulation will be fully implemented (see Section 2.4).

#### **Section 5.2**

##### **Public Safety**

The revenue collected from the DROS Fee will fund the Department's public safety efforts. Specifically, the revenue will provide a consistent revenue stream for the Department's firearms-related regulatory and enforcement activities related to the sale, purchase, manufacture, possession, loan, or transfer of firearms pursuant to any provision listed in Section 16580.

Activities related to checking the background of potential firearm purchasers protects 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 Firearms System and certain aspects of the Armed Prohibited Persons System, 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.

**Section 6**  
**Economic Impacts of the Regulatory Alternatives**

The Department considered three alternatives to the proposed regulation.

**Section 6.1**

**Alternative 1: No DROS Fee**

Although Penal Code section 28233 grants the Department the authority to require a dealer to charge each firearm purchaser a fee in the amount of \$31.19, the Department may exercise its discretion to not implement this fee. All projected economic impact to the state as a result of the DROS Fee would be eliminated if the fee was not implemented. The Department received several public comments that suggested this alternative.

If the Department were to implement Alternative 1, all revenue in fiscal year 2021-22 would be collected in the first half of that fiscal year, the period of July through December 2021. As explained in Section 2.4, to project DROS totals for fiscal year 2021-22, the Department projects 100,000 DROS transactions per month for July through December 2021, for a total of 600,000. If the number of billable DROS transactions continues to be 87 percent of total DROS transactions, the Department estimates that there will be 522,000 billable DROS transactions in the period of July through December 2021. At \$31.19 each, the Department would collect a revenue of \$16,281,180 in the first half of fiscal year 2021-22, and no revenue in the second half of that fiscal year.

If the DROS Fee were to not be implemented as proposed on January 1, 2022, the Department estimates a deficit of \$11,367,074 in fiscal year 2021-22, and \$26,736,279 each fiscal year thereafter (see Table 4).

**TABLE 4: DROS Fund Projections with \$0 DROS Fee As Of January 1, 2022**

|   | <b>FY 20-21<br/>(Projected)</b> | <b>FY 21-22<br/>(Projected)</b> | <b>FY 22-23<br/>(Projected)</b> |
|---|---------------------------------|---------------------------------|---------------------------------|
| <b>(+) DROS Fund Revenue</b>  | \$34,127,724                    | \$16,281,180                    | \$0                             |
| <b>(+) DROS Fund Revenue from other sources including transfers &amp; other adjustments</b> | \$6,074,502                     | \$6,257,746                     | \$6,507,721                     |
| <b>(-) DROS Appropriation</b>   | (\$25,721,000)                  | (\$24,350,000)                  | (\$23,688,000)                  |
| <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>  | \$10,237,226                    | (\$11,367,074)                  | (\$26,736,279)                  |

The 12-month period in which the economic impact of the proposed regulation could potentially exceed \$50 million is defined as January 2022 – December 2022. If the Department were to implement Alternative 1, no revenue would be collected during the second half of fiscal year 2021-22, or during the first half of fiscal year 2022-23. However, the Department’s expenditures are projected to remain the same. As indicated in Table 4, the Department’s expenditures for fiscal year 2021-22 is projected to be \$33,906,000, and its expenditures for fiscal year 2022-23 is projected to be \$33,244,000. To calculate projected expenditures for calendar year 2022, the Department combined the projected expenditures for January through June 2022 (fiscal year 2021-22), with the projected expenditures for July through December 2022 (fiscal year 2022-23). The Department’s expenditures are spread out equally through each fiscal year; half of the expenditures for fiscal year 2021-22 would be \$16,953,000; half of the expenditures for fiscal year 2022-23 would be \$16,622,000. During the 12 months following full implementation of the proposed regulation, January 1, 2022 through December 31, 2022, expenditures are anticipated to be \$33,575,000 (16,953,000 + 16,622,000). As no revenue would be collected to offset expenditures, Alternative 1 would result in an operational deficit of \$33,575,000 in the 12 months following full implementation.

Although the Department’s activities could be funded through a different source, such as an appropriation from the state General Fund, the Department rejects pursuing this alternative. The plain reading of AB 1669 and the legislative history of the bill suggest that the Legislature intended for the new \$31.19 fee authorized by Penal Code section 28233 to fund the Department’s firearms-related regulatory and enforcement activities. Historically, the \$19 DROS Fee was the primary source of revenue for these activities.

Without implementation of the proposed \$31.19 DROS Fee, the Department’s Bureau of Firearms would lose its primary source of funding for firearms-related regulatory and enforcement activity. The Department does not consider this to be a reasonable alternative.

For these reasons, the Department rejects the alternative of not implementing the new DROS Fee.

## **Section 6.2**

### **Alternative 2: Collect the Fee in a Different Manner**

Penal Code section 28233, subdivision (b), gives the Department the discretion to require a licensed firearms dealer to charge a firearm purchaser a fee, but it does not stipulate how the fee should be collected. The DROS Entry System (DES) is a web-based application used by dealers to report the purchase of firearms to the Department. (See Cal. Code Regs, tit. 11, § 4200 et seq.) Proposed Section 4001, subdivision (a) would require that DROS Fees be paid at the same time a dealer submits a purchaser’s identifying information through DES for a background check. Proposed Section 4001, subdivision (b) would require that DROS Fees be remitted through DES as described in Section 4240. The Department considered alternative methods of collecting the fee, such as bypassing the current DES payment mechanism, or waiting to charge the fee until the time of the physical transfer of the firearm.

The Department rejected alternative methods of collection as less effective in funding the program. The process of purchasing a firearm begins at the initiation of the purchase, and involves significant Departmental expenditure before the transfer of ownership is completed. The programs that are authorized to be funded by the DROS Fee are largely concerned with background checks on potential firearms purchasers. A firearm dealer must submit to the Department certain identifying information for every potential firearm purchaser. (Pen. Code, §§ 28100-28490.) As required by Penal Code section 28220, the Department then examines available records to determine whether the potential purchaser is prohibited by state or federal law from possessing, receiving, owning or purchasing a firearm. The Department then notifies the dealer of its determination, and the pending sale is either completed or the sale is denied.

Because the DROS Fee funds the various programs, systems and activities that make this determination of legality possible, the fee must be collected upon submission of firearm purchaser information to the Department, which initiates the determination process. (Pen. Code, § 28220, subd. (a).) If, instead, the dealer waited to collect the DROS Fee until the physical transfer of a firearm at the completion of the sale, the DROS Fee would not be collected in instances where the determination resulted in a rejection or denial, as such a result which would make it unlawful for the firearms dealer to release the firearm to the purchaser to complete the sale. If the DROS Fee were collected at the completion of the purchase, in instances when there is a rejection or denial, the intensive process that resulted in the rejection or denial would not be funded. Because the submission of the purchaser information to the Department initiates the process by which the Department determines the legality of a particular firearm transfer, it is the most reasonable time to collect the DROS Fee.

Collection of the fee at the time of the transfer of ownership, after the background check process is complete, would lead to a loss of revenue to the Department for work that had already been completed. The Department denied approximately 0.9 percent of firearms purchases in 2016, 0.8 percent of firearm purchases in 2017 and 0.7 percent of firearm purchases or transfers in 2018 (see Bureau of Firearms 2018). By taking the average of these three percentages, the Department projects that it will deny 0.8 percent of firearm purchases in 2022. With a projected 836,940 billable DROS transactions in the 12 months following full implementation of the proposed regulation (see Table 1), if 0.8 percent of those transactions were denied before the DROS Fee was collected, the Department would not collect \$208,833 ( $.008 \times 836,940 \times 31.19$ ) from firearms purchasers. Alternative 2 would therefore reduce the direct economic impact of the proposed regulation by \$208,833.

Any reduction to the direct economic impact to the state would result in a concomitant lack of funding for the Department's regulatory and enforcement activities related to the sale, purchase, possession, manufacture, loan or transfer of firearms. To properly fund those activities, the fee must be collected at the initiation of the purchase, not the conclusion. The process of purchasing a firearm begins prior to the conclusion of the sale, and involves significant Departmental expenditure.

Remission of the fee to the Department via the DES is current practice for the DROS Fee and other fees collected from each firearm purchaser by a licensed firearms dealer, and would require no direct impact on the activity of licensed firearms dealers (see Section 2.5.1). Due to these considerations, the Department determined that continued collection of the DROS Fee through DES presents the least restrictive means to collect the fee authorized by Penal Code section 28233.

The Department rejects the alternative of collecting the DROS Fee in a different manner for these reasons, and because the Department has demonstrated a need for the proposed regulation.

### **Section 6.3**

#### **Alternative 3: Additional Benefits through Per-Firearm Fee Collection**

Proposed Section 4001, subdivision (a) imposes the DROS Fee per transaction rather than per firearm. Thus, the proposed DROS Fee for purchasing 10 firearms in one transaction would be the same as purchasing one firearm in one transaction. An alternative considered by the Department that could achieve additional benefits beyond those associated with the proposed major regulation would be to impose a DROS Fee for each firearm purchased, rather than once per transaction of one or more firearms, as proposed. 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. If the Department imposed the \$31.19 DROS Fee for each firearm purchased, rather than for each transaction of one or more firearms, the Department would collect additional revenue to fund the reasonable costs of its firearms-related regulatory and enforcement activities related to the sale, purchase, manufacture, possession, loan, or transfer of firearms.

As explained in Section 2.4, the Department projects that for calendar year 2022, there will be 862,200 total DROS transactions. Billable DROS transactions have been approximately 87 percent of total DROS transactions over the last three years. If the number of billable DROS transactions continues to be 87 percent of total DROS transactions, the Department estimates that there will be 750,114 billable DROS transactions in calendar year 2022. At \$31.19 each, the Department anticipates collecting a revenue of \$23,396,056 in the 12 months following the date the Department anticipates the regulation will be fully implemented.

If, however, the Department imposed a DROS Fee for each firearm purchased, the Department would instead collect a revenue of \$26,892,018 in calendar year 2022 (862,200 total DROS transactions x 31.19). This would result in an additional revenue of \$3,495,962, which could be used for the Department's firearms-related activities, including technology upgrades and personnel costs, and to repay outstanding loans.

The Department rejected this alternative due to statutory constraints. Per Penal Code section 28240, for a single transaction of any number of firearms on the same date, only one billable fee may be charged. Further, the Department's personnel costs associated with each transaction are not usually affected by the number of firearms purchased in the transaction.

## Section 7 Summary of Economic Results

The Department interprets the results of the assessment of the economic impact of the proposed DROS Fee regulation as follows:

The Department estimates a direct impact of \$23,396,056 to firearm purchasers due to the collection of the DROS Fee. Using the RIMS II multiplier to estimate indirect and induced impact, the Department estimates a total direct, indirect and induced economic impact of \$47,049,469 due to the collection of the fee.

In addition, the Department estimates an indirect impact of \$31,127,000 due to the potential impact of the \$31.19 fee on demand for firearms. Using the RIMS II multiplier to estimate indirect and induced impact, the Department estimates a total direct, indirect and induced economic impact of \$62,596,397 due to the potential impact of the \$31.19 fee on demand for firearms.

The total direct, indirect and induced economic impacts is estimated to be \$109,645,866.

The Department anticipates a possible elimination of 564 jobs in the first year of full implementation.

The Department does not anticipate that the new fee will lead to the elimination of existing businesses.

The Department does not anticipate the creation of businesses due to the new fee.

The Department anticipates a possible decrease in investment in the state of \$38,090,110 in the first year of full implementation.

The Department does not anticipate that the new fee will result in incentives for innovation in products, materials, or processes.

Due to the potential decrease of retail firearm sales, the Department anticipates a decrease in state sales tax collected, in the amount of \$1,867,620 in the first year of full implementation of the proposed regulation. The Department anticipates a further \$700,358 decline in sales tax revenue remitted to local governments in the first year of full implementation of the proposed regulation.

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