



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

DRAFT

Date:	05/25/12	Bill No:	<u>Assembly Bill 2312</u>
Tax Program:	Medical Marijuana	Author:	Ammiano
Sponsor:	Author	Code Sections:	Chapter 4 (commencing with Section 7294)
Related Bills:		Effective Date:	01/01/13

This analysis only addresses the provisions that impact the BOE.

BILL SUMMARY

Among other things, this bill authorizes a county to levy a transactions and use tax up to 5% (or a city to levy such a tax up to 2%) on tangible personal property that is medical marijuana or medical marijuana-infused products (medical marijuana) subject to current voter approval thresholds.

Summary of Amendments

Since the previous analysis, this bill was amended to, among other things, delete the unspecified medical marijuana rate increment and provide that the combined medical marijuana within any county and city shall not exceed 5 percent, and that the city rate itself shall not exceed 2 percent.

ANALYSIS

CURRENT LAW

The Board of Equalization (BOE) administers locally-imposed sales and use taxes under the Bradley-Burns Uniform Local Sales and Use Tax Law (local taxes) and under the Transactions and Use Tax Law (district taxes), which are provided in separate parts of the Revenue and Taxation Code. Cities and counties are required to contract with the BOE to perform all functions in the administration and operations of the ordinances imposing the local and the district taxes.

The **Bradley-Burns Uniform Local Sales and Use Tax Law** (Part 1.5, commencing with Revenue and Taxation Code Section 7200) authorizes cities and counties to impose a local sales and use tax. The rate of tax is fixed at 1.25 percent of the sales price of tangible personal property sold at retail in the local jurisdiction, or purchased outside the jurisdiction for use within the jurisdiction. However, beginning July 1, 2004, and continuing through the “revenue exchange period” (also known as the “Triple Flip”), Section 7203.1 temporarily suspends the authority of a county or a city to impose a tax under Sections 7202 and 7203, and instead provides that the applicable rate is the following: (1) in the case of a county, 1 percent; and (2) in the case of a city, 0.75 percent or less. “Revenue exchange period” means the period on or after July 1, 2004, and continuing until the Department of Finance notifies the BOE, pursuant to Government Code Section 99006, that the \$15 billion Economic Recovery Bonds have been repaid or that there is sufficient revenue to satisfy the state’s bond obligations.

Of the 1 percent, cities and counties use the 0.75 percent to support general operations.

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The remaining 0.25 percent is designated by statute for county transportation purposes and may be used only for road maintenance or the operation of transit systems. The counties receive the 0.25 percent tax for transportation purposes regardless of whether the sale occurs in a city or in the unincorporated area of a county. All local jurisdictions impose the Bradley-Burns local taxes at the uniform rate of 1 percent.

The **Transactions and Use Tax Law** (Part 1.6, commencing with Revenue and Taxation Code Section 7251) and the **Additional Local Taxes Law** (Part 1.7, commencing with Section 7285) authorize cities and counties to impose district taxes under specified conditions. **Section 7285** authorizes a county to impose a district tax for general purposes at a rate of 0.125 percent, or a multiple thereof, if the ordinance proposing the tax is approved by a two-thirds vote of the board of supervisors and a majority vote of the qualified voters of the county. **Section 7285.5** authorizes a county to impose a district tax for special purposes at a rate of 0.125 percent, or a multiple thereof, if the ordinance proposing the tax is approved by a two-thirds vote of the board of supervisors and a two-thirds vote of the qualified voters of the county.

With respect to cities, **Section 7285.9** authorizes a city to impose a district tax for general purposes at a rate of 0.125 percent, or a multiple thereof, if the ordinance proposing the tax is approved by a two-thirds vote of all members of the governing body and a majority vote of the qualified voters of the city. **Section 7285.91** authorizes a city to impose a district tax for special purposes at a rate of 0.125 percent, or a multiple thereof, if the ordinance proposing the tax is approved by a two-thirds vote of all member of the governing body and a two-thirds vote of the qualified voters of the county.

The combined rate of all district taxes imposed in any county cannot exceed 2 percent.

Graffiti Tax. In addition to the district taxes authorized to be levied by local jurisdictions as a percentage of the sales price as described in the above paragraph, Chapter 3 of the **Additional Local Taxes law** authorizes cities and counties, upon approval by two-thirds of the electors voting on the measure, to levy a distinctly different tax. Under this chapter, cities and counties are authorized to levy a “graffiti prevention tax” on the privilege of selling at retail aerosol paint containers, containers of any other marking substance, specified felt tip markers and other marking instruments at the rate of no more than 10 cents per aerosol paint container and no more than 5 cents per felt tip marker or other marking instrument. Although this chapter has been in law since 1991, no local jurisdictions have ever levied the tax.

PROPOSED LAW

Among other things, this bill would add Article 2.8 (commencing with Section 11362.84) to the Health and Safety Code to enact the Medical Marijuana Regulation and Control Act (Act) to regulate and control specified medical marijuana activities. The Act would be administered by the Board of Medical Marijuana Enforcement, which this bill creates within the Department of Consumer Affairs.

This bill, as it pertains to the Board of Equalization (BOE), would add Chapter 4 (commencing with Section 7294) to Part 1.7 of Division 2 of the Revenue and Taxation Code to authorize the board of supervisors of any county, or governing body of any city, to levy, increase, or extend a transaction and use tax for tangible personal property that is medical marijuana upon two-thirds approval by the board of supervisors or city council and either a majority or a two-thirds approval of the voters. The ordinance proposing a tax would establish how the revenues would be expended and, therefore,

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determine the vote requirement. The transactions and use tax imposed upon medical marijuana would conform to the Transactions and Use Tax Law Part 1.6 (commencing with Section 7251).

Proposed Section 7294.6 provides that, notwithstanding any other law, the combined rate of the county and city medical marijuana tax shall not exceed the rate of 5 percent.

Section 7295.6 limits the authority of a city to impose a marijuana tax to a rate not to exceed 2 percent. An ordinance proposing a tax must contain a provision that any person subject to a transactions and use tax under a county ordinance shall be entitled to a credit against the payment of taxes due under that ordinance in the amount of transactions and use tax due to any city in the county.

The bill becomes effective on January 1, 2013.

IN GENERAL

Cities and counties may impose a district tax for general or specific purposes. These taxes can be imposed either directly by the city or county or through a special purpose entity established by the city or county. Counties can also establish a transportation authority to impose district taxes under the Public Utilities Code.

Beginning October 1, 2012, there will be 147 local jurisdictions (city, county, and special purpose entity) imposing a district tax for general or specific purposes. Of the 147 jurisdictions, 41 are county-imposed taxes and 106 are city-imposed taxes.

The maximum combined rate of all district taxes imposed in any county cannot exceed 2 percent. The city district taxes count against the 2 percent maximum. District taxes increase the tax rate within a city or county by adding the district tax rate to the combined state and local (Bradley-Burns local tax) tax rate of 7.25 percent.

Generally, under the Transactions and Use Tax Law, district tax rates are imposed at a rate of 0.25 percent or 0.25 percent increments up to the 2 percent limit. As discussed above, recent amendments to the Additional Local Taxes Law allow cities and counties to levy, increase or extend district taxes at a rate of 0.125 percent, or a multiple thereof. Currently, the district tax rates vary from 0.10¹ percent to 1 percent. The combined state, local, and district tax rates range from 7.375 percent to 9.25 percent, with the exception of the cities of South Gate and Pico Rivera (9.75%) in Los Angeles County².

Some cities and counties have more than one district tax in effect, while others have none. A listing of the district taxes, rates, and effective dates is available on the BOE's website: www.boe.ca.gov/sutax/pdf/districtatelist.pdf.

BACKGROUND

Medical Marijuana Sellers – Sales Tax. In 1996 California voters passed Proposition 215, also known as the Compassionate Use Act of 1996, which allows patients and their

¹Some cities and counties are authorized by special legislation to impose a district tax at a different specified rate.. For example, the Fresno County Zoo Authority imposes a district tax at a rate of 0.10 percent.

²In 2003, SB 314 (Ch. 785, Murray) authorized the Los Angeles County Metropolitan Transportation Authority to impose a 0.50 district tax for specific transportation projects, and excluded that 0.50 percent tax from the 2 percent limitation. In 2009, voters within Los Angeles County approved an additional 0.50 percent effective July 1, 2009. The 0.50 percent tax increase in Los Angeles County raised the tax rate in the cities of South Gate and Pico Rivera from 9.25 to 9.75 percent.

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primary caregivers to cultivate or possess marijuana for personal medical treatment with the recommendation of a physician, as specified.

In 2003, SB 420 (Ch. 875, Vasconcellos, Stats. 2003) was enacted to establish statewide guidelines for Proposition 215 enforcement. In particular, SB 403 clarified that nonprofit distribution is allowed in certain cases for patient cultivation cooperatives, small-scale caregiver gardeners, and dispensing collectives. However, despite the fact that numerous medical marijuana dispensaries are currently in business in California, the sale of medical cannabis is illegal under federal law.

The sale of medical marijuana has always been considered taxable. The BOE issues seller's permits to those medical marijuana sellers that apply and will issue seller's permits to any other sellers making unlawful sales.

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

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author and is intended to provide a statewide system for regulating and controlling medical marijuana to afford greater certainty and uniformity regarding the rights and obligations of medical marijuana facilities, and for imposition and enforcement of regulations to prevent unlawful cultivation and the diversion of marijuana to nonmedical use.
2. **The May 25, 2012 amendments** (1) delete the medical marijuana tax rate increment, which was unspecified, (2) clarify that the medical marijuana tax rate shall not be considered for purposes of the 2 percent combined rate established for the transactions and use tax, and (3) provide that the combined medical marijuana within any county and city shall not exceed 5 percent, and that the city rate itself shall not exceed 2 percent. The remaining amendments do not affect the BOE.
3. **Conforming to the Transactions and Use Tax Law.** This bill provides that the local transactions and use tax imposed upon medical marijuana shall conform to the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)). However, not all of the provisions under the Transactions and Use Tax Law are conducive to the proposed medical marijuana tax. The author may wish to consider amending the bill to incorporate standalone language for these provisions into proposed Chapter 4 (commencing with Section 7294), which include:
 - **Operative date.** Any new local medical marijuana tax would become operative on the first day of a calendar quarter commencing more than 110 days after the adoption of the ordinance pursuant to Transactions and Use Tax Law Section 7265. However, the 110-day timeframe would not provide the BOE sufficient time to effectively implement the **initial** local medical marijuana tax after the first county and/or city adopts an ordinance imposing such a tax. BOE staff estimates that it would take a minimum of six months to implement the initial medical marijuana program proposed by this bill. In order to provide the BOE with the necessary 6-month lead-time, it is suggested that the bill be amended to provide for a delayed operative date for the first day of the first calendar quarter commencing more than six months after the first ordinance is adopted. This would provide the BOE with sufficient lead-time to successfully implement the initial local medical marijuana tax program.

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As cities and counties come on board, the BOE would need time to notify affected retailers, modify tax returns, develop instructions for BOE staff and affected retailers, and perform minor programming changes. The BOE would need at least one quarter lead time from the date the ordinance is approved by the voters to prepare to administer the medical marijuana tax ordinance. Section 7265 of the Transactions and Use Tax Law provides that an ordinance shall become operative on the first day of a calendar quarter commencing more than 110 days after the adoption of the ordinance, which may not provide the BOE sufficient time to successfully implement a new medical marijuana tax ordinance.

- **Administrative costs.** It appears to BOE staff that there would be three different types of administrative costs associated with the local medical marijuana tax: (1) start-up costs related to the implementation of a new (and distinctly different) tax program, which includes extensive modifications to the BOE's computer system; (2) preparatory costs for subsequent cities and counties adopting a local medical marijuana tax ordinance; and (3) ongoing administrative costs.
 - **Start-up Costs.** The Transactions and Use Tax Law includes provisions for reimbursement to the BOE for preparatory costs (Section 7272) and administrative costs (Section 7273); however, BOE staff has opined that these provisions would not include reimbursement to the BOE for administrative start-up costs. It is not clear how would these one-time start-up costs be funded.
 - **Preparatory Costs.** Preparatory costs include developing procedures, programming for data processing, developing and adopting appropriate regulations, designing and printing forms, developing instructions for BOE staff and taxpayers, and any other necessary preparatory costs. The Transactions and Use Tax Law limits these costs to be paid by a district at \$175,000. It is unknown at this time if the amount specified would sufficiently cover the BOE's actual costs to perform these tasks for a marijuana tax ordinance.
 - **Ongoing Administrative Costs.** Section 7273 of the Transactions and Use Tax Law requires the BOE to charge an amount for its administration of the local transactions and use tax ordinance of each special taxing jurisdiction. Under this statute, the BOE is required to use a model for allocating its costs that is based on the methodology described in Alternative 4C of the November 2004 report by the Board entitled "Response to the Supplemental Report of the 2004 Budget Act." The methodology (referred to as the "modified revenue" model) utilizes the four sales and use tax program elements as reflected in the approved Governor's Budget. Those elements are Audit, Collections, Registration and Returns.

As noted previously, the proposed local medical marijuana tax is distinctly different from the existing transactions and use tax and therefore should not be part of the "modified revenue" model for allocating administrative costs.

In order to avoid any unintended impact on the General Fund, the bill should be amended to incorporate BOE reimbursement provisions specific to the local medical marijuana tax.

4. Costs may exceed revenues. The Transactions and Use Tax Law requires local jurisdictions that levy sales and use taxes to contract with the BOE to administer the district tax so that the entity may levy a tax at a low rate and take advantage of the functions performed by the BOE in administering the sales and use tax system as a whole. Therefore, if a city or county passes an ordinance to impose a transactions and use tax on the sale of medical marijuana, that local jurisdiction would be required to contract with the BOE to perform functions related to the ordinance. The BOE would incur start-up costs related to the implementation of a new tax program, which would be the same regardless of whether one county, or all 58 counties and 482 cities, adopt an ordinance to impose the new tax. The ongoing costs would vary based on the number of jurisdictions adopting a medical marijuana tax ordinance and other factors.

If the tax rate is set too low and/or only a few cities or counties impose the tax, the BOE administrative costs would be paid from a smaller revenue base. Under these circumstances, it is possible that the revenues generated by the proposed tax may not be sufficient to cover the BOE's start-up and ongoing administrative costs.

5. Suggested amendments. In order to avoid any uncertainties or ambiguities in administering the medical marijuana tax, the following amendments are suggested:

- It should be clarified that the credit in Section 7295.6 relates to transactions and use taxes imposed by the city under Section 7295, and not a transactions and use tax imposed on all sales of tangible personal property (e.g., a tax imposed under Section 7285.5 or Section 7285.9).
- This bill does not contain definitions for the terms “medical marijuana” and “medical marijuana-infused products.” Precise definitions for these terms should be incorporated into the bill.

6. Tax could complicate retailers' records and reporting. If approved, a transactions and use tax would be levied on the sale of medical marijuana. As previously stated, retail sales of medical marijuana are already subject to sales tax (including applicable district tax(es)) to the same extent as any other retail sale of tangible personal property. Accordingly, medical marijuana retailers would be burdened with additional record keeping and segregations which would be required for purposes of reporting the correct amount of sales and use tax, any applicable transactions and use taxes, and any applicable marijuana taxes. These segregations have the possibility of increasing reporting errors and confusion.

7. Prescription medicines. Section 6369 of the Sales and Use Tax Law exempts from sales and use tax retail sales of medicines, as defined, under certain conditions, including when furnished by a health facility for patient treatment pursuant to the order of a certificated physician, or when prescribed by a certificated physician and dispensed on a prescription filled by a registered pharmacist in accordance with law. Medical marijuana dispensaries generally do not meet the definition of health care facilities provided in that section. As such, sales of medical marijuana by dispensaries and primary caregivers do not qualify for the exemption provided in Section 6369, whether or not those purchasers possess a medical marijuana identification card. And since caregivers and medical marijuana dispensaries generally are not registered pharmacists, their sales of medical marijuana also do not meet the conditions for the exemption under Section 6369.

COST ESTIMATE

This bill does not increase administrative costs to the BOE because it only authorizes cities and counties to impose a higher amount of tax. Voter approval would be required before any tax is levied pursuant to these provisions.

If a city or county adopted an ordinance to levy the tax, the city or county would be required to contract with the BOE to perform all functions related to the ordinance, and pay to the BOE its costs of preparation to administer the ordinance as well as the costs for the BOE’s services in actually administering the ordinance pursuant to the Transactions and Use Tax Law. Costs for preparation and administration of this tax could be higher than other district taxes the BOE administers since the proposed tax is unlike other district taxes.

As a point of perspective, the BOE’s estimated 2008-09 administrative costs assessed to the existing county special taxing jurisdictions range from \$19,000 to \$2,695,000, with the exception of Los Angeles County (Los Angeles County has a substantial higher number of sellers permits and, consequently, their administrative costs are higher than other jurisdictions).

It should be noted again (see Comment 3) that the reimbursement provisions in the Transactions and Use Tax are not workable for the proposed medical marijuana tax and could unintentionally result in an impact to the General Fund. If the Transactions and Use Tax Law provisions don’t require cities and counties to fully reimburse the BOE for all of its administrative costs, it’s more than likely the General Fund would need to make up the difference. To avoid any impact on the General Fund, amendments to incorporate BOE reimbursement provisions specific to the medical marijuana tax are suggested.

REVENUE ESTIMATE

Since there are several unknown variables related to the proposed local medical marijuana excise tax, a revenue estimate could not be prepared at this time. Specifically, this measure presents the following challenges with respect to producing a revenue estimate:

- BOE staff does not know which local jurisdictions will choose to authorize the establishment of medical marijuana dispensaries and which will not, or what local jurisdictions will not enact a dispensary zoning ordinance thereby allowing the Board of Medical Marijuana Enforcement to authorize and wholly regulate dispensaries within the jurisdiction; nor can staff estimate the number of locations that will be authorized within a jurisdiction.
- BOE staff is not able to create estimates of marijuana consumption and price at the local level.
- BOE staff is not able to estimate the impact that regulation and taxation will have on the consumption and price for those jurisdictions that authorize medical marijuana dispensaries, or for those jurisdictions where medical marijuana dispensaries are wholly regulated by the Board of Medical Marijuana Enforcement.

Analysis prepared by:	Cindy Wilson	916-445-6036	06/20/12
Contact:	Robert Ingenito	916-322-2376	

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