

[Assembly Bill 243](#) (Wood)

Date: 08/17/15

Program: Medical Marijuana Tax

Sponsors: Author

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

Effective immediately

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This analysis only addresses the provisions that impact the Board of Equalization (BOE).

Summary: Among other things, imposes upon each cultivator a per-ounce marijuana tax at an unspecified rate on all cannabis flowers, leaves, and immature plants.

Summary of Amendments: Among other things, the amendments since the previous analysis place the medical marijuana tax within the Revenue and Taxation Code (RTC), revise the tax application from a per-plant tax to a weight-based tax, provide a delayed operative date and loan authorization, and add a track and trace program.

Purpose: To create a regulatory framework around cultivation and to provide funding to address the impacts of illegal marijuana cultivation.

Fiscal Impact Summary: Unknown.

Existing Law: Federal Law. Existing federal law prohibits the manufacture, possession, sale or distribution of marijuana.¹ Congress enacted the Controlled Substances Act² (CSA) as part of the Comprehensive Drug Abuse Prevention and Control Act of 1970. The CSA establishes five “schedules” of certain drugs and other substances designated “controlled substances.”³ For a drug or other substance to be designated as a schedule I controlled substance, it must be found that the substance “has a high potential for abuse,” have “no currently accepted medical use in treatment in the United States,” and “lack accepted safety for use of the drug or other substance under medical supervision.”⁴ Federal law lists marijuana as a schedule I controlled substance, deemed to have no accepted medical use.⁵

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

California’s Sales and Use Tax Law.⁸ Existing law imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state, except where the law specifies an exclusion or exemption. Therefore, under the law, sales tax applies to retail sales of marijuana, including medical marijuana, to the same extent as any other retail sale of tangible personal property.

For patient treatment, the law⁹ exempts from sales and use tax retail sales of medicines, as defined, when the medicines sold or furnished are:

- prescribed by an authorized person and dispensed on a prescription filled by a pharmacist,

¹ 21 U.S.C. § 841 et seq.

² 21 U.S.C. § 801 et seq.

³ 21 U.S.C. §§802(6), 812(a).

⁴ 21 U.S.C. § 812 (b)(1).

⁵ 21 U.S.C. § 812:Schedule I(c)(10).

⁶ Division 10 (commencing with Section 11000) of the HSC.

⁷ HSC Section 11362.5.

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

⁹ Sales and Use Tax Law Section 6369.

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- furnished by a licensed physician to his or her own patient,
- furnished by a health facility for treatment pursuant to a licensed physician's order, or sold to a licensed physician.

Proposed Law: Among other things, this bill adds Section 11362.777 to the HSC to establish the Division of Medical Cannabis Cultivation (Division) within the California Department of Food and Agriculture (CDFA). The bill requires the Division to administer the section as it pertains to medical marijuana cultivation. In part, the bill requires the Division to establish a permitted medical plant identification program at a cultivation site during the cultivation period. The bill requires a unique identifier to be issued for, and attached at the base of, each medical marijuana plant.

Medical Marijuana Tax. The bill adds Part 13.5 (commencing with Section 31001) to Division 2 of the RTC, known as the Medical Marijuana Tax Law (Tax Law). The Tax Law imposes upon each cultivator a marijuana tax at an unspecified rate per ounce on all cannabis flowers, leaves, and immature plant. The Tax Law tasks a designated entity to collect the tax from each cultivator at the time of distribution.

A designated agency must to separately state the amount of tax on the sales receipt provided to the licensed medical marijuana cultivator at the time of sale.

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

Any unreturned amounts the designated entity represents and collects as the medical marijuana tax owed by the cultivator that are not actually owned constitutes a designated entity's debt to the state.

Administration. This Tax Law requires the BOE to administer and collect the medical marijuana plant tax pursuant to the Fee Collection Procedures Law (FCPL).¹⁰ For purposes of the Act, the bill clarifies the terms "fee" and "feepayer" as follows:

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

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

The Tax Law specifically authorizes the BOE to prescribe and adopt tax administration and enforcement regulations including, but not limited to, collections, reporting, refunds, and appeals. The Tax Law authorizes the BOE to consult with the Division, and the Division must provide to the BOE any information necessary for the proper administration of the tax.

Registration, Reporting, and Payment. The medical marijuana tax is due and payable to the BOE quarterly on or before the last day of the month following each calendar quarter. In addition, a return for the preceding calendar quarter must be filed with the BOE using electronic media at the time of payment.

Existing law¹¹ authorizes the payment of the amount due and the filing of returns for periods other than the period or periods specified in the tax and fee laws administered under the FCPL.

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

¹⁰ Part 30 (commencing with Section 55001) of Division 2 of the RTC.

¹¹ RTC §55041.1

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

- 10 percent to the Division to administer the unique identifier program.
- 30 percent to the Division for disbursement to local law enforcement-related activities, state law enforcement-related activities, or both, pertaining to illegal marijuana cultivation.
- 30 percent to the Natural Resources Agency to fund a competitive grant program for environmental cleanup and restoration of public and private lands that have been damaged from illegal marijuana cultivation.
- 30 percent to the multiagency task force, the Department of Fish and Wildlife, and the State Water Resources Control Board project to address the Environmental Impacts of Cannabis Cultivation and to respond to the damages caused from marijuana cultivation on public and private lands in California.

Track and Trace Process. The Tax Law requires the BOE to adopt a system for reporting the movement of cannabis and cannabis products throughout the distribution chain. The system shall employ secure packaging and be capable of providing information to the BOE. This system shall capture, at a minimum, all of the following:

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

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

Operative Date and Funding. The Tax Law becomes operative on the later of the following:

- On or after the first day of the first calendar quarter commencing more than 270 days after adequate funding has been received by the board to implement and administer the Tax Law, or
- On or after the first day of the first calendar quarter commencing more than 180 days from the adoption and funding of the cannabis track and trace process, whichever is later. The BOE shall post a notice on its Internet Web site when this requirement has been satisfied.

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

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

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

On August 29, 2013, the U.S. Department of Justice issued guidance to federal prosecutors regarding cannabis enforcement under the CSA (referred to as the Cole Memo)¹². The Cole Memo reiterated the Department's commitment to enforcing the CSA consistent with Congress' determination that cannabis is a dangerous drug that serves as a significant source of revenue to large-scale criminal enterprises, gangs, and cartels. In furtherance of those objectives, the Cole Memo instructed the Department attorneys and law enforcement to focus on the following eight priorities in enforcing the CSA against cannabis-related conduct:

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

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

On December 16, 2014, Public Law 113-235¹³ became operative which prohibits the United States Department of Justice from using funds to prevent specified states, including California, from implementing state laws that authorize the use, distribution, possession, or cultivation of medical marijuana.

The sale of medical marijuana¹⁴ is 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, the BOE mailed a special notice to California sellers of medical marijuana to clarify the application of tax to medical marijuana sales and the requirement that they must hold a seller's permit.

¹² <http://medicalmarijuana.procon.org/sourcefiles/cole-DOJ-memo-aug-2013.pdf>.

¹³ [H.R. 83](#) / Public Law 113-235, Consolidated and Further Continuing Appropriations Act, 2015, (Dec. 16, 2014; 128 Stat. 2130; 701 pages)

¹⁴ All retail sales, including illegal sales, are subject to tax.

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Commentary:

1. **The August 17, 2015, amendments** place the medical marijuana tax within the RTC, revise the tax application from a per-plant tax to a weight-based tax, provide a delayed operative date and loan authorization, and add a track and trace program.
2. **Taxpayer and incidence of tax lacking.** The bill no longer refers to a “distributor” as the person required to collect the tax from a cultivator. Instead, the bill requires a “designated entity” to collect the tax at the time of distribution. The bill defines a “designated entity” to mean “an entity defined by Section [blank] of the Business and Professions Code, or an entity designated by the board.” Not specifying a taxpayer for Tax Law purposes unnecessarily complicates the BOE’s administration and tax collection, may delay the Tax Law’s implementation, and could result in unintended legal implications.

Furthermore, this bill does not define the tax incidence. While the bill does require a designated entity to collect the tax from a cultivator at the time of distribution, the bill does not define that term.

BOE staff suggests bill amendments to identify the taxpayer required to collect the tax from a cultivator and to specify the tax incidence to allow the BOE to successfully administer and collect the medical marijuana tax.

3. **Suggested amendments.** BOE staff has administrative concerns regarding the medical marijuana tax provisions. These concerns include, but are not limited to, inconsistent references to cannabis and marijuana throughout the bill, the lack of definitions for key terms (i.e. “distribution), a nonexistent audit trail (i.e. cultivator licensee information, invoice requirements for both the cultivator and designated entity), and capturing the tax where the cultivator also processes the product into a form other than a flower or leaves. BOE staff is working with the author’s office to draft appropriate amendments to address these concerns.
4. **Track and trace process.** This bill requires the BOE to adopt a track and trace system for reporting the movement of marijuana throughout the distribution chain. A track and trace system appears to be a valuable tool to track product for anti-diversion efforts or to trace product back to the source in the case of a recall. However, this bill only establishes licensing or tax registration for cultivators and a designated entity. As such, other persons, such as a wholesaler or dispensary, would have no obligation to participate in the track and trace process thus making the program deficient and unworkable. The author may wish to consider requiring other persons in the distribution chain to register with the BOE for Tax Law purposes, or place the track and trace systems in the Sales and Use Tax Law, to allow for an effective program.
5. **Related legislation.** Assembly Bill 266 (Bonta) enacts the Medical Cannabis Regulation and Control Act, which creates, in part, the BOE Division of Medical Cannabis Regulation within the BOE to administer the Act as it pertains to dispensaries, distributors, and transporters. Senate Bill 643 (McGuire) requires the BOE to compile a report on estimated and expected marijuana tax revenues.

Administrative Costs: BOE administrative costs related to this bill are substantial. These costs include: taxpayer identification, notification, and registration; regulation development; manual and publication revisions; tax return design; computer programming; return, payment, and refund claim processing; audit and collection tasks; staff training; and public inquiry responses. These costs are estimated to be \$705,000 for Fiscal Year (FY) 2015-16, \$3.9 million for FY 2016-17, \$3.6 million for FY 2017-18, \$3.7 million for FY 2018-19 and ongoing.

These costs do not include BOE costs to contract for the track and trace program as these costs are unknown.

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The administrative costs estimated for this bill are based on several assumptions **that may ultimately result in the costs being higher or lower** if this bill is signed into law. For example, the bill does not specify a taxpayer. As such, the BOE assumed the designated entity would be a distributor, a person in the distribution chain that does not exist currently. Since a distributor does not currently exist, the BOE had to assume, based on available data that 2,000 distributors would register and remit to the BOE. Furthermore, staff had to make assumptions regarding pending amendments that would allow for an adequate audit trail and specify the incidence of tax.

Revenue Impact: This bill does not specify a per ounce tax rate for cannabis flowers, leaves and immature plant. As such, a revenue estimate could not be prepared.