



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	05/05/11	Bill No:	<a href="#">Senate Bill 626</a>
Tax Program:	Sales and Use Tax	Author:	Calderon
Sponsor:	Author	Code Sections:	BPC Division 8.9 (commencing with 22992) RTC 7059
Related Bills:		Effective Date:	01/01/12

## BILL SUMMARY

This bill would:

- Enact the Cannabis Certification and Regulation Act of 2011 containing Legislative findings and declarations; and
- Require the Board of Equalization (BOE) to establish a task force to conduct a study to determine the most efficient means to enhance collection of applicable state and local sales and use tax on retail sales of cannabis or cannabis products and to ensure the proper regulation of cannabis and cannabis products, as described, and submit a report on the results of the study to the Legislature.

## ANALYSIS

### CURRENT LAW

**Federal Law.** Existing federal law prohibits the manufacture, possession, sale, or distribution of marijuana. (21 U.S.C. § 841 *et seq.*) Congress enacted the Controlled Substances Act (21 U.S.C. § 801 *et seq.*) (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.” (21 U.S.C. §§802(6), 812(a).) For a drug or other substance to be designated 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 under medical supervision.” (21 U.S.C. § 812 (b)(1).) Federal law lists marijuana as a schedule I controlled substance, deemed to have no accepted medical use. (21 U.S.C. § 812:Schedule I(c)(10).)

**State Law.** Under existing law, the California Uniform Controlled Substances Act (Division 10 (commencing with Section 11000) of the Health and Safety Code) 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. (Health and Safety Code Section 11362.5)

There is currently no statewide regulatory or licensing program for the sale and distribution of marijuana.

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**Sales and Use Tax Law.** Under the existing Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), except where specifically exempted by statute, a tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. 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, and illegal drugs are subject to tax to the same extent as any lawful retail sale of tangible personal property.

Section 6369 of the Sales and Use Tax Law exempts from sales and use tax retail sales of medicines, as defined, 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 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.

Under the law, 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 is required to apply to the BOE for a seller's permit on a form prescribed by the BOE. Wholesalers and suppliers, as well as retailers, must obtain a seller's permit. Section 6071 of the Sales and Use Tax Law specifies that any person that engages in business as a seller in this state without a seller's permit, and each officer of any corporation which so engages in business, is guilty of a misdemeanor, punishable by a fine of not less than \$1,000 and not more than \$5,000, or imprisonment not exceeding one year in the county jail, or both the fine and imprisonment in the discretion of the court.

Also, under existing law, persons who fail to file a sales and use tax return and pay their tax obligations may be held liable for past tax obligations, together with interest and penalties, for up to eight prior years (except in the case of fraud, for which there is no limitation on the period in which past tax obligations may be assessed).

#### **PROPOSED LAW**

This bill would add Division 8.9 (commencing with Section 22992) to the Business and Professions Code to enact the Cannabis Certification and Regulation Act of 2011 (Act), which provides various findings and declarations focused on issues related to California's medical marijuana dispensaries authorized to sell medical marijuana under the Compassionate Use Act, including intentional evasion of taxes, misuse of medical marijuana dispensaries as sources of illegal distribution and consumption, and dispensaries not having clearly defined legal framework for acquiring medical marijuana. The findings and declarations also state the intent to enact legislation similar to the Cigarette and Tobacco Products Licensing Act of 2003<sup>1</sup> to license and control the distribution of medical marijuana.

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<sup>1</sup> Division 8.6 (commencing with Section 22870) of the Business and Professions Code.

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This bill would also add Section 7059 to the Revenue and Taxation Code to require the BOE to establish a task force to conduct a study to determine the most efficient means to obtain compliance under the Sales and Use Tax Law by sellers of cannabis and cannabis products that are engaged in business in this state and ensure the proper regulation of the cultivation, transportation, and distribution of cannabis and cannabis products. In conducting the study, the task force would be required to consider all of the following:

- The current strategies of the BOE that encourage compliance with the Sales and Use Tax Law from cannabis or cannabis products sellers engaged in business in this state.
- The advantages or disadvantages of implementing a stamp system for cannabis or cannabis products similar to that used for cigarettes under the California Cigarette and Tobacco Products Tax Law (Part 13 (commencing with Section 30001)) of Division 2 of the Revenue and Taxation Code.
- Strategies that would assist the BOE in identifying sellers of cannabis or cannabis products, including the use of state or local law enforcement agencies.
- Strategies that would provide incentives for cannabis or cannabis product sellers to register and pay the tax imposed by the Sales and Use Tax Law without the possibility of self-incrimination.
- The potential administrative costs to the BOE for implementing and administering any system that the BOE identifies that would enhance collection of applicable state and local sales and use tax on the sale and use of cannabis or cannabis products in this state.
- Strategies that would assure quality control of cannabis and cannabis products, including laboratory testing for potency, pathogens, and pesticides.
- The advantages or disadvantages of establishing a state level program for the licensing, regulation, and enforcement of best practices for the cultivation, processing, and distribution of cannabis and cannabis products for medical use.

The task force would be composed of nine persons, including one representative each from the California Police Chiefs Association, the California Narcotic Officer's Association, the California District Attorneys Association, the California Medical Association, the Attorney General, the California Cannabis Association, and the Americans for Safe Access and two representatives appointed by the Chair of the BOE.

The BOE would be required to submit a report to the Legislature with the results of the study no later than six months after the effective date of the bill. In the event the report includes a strategy that is feasible and would benefit the state and local sales and use tax revenue stream and minimize noncompliance by cannabis or cannabis products sellers engaged in business in this state, the report would also recommend a strategy for implementation.

#### **IN GENERAL**

Existing law, as authorized under the Compassionate Use Act, allows persons or primary caregivers to cultivate or possess marijuana for medical use when recommended by a physician, as specified.

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Despite the fact that numerous medical cannabis dispensaries are currently in business in California, the sale of medical cannabis is strictly illegal under federal law. Under state law, the sale is lawful in certain defined circumstances as provided by SB 420 (Ch. 875, Stats. 2003), which established statewide guidelines for Proposition 215 enforcement. In particular, non-profit distribution is allowed in certain cases for patient cultivation co-ops and small-scale caregiver gardeners.

Up until late 2005, the BOE's longstanding policy was to not issue a seller's permit to a person whose sole selling activity was the unlawful sale of tangible personal property, so as not to confer permissive authority or condone an illegal activity. However, although it was BOE policy to not issue seller's permits, the sales tax applies to all retail sales of illegal substances in this state, and the BOE may audit and make assessments of any unreported tax on such sales.

However, after hearing a case that came before the Members of the BOE involving medical marijuana sales, and recognizing the difficulty in reconciling the BOE's authority to issue assessments for taxes due from a seller's marijuana sales while not issuing seller's permits to such sellers, as well as taking into account the legality of some sales of marijuana as authorized in SB 420, the BOE changed its policy. Now, 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. And, in order to reduce concerns about confidentiality and self-incrimination, the BOE allows an applicant of a seller's permit to omit information normally requested on the application, such as the products the applicant intends to sell, the names and addresses of suppliers, and the products the applicant intends to purchase. As such, the exact number of dispensaries registered with the BOE is unknown.

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.

#### **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. 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.

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**COMMENTS**

1. **Sponsor and purpose.** This measure is sponsored by the author and intended to create a mechanism for studying the best ways to control, regulate, and test medical marijuana cultivation and distribution.
2. **Medical Marijuana Program.** The Attorney General (AG) assembled a 29-member task force to address the implementation of the Compassionate Use Act. This task force, which was comprised of patients, law enforcement, doctors, and local government representatives, created enforceable recommendations that included the establishment of a registry identification program administered by DPH and the requirement that the DPH determine the amount of appropriate medical marijuana. SB 420 (Ch. 875, Stats. 2003), which established the Medical Marijuana Act (MMA) Program (Article 2.5 (commencing with Section 11362.7) of Part 6 of Division 10 of the Health and Safety Code, resulted from these task force recommendations.

Among other things, the provisions of the MMA Program require the AG to develop and adopt appropriate guidelines to ensure the security and non-diversion of marijuana grown for medical use by patients qualified under the Compassionate Use Act. To fulfill this requirement, the AG issued [Guidelines for the Security and Non-Diversion of Marijuana Grown for Medical Use](#). In part, the issued guidelines are to (1) ensure that marijuana grown for medical purposes remains secure and does not find its way to non-patients or illicit markets, (2) help law enforcement agencies perform their duties effectively and in accordance with California law, and (3) help patients and primary caregivers understand how they may cultivate, transport, possess, and use medical marijuana under California law.

The required considerations pursuant to this measure, as they relate to quality control and licensing, regulation, and enforcement of cannabis, more appropriately belong under the MMA Program since they relate to the safety and distribution of medical marijuana. In addition, since these considerations are outside the area of tax administration, it is recommended that an agency, such as the AG's Office or the DPH, lead the study. BOE staff is willing to be involved as a task force member with regard to its duties and expertise under the Sales and Use Tax Law and Cigarette and Tobacco Products Licensing Act of 2003.

3. **Is a sales tax study necessary?** The mission of the BOE is to serve the public through fair, effective, and efficient tax administration. This measure's requirement for a study to determine the most efficient means to obtain compliance under the Sales and Use Tax Law by sellers of cannabis and cannabis products is related to tax administration and falls under the purview of the BOE. However, it is questionable if such a mandate is necessary. The BOE continuously works to develop new approaches and processes to address specific areas of non-compliance for the tax and fee programs it administers, which include enhanced collection of the sales and use tax on retail sales of cannabis and cannabis products. It therefore appears the study, as it relates to enhanced collection of sales and use tax on retail sales of cannabis, duplicates existing BOE efforts in the area of the "tax gap" (the difference between taxes owed and taxes paid) and is not necessary.

4. **Report due date.** This bill would require a report to the Legislature with the results of the study by no later than six months after the effective date of the bill. It is questionable if a six month timeframe is sufficient to assemble a task force, address each of the considerations, and submit the required report to the Legislature. The author may wish to consider amending the report due date to January 1, 2013, which would allow for adequate time to successfully complete the report and align with the bill introduction deadline for any statutory recommendations.

#### **COST ESTIMATE**

Administrative costs related to staff time would be incurred in establishing a task force and conducting the proposed study. An estimate of these costs is pending; however, it's estimated that these costs would be substantial (over \$250,000 and under \$1 million).

#### **REVENUE ESTIMATE**

This bill would not impact state revenues.

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