

# Memorandum

**To:** Honorable Jerome E. Horton, Chairman  
Senator George Runner, Vice-Chair  
Honorable Fiona Ma, CPA, Second District  
Honorable Diane L. Harkey, Fourth District  
Honorable Betty T. Yee, State Controller

**Date :** May 14, 2015

**From:** David J. Gau, Chief Deputy Director

**Subject: Cannabis Compliance Pilot Project Statement**

Attached for your information is the project statement for the Cannabis Compliance Pilot Project. This project statement identifies project goals and objectives and is intended to be a living document that allows flexibility to adjust as new needs are identified. As mentioned in the project statement, this pilot project will be conducted in Districts 1 and 2; and the project team will prepare a report to the Board on findings regarding non-compliance within the medical cannabis industry and recommend initiatives to increase voluntary compliance.

The project team will provide periodic updates. If you have any questions, please contact me at (916) 323-9070.

DG:cl

cc: Ms. Shellie Hughes  
Ms. Kari Hammond  
Mr. Sean Wallentine  
Mr. Jim Kuhl  
Mr. Russell Lowery  
Ms. Yvette Stowers  
Ms. Cynthia Bridges



# California State Board of Equalization

## **Cannabis Compliance Pilot Project**

***Project Statement***

*May 14, 2015*

## Cannabis Compliance Pilot Project *Project Statement*

### **Project Overview**

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Under the current Sales and Use Tax Law<sup>1</sup> and implementing regulations, Medical Cannabis Dispensaries (retailers) are treated the same as any other business making sales of tangible personal property in this state. This includes the requirements to obtain a seller's permit and timely pay tax and file returns. Retailers are also subject to audit and collection actions, and there is no specific exemption from sales or use tax for sales or consumption of medical cannabis.

Prior to 2005, the California State Board of Equalization (BOE) did not issue sellers' permits to retailers under the premise that it was an illegal business. In October 2005, the Board directed staff to issue seller's permits to all retailers of medical cannabis as to provide a mechanism for retailers to collect and remit sales tax. Current registration policy allows taxpayers to "decline to state" the type of tangible personal property sold to reduce the risk of self-incrimination. This is one reason why the precise number of cannabis retailers operating in California is unknown. Additionally, the compliance rate among cannabis growers, many of whom are wholesalers of tangible personal property and are generally required to hold seller's permits, is extremely low.

In February 2014, the BOE instituted a policy to no longer accept cash payments, and encouraged taxpayers to pay online using their bank account information or credit card(s). A hardship policy, or "No Cash Exemption Request," was created at the time to assist certain taxpayers (primarily medical cannabis retailers) who have cash-based businesses and who refrained from obtaining a bank account out of a well-founded fear that the federal government could confiscate their assets. However, the absence of bank accounts, among other factors, renders the BOE's normal records verification procedures impractical, and further exacerbates our ability to track gross retail sales of medical cannabis.

Effectively administering the Sales and Use Tax Law as it relates to medical cannabis presents the BOE with several immediate challenges: (1) BOE only has a rough estimate of how many retailers and growers operate in California; (2) uncertainty surrounding the assumptions made to determine current sales and use tax revenue, volume of cannabis produced, current rate of consumption, and lost revenue due to non-compliance; and (3) recent increase in delivery services with no fixed business location makes tracking and monitoring retail sales difficult, and if recreational use becomes legal in the near future, BOE is unprepared as an agency to address this additional compliance challenge.

To improve industry compliance, BOE must first identify the barriers and scope of non-compliance among current retailers and growers. Once these determinations have been made, staff will provide the Board with their findings and make recommendations to address the issues. This project statement identifies project goals and objectives and is intended to be a living document that allows flexibility to adjust as new needs are identified, such as legislative and/or regulatory changes, along with ballot initiative(s) related to the cannabis industry.

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<sup>1</sup> Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code (RTC).

# Cannabis Compliance Pilot Project

## Project Statement

### Project Goals

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- (1) Determine the scope of non-compliance and identify the current and potential tax revenue, volume of cannabis produced, California's rate of consumption, lost revenue due to non-compliance, and current industry practices.
- (2) Identify barriers that impede voluntary tax compliance by each segment of the industry (e.g., growers, distributors, retailers) for the purpose of developing strategies to address the barriers.
- (3) In coordination with Legislative Division and relevant program staff, provide recommendations (statutory, regulatory, policy) for increasing voluntary compliance among growers and retailers.
- (4) Coordinate with Legislative Division and relevant program staff on issues related to cannabis.

### Project Objectives

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- Provide estimates for the following: current sales and use tax revenue, potential sales and use tax revenue, volume of cannabis produced, volume necessary to satisfy California's current rate of consumption, and lost revenue due to non-compliance.
- Provide an agency strategy and recommendations to overcome barriers and increase voluntary compliance.
- Identify key industry stakeholders and their legal and government affairs representatives to gain a better understanding of industry-specific business practices, while helping establish and leverage credibility among local retailers and growers to proactively address current and future obstacles to industry compliance.
- Collaborate with other state and federal agencies (ABC, EDD, FTB, IRS, DOJ, SWQCB, etc.) to identify current and potential regulatory and administrative issues related to the taxation of cannabis.

### Project Roles and Responsibilities

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#### Cannabis Compliance Project Team

- Project Director (Ken Pfeiffer) – Responsible for the implementation and oversight of the Cannabis Compliance Pilot Project.
- Project Lead (David Kinst) – Administer and coordinate program objectives between SCOP teams, district field staff, project liaisons, industry stakeholders and their government affairs representatives, outside agencies, and local governments.

# **Cannabis Compliance Pilot Project**

## *Project Statement*

### **Program Liaisons**

- Special Taxes Liaison (Richard Parrott) – Special tax and fee expertise and analysis.
- Legal Liaison (Greg Day) – Legal expertise and analysis.
- Legislative Liaison (Michele Pielsticker and Cindy Wilson) – Monitor and track all legislative, regulatory, and initiative changes related to the medical cannabis industry, and provide legislative and tax policy expertise and analysis.
- Research Liaison (Mark Durham) – Research and statistical expertise and analysis.
- Tax Policy Division Liaison (Brad Miller) – Assist with the development of city and county government initiatives; and analyze potential legislation, ballot initiatives, and regulatory recommendations.

### **Project Resources**

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Program liaison staff identified above in the “Roles and Responsibilities” section will be used for this pilot program. Additional program resources may be requested as needed

### **Project Deliverables**

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The project team will prepare a report for the Board on findings regarding non-compliance within the medical cannabis industry and recommend initiatives to increase voluntary compliance; and a work plan for implementing recommended initiatives.

### **Project Timeline**

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This pilot project will be conducted in Districts 1 and 2.

Overall, the pilot project timeline will be as follows:

2015

- March 13 – Draft Project Statement submitted
- April 27 – First Project/Liaison Team meeting
- April 30 – Project Statement finalized
- November 1 – Findings & Recommendations Report

## **Cannabis Compliance Pilot Project** *Project Statement*

### **Strategic Fit**

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This project supports the BOE's goals and objectives contained in BOE's 2010-15 Strategic Plan. Specifically, the project supports Goal 2, Maximize Voluntary Compliance. By identifying the scope of non-compliance in the medical cannabis industry and the specific barriers that prevent voluntary compliance, the project will produce specific recommendations for improving compliance. Accordingly, the project will assist the BOE in reducing the tax gap (Objective 2.1) and improving taxpayer education and outreach (Objective 2.2).

### **Project Measuring, Results, and Evaluation**

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Meetings will be held as needed between the project team and program liaisons. The status of project objectives will be reported to the BOE's Chief Deputy Director and staff on a bi-weekly basis.

The success of the pilot program will be based on the findings and recommendations report and whether program goals and objectives in this project statement are met

### **Project Team Contact Information**

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