



STATE BOE OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/18/11	Bill No:	Senate Bill 847
Tax Program:	Medical Cannabis Licensing Indicia	Author:	Correa
Sponsor:		Code Sections:	Division 8.9 (commencing with Section 22992.10) of BPC
Related Bills:	SB 626 (Calderon)	Effective Date:	01/01/12

BILL SUMMARY

This bill would require the Board of Equalization (BOE) to administer a medical cannabis licensing indicia program.

ANALYSIS

CURRENT LAW

Revenue and Taxation Code Section 30161 (Cigarette and Tobacco Products Tax Law¹) generally provides that the cigarette tax imposed with respect to the distribution of cigarettes shall be paid by distributors through the use of indicia (stamps) or meter impressions. Stamps and meter impressions, pursuant to Section 30162, are required to be of such designs, specifications, and denominations as may be prescribed by the BOE. Stamps and meter impressions must be generated by a technology capable of being read by a scanning or similar device and be encrypted with, at a minimum, the following information:

- The name and address of the wholesaler or distributor affixing the stamp or meter impression.
- The date the stamp or meter impression was affixed.
- The denominated value of the stamp or meter impression.

The BOE is required to also prescribe by regulation the method and manner in which stamps or meter impressions are to be affixed to packages of cigarettes.

PROPOSED LAW

This bill would add Division 8.9 (commencing with Section 22992.10) to the Business and Professions Code to enact the Medical Cannabis Licensing Act (Act). Among other things, the Act would establish several medical cannabis-related programs, including programs for indicia, licensing, product safety inspection, and facilities security.

Indicia Program. Chapter 3 (commencing with Section 22992.45) of the Act would establish a Medical Cannabis Licensing Indicia Program (Program) that would be administered by the BOE. The program would require the BOE, in consultation with Department of Public Health (DPH), to design a system requiring the use of indicia upon

¹ Part 13 of Division 2 of the Revenue and Taxation Code

all medical marijuana using reasonably available technology to facilitate all of the following related to the production, distribution, and sale of medical marijuana pursuant to a license under the Act:

- Secure production, distribution, and sale of uncontaminated and affordable medical marijuana product.
- Effective enforcement of applicable state laws.
- Effective tracking and tracing of medical marijuana products.
- Field auditing and inspections.
- Elimination and apprehension of counterfeit marijuana product and indicia.
- Collection of all applicable fees for the purposes of the Act.
- Prevention of marijuana sales that are not authorized under the Act, the Compassionate Use Act, or the Medical Marijuana Program.

The term “indicia” would be defined to mean a mark, sign, stamp, or other evidence of issuance of a license and payment of applicable fees required by the Act. The applicable fees required by the Act would include, in part, an application fee, license fee, annual renewal fee, reinstatement fee, indicia fee, product testing and facilities inspection fee, annual security fee, and correction plan fee. These fees are briefly discussed below.

The indicia designed by the BOE would have to be secure, counterfeit resistant, and encrypted with certain information to identify, at a minimum, all of the following:

- The name and address of the party affixing the indicia to the final units of sale.
- The date the indicia are affixed to the final units of sale.
- The denominated value of the indicia.

Furthermore, with respect to tracking and tracing technology, the indicia would have to be capable of utilizing high-security encrypted coding, similar to that in use on tobacco commercialized in California, to reasonably ensure and monitor that all medical marijuana produced, distributed, and sold in California is in compliance with applicable law. The indicia would also have to be readable and traceable from the point of production to the point of sale and readable by a scanner or similar device that may be utilized by the DPH, the BOE, or licensed medical marijuana product producers, distributors, sellers, and certain other persons.

The bill would require the indicia designed, developed, and produced or procured by the BOE to be suitable to be affixed to product in bulk during production and affixed to standardized retail medical marijuana packages for distribution and sale.

The Program also requires the BOE, in consultation with the DPH, to adopt regulations to (1) determine the standardized design and size of the package and location of the indicia, (2) provide for the distribution of the indicia, (3) establish an indicia fee, which would be capped at an unspecified amount for bulk product in production and standardized retail medical marijuana packages, (4) prohibit the authorization of any person to sell indicia except duly constituted agents and assistants of the BOE or the DPH, and (5) identify other persons authorized to utilize a scanner or similar device. The indicia fee that would be established pursuant to the regulations must not exceed the cost of administering and enforcing the Program, including, but not limited to, all administrative costs of the BOE and the DPH.

A licensee would be prohibited from engaging in the production, distribution, or sale of medical marijuana without complying with the Program, commencing with the effective date of the regulations. Only parties approved by the regulations of the BOE would be authorized to affix and cancel the indicia.

The Program would also require indicia to be produced in a secure facility certified in accordance with accepted industry security assistance standards, incorporate overt, semi-covert, and covert data, and capture encrypted data in real time. The encrypted data collected would be retained by the state in a secure data collection, management, and decision support system.

And lastly, the Program would require licensees to maintain records in regard to medical marijuana products and the associated indicia, as prescribed, and those records must be available to the DPH and the BOE for inspection and audit.

The Act would also establish the following programs:

- **Licensing.** Chapter 2 (commencing with Section 22992.25) would establish a licensing program for producers, distributors, and sellers of medical cannabis. The licensing program would be administered by the DPH. A license would be valid for a 12-month period and renewed annually. An unspecified fee would be required to be submitted with each application and application for renewal, and for each reinstated license.
- **Safety Inspection.** Chapter 4 (commencing with Section 22992.60) would require the DPH to establish a program of medical marijuana testing with the goal of ensuring that medical marijuana distributed under the Compassionate Use Act is free from contamination and not otherwise adulterated and a program for facilities inspection to ensure hygienic conditions and product safety. The DPH would also be required to establish an unspecified product testing and facilities inspection fee that would be collected as a component of the annual licensing fee.
- **Facilities Security.** Chapter 5 (commencing with Section 22992.75) would require the DPH, in consultation with the Attorney General, to establish a medical cannabis facilities security program to ensure that licensee facilities meet specified security requirements. The DPH would conduct facility security inspections, which may be combined with product safety inspections.

A licensee would be required to notify the DPH and the BOE within five business days of any employee who no longer is employed by the licensee, and any other personnel changes, as determined by the regulations of the DPH or BOE.

The DPH would also be required to assess an annual fee to each licensee to recover the costs of implementing the medical cannabis facilities security provisions within Chapter 5, which may be assessed as a component of the license or renewal fee.

Medical Cannabis Licensing Fund (Fund): All moneys collected pursuant to the Act would be deposited in the Fund, which the bill would establish within the State Treasury. Moneys in the Fund would be continuously appropriated to the DPH solely for the purpose of fully funding all costs associated with implementing, enforcing, and administering the Act. The DPH and the BOE would be required to enter into an interagency agreement relating to the allocation of moneys in the Fund from the DPH to the BOE for costs incurred in the performance of the BOE's duties under the Act.

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

The Act would also establish the Medical Cannabis Enforcement Penalties Account (Account) within the Fund to receive specified civil penalties assessed against any licensee for knowing or willful failure to comply with any provision of the Act. Moneys in the Account would be available, upon appropriation by the Legislature, for the purposes of the Act.

Licensing Enforcement and Immunities. The DPH, the BOE, and their authorized agents would be the sole agencies for the enforcement and regulation of the Act.

If a licensee fails to comply with the Act, or any rule or regulation adopted by the DPH or BOE, the DPH, in consultation with the BOE, would be required to give the licensee at least 10 days notice in writing, specifying the time and place of hearing and requiring the licensee to show cause why the license should not be suspended or revoked. Upon hearing, the license may be suspended or revoked.

The DPH would be prohibited from restoring a suspended license, or from issuing a new license to a person whose license has been revoked, unless the DPH is satisfied that the person has made a satisfactory good faith showing that the person will comply with the Act.

The provisions of this bill would become effective January 1, 2012.

BACKGROUND

In 2009, Assembly Member Ammiano introduced AB 390, a measure that would have imposed a fee of fifty dollars (\$50) per ounce on the retail sale of marijuana in this state. The BOE would have administered and collected the fee, with the revenues dedicated to drug education, awareness, and rehabilitation programs. That bill would have also required the Department of Alcoholic Beverage Control (ABC) to license both commercial cultivators of marijuana and wholesalers of marijuana, who would be allowed to package and prepare marijuana for sale and would be authorized to sell marijuana to licensed sales outlets. That bill died in the Assembly Committee on Health without being heard.

In 2010, Assembly Member Ammiano introduced AB 2254, which was very similar to AB 390. That bill was never heard in the Assembly Committee on Public Safety. Also in 2010, Senator Calderon introduced SBx6 17 that would have enacted a cannabis licensing program similar to the Cigarette and Tobacco Products Licensing Act of 2003². That bill was never referred to a policy committee for hearing. Senator Calderon later authored SB 1131 (2010), which would have enacted the Sales Tax Enforcement Act of 2010, with the intent to better assist the BOE in collecting the sales tax generated by marijuana sales. That bill died in Assembly Rules without referral to a policy committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the city of Anaheim and is intended to provide a regulation structure for the production, distribution, and sale of medical marijuana in California.

² Division 8.6 (commencing with Section 22970) of the Business and Professions Code

- 2. Smart cigarette tax stamp.** Senate Bill 1701 (Ch. 881, Stats. 2002) required the BOE, as of January 1, 2005, to replace the heat-applied decal stamps and meter impressions with stamps and meter impressions generated by a technology capable of being read by a scanning or similar device and encrypted with specified information. In California, stamps, which are affixed to packages of cigarettes by a distributor (a person making the first sale of untaxed cigarettes in California), are the method of tax payment for cigarettes.

The data contained within the encryption of each cigarette tax stamp includes, at a minimum, the name and address of the distributor affixing the stamp or meter impression, the date the stamp or meter impression was affixed, and the denominated value of the stamp or meter impression. This encrypted information provides BOE investigators limited “track and trace” capability by allowing verification of tax paid product, the date the stamp was affixed to the cigarette package, and the distributor that affixed the stamp, utilizing specialized validation scanning devices in the field that are designed to read the encrypted information on the stamp or indicate the absence of it.

The cigarette tax stamp’s track and trace ability is limited since it does not track the sale of cigarettes through the distribution chain. This is verified through records required to be maintained by manufacturers, importers, distributors, wholesalers, and retailers. Records would also be used, if available, for unstamped cigarettes since, without a stamp, the product cannot be traced back to the distributor. True track and trace ability would provide information such as current and past locations (and other information) in a real-time database or arrival or departure information similar to FedEx package tracking.

With respect to counterfeiting, visual representations or images of California’s tax stamp have been discovered in the marketplace; however, there has been no successful duplication of the tax stamp’s encryption or security features. These counterfeit replicas of California’s tax stamp are easily detected by BOE staff through the use of a validation scanning device.

- 3. Is the BOE the appropriate agency to administer the Program?** Since 2004, a contract has been awarded twice for the procurement of cigarette tax stamps, with the most recent multi-year contract awarded on July 23, 2010. For each of these contracts, the BOE and the Department of General Services (DGS) conducted a formal procurement process to identify a vendor of the new cigarette tax stamp and stamping machinery.

While the BOE has experience in the procurement of cigarette tax stamps, it does not have the expertise to design the indicia system required by this bill.

In part, the BOE, in consultation with the DPH, would be required to design indicia capable of being affixed to product in bulk production and to standardized retail medical marijuana packages. The designed indicia system also has several requirements that must be met, with respect to the production, distribution, and sale of medical marijuana, to facilitate (1) secure production, distribution, and sale of uncontaminated and affordable medical marijuana, (2) effective tracking and tracing capabilities, and (3) the prevention of marijuana sales not authorized under the Compassionate Use Act. The BOE has no expertise in these areas as they are outside the BOE’s purview of tax administration.

Another requirement for the indicia system is that it facilitates the effective enforcement of “applicable state laws.”

The state law applicable to the BOE would be the Sales and Use Tax Law,³ which imposes a tax on all retailers for the privilege of selling tangible personal property at retail in this state, except where specifically exempted by statute. Tangible personal property is defined in law to mean any personal property which may be seen weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. Therefore, under the law, retail sales of marijuana, including medical marijuana, are subject to tax to the same extent as any other lawful retail sale of tangible personal property.

Since the sales tax is imposed at the time of retail sale, an indicia system would not facilitate in the effective enforcement of the Sales and Use Tax Law. While a track and trace mechanism could alert the BOE to retail sales of medical marijuana, it would not provide sufficient information (sales price) to allow the BOE to calculate the amount of sales tax due. And, due to the various prices of medical marijuana, the wide variety of quantities sold, and untraceable cash transactions, it would be particularly difficult to determine the proper amount of tax.

Given that the BOE is not familiar with the indicia design and procurement requirements imposed by this bill and the indicia system would not facilitate the BOE in its role of tax administration, it is suggested that the bill be amended to remove the BOE as the agency required to administer the Program. If this bill is amended as suggested, the BOE staff would be available to meet with the agency required to administer the Program to provide its experience and expertise in the procurement of the cigarette tax stamp.

4. **Other BOE roles.** In addition to administering the Program, this measure would require, under Section 22993.20(a), the BOE, along with the DPH, to be the sole agencies for the enforcement of, and the regulation of activity authorized pursuant to, the Act. It is unclear why the BOE is referenced as an agency required to enforce the Act as a whole when the BOE’s only mandate is to administer the Program. Furthermore, Section 22993.25(a) authorizes the DPH, in consultation with the BOE, to suspend or revoke a license. Why would the DPH consult with the BOE to suspend or revoke a license for a DPH-administered program? If a licensee violates any provision of the Program, the BOE would simply notify the DPH, which could then take action on a license as it deems necessary.
5. **The manner in which the BOE is reimbursed should be changed to a direct appropriation.** The BOE’s administrative costs pursuant to this bill would be reimbursed by the DPH, which is inconsistent with other tax or fees the BOE is required to administer and collect.

When the BOE is required by statute to administer a program and/or collect a tax or fee, the BOE is reimbursed by a direct appropriation through the annual budget development process. Most programs administered by the BOE are “direct appropriation programs,” such as the Sales and Use Tax Law, Motor Vehicle Fuel Tax Law, Use Fuel Tax Law, Diesel Fuel Tax Law, Alcoholic Beverage Tax Law, Cigarette and Tobacco Products Tax Law, Cigarette and Tobacco Products Licensing Act of 2003, Energy Resources Surcharge Law, Emergency Telephone

³ Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code

Users Surcharge Law, Covered Electronic Waste Recycling Fee Law, Underground Storage Tank Maintenance Fee Law, Marine Invasive Species Fee Law, Natural Gas Surcharge Law, and Water Rights Fee Law.

This bill should be amended to change the method for reimbursing the BOE for its costs related to the Program to a direct appropriation from the Fund through the annual budget development process to conform with other programs the BOE is required to collect and/or administer.

6. **Administrative fee collection.** This measure would require the BOE to establish an indicia fee to be paid by the licensee, which would be paid in a manner determined by regulations adopted by the BOE. The bill does not, however, specify the BOE as the agency responsible for collecting the indicia fee from licensees. It is also not clear if the BOE is to collect the other fees assessed by the DPH.

If the author intends for the BOE to collect the indicia or other fees, the bill should be amended to authorize the BOE to collect the proposed fees pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001), of Division 2, of the Revenue and Taxation Code). The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund and appeals provisions, as well as providing the BOE the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

7. **Suggested amendment.** This measure would require a person that produces, distributes, or sells medical marijuana to have in place and maintain a license. Persons desiring a license would be required to file a license application on a form prescribed by the DPH containing specified information. Board staff suggests that in addition to the information currently specified in the bill, an application should also request the sales and use tax seller's permit number held by the person since every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax, including marijuana, is required to hold a seller's permit.

22992.30. (a)(5) The California seller's permit number issued by the Board of Equalization.

(6) Any other information the department may require.

8. **Related legislation.** SB 626 (Calderon) would enact the Cannabis Certification and Regulation Act of 2011, which would impose certification requirements on cannabis and cannabis product growers, wholesalers, retailers, and transporters.

COST ESTIMATE

The BOE would incur costs related to the procurement (testing, operation, and evaluation of indicia), promulgating regulations, notifying licensed producers, distributors, and sellers of medical cannabis, and developing forms and publications. The BOE would also incur costs related to computer programming if required to collect the proposed indicia fee. A detailed cost estimate is pending.

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These estimated costs do not include the vendor cost to produce the medical cannabis indicia because the costs are unknown at this time. The bill should be amended to secure funding for the indicia procurement. In addition, the bill should also identify the source of those funds if the Fund, or Account within the Fund, does not have the revenue to support the indicia procurement.

REVENUE ESTIMATE

This bill does not specify the amount of the indicia fee to be paid by a licensee for bulk product in production and standardized retail medical marijuana package indicia, therefore a revenue estimate could not be prepared.

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