

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

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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**

**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.

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## 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 11359<sup>1</sup>: but see the Medical Marijuana Program Act, Health & Safety Code section 11362.765, *People v. Urziceanu* (September 12, 2005, CO45276) \_\_\_ Cal.App.4<sup>th</sup> \_\_\_ [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.

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<sup>1</sup> 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* (9<sup>th</sup> 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.<sup>2</sup>

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<sup>2</sup> 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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