



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Introduced:	02/23/09	Bill No:	AB 390
Tax:	Marijuana Fee	Author:	Ammiano
Related Bills:			

This analysis will only address the provisions which impact the State Board of Equalization (Board).

BILL SUMMARY

Among other things, this bill would impose a fee of fifty dollars (\$50) per ounce on the retail sale of marijuana in this state. The Board would be required to administer and collect the fee on or after a specified date, and the funds would be dedicated to drug education, awareness, and rehabilitation programs.

ANALYSIS

CURRENT LAW

Federal Law. Existing federal law prohibits the manufacture, possession, sale or distribution of marijuana. (21 U.S.C. § 841 et seq.) Congress enacted the Controlled Substances Act, (21 U.S.C. § 801 et seq.) (CSA) as part of the Comprehensive Drug Abuse Prevention and Control Act of 1970. The CSA establishes five “schedules” of certain drugs and other substances designated “controlled substances.” (21 U.S.C. §§802(6), 812(a).) For a drug or other substance to be designated a schedule I controlled substance, it must be found that the substance “has a high potential for abuse,” have “no currently accepted medical use in treatment in the United States,” and lack accepted safety for use of the drug or other substance under medical supervision.” (21 U.S.C. § 812 (b)(1).) Federal law lists marijuana as a schedule I controlled substance, deemed to have no accepted medical use. (21 U.S.C. § 812:Schedule I(c)(10).)

State Law. Existing state law prohibits, except as authorized by law, the possession, cultivation, transportation, and sale of marijuana and derivatives of marijuana. (Health and Safety Code Sections 11357, 11358, 11359, and 11360.)

Existing state law, as authorized under The Compassionate Use Act of 1996 (Proposition 215 of 1996), allows a patient or the patient’s primary caregiver to cultivate or possess marijuana for the patient’s medical use when recommended by a physician, as specified. (Health and Safety Code Section 11362.5)

Under existing law, there is no fee imposed on the possession, sale, transport or cultivation of marijuana or derivatives of marijuana.

Under existing Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code), sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state, except where specifically exempted by statute. Tangible personal property is defined in law to mean any personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. Therefore, under the law, retail sales of marijuana and any other illegal drugs or property, are subject to sales or use tax to the same extent as is any lawful retail sale of tangible personal property.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

PROPOSED LAW

This bill would, among other things, add Part 14.6 (commencing with Section 34001) to Division 2 of the Revenue and Taxation Code (RTC) to enact the Marijuana Supplemental Fee Law. This bill would impose a fee of fifty dollars (\$50) per ounce for the sale of marijuana sold at retail in this state on or after the date determined by Business and Professions Code (BPC) Section 25406. BPC Section 25406 provides that the bill's provisions shall be enforced when the later of the following has occurred: (1) 30 days after the operative date of the regulations issued pursuant to Chapter 14.5 (commencing with Section 25400) of Division 9 of the BPC (added by this bill), or 2) 30 days after the date when federal law permits the possession and sale of marijuana consistent with BPC Chapter 14.5.

Definitions. This bill would define "marijuana," for purposes of imposing the supplemental fee under the RTC, to include all marijuana, concentrated cannabis, and their derivatives, except that marijuana containing less than one-half of 1 percent tetrahydrocannabinol by weight is not subject to this supplemental fee. The bill provides that this fee shall not be imposed on marijuana used medicinally with a doctor's recommendation as specified in Health and Safety Code Section 11362.5, which is known and cited as The Compassionate Use Act of 1996.

This bill would also define "retailer," for purposes of imposing the supplemental fee, to mean any retailer licensed pursuant to BPC Section 23394.1 who sells marijuana at retail. BPC Section 23394.1 provides that an off-sale general license authorizes the sale, to consumers only and not for resale, of marijuana, concentrated cannabis, or any of its derivatives pursuant to the provisions of BPC Chapter 14.5.

Collection and Administration. Returns and payments, determinations, collections of fees, overpayments and refunds, and administration required under the provisions of this bill would be governed by Chapters 5, 6, 7, and 8 of the Sales and Use Tax Law. The Board would be required to enforce the provisions and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this bill.

Disposition of Fund and Adjustment of Fees. Any amounts required to be paid under this part would be deposited into the Drug Abuse Prevention Supplemental Funding Account, which this bill would create in the State's General Fund. Upon appropriation by the Legislature, the monies in the fund would be used exclusively for drug education, awareness, and rehabilitation programs under the jurisdiction of the Department of Alcohol and Drug Programs.

The Department of Alcohol and Drug Programs would be required to review annually the fee imposed under this part to determine whether a lesser fee would provide sufficient resources to support its drug education, awareness, and rehabilitation programs. Based on this annual review, the Department of Alcohol and Drug Programs would be required to adjust the fee to an amount not to exceed fifty dollars (\$50) per ounce of marijuana that is necessary to fund the programs.

Other provisions. Under proposed Chapter 14.5, *Commercial Marijuana Production and Sale*, of Division 9 of the BPC, the Department of Alcoholic Beverage Control (ABC) would license both commercial cultivators of marijuana and wholesalers of marijuana, who would be allowed to package and prepare marijuana for sale and would be authorized to sell marijuana to licensed sales outlets. These provisions would establish fees for the initial application for a license and fees for each annual renewal of a license.

Effective and operative date. The provisions of the bill would become effective on January 1, 2010; however, the bill's provisions would become operative the later of either: (1) 30 days after the operative date of the regulations issued pursuant to Chapter 14.5 of Division 9 of the BPC, or (2) 30 days after the date when federal law permits the possession and sale of marijuana consistent with Chapter 14.5.

BACKGROUND – MEDICAL MARIJUANA SELLERS – SALES TAX

As previously stated, 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, SB 420 (Ch. 875, Vasconcellos, Stats. 2003) was enacted to establish statewide guidelines for Proposition 215 enforcement. In particular, SB 403 clarified that nonprofit distribution is allowed in certain cases for patient cultivation cooperatives, small-scale caregiver gardeners, and dispensing collectives. However, despite the fact that numerous medical marijuana dispensaries are currently in business in California, the sale of medical cannabis is illegal under federal law.

Up until late 2005, the Board's longstanding policy was to not issue a seller's permit to a person whose sole selling activity is the unlawful sale of tangible personal property, so as not to confer permissive authority or condone an illegal activity. However, although it was Board policy not to issue seller's permits, the sale of medical marijuana has always been considered taxable.

In October 2005, the Board changed its policy after hearing a case that came before the Members of the Board involving medical marijuana sales, when the Board recognized the difficulty in reconciling its authority to issue assessments for taxes due from a seller's marijuana sales while, at the same time, not issuing seller's permits to such sellers, and also took into account the legality under state law of some sales of marijuana as authorized in SB 420. Now, the Board issues seller's permits to those medical marijuana sellers that apply and will issue seller's permits to any other sellers making unlawful sales.

As part of the Board's education outreach efforts, a special notice was mailed to California sellers of medical marijuana to clarify the application of tax to sales of medical marijuana and the requirement that they must hold a seller's permit.

COMMENTS

1. **Sponsor and purpose.** Assembly Member Ammiano is sponsoring this measure in an effort to generate more revenue for the state by regulating and taxing marijuana in a manner similar to alcohol.
2. **Sales of marijuana would be subject to the proposed fee and the sales tax.** As previously stated, retail sales of marijuana are subject to tax to the same extent as any other lawful retail sale of tangible personal property. Under the provisions of this bill, a retailer must apply to the ABC to obtain a license to sell marijuana at retail and be liable for the fee on its sales of marijuana in this state. In addition to the proposed fee, a licensed marijuana retailer would be required to apply for a seller's permit, file returns, and pay sales tax to the Board.

It should also be noted that the proposed fee would be included in the amount on which the sales tax would be imposed. Under current law, sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. The proposed marijuana fee would not be specifically excluded from gross receipts or sales price, so it would be included in the amount on which sales tax is computed.

3. **What if marijuana is sold in amounts less than one ounce?** It is not clear if the proposed fee would apply to retail sales of marijuana that are sold in amounts of less than one ounce. It is our understanding that medical marijuana is often sold in containers or packages of 1/8 of an ounce. Medical marijuana may also be purchased in the form of cigarette or joint. Would the sale of one or more joints, which would be less than an ounce, be subject to the fee? Would other marijuana products, such as edible products (e.g., brownies) containing marijuana be subject to the fee?

This bill would require that the ABC develop an inspection and tracking system to ensure that marijuana may not be sold by an off-sale general licensee if that marijuana has not been assessed the proposed fee. While it is not specific, it appears that the intent of the bill is to make all sales of marijuana made by an off-sale general licensee subject to the proposed fee.

4. **Operative date depends on federal changes.** BPC Section 25406 provides that the ABC will begin enforcing the bill's provisions beginning the later of when the following occur: (1) 30 days after the operative date of the regulations issued pursuant to Chapter 14.5 of Division 9 of the BPC, or (2) 30 days after the date when federal law permits the possession and sale of marijuana consistent with Chapter 14.5. Therefore, it appears the fee would be imposed on the retail sale of marijuana when such sale is permitted by the federal government. As the Board would require sufficient time to implement the fee collection provisions of the bill, it is recommended that the bill be revised to set an operative date for imposition and collection of the fee to be, e.g., the first day of the quarter beginning no less than 180 days after the later of the two events occurs.
5. **The bill provides for three types of licenses issued by the ABC.** The ABC would be responsible for issuing a license to commercial cultivators of marijuana (BPC Section 25401), marijuana wholesalers (BPC Section 25403), and marijuana retailers (BPC Section 23394.1). Marijuana wholesalers are authorized to package and prepare marijuana for sale and are also authorized to sell marijuana to licensed sales outlets. A retailer (off-sale general licensee) would be authorized to sell marijuana to consumers only and not for resale.

The ABC is required to adopt and enforce regulations concerning the operations of commercial cultivators of marijuana, the sale and packaging of marijuana by wholesale licensees, and the sale of marijuana by off-sale general licensees. These regulations shall include an inspection and tracking system to ensure that marijuana cultivated, distributed, and ultimately sold by an off-sale general licensee is assessed the proposed fee.

6. **Proposed fee should reference the Fee Collections Procedures Law.** As written, the proposed fee, to the extent feasible, would be administered and collected in a manner consistent with the Sales and Use Tax Law, including the returns and payments, determinations, collections of fees, overpayments and refunds. However, since this fee does not parallel the sales and use tax, it is

recommended that the administrative provisions be placed under the Fee Collections Procedures Law (Part 30 (commencing with Section 55001) of Division 2, of the Revenue and Taxation Code).

The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund and appeals provisions, as well as providing the Board the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

The bill should also be amended to specify a due date for the fee and return and to authorize the payment of refunds on overpayments of the fee.

Staff will work with the author's office to address these issues as the bill progresses through the legislative process.

7. **Disposition of proceeds – refund payments and administrative costs.** While the bill provides that the any amount required to be paid to the State be deposited in the Drug Abuse Prevention Supplemental Funding Account in the State's General Fund, which this bill creates, and be expended exclusively for drug education, awareness, and rehabilitation programs, the bill does not specify how payments for refunds and the Board's administrative costs would be funded. The bill should be amended to address this issue.
8. **The Board would need adequate time to notify feepayers of any reduction in the fee.** The ABC would be required annually to review the proposed fee to determine whether a lesser fee would provide sufficient resources to support its drug education, awareness, and rehabilitation programs. It is suggested that the bill be amended to specify a date by which the ABC must notify the Board of a change in the fee rate, prior to the date the change would be effective, to provide Board staff sufficient time to notify feepayers of any fee rate change.
9. **Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the fees imposed are in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

COST ESTIMATE

The Board would incur substantial administrative costs in creating a new fee program, identifying and notifying affected feepayers, developing computer programs, developing returns and supplemental schedules, developing publications and regulations, preparing and mailing special notices, training staff, and responding to numerous inquiries from affected feepayers and the public.

This bill provides that the proposed fee would not be enforced until federal law permits the possession and sale of marijuana consistent with the provisions under the BPC.

An estimate of these costs is pending.

REVENUE ESTIMATE**BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

Under this measure, the definition of marijuana includes all marijuana, concentrated cannabis, and their derivatives, except that marijuana containing less than one-half of one percent tetrahydrocannabinol by weight is not subject to this fee. Further, the measure provides that this fee shall not be imposed on marijuana used medicinally with a doctor's recommendation as specified in Health and Safety Code Section 11362.5.

According to the report titled *Marijuana Production in the United States (2006)*, an estimated 22.3 million pounds of marijuana was grown in the U.S. in 2006 with a value of \$35.8 billion. California was the top producing state; it produced 8.6 million pounds with a value of \$13.8 billion. The report also discusses that, although most marijuana is produced for local, in-state use, California is considered an export state in which marijuana is produced for both in-state use and export to other states. Our literature review indicates that estimated consumption of marijuana in California amounts to one million pounds per year, or 16 million ounces.

Based on the estimated 16 million ounces of annual consumption in California and several assumptions (which are summarized in the Qualifying Remarks section), the revenue effect of the bill is an estimated total annual revenue gain of \$1.4 billion, as follows:

- \$990 million from the proposed \$50 per ounce levy on retail sales of marijuana
- \$392 million in sales tax revenues

REVENUE SUMMARY

The revenue impact of imposing a \$50 per ounce levy on retail sales of marijuana in California would be as follows:

	Sales and Use Tax Revenue (In Millions of Dollars)	
Net Excise Revenue Gain	\$	990
State (6.00%)	\$	263
Fiscal Recovery Fund (0.25%)		11
Local (2.00%)		88
Special District (0.75%)		31
Total Sales and Use Tax Revenue	\$	392
Total revenue from the excise tax and sales and use tax	\$	1,382

Qualifying Remarks. This estimate is based on numerous assumptions, all of which come from law enforcement estimates and academic studies. The most significant ones are as follows:

- Legalization of marijuana would cause its street price to decline by 50 percent.
- This 50 percent decline in price would lead to additional consumption of 40 percent.
- The imposition of the \$50/ounce tax would then lead to reduced consumption of 11 percent.

Some of the revenue raised would result from additional residents consuming marijuana (that were not doing so when it was prohibited by law) in response to its being legalized. However, a portion of this additional consumption could be at the expense of cigarettes and alcohol currently being consumed; in other words, there could be a “substitution effect” toward marijuana and away from cigarettes and alcohol. To the extent that this happens, current excise taxes from cigarettes and alcohol would switch to marijuana and the net revenue gain from the bill would be somewhat less than the \$1.4 billion number cited above (exactly how much lower is unknown).

The same is true with respect to the sales and use tax component of the estimate. In other words, consumers choosing to increase their consumption of marijuana would likely do so by reducing their consumption elsewhere, some of which is subject to the sales and use tax (such as cigarettes), some of which is not (such as groceries and most services). If consumers are simply switching their consumption toward marijuana and away from some other taxable good, the increase in sales tax revenue from this measure would be less.

As currently drafted, this measure stipulates that “each person 21 years of age or older may have in cultivation no more than 10 mature plants at any given time.” Substantial home production would clearly have an impact on the revenues generated. Available research indicates, however, that such production is likely to be minimal.

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