

[Assembly Bill 243](#) (Wood)

Date: 07/02/15

Program: Medical Marijuana Plant Tax

Sponsors: Author

Health and Safety Code (HSC) Section 11362.777

Effective immediately but tax operative June 1, 2016

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

Summary: Among other things, imposes upon a licensed medical marijuana cultivator a \$50 per medical marijuana plant tax to be collected by a licensed medical marijuana distributor.

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

Fiscal Impact Summary: Annual plant tax revenue of \$59 million, and \$5.0 million in sales and use tax revenue.

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

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

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

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

- prescribed by an authorized person and dispensed on a prescription filled by a pharmacist,
- furnished by a licensed physician to his or her own patient,

¹ 21 U.S.C. § 841 et seq.

² 21 U.S.C. § 801 et seq.

³ 21 U.S.C. §§802(6), 812(a).

⁴ 21 U.S.C. § 812 (b)(1).

⁵ 21 U.S.C. § 812:Schedule I(c)(10).

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

⁷ HSC Section 11362.5.

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

⁹ Sales and Use Tax Law Section 6369.

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

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

Medical Marijuana Plant Tax. On and after June 1, 2016, a \$50 tax per medical marijuana plant with a unique identifier will be imposed upon a licensed medical marijuana cultivator. The unique identifier serves as the indicator for determining sales quantity. The bill requires the licensed medical marijuana distributor to collect the tax from the licensed medical marijuana cultivator at the time of sale. A licensed medical marijuana distributor is authorized to retain reimbursement pursuant to regulations approved by the Board of Equalization (BOE) before June 1, 2016, for start-up costs associated with the collection of the tax. The distributor must claim the reimbursement on the first return or next consecutive returns until the entire reimbursement amount is retained. The bill also requires a licensed medical marijuana distributor to separately state the amount of tax on the sales receipt provided to the licensed medical marijuana cultivator at the time of sale.

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

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

- "Fee" includes the medical marijuana plant tax imposed by this bill; and
- "Feepayer" includes a licensed medical marijuana distributor.

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

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

Registration, Reporting, and Payment. Every licensed medical marijuana cultivator must register with the BOE on a BOE-prescribed form.

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

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

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

¹¹ RTC §55041.1

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

Distribution Chain. The bill requires a licensed medical marijuana cultivator to sell his or her medical marijuana products only to a licensed medical marijuana distributor. No other sales by a licensed medical marijuana cultivator are allowed, nor are sales of medical marijuana plants without a unique identifier.

Deposit of Revenues. The BOE must deposit all revenues, less refunds, into the Marijuana Production and Environment Mitigation Fund, which this bill creates in the State Treasury. All moneys deposited into the fund are continuously appropriated to the BOE without regard to fiscal years for the purposes of Section 11362.777, and allocated by the BOE as follows:

- Five dollars (\$5) shall go to the Division to administer the unique identifier program.
- Fifteen dollars (\$15) shall go to the Division for disbursement to local law enforcement-related activities, state law enforcement-related activities, or both, pertaining to illegal marijuana cultivation.
- Fifteen dollars (\$15) shall go to the Natural Resources Agency to fund a competitive grant program for environmental cleanup and restoration of public and private lands that have been damaged from illegal marijuana cultivation.
- Fifteen dollars (\$15) shall go to the multiagency task force, the Department of Fish and Wildlife, and the State Water Resources Control Board project to address the Environmental Impacts of Cannabis Cultivation and to respond to the damages caused from marijuana cultivation on public and private lands in California.

Report. On or before January 1, 2021, the BOE must submit a report to the Legislature on the total amount of revenue collected over the five-year time period from the medical marijuana plant tax.

This bill becomes effective immediately upon enactment, but the medical marijuana plant tax becomes operative June 1, 2016.

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

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

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

- Preventing the distribution of marijuana to minors;

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

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

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

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

The sale of medical marijuana¹⁴ is taxable. The BOE issues seller's permits to those medical marijuana sellers that apply and will issue seller's permits to any other sellers making unlawful sales.

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

Commentary:

1. **Administrative program start-up cost funding essential.** This bill imposes the medical marijuana plant tax on and after June 1, 2016. As a result, the BOE must begin to implement the bill upon enactment, which requires current year funding. Without Fiscal Year 2015-16 funding, the BOE cannot begin implementation. **As such, tax collections may be at risk without sufficient funding and implementation time.**

Typically, the BOE seeks administrative cost reimbursement from the account or fund into which tax proceeds are deposited. However, this bill creates the Marijuana Production and Environmental Mitigation Fund (Fund), which lacks funding to reimburse the BOE prior to collection of the tax. Upfront BOE implementation cost reimbursement is essential. Thus, BOE staff suggests the bill authorize a loan from the General Fund (GF) or other eligible fund to the Fund. The loan would be repaid from taxes collected.

Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the proposed tax program. **Without an appropriation, it may be necessary for the BOE to divert GF dollars to implement the proposed tax program. A GF diversion typically results in a negative impact on GF-supported programs and related State and local government revenues.**

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

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

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- 2. Delayed operative date necessary.** To effectively implement this bill, the BOE must: (1) notify taxpayers; (2) develop computer programs; (3) hire and train key staff; (4) create and revise necessary forms and schedules; and (5) answer taxpayer inquiries. These functions must take place before the tax becomes operative. The current effective date of June 1, 2016, is insufficient. BOE staff estimates the implementation to take a minimum of eight months from the date of funding. Accordingly, the BOE staff recommends an amendment to provide an operative date on and after the first day of the first calendar quarter commencing more than 240 days after the effective date of the bill.
- 3. Suggested amendments.** BOE staff has several administrative concerns regarding the medical marijuana plant tax provisions. These concerns include, but are not limited to, the lack of definitions, tax imposition language, BOE reimbursement for ongoing administrative costs, licensed medical marijuana distributor start-up cost reimbursement, emergency regulation authority, and placement of the tax provisions within the HSC. BOE staff is working with the author's office to draft appropriate amendments to address these concerns.
- 4. Conforming to industry practice.** This bill imposes a medical marijuana plant tax collected by a licensed medical distributor from a licensed medical cultivator at the time of sale. However, BOE staff understands that cultivators typically do not sell intact mature plants. In general, cultivators grow, harvest the plant, and subsequently sell the processed (e.g. dried marijuana) plant in the form of flower and/or trim. Accordingly, staff has concerns that a per medical marijuana plant tax may not be workable in its current form.

The author may wish to consider a tax administered and collected by the Division through collection of a \$50 per plant tax for each unique identifier issued to a medical marijuana cultivator. Such a collection mechanism would fit neatly within the Division's requirement to implement the unique identification program, thus saving BOE-related implementation, administrative, and collection costs. The collection mechanism also eliminates the need for a licensed medical marijuana distributor to collect the tax from a licensed medical marijuana cultivator and remit those amounts to the BOE. This would increase revenues for law enforcement activities and environmental cleanup and restoration that would otherwise be used to reimburse distributors for their start-up costs associated with the collection of the tax.

- 5. Related legislation.** Assembly Bill 266 (Bonta) enacts the Medical Cannabis Regulation and Control Act, which creates, in part, the BOE Division of Medical Cannabis Regulation within the BOE to administer the Act as it pertains to dispensaries, distributors, and transporters. Senate Bill 643 requires the BOE to compile a report on estimated and expected marijuana tax revenues.

Administrative Costs: BOE administrative costs related to this bill are substantial. These costs include: taxpayer identification, notification, and registration; regulation development; manual and publication revisions; tax return design; computer programming; return, payment, and refund claim processing; audit and collection tasks; staff training; and public inquiry responses. A detailed cost estimate is pending.

Revenue Impact:

Background, Methodology, and Assumptions. Detailed assumptions, sources, and calculations are shown on page 7 (Medical Marijuana Spending and Supply Sources table). Our major assumptions are:

- \$220 per ounce is a typical price of medical marijuana (Line 3).
- \$1.3 billion is a reasonable estimate of the value of medical marijuana sales in 2014 (Line 6).
- 95% of medical marijuana is grown in California, and 5% is imported. This postulation is founded on discussions with BOE staff members who have worked with local city and county officials and have interviewed growers and industry representatives (Line 10).

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- 40% of medical marijuana plants are grown indoors and 60% are grown outdoors (Lines 12 and 13).
- Average yield is 2 ounces of usable product per plant for indoor grows and 96 ounces per plant for outdoor grows. These premises are grounded on discussions with BOE staff (Lines 14 and 15).

Based on these assumptions, staff calculates that about 1.18 million plants are cultivated annually in California to supply medical marijuana (Line 18). A tax of \$50 per medical marijuana plant yields revenues of about \$59 million (Line 19).

Furthermore, staff assumes the tax on medical marijuana plants will be passed on to consumers and that the medical marijuana dispensaries will comply with California’s Sales and Use Tax Laws.

Revenue Summary. Annual revenues from a \$50 per medical marijuana plant tax are estimated to be approximately \$59 million.

Related sales tax impacts are \$5.0 million, as follows:

<i>Sales Tax Revenues (Millions of Dollars)</i>	
Fiscal Year 2016-17	
State General Fund 3.6875%	\$2.2
State General Fund 0.25%	0.1
State Education Protection 0.25%	0.1
Local Revenue Fund 2011 1.0625%	0.6
State (Local Revenue Fund) 0.50%	0.3
State (Local Public Safety Fund) 0.50%	0.3
Local (City/County) 1.25%	0.7
Special District Tax 0.92%	0.5
Total SUT Impact (8.42%)	\$5.0
<i>Detail may not add to total due to rounding.</i>	

Qualifying Remarks. These estimates are highly uncertain and vary greatly depending on the assumptions made. Furthermore, staff continues to research the California medical marijuana industry and these estimates are subject to change to the extent that more accurate data is obtained.

This Revenue Estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Medical Marijuana Spending and Supply Sources

Line No.			Source
	<u>Total Marijuana Spending</u>		
1	Total U.S. Marijuana Spending in 2014 (\$ Millions)	\$47,489	<i>What America's Users Spend on Illegal Drugs: 2000-2010</i> , Office of National Drug Control Policy, 2014; projected to 2014 using trend analysis by BOE staff
2	Total U.S. Marijuana Spending in 2014 (Million Ounces)	216	<i>What America's Users Spend on Illegal Drugs: 2000-2010</i> ; projected to 2014 using trend analysis by BOE staff
3	Implied Average Price per Ounce	\$220	Line 1 / Line 2
4	Assumed California Percentage	13.9%	<i>The Effect of Medical Marijuana Laws on Marijuana, Alcohol, and Hard Drug Use</i> , National Bureau of Economic Research, Working Paper 20085, 2014; applied by BOE staff to CA population percentage of U.S.
5	Total CA Marijuana Spending in 2014 (\$ Millions)	\$6,610	Line 1 x Line 4
6	<u>Medical Marijuana Spending (\$Millions)</u>	\$1,323	<i>The State of Legal Marijuana Markets</i> , 3rd edition, 2015, Arcview Market Research
7	Medical Ounces (millions)	6.01	Line 6 / Line 3
8	CA Medical Percentage of CA Total Marijuana Spending	20%	Line 6 / Line 5
9	<u>Supply Sources</u>		
10	California-Grown Percentage	95%	Board of Equalization staff and industry representatives
11	California-Grown Medical (Million Ounces)	5.71	Line 7 x Line 10
12	Indoor Percentage	40%	<i>Government Income Projections for California's Cannabis Industry</i> , Full Circle Cannabis Consultations, 2013
13	Outdoor Percentage	60%	
14	Indoor Yield per Plant (Ounces)	2	Board of Equalization staff and industry representatives
15	Outdoor Yield per Plant (Ounces)	96	Board of Equalization staff and industry representatives
16	Number of Indoor Plants	1,142,417	(Line 11 x Line 12) / Line 14
17	Number of Outdoor Plants	35,701	(Line 11 x Line 13) / Line 15
18	Total Number of Plants	1,178,117	Line 16 + Line 17
19	AB 243 Revenues (\$ Millions)	\$59	Line 18 x 50 x 0.000001

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