



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0043
TELEPHONE (916) 445-1441
FAX (916) 445-2388
www.boe.ca.gov

BETTY T. YEE
Acting Member
First District, San Francisco

BILL LEONARD
Second District, Sacramento/Ontario

CLAUDE PARRISH
Third District, Long Beach

JOHN CHIANG
Fourth District, Los Angeles

STEVE WESTLY
State Controller, Sacramento

RAMON J. HIRSIG
Executive Director

October 14, 2005

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the October 25, 2005 Business Taxes Committee meeting. This meeting will address the proposed revisions to Compliance Policy and Procedure Manual (CPPM) Chapter 2, *Registration*.

Action 1 on the agenda concerns proposed revisions regarding the issuance of a seller's permit to a person requesting a seller's permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m. on Tuesday, October 25, 2005** in Room 121 at the address shown above.

Sincerely,

Randie L. Henry, Deputy Director
Sales and Use Tax Department

RLH: ca

Enclosures

cc: (all with enclosures)

Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member, First District (MIC 71)
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Member's Office, Third District (via e-mail)
Ms. Sylvia Tang, Board Member's Office, First District (via e-mail)
Mr. Steve Kamp, Board Member's Office, First District (MIC 71)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Ms. Selvi Stanislaus (MIC 82)
Mr. Randy Ferris (MIC 82)
Ms. Carla Caruso (MIC 82)
Ms. Sharon Jarvis (MIC 82)
Ms. Janice Thurston (via e-mail)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (MIC 85)
Mr. Rey Obligacion (via e-mail)
Mr. Todd Gilman (MIC 70)
Mr. Kenneth Topper (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Freda Orendt (via e-mail)
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. Jeffrey L. McGuire (MIC 92 and via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Mr. Charles E. Arana Jr. (MIC 50)
Ms. Cecilia Watkins (MIC 50)

AGENDA — October 25, 2005 Business Taxes Committee Meeting
Proposed revisions to Compliance Policy and Procedures Manual (CPPM) Chapter 2, Registration, regarding issuance of a seller's permit to a person requesting a permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state

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| <p>Action 1 — Issuance of Seller's Permit</p> <p>Compliance Policy and Procedures Manual section 210.010 Agenda, pages 2-3</p> | <p>Adopt either:</p> <p>Staff's recommendation to revise Board policy and issue a seller's permit to a person applying for one, regardless of whether the sale of such property is lawful in this state.</p> <p style="text-align: center;">OR</p> <p>Acting Board Member Betty Yee's recommendation to issue a seller's permit to a person requesting one for the sale of medical marijuana as defined in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act, the sale of which is taxable in this state.</p> <p style="text-align: center;">OR</p> <p>Make no changes to current Board policy.</p> |
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AGENDA — October 25, 2005 Business Taxes Committee Meeting
Proposed revisions to Compliance Policy and Procedures Manual (CPPM) Chapter 2, Registration, regarding issuance of a seller's permit to a person requesting a permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state

| Action Item | Language Proposed by Staff | Language Proposed by Acting Board Member Yee |
|-------------|---|--|
| ACTION 1 – | <p>SALES TAX PERMITS 210.000</p> <p>SELLER'S PERMIT 210.010</p> <p>Every person desiring to engage in the business of selling tangible personal property, the gross receipts from the ultimate retail sale of which must be included in the measure of sales tax, must file an application for a seller's permit for each place of business in California. The applicant must furnish such security, as the Board deems necessary, in a form acceptable to the Board.</p> <p>Persons from out of state who maintain a stock of goods in California from which orders are filled are considered "sellers" under the California Sales and Use Tax law, and are required to hold a seller's permit. (Revenue and Taxation Code section 6006.)</p> <p><u>A seller's permit shall be issued to any person who requests one for the sale of tangible personal property the gross receipts from the retail sale of which are required to be included in the measure of sales tax. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.</u></p> <p>Under the Sales and Use Tax Law, "person" is defined as any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. A</p> | <p>SALES TAX PERMITS 210.000</p> <p>SELLER'S PERMIT 210.010</p> <p>Every person desiring to engage in the business of selling tangible personal property, the gross receipts from the ultimate retail sale of which must be included in the measure of sales tax, must file an application for a seller's permit for each place of business in California. The applicant must furnish such security, as the Board deems necessary, in a form acceptable to the Board.</p> <p>Persons from out of state who maintain a stock of goods in California from which orders are filled are considered "sellers" under the California Sales and Use Tax law, and are required to hold a seller's permit. (Revenue and Taxation Code section 6006.)</p> <p><u>A seller's permit shall be issued to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the Sales and Use Tax Law.</u></p> <p>Under the Sales and Use Tax Law, "person" is defined as any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state,</p> |

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Proposed revisions to Compliance Policy and Procedures Manual (CPPM) Chapter 2, Registration, regarding issuance of a seller's permit to a person requesting a permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state

| Action Item | Language Proposed by Staff | Language Proposed by Acting Board Member Yee |
|-------------|--|--|
| | <p>cooperative association that is not incorporated is treated as a partnership with each member fully liable. (Revenue and Taxation Code section 6005.)</p> <p>Any administrator, executor, trustee or any other person who operates a business as a fiduciary must file an application for a permit or license. These persons, although under the jurisdiction of the courts, must operate according to the laws of the state.</p> <p>"Living Trust" is a legal entity set up by persons for estate planning purposes. A person may place his/her assets into a living trust, and upon his/her death, assets may be distributed more quickly to heirs, often bypassing probate entirely. A living trust must have a trustee. Living trusts may operate businesses, and should be treated as a corporation when processing applications. Offices should view copies of legal documents establishing a living trust if any doubt exists whether the trust has been properly formed.</p> <p>Other types of trusts that are about to engage in business should establish to the Board's satisfaction that they are legally formed. "Legally formed" would include documentation from the Franchise Tax Board, Secretary of State, Superior Court, or other authority, or for living trusts, copies of documents establishing the legal trust. If any doubt exists a permit should not be issued until further investigation is made.</p> | <p>or any other group or combination acting as a unit. A cooperative association that is not incorporated is treated as a partnership with each member fully liable. (Revenue and Taxation Code section 6005.)</p> <p>Any administrator, executor, trustee or any other person who operates a business as a fiduciary must file an application for a permit or license. These persons, although under the jurisdiction of the courts, must operate according to the laws of the state.</p> <p>"Living Trust" is a legal entity set up by persons for estate planning purposes. A person may place his/her assets into a living trust, and upon his/her death, assets may be distributed more quickly to heirs, often bypassing probate entirely. A living trust must have a trustee. Living trusts may operate businesses, and should be treated as a corporation when processing applications. Offices should view copies of legal documents establishing a living trust if any doubt exists whether the trust has been properly formed.</p> <p>Other types of trusts that are about to engage in business should establish to the Board's satisfaction that they are legally formed. "Legally formed" would include documentation from the Franchise Tax Board, Secretary of State, Superior Court, or other authority, or for living trusts, copies of documents establishing the legal trust. If any doubt exists a permit should not be issued until further investigation is made.</p> |

Issue Paper Number **05 - 009**



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

**Proposed revisions to Compliance Policy and Procedures Manual
(CPPM) Chapter 2, *Registration*, regarding issuance of a seller's permit
to a person requesting a permit for the sale of tangible personal property,
regardless of whether the sale of such property is lawful in this state**

I. Issue

Should Compliance Policy and Procedures Manual (CPPM) Chapter 2, *Registration*, be revised to clarify whether the Board should issue a seller's permit to a person requesting a seller's permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state?

II. Staff Recommendation

Staff recommends that CPPM Chapter 2, *Registration*, be revised to provide that a seller's permit shall be issued to any person who requests one for the sale of tangible personal property the gross receipts from the retail sale of which are required to be included in the measure of sales tax. In general, the person requesting the permit must fully complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

See Issue Paper pages 5-7, and Agenda Action item 1. A comparison of staff's and Ms. Yee's proposed language is attached as Exhibit 2.

III. Other Alternatives Considered

A. Alternative 1

Ms. Betty Yee, Acting Board Member, First District, recommends that CPPM Chapter 2, *Registration*, be revised to provide that a seller's permit shall be issued to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

See Issue Paper pages 7-8, and Agenda Action item 1. A comparison of staff's and Ms. Yee's proposed language is attached as Exhibit 2.

B. Alternative 2

Make no changes to current Board policy.

Issue Paper Number: U05 - 009U

IV. Background

At a Board hearing on February 8, 2005, the Board heard a case involving the sale of marijuana and directed staff to initiate the Business Taxes Committee (BTC) process to review its policy regarding issuance of seller's permits to sellers requesting a permit for the sale of "medical" marijuana or other tangible personal property, regardless of whether the sale of that property is lawful in this state. The Board is seeking to provide clear guidance to sellers of "medical" marijuana or other tangible personal property regarding the application of tax to their sales, their liability to pay the tax to the Board, and the mechanism available to report the tax.

Revenue and Taxation Code (RTC) section 6051 imposes a sales tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail in this state, except as specifically exempted by statute. Section 6091 provides that it "shall be presumed that all gross receipts are subject to the tax until the contrary is established...." Nothing in the Sales and Use Tax Law specifically exempts from taxation the gross receipts from the retail sale of contraband or illegal substances. Therefore, sales of "medical" marijuana are subject to tax, regardless of whether or not such sales are legal in this state. In addition, a person making sales of "medical" marijuana owes sales tax whether or not that person has a seller's permit.

Current Board policy regarding issuance of seller's permits

Generally, when a person applies for a seller's permit to sell tangible personal property in this state, the Board issues a seller's permit to that person. The permit includes a warning indicating it is not a permit to sell tangible personal property unlawfully. Specifically, the permit states: "This permit does not authorize the holder to engage in any business contrary to laws regulating that business or to possess or operate any illegal device." If the person sells tangible personal property the sale of which is lawful, such as T-shirts, pipes, vitamins, or medical supplies, the person must hold, and will be issued, a seller's permit for the sale of these items. However, if the person also sells tangible personal property the sale of which is unlawful, the person is required to report and pay the tax on the gross receipts from the sale of all tangible personal property, including property the sale of which is unlawful.

The Board's longstanding policy precluded the issuance of a seller's permit to a person whose only selling activity is the unlawful sale of tangible personal property. This policy is explained in Sales and Use Tax Annotation 410.0202, *Refusal to Issue a Seller's Permit* (9/30/85; 7/15/96) (Exhibit 3). That annotation states that a party to an illegal enterprise cannot require the Board to issue, or to continue in good standing, a seller's permit which specifically grants the privilege of engaging in the illegal enterprise. The annotation concludes, "The Board's staff discretion must be exercised so as not to confer permissive authority on a person to embark on, or to continue, an illegal activity." (*Ibid.*)

Some 10 years after issuance of this annotation, the Compassionate Use Act of 1996 ("Compassionate Use Act") decriminalized the cultivation and use of marijuana by certain persons on the recommendation of a physician (Health & Safety Code, section 11362.5). However, under the Compassionate Use Act, the sale or possession for sale of marijuana remains illegal (Health & Safety

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Code, sections 11362.5, 11360(a), and 11359¹: but see the Medical Marijuana Program Act, Health & Safety Code section 11362.765, *People v. Urziceanu* (September 12, 2005, CO45276) ___ Cal.App.4th ___ [2005 Cal. App. LEXIS 1419]. Consistent with the Board policy in place before the Compassionate Use Act, the Board had continued its policy not to issue seller's permits for the unlawful sale of tangible personal property. Thus, no seller's permits were being issued for the sale of marijuana. However, notwithstanding this policy, the Board has the authority to assess tax on sales of marijuana or other unlawful substances when it becomes aware of such sales. With regard to "medical" marijuana and the Compassionate Use Act, the Board's policy is reflected in Sales and Use Tax Annotation 410.0178, *Medical Marijuana* (12/9/02). (Exhibit 4). That annotation explains, in part, that when a person informs the Board in an application for a seller's permit that he or she plans to sell "medical" marijuana, that person will be informed that (1) a seller's permit will be issued for the sale of legal tangible personal property, (2) the seller's permit does not allow for the sale of "medical" marijuana or other illegal merchandise, and (3) if "medical" marijuana is sold, its sale is subject to tax.

At the February 8, 2005, Board hearing, several concerns were expressed regarding this issue. Some believe it is difficult to reconcile the Board's authority to issue assessments for taxes due from a seller's sales of marijuana when the Board will not issue permits to sellers for the sale of marijuana who wish to be permitized so they have the mechanism to pay the tax they owe. The Board's position in denying permits for the sale of marijuana has been that it is not in a position of condoning illegal enterprise. However, if a taxpayer has a seller's permit because it is engaged in lawful sales, the taxpayer is responsible to report tax on the gross receipts from sales of all products, including marijuana. On the other hand, the Board could assess tax on gross receipts from marijuana sales when information of the sales comes to Board attention, regardless of whether the nonpermitized seller collected tax reimbursement from its customers.

Interested parties meetings were held on June 28 and August 11, 2005, to discuss whether current Board policy should change and several interested parties submissions were received on this topic. There was generally agreement that there should be a mechanism provided by the Board to allow a retailer who is liable for the tax to report the tax due on its sales. Some interested parties took exception to staff's opinion that sales of "medical" marijuana remain unlawful in this state. In addition, concerns were raised regarding confidentiality and self-incrimination issues, and the retroactive effect of any change in Board policy.

¹ The sale of marijuana, and the possession for sale of marijuana, are also illegal under federal law. The federal Controlled Substances Act (CSA) provides that, "[e]xcept as authorized by this subchapter, it shall be unlawful for any person knowingly or intentionally...to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance." (21 U.S.C. § 841(a)(1).) Provisions of the CSA establish various exceptions. For marijuana (and other drugs that have been classified as "schedule I" controlled substances), only one exception is available, and that is for federal government-approved research projects. (21 U.S.C. § 823(f); *United States v. Oakland Cannabis Buyers' Cooperative* (2001) 532 U.S. 483, 489-490.) In *United States v. Oakland Cannabis Buyers' Cooperative*, *supra*, 532 U.S. 483, 494, the United States Supreme Court held that a defense of medical necessity was unavailable to the CSA's prohibition of the manufacture and distribution of marijuana. The Court also noted that a medical necessity defense was likewise unavailable to any other prohibition of the CSA. (*Id.* at p. 494, fn. 7.)

The federal CSA applies to "intrastate incidents of the traffic in controlled substances," as well as to interstate traffic in controlled substances. (21 U.S.C. § 801(6) [emphasis added].) Accordingly, the manufacture and distribution of marijuana in intrastate traffic in California is prohibited by federal law. (*United States v. Tisor* (9th Cir. 1996) 96 F. 3d 370, 372-375.)

We note that on June 6, 2005, the United States Supreme Court issued its opinion in *Gonzales, et al. v. Raich, et al.* (2005) ___ U.S. ___ [125 S.Ct. 2195; 162 L.Ed.2d 1; 2005 U.S. LEXIS 4656], holding that Congress's Commerce Clause authority includes the power to prohibit the cultivation and consumption of marijuana, including locally cultivated and domestically used marijuana. The Supreme Court held that the CSA, a federal statute validly enacted under the Commerce Clause, prohibits intrastate cultivation and use of marijuana in compliance with state law, that is, the Compassionate Use Act of 1996 (Health & Safety Code, § 11362.5). (*Ibid.*)

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V. Discussion

When the Board referred this issue to the Business Taxes Committee, it directed staff to review its policy of denying a seller's permit to a seller who requests one for the sale of "medical" marijuana or tangible personal property the sale of which is unlawful in this state. The interested parties' submission discussed below addresses the constitutionality of the tax scheme in regard to sales of marijuana, and the qualification of dispensaries as health facilities, but it does not make a recommendation for Board action concerning the granting of a seller's permit to those sellers requesting one for the sale of "medical" marijuana. Therefore, it is outside the scope of the specific issue before the Board and is included in this paper for discussion purposes only.

In his August 10, 2005 submission, Mr. Joseph D. Elford of Americans for Safe Access (ASA), a medical marijuana advocacy organization, contends that the tax scheme is unconstitutional and unrealistic because it requires medical marijuana dispensary operators to incriminate themselves and others. In addition to the constitutional question, ASA argues that while dispensaries conduct retail sales of medical marijuana, their sales are exempt under RTC section 6369(a)(3). RTC 6369(a)(3) provides that sales of medicines are exempt from sales and use taxes if furnished by a health facility for patient treatment pursuant to the order of a licensed physician. ASA believes that sales of "medical" marijuana by dispensaries meet this definition because in its view, marijuana qualifies as medicine and dispensaries as health facilities. ASA's full submission is attached as Exhibit 5.

Current law does not specifically exempt or exclude from taxation sales of marijuana or "medical" marijuana. Current sales and use tax law also requires every person desiring to conduct business as a seller of tangible personal property to file an application for a permit. The Board has no basis to exempt or exclude from tax sales of property that are not exempt or excluded by statute. As set forth in the privacy notice the Board furnishes to all applicants, the Board has entered into information-sharing agreements with various federal, state, and local government agencies, and may disclose information to the proper officials of these agencies. In addition, an existing Governor's Order authorizes disclosure of information to local law enforcement and the United States Attorney. Moreover, this agency may be compelled to produce information or documents in court proceedings by means of a subpoena or subpoena duces tecum. (See, e.g., Code of Civil Procedure section 1985, et seq.) While staff recommends revising Board policy to issue seller's permits to persons who request one and are engaged in the sale of marijuana, staff believes it does not have the authority either to (1) protect such a group of taxpayers from disclosure of available information pursuant to information-sharing agreements, Governor's Order, and statute, or (2) override the statutory requirements to maintain records and collect the information necessary to administer the sales and use tax program. However, staff further recommends that a person applying for a seller's permit who does not wish to provide information concerning the type of property being sold, generally be issued a seller's permit after the Department (1) advises the seller that the information he or she does not provide may prevent the Board from providing him or her with certain information regarding the correct application of tax to transactions common in the seller's industry, and (2) obtains a written acknowledgement that the seller has waived the opportunity to receive industry-specific information from the Board that may provide helpful tax compliance guidance.²

² Certain interested parties have argued that requiring sellers of "medical" marijuana to apply for seller's permits would violate their constitutional rights against self-incrimination regardless of whether or not such applicants are required by the Board to state their intention to sell "medical" marijuana at retail on their applications.

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Moreover, the constitutionality of provisions of the Sales and Use Tax Law requiring a seller to hold a seller's permit and to remit tax to this Board, is not and cannot be at issue here. The California Constitution specifies that an administrative agency, such as the Board, has no power to declare a statute unconstitutional. (Cal. Const., art. III, § 3.5.) Lastly, we note that the Board policy at issue deals exclusively with persons who request seller's permits of the Board, and who choose to provide the information required for issuance of a seller's permit.

In regard to ASA's position that sales of medical marijuana by dispensaries are exempt from tax based on RTC section 6369, staff believes that dispensaries do not meet the definition of health care facilities provided in that section, and that sales of "medical" marijuana by dispensaries and primary caregivers are subject to tax. In addition, the statute exempts sales and use of "medicines" when prescribed by a licensed physician and dispensed on a prescription filled by a registered pharmacist in accordance with law. Since caregivers and "medical" marijuana dispensaries generally are not registered pharmacists, their sales are subject to tax. The application of tax to sales of "medical" marijuana by dispensaries, and whether such sales are subject to exemption or exclusion from tax under existing statutes is beyond the scope of this Business Taxes Committee topic. However, any "medical" marijuana dispensary, or other party may request an opinion letter from the Board's Legal Department regarding the application of tax to its specific set of facts.

VI. Staff Recommendation

A. Description of the Staff Recommendation

Staff has reconsidered its earlier policy of denying a seller's permit to a person who requests it when it is determined that the person is engaged in unlawful activities. Staff is proposing to revise CPPM Chapter 2, *Registration*, to issue a seller's permit to any person requesting one for the sale of tangible personal property, the sale of which is taxable in this state. The following statement is proposed to be added to section 210.010:

A seller's permit shall be issued to any person who requests one for the sale of tangible personal property the gross receipts from the retail sale of which are required to be included in the measure of sales tax. In general, the person requesting the permit must fully complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

However, staff further recommends that a person applying for a seller's permit who does not wish to provide information concerning the type of property being sold, generally be issued a seller's permit after the Department (1) advises the seller that the information he or she does not provide may prevent the Board from providing him or her with certain information regarding the correct application of tax to transactions common in the seller's industry, and (2) obtains a written acknowledgement that the seller has waived the opportunity to receive industry-specific information from the Board that may provide helpful tax compliance guidance. Staff will develop and distribute a form to be used for this purpose.

The proposed revisions are illustrated in Exhibit 2.

Under the proposed policy, when a seller of tangible personal property including marijuana requests a permit as required by statute, the Board will no longer deny issuance of the permit on the basis that the sale of the property or the property itself is unlawful. Rather, a permit will be issued so long as standard information necessary to administer the sales and use tax program is provided. Staff's policy change is not limited to sellers of "medical" marijuana. It would also apply to sellers of other

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tangible personal property who request seller's permits, regardless of whether the sales of that property are lawful in this state. The staff recommendation includes adding cautionary language to the seller's permit to emphasize that the permit does not authorize the unlawful sale of tangible personal property in this state. The staff recommendation presumes that a person applying for a seller's permit, whether engaged in legal or unlawful sales, or selling "medical" marijuana, will provide information requested on an application for permit and on the sales and use tax return forms (Form BOE-400-SPA, *California Seller's Permit Application*, can be obtained at any field office or on the Board's website at <http://www.boe.ca.gov/pdf/boe400spa.pdf>). Information requested on an application generally includes owner and business names, address, type of business, start date, list of vendors, banking information, and social security number(s). In addition, the seller's permit application asks what items will be sold. This information is generally required for the issuance of a seller's permit and to properly code the account for the proper administration of the sales and use tax program in a uniform and fair manner. Among other things, it is used to determine the taxpayer's reporting basis (quarterly, yearly); send notices, tax returns, and billings; correspond with taxpayers; distribute local and transit taxes to appropriate jurisdictions; and develop statistical data.

In addition, the staff recommendation does not discriminate among taxpayers and provides that all of the returns on which the self-assessments are made are subject to verification by audit. (CPPM 505.020). Lastly, the staff recommendation does not place staff members in the position of determining whether an applicant for a seller's permit is engaged in legal selling activity.

Some interested parties expressed their view that a tax exemption should apply for any taxes considered due on past sales of "medical" marijuana because of what they view as "the inherent confusion in tax policies and to ensure future compliance." Staff believes the Board has no authority to apply an exemption for overdue taxes. Industry may wish to pursue a legislative proposal for such amnesty.

However, RTC section 6596 and Regulation 1705, *Relief from liability*, provide relief from tax, penalty, or interest charges if the Board determines a taxpayer did not correctly report tax because it reasonably relied on written advice provided by the Board regarding a transaction. Any seller who relied on such advice may apply with the Board for relief from the tax, interest, and penalty. Requests received by the Board are handled on a case by case basis based on the provisions of the statute and the regulation. An electronic copy of Regulation 1705 is available at <http://www.boe.ca.gov/pdf/reg1705.pdf>.

B. Pros of the Staff Recommendation

- Provides a tax reporting mechanism to sellers who were unable to obtain a seller's permit in the past due to the unlawful sales they engage in.
- Reduces the competitive disadvantage that current permit holders have, including those selling "medical" marijuana, over retailers selling similar property without a permit and without reporting the taxes due.
- Allows retailers to seek reimbursement of the tax due to the state from their customers.

C. Cons of the Staff Recommendation

Could be misinterpreted as validating unlawful activities.

D. Statutory or Regulatory Change

No statutory change is required.

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E. Administrative Impact

Following approval by the Business Taxes Committee, CPPM Chapter 2 will be distributed to all holders of the CPPM. Would require revisions to published annotations and advice letters to the extent these conflict with staff's recommendation. Would require revisions to seller's permit forms to emphasize that the permit does not authorize the unlawful sale of property in this state. Would require development and distribution of "acknowledgement and waiver" form for seller's permit applicants who elect not to provide information concerning the type of property being sold on the permit application.

F. Fiscal Impact

1. Cost Impact

No additional costs. The costs associated with the workload to do the following activities are routine and included in the Boards annual budget: (1) maintain and distribute the CPPM chapters; (2) revise the seller's permit form; and (3) develop and distribute "acknowledgement and waiver" form.

2. Revenue Impact

Negligible. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

Will allow all sellers of tangible personal property to obtain seller's permits, regardless of the nature of their sales, so long as the gross receipts from the retail sale of which are required to be included in the measure of tax.

H. Critical Time Frames

No operative date is proposed. Upon Board approval, the revised CPPM Chapter 2 will be posted on the Board's website and distributed to Board staff, and any necessary forms will be developed and revised.

VII. Alternative 1

A. Description of the Alternative

Ms. Betty Yee recommends that CPPM Chapter 2, *Registration*, be revised to allow the issuance of a seller's permit to those "medical" marijuana sellers who apply for one. She proposes the following language be added to section 210.010:

A seller's permit shall be issued to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

The proposed revisions to section 210.010 are illustrated in Exhibit 2.

In her August 1, 2005 submission in support of issuing a seller's permit for seller's of "medical" marijuana, Ms. Yee explains that the proposal recognizes the November 1996 voter approval of Proposition 215, the Compassionate Use Act, codified in Health & Safety Code section 11362.5. This statute legalized the possession and/or cultivation of "marijuana for personal medical purposes of the

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patient upon the written or oral recommendation of the physician.” However, it did not address the sale of medicinal marijuana. Since medicinal marijuana is indisputably tangible personal property, sales of it are indisputably taxable under Revenue & Taxation Code section 6016, which defines ”tangible personal property” as “personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses.” Since the sale of medicinal marijuana is a taxable transaction, it makes no sense for the Board to refuse to grant the seller’s permit that Regulation 1699 requires of anyone proposing to sell tangible personal property.

Ms. Yee’s proposal differs from the staff recommendation in that it limits the change in current policy to persons identifying themselves as selling “medical” marijuana.

B. Pros of the Alternative

- Provides “medical” marijuana organizations a means to report and pay the sales and use tax due.
- Reduces the competitive disadvantage that current permit holders selling “medical” marijuana have over retailers selling similar property without a permit and without reporting the taxes due.
- Allows retailers of “medical” marijuana to seek reimbursement of the tax due to the state from their customers.

C. Cons of the Alternative

- Would require applicants to disclose that they are retailers of “medical marijuana” whether they want to or not. .
- May convey the message that sale and possession for sale of “medical” marijuana are lawful.

D. Statutory or Regulatory Change

No statutory change is required.

E. Administrative Impact

Following approval by the Business Taxes Committee, CPPM Chapter 2 will be distributed to all holders of the CPPM. Would require revisions to published annotations and advice letters to the extent these conflict with this alternative.

F. Fiscal Impact

1. Cost Impact

No additional costs. The costs associated with the workload to maintain and distribute the CPPM chapters are routine and included in the Board’s annual budget.

2. Revenue Impact

Negligible. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

Will allow all sellers of “medical” marijuana who identify themselves as such to now obtain seller’s permits.

H. Critical Time Frames

No operative date is proposed. Upon Board approval, the revised CPPM Chapter 2 will be posted on the Board’s website and distributed to Board staff.

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VIII. Alternative 2

A. Description of the Alternative

Make no changes to current Board policy.

B. Pros of the Alternative

Does not imply that permissive authority has been conferred on a person to embark on, or to continue, an activity which is unlawful under either state or federal law.

C. Cons of the Alternative

Does not provide sellers of “medical” marijuana or property the sale of which is unlawful with the means to report the taxes due.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

None.

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: October 11, 2005

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REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



Proposed revisions to Compliance Policy and Procedures Manual (CPPM) Chapter 2, Registration, regarding issuance of a seller's permit to a person requesting a permit for the sale of tangible personal property, regardless of whether the sale of such property is lawful in this state

Staff Recommendation

Staff recommends that CPPM Chapter 2, Registration, be revised to provide that a seller's permit shall be issued to any person who requests one for the sale of tangible personal property the gross receipts from the retail sale of which are required to be included in the measure of sales tax. In general, the person requesting the permit must fully complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

Alternative 1

Ms. Betty Yee, Acting Board Member, First District, recommends that CPPM Chapter 2, Registration, be revised to provide that a seller's permit shall be issued to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

Alternative 2

Make no changes to current Board policy.

Revenue Estimate

Background, Methodology, and Assumptions

Staff Recommendation:

The staff recommendation would provide a seller's permit to anyone requesting a permit for the sale of tangible personal property. This would include persons engaged in unlawful sales, as long as the tangible personal property they are selling is taxable. However, the seller's permit application requires the permit holder to disclose the name of the business, full name of business owner, full name of partners, officers, and members; social security numbers; driver license numbers; type of business; and the type of items being sold. It also requires the permit holder to disclose the business address and banking information.

Based on a report from the Office of National Drug Control Policy, Californians spent about \$7.8 billion on illicit drugs in 2000. In addition, according to a California Highway Patrol report cargo theft of stolen goods amounts to approximately \$1 billion annually. If individuals and criminal organizations paid tax on the sales of tangible personal property from illicit criminal activity to the Board, this would amount to approximately \$700 million (\$8.8 billion x 7.92%) in annual state and local sales tax revenue. However, it is reasonable to say that because of disclosure requirements and the extremely high risk of criminal prosecution, individuals and criminal organizations selling tangible personal property from illegal criminal activity will not request a seller's permit. Therefore, the revenue impact from staff's proposal would be to the extent of cannabis clubs reporting taxable sales of medicinal marijuana.

Alternative 1

Alternative 1 would provide a seller's permit to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996. Based on a list compiled from the American Medical Marijuana Association website, there are at least 145 clubs or centers providing "medical" marijuana in this state. Twenty-seven of the 145 clubs listed were found to hold seller's permits but it is unclear whether their reported sales included sales of "medical" marijuana.

We have not been able to determine how much medicinal marijuana is sold in the State each year. However, based on information gathered from the Office of National Drug Control Policy, Californians spent approximately \$1 billion on illicit marijuana in 2000. If we assume that 1% of this amount is consumed for legitimate medicinal purposes, we estimate that at least \$10 million of medicinal marijuana is sold each year. Nonetheless, we cannot assume that Alternative 1 would result in full participation and compliance. State and Federal statute prohibits the possession, manufacture, and distribution for sale of marijuana. Marijuana is a Schedule 1 drug by Federal statute, 21 USCS section 812, and is punishable with sentences from less than five years to life in prison. In June 2005, the U.S. Supreme Court (6-3 vote) in *Gonzales v. Raich* held that federal laws prohibiting the use of medical marijuana remain in effect regardless of state laws that permit its use. This ruling by the U.S. Supreme Court had a chilling impact on cannabis clubs in California. Cannabis clubs will not likely expose themselves by disclosing information through a seller's permit application that would incriminate them. Therefore the revenue impact from Alternative 1, if any, would be negligible.

Alternative 2

Alternative 2 has no revenue effect. No changes are made to current Board policy.

Revenue Estimate

Revenue Summary

The revenue impact from staff's proposal would be to the extent of cannabis clubs reporting taxable sales of medicinal marijuana.

The revenue impact from Alternative 1, if any, would be negligible, because cannabis clubs will not likely disclose information on a seller's permit application that would further subject them to criminal prosecution.

Alternative 2 has no revenue effect.

Preparation

Bill Benson, Jr., Research and Statistics Section, Legislative Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative Division, and Mr. Jeff McGuire, Tax Policy Manager, Sales and Use Tax Department reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of October 11, 2005

SALES TAX PERMITS**210.000****SELLER'S PERMIT****210.010**

Every person desiring to engage in the business of selling tangible personal property, the gross receipts from the ultimate retail sale of which must be included in the measure of sales tax, must file an application for a seller's permit for each place of business in California. The applicant must furnish such security, as the Board deems necessary, in a form acceptable to the Board.

Persons from out of state who maintain a stock of goods in California from which orders are filled are considered "sellers" under the California Sales and Use Tax law, and are required to hold a seller's permit. (Revenue and Taxation Code section 6006.)

Add staff's recommendation :

A seller's permit shall be issued to any person who requests one for the sale of tangible personal property the gross receipts from the retail sale of which are required to be included in the measure of sales tax. In general, the person requesting the permit must fully complete a seller's permit application and provide the information necessary for the Board to administer the state's sales and use tax laws.

or add Acting Board Member Yee's recommendation:

A seller's permit shall be issued to any person who requests one for the sale of marijuana for medical purposes to a patient or primary caregiver upon the recommendation of a physician, as provided for in the Compassionate Use Act of 1996 and the Medical Marijuana Program Act. In general, the person requesting the permit must complete a seller's permit application and provide the information necessary for the Board to administer the Sales and Use Tax Law.

Under the Sales and Use Tax Law, "person" is defined as any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. A cooperative association that is not incorporated is treated as a partnership with each member fully liable. (Revenue and Taxation Code section 6005.)

Any administrator, executor, trustee or any other person who operates a business as a fiduciary must file an application for a permit or license. These persons, although under the jurisdiction of the courts, must operate according to the laws of the state.

"Living Trust" is a legal entity set up by persons for estate planning purposes. A person may place his/her assets into a living trust, and upon his/her death, assets may be distributed more quickly to heirs, often bypassing probate entirely. A living trust must have a trustee. Living trusts may operate businesses, and should be treated as a corporation when processing applications. Offices should view copies of legal documents establishing a living trust if any doubt exists whether the trust has been properly formed.

Other types of trusts that are about to engage in business should establish to the Board's satisfaction that they are legally formed. "Legally formed" would include documentation from the Franchise Tax Board, Secretary of State, Superior Court, or other authority, or for living trusts, copies of documents establishing the legal trust. If any doubt exists a permit should not be issued until further investigation is made.

Annotation 410.0202, Refusal to Issue a Seller's Permit

410.0202 Refusal to Issue a Seller's Permit. The Board does have a legal basis for refusing to issue or revoking a seller's permit when state law makes it illegal to sell tangible personal property at the particular location in question. A person cannot legally engage in business as a seller at locations where selling is forbidden by state law (including state regulations which have the force and effect of law). The legal basis is that a party to an illegal enterprise cannot require the Board to issue, or to continue in good standing, a seller's permit which specifically grants the privilege of engaging in the illegal enterprise. The Board's staff discretion must be exercised so as not to confer permissive authority on a person to embark on, or to continue, an illegal activity. (*Asher v. Johnson*, 26 Cal.App.2d 403). 9/30/85; 7/15/96.

Annotation 410.0178, Medical Marijuana

410.0178 Medical Marijuana. An application was submitted to the Board to obtain a seller's permit for the purpose of selling "vitamins, air purifiers and medicinal marijuana." Since the applicant was selling "tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax," the club qualified as a "seller" as defined by Revenue and Taxation Code section 6014. Therefore, the permit was issued to the club even though the application submitted by the club's proprietors indicated that some of the sales would include "medical" marijuana. Although the cultivation and use of marijuana by certain persons on the recommendation of a physician was decriminalized by the enactment of the "Compassionate Use Act of 1996," the sale of, or possession for sale of, marijuana (for medical purposes or not) is still illegal under California law. Since 1996 the Board has adopted a policy of not issuing seller's permits to a person or persons who will engage solely in the sale of marijuana. In addition, the sale of "medical" marijuana is not an exempt sale of "medicine" because it is not "commonly recognized as a substance or preparation for medicinal use" as required by Revenue and Taxation Code section 6369. Even if marijuana were regarded as a medicine, the sale of marijuana, when sold without a prescription from a licensed physician or when furnished by other than a licensed medical facility, does not meet the requirements for exemption from sales tax as set forth in Regulation 1591, subdivisions (a)(9) and (d). The Sales and Use Tax Law authorizes the Board's imposition and collection of tax measured by gross receipts from the reported illegal sale of "medical" marijuana. Revenue and Taxation Code section 6051 imposes a sales tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail in this state, except as specifically exempted by statute. Revenue and Taxation Code section 6901 further provides that it "shall be presumed that all gross receipts are subject to tax unless the contrary is established . . ." Nothing in the Sales and Use Tax Law specifically excludes from taxation the gross receipts from the sale of contraband or illegal substances. When a person informs the Board in an application for a seller's permit that it plans to sell "medical" marijuana or "medical" cannabis, the Board has been put on notice that the seller is engaging in an illegal enterprise. The Board does not condone illegal activity. The Board should inform the applicant that although a seller's permit will be issued for the sale of legal tangible personal property, the permit does not allow for the sale of "medical" marijuana or other illegal merchandise. If "medical" marijuana is sold, its sale is subject to tax. 12/9/02. (2003-3).



1322 Webster St., Suite 208
Oakland, CA 94612
www.SafeAccessNow.org
Phone: 510-251-1856
Fax: 510-251-2036

Americans for Safe Access

August 10, 2005

Mr. Jeffrey L. McGuire
Chief, Tax Policy Division
Sales and Use Tax Department
State Board of Equalization
450 N Street
Sacramento, CA 94279-0092

Dear Mr. McGuire:

Americans for Safe Access (“ASA”), a medical marijuana advocacy organization in Oakland, California, submits the following position paper regarding the taxation of sales of medical marijuana. In particular, because the tax scheme requires dispensary operators to incriminate themselves and others, it is unconstitutional and unrealistic, as is discussed in Part II.

I. Not All Sales of Medical Marijuana Are Illegal

As an initial matter, it is important to note that the California Legislature has explicitly authorized the payment of compensation to primary caregivers, which includes “reasonable compensation incurred for services provided” and out-of-pocket expenses. (See Health & Safety Code § 11362.765(c)).¹ Separately, it has authorized “collectives” and “cooperatives” to form within the state to distribute marijuana. (See Health & Safety Code § 11362.775).² Thus, in determining the legality of marijuana sales, different types of relationships must be considered.

¹ Health & Safety Code § 11362.7 provides as follows:

(c) A primary caregiver who receives compensation for actual expenses, including reasonable compensation incurred for services provided to an eligible qualified patient or person with an identification card to enable that person to use marijuana under this article, or for payment for out-of-pocket expenses incurred in providing those services, or both, shall not, on the sole basis of that fact, be subject to prosecution or punishment under Section 11359 or 11360.

² Health & Safety Code § 11362.775 provides as follows:

Qualified patients, persons with valid identifications cards, and the designated primary caregivers of qualified patients and persons with identification cards, who associate within the State of California in order collectively or cooperatively to cultivate marijuana for medical purposes, shall not solely on the basis of that fact be subject to state criminal sanctions under Section 11357, 11358, 11359, 11360, 11366, 11366.5, or 11570.

First, there are “primary caregivers,” which are defined by statute as “the individual[s] designated by [qualified patients] who [have] consistently assumed responsibility for the housing, health, or safety of [those] person[s].” (Health & Safety Code § 11362.5(e)). The Legislature has authorized payments of compensation to primary caregivers for their expenses, including reasonable compensation for their labor. To the extent that such exchanges be construed as “sales,” they are legal and exempt from taxation because they do not operate on a “retail” basis. (Cf. Health & Safety Code § 11362.765(a) [“nothing in this section shall authorize the individual to smoke or otherwise consume marijuana unless otherwise authorized by this article, nor shall anything in this section authorize any individual or group to cultivate or distribute marijuana for profit”]).

Second, there are “medical marijuana patient collectives,” or “patient collectives,” which are organizations of multiple qualified patients and/or primary caregivers who associate together to cultivate and distribute marijuana to each other without the direct exchange of money. Again, since these types of collectives do not operate on a “retail” basis, they are exempt from the sales and use tax.

Third, there are “medical marijuana dispensing collectives,” hereinafter “dispensaries,” which are the same as patient collectives, except that they conduct retail sales of medical marijuana. This category of medical marijuana distribution is the primary focus of the remainder of this position paper.

II. It Would Violate the Constitutional Right against Self-Incrimination to Require the Sales Tax

Regardless whether medical marijuana sales by dispensaries comport with state law, they remain illegal under federal law. Because the Board of Equalization can offer no assurance that it will not turn over the highly incriminating information it collects from dispensaries to federal authorities, it would violate the right against self-incrimination to require the individuals who operate the dispensaries to report their gross receipts and other information.

When analyzing whether a tax statute violates the Fifth Amendment, the principal issue is whether compliance with the statute confronts the taxpayer with a “real and appreciable” hazard of self-incrimination. (*Marchetti v. United States* (1968) 390 U.S. 39, 48, 88 S.Ct. 697, 701). In *Marchetti*, the United States Supreme Court established a three-part test for determining the issue. This three-part test is as follows:

First, whether the conduct being regulated is part of “an area permeated with criminal statutes” and whether the individuals who engage in that conduct are part of a group “inherently suspect of criminal activities.” (390 U.S. at 47, 88 S.Ct. at 702). *Second*, whether the statutory tax requires the taxpayer, under penalty of criminal prosecution, to disclose information “he might reasonably suppose would be available to prosecuting authorities.” (390 U.S. at 48, 88 S.Ct. at 703). *Third*, whether the required information would prove a “significant ‘link in a chain’ of evidence tending to establish his guilt.” (*Ibid.*).

Applying this test to the proposed tax on the sale of medical marijuana reveals that this tax scheme would be unconstitutional.

As for the first prong of the test, it hardly bears stating that the possession, manufacture, and delivery of marijuana is an area replete with criminal statutes under both state and federal law. Furthermore, as applied here, the sales and use tax targets a group of individuals whose activities are inherently suspect of criminality. The tax scheme fails this first prong.

With respect to the third part of the test, the proposed tax requires the taxpayer to provide extensive information that could be used to incriminate him and may well be passed along to prosecuting authorities. As stated by the Board in its Second Discussion paper on the subject, an operator of a medical marijuana dispensary is required to complete an application for a permit (Form BOE-400-SPA, *California Seller's Permit*), which requests such information as: the owner and business names, address, type of business, start date, list of vendors, banking information, and what items would be sold. (See Second Discussion Paper, dated July 25, 2005, at 7). This information is highly incriminatory and would be, to say the least, useful to the investigation of a dispensary operator's activities and may constitute a direct admission of his guilt under federal law. Such information is far more extensive and incriminating than that required for marijuana tax stamps, which have been found to be unconstitutional due to their incriminating character. (See, e.g., *State v. Smith* (1991) 120 Idaho 77, 79, 813 P.2d 888, 890). This factor counsels strongly in favor of a finding that the proposed tax scheme would be unconstitutional.

Finally, with respect to the second prong of the *Marchetti* test -- confidentiality -- the Board not only will not provide any assurance that the incriminating information required of dispensaries will remain confidential, but, to the contrary, it expressly notes the risk of a leak. Its Second Discussion Paper states as follows:

As set forth in the privacy notice the Board furnishes all applicants, the Board has entered into information-sharing agreements with various federal, state, and local government agencies, and may disclose information to the proper officials of these agencies. In addition, an existing Governor's Order authorizes disclosure of information to local law enforcement and the United States Attorney. Moreover, this agency may be compelled to produce information or documents in court proceedings by means of a subpoena or subpoena duces tecum. (See, e.g., Code of Civil Procedure section 1985, et seq.) While staff recommends revising Board policy to issue seller's permits to sellers engaged in unlawful sales, staff believes it does not have the authority to protect a group of taxpayers from disclosure, pursuant to information-sharing agreements, Governor's Order, and statute, of available information, or the authority to override the statutory requirements to maintain records and collect the information necessary to administer the sales and use tax program.

(Second Discussion Paper, dated July 25, 2005, at 7-8). To require the reporting of incriminating information in this manner, with no assurances that such information will not be turned over to the federal authorities for federal prosecution, would violate the constitutional right against self-incrimination. (See *State v. Smith* (1991) 120 Idaho 77, 79, 813 P.2d 888, 890 [tax stamp requirement for controlled substances found unconstitutional; although purchaser of drug stamps was not required to give identifying information when paying the tax, there was no penalty for disclosure of information by tax commission employees or agents and there was no express prohibition against using the information obtained through the purchase of the stamps in criminal proceedings or investigations, which rendered taxing regulation unconstitutional; unconstitutionality later cured by statute requiring confidentiality of information provided by taxpayer]; cf. *Leary v. United States* (1969) 395 U.S. 6, 29, 89 S.Ct. 1532, 1544 [petitioner's noncompliance with transfer tax provisions of Marijuana Tax Act would have exposed defendant to prosecution under state narcotics laws, so plea of self-incrimination was complete defense to prosecution for noncompliance; information gathered was to be given to state and local law enforcement upon request]; *Marchetti, supra*, 390 U.S. at 61 [holding that timely assertion of privilege against self-incrimination operated as complete defense to prosecution for failure to register and pay federal tax on gambling]; *People v. Duleff* (1973) 183 Colo. 213, 218, 515 P.2d 1239, 1241 [holding that requirement of license to cultivate marijuana violates defendant's right against self-incrimination]).

III. Medical Marijuana Sales By Dispensaries Are Exempt from Taxation Under Revenue and Taxation Code § 6369(a)(3)

In addition to the constitutional questions presented, medical marijuana sales by dispensaries are exempt from taxation as “medicine” dispensed by a “health care facility,” pursuant to Revenue & Taxation Code § 6369(a)(3). Revenue and Taxation Code section 6369, and functionally identical Sales and Use Tax Regulation 1591, provide: “Sales of medicines are exempt from sales and use taxes if . . . (3) furnished by a health facility for patient treatment pursuant to the order of a licensed physician.” Medical marijuana sales by dispensaries meets this definition.

A. Marijuana Is “Medicine”

Through their enactment of California Health and Safety Code section 11362.5, the “Compassionate Use Act,” the California electorate declared as the public policy of this State that marijuana is medicine. (See Health & Safety Code § 11362.5(b)(1)(A) [declaring as purpose of Act to “ensure that seriously ill Californians have the right to obtain and use marijuana for medical purposes where that medical use is deemed appropriate and has been recommended by a physician”]). Indeed, to qualify as “medicine” for purposes of the Revenue and Taxation Code, a substance need not be dispensed by prescription. (*Purdue Frederick Co. v. State Board of Equalization* (1990) 218 Cal.App.3d 1021, 1028). Rather, the Legislature has defined “medicine” to encompass “any substance or preparation intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease and which is commonly recognized as a substance or preparation intended for that use.” (Revenue & Taxation Code § 6369(b)).

In addition to the California’s electorate’s declaration, the facts establish that marijuana is a “substance or preparation intended for use by . . . internal application to the human body in the . . . treatment . . . of disease and which is commonly recognized as a substance or preparation intended for that use.” (Cf. *Purdue, supra*, 218 Cal.App.3d at 1028 and fn.4 [rejecting Board’s construction of “treatment” as too narrow; adopting dictionary definition of “treatment” as “to care for or deal with medically or surgically” and “to act upon with some agent esp. to improve or alter. . . .”] [citing Webster's New Collegiate Dict. (9th ed. 1983) p. 1257]). Numerous peer-reviewed studies, including a National Institute of Medicine (“IOM”) study commissioned by the federal government, establish that marijuana is effective in treating various illnesses. For instance, more than 6,500 published scientific articles on medical applications for marijuana are found in the National Library of Medicine’s database (<http://pubmed.com>). Of these, many are clinical studies that show marijuana’s efficacy for treating pain, nausea, loss of appetite and spasticity.

Specifically, with respect to pain management, the IOM cited three double-blind, placebo-controlled studies on treating cancer pain, which found marijuana’s primary psychoactive component to be comparable to codeine in effectiveness, but without the nausea and other debilitating side effects. (Noyes Jr R, Brunk SF, Baram DA, Canter A 1975a; Noyes R, Jr, Brunk SF, Avery DH, Canter A 1975b; Staquet M, Gantt C, Machin D 1978). The IOM also reports that an experimental study on pain showed that “cannabinoids were comparable with opiates in potency and efficacy. . . .”

Other research on marijuana’s efficacy for pain management includes a human study showing statistically significant increases in pain threshold after smoking marijuana (Milstein, MacCannell, Karr & Clark 1975), as well as numerous case studies of patients who voluntarily employed marijuana to treat painful conditions, including a woman whose severe juvenile rheumatoid arthritis was resistant to standard medicine but responsive to marijuana therapy (Grinspoon & Bakalar 1997, Randall 1991, Noyes & Baram 1974). As noted in the chapter on “The Role of Cannabis and Cannabinoids in Pain Management” in the sixth edition of *Pain Management: A Guide for Clinicians* (Russo 2003), “these accounts fulfill criteria of ‘N-of-1 studies’ and have been accepted by epidemiologists as proof of efficacy in rare conditions or ones in which blinded controlled trials are technically difficult (Guyatt, et al 1990, Larson 1990).” On the basis of these studies and other research published before the HHS response, a review of indications for medical treatment with marijuana concluded “any patient with pain unrelieved by conventional analgesics should have access to smoked marijuana” (Hollister 2000).

On treating nausea, the IOM reported on numerous clinical studies – including “a carefully controlled double-blind study” and a “a double-blind, cross-over, placebo-controlled study” – showing that both marijuana and select cannabinoids are effective antiemetics for patients suffering nausea and lack of appetite related to both cancer treatment and HIV/AIDS. In fact, the IOM concluded that marijuana is not only effective, but “[f]or patients such as those with AIDS or who are undergoing chemotherapy and who suffer simultaneously from severe pain, nausea, and appetite loss, cannabinoid drugs might offer broad-spectrum relief not found in any other single medication.”

Moreover, a review of clinical studies conducted in several states during the past two decades has shown that, in 768 patients, marijuana was a highly effective antiemetic in chemotherapy (Musty and Rossi 2001). Recent double-blind, placebo-controlled studies of HIV/AIDS patients showed that marijuana both reduced neuropathic pain and produced weight gain without immunological compromise (Abrams et al. 2003). Clinical studies of Multiple Sclerosis, for which there are few effective treatments, have shown cannabis extracts to be effective for spasticity and other symptoms (Wade et al. 2003; Zajicek et al. 2003), as well as chronic pain (Notcutt and Rangappa 2004). Three additional articles supporting the benefit of marijuana in treating MS patients for spasticity (Vaney), pain, sleep and spasticity (Wade) and bladder function (Brady) appear in the August 2004 issue of the journal *Multiple Sclerosis*. The non-psychoactive marijuana component cannibidol (CBD) has also been shown to have numerous medical applications as an anti-inflammatory and neuroprotective agent (Mechoulam, Parker, and Gallily 2002; Pertwee 2004; Russo 2003) (Mechoulam, Parker, and Gallily 2002; Pertwee 2004; Russo 2003) and as a treatment for rheumatoid arthritis (Malfait et al. 2000).

Lastly, a study of patients who have used standardized, heat-sterilized, quality-controlled medical marijuana as part of the federal government's Compassionate Investigational New Drug Program demonstrated the long-term clinical effectiveness of marijuana in treating chronic musculoskeletal pain, spasm and nausea, and spasticity of Multiple Sclerosis (Russo 2002). After using medical marijuana supplied by the federal government for periods ranging from 11 to 27 years, these patients showed no functionally significant problems in their physiological systems, as determined by MRI scans of the brain, pulmonary function tests, chest X-ray, neuro-psychological tests, hormone and immunological assays, electroencephalography, P300 testing, and neurological clinical examination.

This nonexhaustive list of studies evidencing marijuana's usefulness in treating various illness shows that marijuana is "commonly recognized as a substance . . . intended for" medical use. Through their enactment of the Compassionate Use Act, the voters of California have confirmed this.

B. Dispensaries Are "Health Facilities"

As "medicine," marijuana sales are exempt from taxation if "[f]urnished by a health facility for treatment of any person pursuant to the order of a licensed physician and surgeon, dentist, or podiatrist." (Revenue & Taxation Code § 6369(a)(3)). Contrary to the Board of Equalization's narrow definition of a "health facility" as limited to in-patient facilities defined under Health and Safety Code section 1250 (see Regulation 1591(a)(4)), the Revenue and Taxation Code also includes "clinics" under Health and Safety Code section 1250 within this definition. (Revenue & Taxation Code § 6369(d)).³ Section 1250, in turn, defines a "clinic" as any "organized outpatient health facility which provides direct

³ Revenue & Taxation Code § 6369(d) provides:

(d) "Health facility" as used in this section has the meaning ascribed to it in Section 1250 of the Health and Safety Code, and also includes any "clinic" as defined in Section 1200 of the Health and Safety Code.

medical, surgical, dental, optometric, or podiatric advice, services, or treatment to patients who remain less than 24 hours, and which may also provide diagnostic or therapeutic services to patients in the home as an incident to care provided at the clinic facility.” (Health & Safety Code § 1200).⁴

Dispensaries meet this definition, as they provide direct medical services and treatment to qualified patients. Although the marijuana is not “dispensed on prescription filled by a registered pharmacist,” as required for exemption under Revenue and Taxation Code section 6369, subdivision (a)(1), it is furnished pursuant to the “order,” or written recommendation, of a licensed physician, at least from the perspective of the provider. Thus, medical marijuana sales by dispensaries are exempt from taxation under Revenue and Taxation Code section 6369, subdivision (a)(3).

CONCLUSION

For the foregoing reasons, it is the position of ASA that medical marijuana sales by dispensaries should not be taxed.

Sincerely,

Joseph D. Elford
Staff Attorney
Americans for Safe Access

⁴ By comparison, the statute explicitly excludes from its definition of a “clinic” “[a] place, establishment, or institution which solely provides advice, counseling, information, or referrals on the maintenance of health or on the means and measures to prevent or avoid sickness, disease, or injury, where such advice, counseling, information, or referrals does not constitute the practice of medicine, surgery, dentistry, optometry, or podiatry, shall not be deemed a clinic for purposes of this chapter.” (*Ibid.*)