

Date of Hearing: April 18, 2017

ASSEMBLY COMMITTEE ON BUSINESS AND PROFESSIONS

Rudy Salas, Chair

AB 963 (Gipson) – As Amended April 5, 2017

NOTE: This bill is doubled referred, and if passed by this Committee, will be referred to the Assembly Committee on Revenue and Taxation.

SUBJECT: Taxation: marijuana.

SUMMARY: Designates the tax collected on cannabis transactions at the wholesale level as a debt to the state, held in trust at the time the transaction occurs, rather than at the time the business files the return; specifies that if a cannabis business has his/her assets and cash seized by the Federal Government, the state will have a valid claim to the tax dollars that the business is holding in trust; requires the wholesaler to collect the cultivation tax and prepayment of the marijuana excise and sales taxes under a track and trace system; and establishes the Criminal Cannabis Enforcement Team within the Board of Equalization (Board) to coordinate, investigate, and prosecute felony level untaxed or under-reported sales of cannabis.

EXISTING LAW:

- 1) Establishes the Bureau of Marijuana Control, also referred to as the Bureau of Medical Cannabis Regulation (Bureau), under the Department of Consumer Affairs (DCA), to establish a comprehensive system to control and regulate the cultivation, distribution, transport, storage, manufacturing, processing, and sale of cannabis products (Business and Professions Code (BPC) § 26000 et seq.; BPC § 19302)
- 2) Authorizes a county to impose a tax on the privilege of cultivating, dispensing, producing, processing, preparing, storing, providing, donating, selling, or distributing medical cannabis or medical cannabis products by a licensee, as specified. (BPC § 19348)
- 3) Defines "person with an identification card", for purposes of the Medical Marijuana Program to mean an individual who is a qualified patient who has applied for and received a valid identification card pursuant to this article. (Health and Safety Code (HSC) § 11362.7(c))
- 4) Defines "primary caregiver" for purposes of the Medical Marijuana Program to mean the individual, designated by a qualified patient or by a person with an identification card, who has consistently assumed responsibility for the housing, health, or safety of that patient or person, as specified. (HSC § 11362.7(d))
- 5) Requires the Department of Public Health (DPH) to establish and maintain a voluntary program for the issuance of identification cards to qualified patients who satisfy specified requirements and voluntarily apply to the identification card program. (HSC § 11362.71)
- 6) Establishes specified exemptions from the computation of sales tax. (Revenue and Taxation Code (RTC) § 6381 et. seq)
- 7) Requires effective January 1, 2018, a marijuana excise tax to be imposed upon purchasers of marijuana, or marijuana products sold in this state at a rate of 15 percent of the gross receipts

of any retail sale by dispensary or other person required to be licensed, as specified, to sell marijuana and marijuana products directly to a purchaser. (RTC §34011(a))

- 8) States that sales and use tax does not apply to retail sales of medical cannabis, medical cannabis concentrate, edible medical cannabis products or topical cannabis, as specified, when a qualified patient or primary caregiver for a qualified patient provides his or her card issued under the Medical Marijuana Program and a valid government-issued identification card. (RTC § 34011(g))
- 9) Requires, effective January 1, 2018, an imposed cultivation tax on all harvested marijuana that enters the commercial market, upon all persons required to be licensed to cultivate marijuana and specifies the tax is due after the marijuana is harvested. (RTC § 34012(a))
- 10) Specifies that all persons required to be licensed involved in the cultivation and retail sale of marijuana or marijuana products must obtain a separate fee-free permit from the Board, pursuant to regulations, and any person required to obtain a permit who engages in business as a cultivator, dispensary, retailer, microbusiness or nonprofit without a permit or after a permit has been disciplined and each officer of any corporation which engages in business is guilty of a misdemeanor. (RTC § 34014(a))
- 11) States that any peace officer or Board employee granted limited peace officer status, upon presenting appropriate credentials, is authorized to enter any place, as specified, to conduct inspections. (RTC § 34016(a))
- 12) Specifies that upon discovery by the Board or a law enforcement agency that a licensee or any other person possesses, stores, owns, or has made a retail sale of marijuana or marijuana products, without evidence of tax payment or not contained in secure packaging, the Board or law enforcement agency is authorized to seize the marijuana or marijuana products, as specified. (RTC § 34016(c))
- 13) Requires, beginning Fiscal Year (FY) 2017-2018, the Department of Finance to estimate revenues to be received, and to provide those estimate to the Controller no later than June 15 of each year; and, further requires the Controller to use those estimates when disbursing funds. (RTC § 34019(a))
- 14) Requires the Legislative Analyst's Office to submit a report to the Legislature by January 1, 2020, with recommendations to the Legislature for adjustments to the tax rate to achieve the goals of undercutting illicit market prices and discouraging use by persons younger than 21 of age while ensuring sufficient revenues are generated. (RTC § 34017)

THIS BILL:

- 15) Defines, "person with identification card" and "primary caregiver" to have the same meaning as specified in current law.
- 16) Specifies that any purchaser who furnishes a seller with a false or falsified identification card to be liable to the state for the amount of tax that would be due if he or she had not given a card; and, in addition to the tax, the purchaser is liable to the state for a penalty of 10 percent of the tax or five hundred dollars, whichever is greater for each purchase made for personal

gain or to evade the payment of tax.

- 17) Specifies that a "false or falsified" identification card includes any driver's license or other identification card issued by a governmental agency, including a card issued under the Medical Marijuana Program, as specified, that has been stolen, altered, forged, duplicated, reproduced, or counterfeited.
- 18) States that a seller is relieved of liability for the sales tax if the purchaser furnishes the seller with valid identification cards, as specified, and the seller takes the identification cards in good faith.
- 19) Specifies that any person required to make prepayment may not be required to make additional prepayment provided that more than 75 percent of the gross receipts of that person are from the retail sale of marijuana or marijuana products.
- 20) Defines "marijuana" and "marijuana products" have the same meanings as those terms are defined in RTC § 34010.
- 21) Specifies that "cultivator" and "manufacturer" shall have the same meaning as those terms are defined in BPC §§ 19300 and 26000.
- 22) Defines "distribution" as the sale or delivery of marijuana and marijuana products from a wholesaler to a retailer.
- 23) Specifies that "wholesaler" has the same meaning as that term is defined in RTC § 34010.
- 24) Defines "sale" as the transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of marijuana or marijuana products to a retailer for a consideration, or a distribution without consideration.
- 25) States that any time a wholesaler makes a distribution of marijuana or marijuana products in this state to a retailer, the wholesaler shall collect a prepayment of the retail sales tax, in the following manner:
 - 1) When the distribution is a sale, the prepayment shall be based on the gross receipts derived from that sale of marijuana or those marijuana products.
 - 2) If a cultivator or a manufacturer is also the retailer, the prepayment shall be based on the wholesale cost of the marijuana or marijuana products, as determined by the Board.
 - 3) If the wholesaler is not required to hold a seller's permit pursuant to this part, the prepayment shall be based on the wholesale cost, as determined by the Board.
- 26) Requires each wholesaler to report and pay the prepayment amounts to the Board, in a form as prescribed by the Board, in the period in which the marijuana or marijuana products are distributed. The prepayment amounts shall be collected by the wholesaler from the retailer to which the marijuana or marijuana products are distributed. Subject to any credit or refund due to the retailer, the prepayment amount is deemed to be public moneys that are the property of the State of California. The wholesaler required to collect and remit the prepayment amount shall hold the prepayment amount in trust for the state. The prepayment

amount constitutes a debt owed by the wholesaler to this state until reported and paid to the Board, until satisfactory proof has been submitted to prove that the retailer of the marijuana or marijuana products has paid the retail sales tax to the Board, or until a wholesaler that has consumed the marijuana or marijuana products has paid the use tax to the Board on the sales price, if applicable, of the amount consumed.

- 27) Requires each wholesaler to provide the retailer with an invoice for, or other evidence of the collection of, the prepayment amounts, which shall be separately stated on the invoice.
- 28) Requires each wholesaler to report to the Board, in a form as prescribed by the Board and for the period in which the marijuana and marijuana products were distributed, all of the following:
 - 1) The amount of marijuana and marijuana products distributed, the gross receipts derived from any sale, or the wholesale cost, whichever is applicable, the amount of sales tax prepayments collected by the wholesaler, and any other information deemed necessary by the Board.
 - 2) If the amount of sales tax prepayments collected by the wholesaler is greater than the amount of sales tax prepayments made by the wholesaler, then subject to any credit or refund due to the retailer, the excess is deemed to be public moneys that are the property of the State of California. The wholesaler required to collect and remit the sales tax prepayment shall hold the amount of the excess in trust for the state. The excess constitutes a debt owed by the wholesaler to the state until reported and paid to the Board, or until satisfactory proof has been submitted that the retailer of the marijuana or marijuana products has paid the tax to the Board.
- 29) Specifies that the amount of a prepayment paid by the retailer shall constitute a credit against its sales and use taxes due and payable for the period in which the retail sale was made. Failure of the wholesaler to report prepayments or a wholesaler's failure to comply with any other duty under this article shall not constitute grounds for denial of the credit to the retailer, either on a temporary or permanent basis or otherwise. To be entitled to the credit, the retailer shall retain for inspection by the Board any receipts, invoices, or other documents showing the amount of sales tax prepaid to its wholesaler, together with the evidence of payment.
- 30) Requires that the rate of the prepayment required to be collected shall be the combined rate of tax imposed on all sales of marijuana or marijuana products sold by wholesalers in this state.
- 31) Permits the Board to require a wholesaler to provide the Board with a list of retailers to which the marijuana or marijuana products were distributed.
- 32) Permits the Board to require additional, other, or supplemental reports, in any form which the Board may require, from wholesalers with respect to their distributions of marijuana or marijuana products, which shall include, but not be limited to, the name of the retailer to whom the marijuana or marijuana products was distributed, the retailer's license number issued, a description of the product distributed, including the weight of the marijuana included in each distribution, the date of each sale or distribution, and any gross receipts derived from each sale of marijuana or marijuana product.

- 33) Specifies that any wholesaler that fails to comply is guilty of a misdemeanor.
- 34) Requires the wholesaler to file its prepayment form together with a remittance of the prepayment amounts, if any, required to be payable to the Board, on or before the last day of the month following the monthly period to which the prepayment form or each prepayment relates.
- 35) States that any wholesaler that fails to make a timely remittance to the Board of the prepayment amounts, shall also pay a penalty of 10 percent of the amount of the prepayment due but not paid, plus interest at the modified adjusted rate per month, or fraction thereof, from the date the prepayment became due and payable to the state until the date of payment.
- 36) Specifies that the penalty amount shall be 25 percent if the wholesaler knowingly or intentionally fails to make a timely remittance.
- 37) Indicates that the following persons that have paid prepayment amounts either directly to the Board or to the wholesaler from which the marijuana or marijuana products were purchased shall be refunded those amounts:
 - 1) Any retailer that sells marijuana or marijuana products that are exempt from the sales or use tax.
 - 2) Any retailer that has lost the marijuana or marijuana products through fire, flood, theft, spoilage, or accident, prior to any retail sale.
 - 3) Any retailer that has paid prepayment amounts on products exempted from the sales and use tax, when the prepayment amounts paid are in excess of the amount due and payable for the period in which the retail sale of those products was made.
- 38) Authorizes the Board, in lieu of a refund, to authorize a credit to be taken by the person to whom the refund is due upon his or her prepayment form or sales and use tax return.
- 39) Permits the Board to require any wholesaler to place with the Board any security that the Board determines is necessary to ensure compliance. The amount of the security shall be fixed by the Board but shall not be greater than three times the estimated average liability of wholesalers required to file returns for monthly periods, determined in any manner that the Board deems proper, or five hundred thousand dollars (\$500,000), whichever amount is less. These amounts apply regardless of the type of security placed with the Board. The amount of the security may be increased or decreased by the Board subject to the maximum amounts.
- 40) Permits the Board to sell the security at public auction if it becomes necessary to so do in order to recover any tax or any amount required to be collected or penalty due. Notice of the sale may be served upon the person that placed the security personally or by mail. If service is by mail, service shall be made in the manner prescribed for service of a notice of a deficiency determination and shall be addressed to the person's address as it appears in the records of the Board. However, security in the form of a bearer bond issued by the United States or the State of California which has a prevailing market price may be sold by the Board at a private sale at a price not lower than the prevailing market price thereof. Upon any sale, any surplus above the amounts due shall be returned to the wholesaler that placed the security.

- 41) Specifies that a wholesaler that is not required to hold a seller's permit pursuant shall register with the Board on a form prescribed by the Board and shall set forth the name under which the wholesaler transacts or intends to transact business, the location of the wholesaler's place or places of business, and other information as the Board may require.
- 42) Defines "wholesaler" as a person that makes a distribution of marijuana or marijuana products. For purposes of this subdivision and for the imposition of marijuana excise taxes pursuant to this part, "distribution" shall mean sale or delivery of marijuana or marijuana products from a wholesaler to a retailer.
- 43) Defines "arm's length transaction" as a sale in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction. A sale between relatives, related companies, or partners is presumed not to be made at "arm's length."
- 44) Defines "retailer" as a dispensary or other person required to be licensed, or a retailer, microbusiness, nonprofit, or other person required to be licensed to sell marijuana or marijuana products directly to a purchaser.
- 45) Defines "sale" as the transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of marijuana or marijuana products to a retailer for a consideration.
- 46) Specifies that at any time that marijuana or marijuana products are distributed to a retailer in this state, the wholesaler shall collect a prepayment of the marijuana excise tax as follows:
 - 1) When the distribution is a sale, the prepayment shall be based on the gross receipts derived from the sale of marijuana or marijuana products to that retailer in an arm's length transaction.
 - 2) If a cultivator or a manufacturer is also the retailer, the prepayment shall be based on the wholesale cost of the marijuana and marijuana products, as determined by the Board.
- 47) Requires each wholesaler to report and pay the prepayment amounts to the Board, in a form as prescribed by the Board, in the period in which the marijuana or marijuana products are distributed. The prepayment amounts shall be collected by the wholesaler from the retailer to which the marijuana or marijuana products are distributed.
- 48) Finds that, subject to any credit or refund due to the retailer, the prepayment amount is deemed to be public moneys that are the property of the State of California. The wholesaler required to collect and remit the prepayment amount shall hold the prepayment amount in trust for these purposes. The prepayment amount constitutes a debt owed by the wholesaler to this state until reported and paid to the Board, or until satisfactory proof has been submitted to prove that the retailer of the marijuana or marijuana products has paid the marijuana excise tax to the Board.
- 49) Requires each wholesaler to provide the retailer with an invoice for, or other evidence of the collection of, the prepayment amounts, which shall be separately stated thereon.

- 50) Requires each wholesaler to report to the Board, using electronic media, for the period in which the marijuana and marijuana products were distributed, all of the following:
- 1) The amount of marijuana and marijuana products distributed, the gross receipts derived from the sale or wholesale cost, the amount of marijuana excise tax prepayments collected by the wholesaler, and any other information deemed necessary by the Board.
 - 2) If the amount of marijuana excise tax prepayments collected by the wholesaler is greater than the amount of marijuana excise tax prepayments made by the wholesaler, then subject to any credit or refund due to the retailer, the excess is deemed to be public moneys that are the property of the State of California. The wholesaler required to collect and remit the marijuana excise tax prepayments shall hold the excess in trust for these purposes. The excess constitutes a debt owed by the wholesaler to the state until reported and paid to the Board, or until satisfactory proof has been submitted that the retailer of the marijuana or marijuana products has paid the tax to the Board.
- 51) States that the amount of a prepayment paid by the retailer shall constitute a credit against its marijuana excise taxes due and payable for the period in which the sale was made. Failure of the wholesaler to report prepayments or a wholesaler's failure to comply with any other duty under this part shall not constitute grounds for denial of the credit to the retailer, either on a temporary or permanent basis or otherwise. To be entitled to the credit, the retailer shall retain for inspection by the Board any receipts, invoices, or other documents showing the amount of marijuana excise tax prepaid to its wholesaler, together with the evidence of payment.
- 52) Requires the rate of the prepayment required to be collected to be ____ on the gross receipts or wholesale cost of the marijuana or marijuana products distributed to a retailer by a wholesaler in this state.
- 53) Specifies that in the case where a wholesaler does not make a sale to a dispensary at the time of distribution, the wholesaler shall maintain a copy of the contract, or other information deemed necessary by the Board, indicating the price and quantity of marijuana or marijuana products to be sold and any other information deemed necessary by the Board.
- 54) Specifies that in the case of a person with a Type 10A, or producing dispensary, license or other person required to be licensed where the cultivator or manufacturer and dispensary or retailer to whom the marijuana or marijuana product is distributed are the same person, a wholesaler shall maintain any information deemed necessary by the Board to ascertain wholesale cost.
- 55) States that returns or reports shall be authenticated in a form or pursuant to methods as may be prescribed by the Board. If the prepayment of marijuana excise tax is paid by stamp or other marking, the Board may by regulation determine when and how the tax shall be paid.
- 56) Permits the Board to require a wholesaler to provide the Board with a list of purchasers to which the marijuana or marijuana products were sold.
- 57) Permits the Board to require additional, other, or supplemental reports, in any form which the Board may require, from wholesalers with respect to their distribution of marijuana or marijuana products to a retailer, which shall include, but not be limited to, the name of the

purchaser, the number of the purchaser's license issued, a description of the product distributed, including the date of each distribution, and the wholesale cost or gross receipts derived from each sale of marijuana or marijuana products.

- 58) Specifies that any wholesaler that fails to comply is guilty of a misdemeanor.
- 59) Requires the wholesaler to file its prepayment form together with a remittance of the prepayment amounts, if any, required to be collected payable to the state Board, on or before the last day of the month following the monthly period to which the prepayment form or each prepayment relates.
- 60) States that any wholesaler that fails to make a timely remittance to the Board of the prepayment amounts, shall also pay a penalty of 10 percent of the amount of the prepayment due but not paid, plus interest at the modified adjusted rate per month, or fraction thereof, from the date the prepayment became due and payable to the state until the date of payment.
- 61) Specifies that the penalty amount shall be 25 percent if the wholesaler knowingly or intentionally fails to make a timely remittance.
- 62) Authorizes the Board to relieve the penalty imposed.
- 63) Specifies that any person that has paid prepayment amounts either directly to the Board or to the person from which the marijuana or marijuana products were distributed shall be refunded those amounts with respect to marijuana or marijuana products lost through fire, flood, theft, spoilage, or accident, prior to any retail sale.
- 64) States that in lieu of a refund, the Board may authorize a credit to be taken by the person to whom the refund is due upon his or her prepayment form or marijuana excise tax return.
- 65) Permits the Board to require any wholesaler subject to this part to place with the Board any security that the Board determines is necessary to ensure compliance with this part. The amount of the security shall be fixed by the Board but shall not be greater than three times the estimated average liability of wholesalers required to file returns for monthly periods, determined in any manner that the Board deems proper, or five hundred thousand dollars (\$500,000), whichever amount is less. These amounts apply regardless of the type of security placed with the Board. The amount of the security may be increased or decreased by the Board subject to the maximum amounts.
- 66) Allows the Board to sell the security at public auction if it becomes necessary to so do in order to recover any tax or any amount required to be collected or penalty due. Notice of the sale may be served upon the person that placed the security personally or by mail. If service is by mail, service shall be made in the manner prescribed for service of a notice of a deficiency determination and shall be addressed to the person's address as it appears in the records of the Board. However, security in the form of a bearer bond issued by the United States or the State of California which has a prevailing market price may be sold by the Board at a private sale at a price not lower than the prevailing market price thereof. Upon any sale, any surplus above the amounts due shall be returned to the wholesaler that placed the security.

- 67) Allows the Board to prescribe by regulation a method and manner for prepayment of the marijuana excise tax that utilizes tax stamps or other markings that indicate that all required tax has been paid on the product to which the tax stamp or marking is affixed.
- 68) Further specifies that the Board may prescribe the following by regulation:
- 1) The Board may prescribe by regulation a method and manner for payment of the cultivation tax that utilizes tax stamps or state-issued product bags that indicate that all required tax has been paid on the product to which the tax stamp is affixed or in which the marijuana is packaged.
 - 2) A method and manner for collection and remittance of the cultivation tax by wholesalers.
- 69) States that subject to any credit or refund due to the cultivator all sums of money paid by a person as the cultivation tax are public moneys that are the property of the State of California. The wholesaler required to collect and remit the cultivation tax shall hold the cultivation tax in trust for these purposes. The collected cultivation tax constitutes a debt owed to the state until reported and paid to the Board, or until satisfactory proof has been submitted that the cultivator has paid the cultivation tax to the Board. A wholesaler that has collected any amount of cultivation tax in excess of the amount of the cultivation tax actually due from a cultivator, may refund that overpayment to the cultivator, even though the overpayment has already been paid over to the Board and a corresponding credit or refund has not yet been secured. The wholesaler may claim a credit for that overpayment against the amount of cultivation tax due upon any other quarterly return, if the credit is claimed in a return dated no later than three years from the date of overpayment.
- 70) Requires every cultivator in this state to be liable for the cultivation tax until it has been paid to this state, except that payment to a wholesaler with a permit issued under this part is sufficient to relieve the cultivator from further liability for the tax. Any cultivation tax collected from a cultivator that has not been remitted to the Board shall be deemed public moneys that are the property of the State of California. The collected tax constitutes a debt owed to the state by the wholesaler until reported and paid to the Board. Nothing in this part shall impose any obligation upon a wholesaler to take any legal action to enforce the collection of the cultivation tax. The wholesaler shall provide the Board with amounts uncollected which total ____ dollars (\$____) or more on a cumulative basis with respect to a single cultivator along with the names, addresses, and reasons of the cultivators refusing to pay the cultivation tax.
- 71) Requires that the tax collected by the wholesaler from the cultivator shall be stated separately from the price or value of the harvested marijuana on the invoice or other price or value displayed on any proof of sales or documentation of a transaction.
- 72) States that whenever any person fails to comply with any rule or regulation of the Board, the Board, upon hearing, after giving the person at least 10 days' notice in writing specifying the time and place of the hearing and requiring the person to show cause why the permit should not be suspended or revoked, may suspend or revoke the permit held by the person. The Board shall give to the person written notice of the suspension or revocation of any of the person's permits. The notices herein required may be served personally or by mail in the manner prescribed for service of notice of a deficiency determination. The Board shall not issue a new permit after the revocation of a permit unless it is satisfied that the former holder

of the permit will comply with the provisions of this part and the regulations of the Board prescribed and adopted under this part.

- 73) Authorizes the Board to create a Criminal Cannabis Enforcement Team for the purpose of combating criminal tax evasion associated with marijuana, marijuana products, and marijuana accessories that may include, but not be limited to, representatives from the following:
 - 1) The Board.
 - 2) The Franchise Tax Board.
 - 3) Employment Development Department.
 - 4) State licensing authorities.
- 74) Permits authorized team members to exchange intelligence, data, documents, information, complaints, or lead referrals for the purpose of investigating criminal tax evasion associated with marijuana, marijuana products, and marijuana accessories.
- 75) Prohibits any member or ex-member of the Criminal Cannabis Enforcement Team, any agent employed by any agency, or any person who has at any time obtained knowledge from any of the foregoing agencies or persons from divulging or making known in any manner not provided by law, any of the confidential information received by, or reported to, the team. Information exchanged pursuant to this section shall retain its confidential status and shall remain subject to any applicable confidentiality provisions.
- 76) Specifies that all persons required to be licensed involved in the cultivation and retail sale cultivation, retail sale, or distribution of marijuana or marijuana products must obtain a separate permit from the Board pursuant to regulations adopted by the Board. No fee shall be charged to any person for issuance of the permit. Any person required to obtain a permit who engages in business as a cultivator, dispensary, retailer, microbusiness, distributor, or nonprofit without a permit or after a permit has been canceled, suspended, or revoked, and each officer of any corporation which so engages in business, is guilty of a misdemeanor.
- 77) Requires the Board to issue a permit to a cultivator, retailer, or wholesaler upon receipt of a completed application and any security required by the Board, unless any of the following apply:
 - 1) The cultivator, retailer, or wholesaler, or if the cultivator, retailer, or wholesaler is not an individual, any person controlling the cultivator, retailer, or wholesaler, has previously been issued a permit that is suspended or revoked by the Board for violations, as specified.
 - 2) The cultivator's, retailer's, or wholesaler's permit was revoked or is subject to revocation proceedings for violation of any of the provisions of this division, unless it has been more than five years since a previous permit for the cultivator, retailer, or wholesaler was revoked.

- 3) The cultivator, retailer, or wholesaler is applying for a permit for a premises or business that is the same as that of a cultivator, retailer, or wholesaler whose license was revoked or is subject to revocation proceedings for violation of any of the provisions of this part, unless the person applying for the permit provides the Board with documentation demonstrating that the applicant has acquired or is acquiring the premises or business in an arm's length transaction. For purposes of this section, an "arm's length transaction" is defined as a sale in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction. A sale between relatives, related companies, or partners, or a sale for the primary purpose of avoiding the effect of the violations of this division that occurred at the cultivator or retailer location, is presumed not to be made at "arm's length."
 - 4) The cultivator, retailer, or wholesaler, or if the cultivator, retailer, or wholesaler is not an individual, any person controlling the cultivator, retailer, or wholesaler, has been convicted of a felony.
 - 5) The cultivator, retailer, or wholesaler does not possess all required permits or licenses.
- 78) States that any cultivator, retailer, or wholesaler who is denied a permit may petition for a redetermination of the Board's denial of the permit within 30 days after service upon that cultivator, retailer, or wholesaler, of the notice of the denial of the permit. If a petition for redetermination is not filed within the 30-day period, the determination of denial becomes final at the expiration of the 30-day period.
- 79) Requires that every petition for redetermination shall be in writing and shall state the specific grounds upon which the petition is founded. The petition may be amended to state additional grounds at any time prior to the date on which the Board issues its order or decision upon the petition for redetermination.
- 80) States that if the petition for redetermination is filed within the 30-day period, the Board shall reconsider the determination of the denial and, if the cultivator, retailer, or wholesaler has so requested in the petition, shall grant the cultivator, retailer, or wholesaler an oral hearing and shall give the cultivator, retailer, or wholesaler at least 10 days' notice of the time and place of the hearing. The Board may continue the hearing from time to time as may be necessary.
- 81) Indicates that the order or decision of the Board upon a petition for redetermination becomes final 30 days after mailing of notice thereof.
- 82) Requires that the marijuana excise tax and cultivation tax imposed is due and payable to the Board quarterly on or before the last day of the month following each quarterly period of three months. On or before the last day of the month following each quarterly period, a return for the preceding quarterly period shall be filed with the Board by each person required to be licensed for cultivation or retail sale using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the Board. If the cultivation tax is paid by stamp or remitted by the wholesaler the Board may by regulation determine when and how the tax shall be paid.
- 83) Requires any person required to make, render, sign, or verify any return or report who makes any false or fraudulent return or report with intent to defeat or evade the determination

required by law to be made is guilty of a misdemeanor. The person shall for each offense be fined not less than three hundred dollars (\$300) and not more than five thousand dollars (\$5,000), or be imprisoned for not exceeding one year in the county jail, or be subject to both fine and imprisonment, in the discretion of the court.

- 84) States that any person who fails or refuses to file any report required to be made or who fails or refuses to furnish a supplemental report or other data required by the Board is guilty of a misdemeanor and subject to a fine not to exceed one thousand dollars (\$1,000) for each offense.
- 85) States that any person who falsely or fraudulently makes, forges, alters, reuses, or counterfeits any evidence of the cultivation tax or marijuana excise tax imposed by this part, or tampers with any metering machine authorized by regulation under this part, or causes or procures to be falsely or fraudulently made, forged, altered, reused, or counterfeited, any such evidence of the cultivation tax or marijuana excise tax or knowingly and willfully utters, publishes, passes, or tenders as genuine any such false, forged, altered, reused, or counterfeited evidence of the cultivation tax or marijuana excise tax, for the purpose of evading the taxes imposed by this part, is guilty of a felony and subject to imprisonment for two, three, or four years, or to a fine of not less than one thousand dollars (\$1,000) and not more than twenty-five thousand dollars (\$25,000), or to both fine and imprisonment.
- 86) States that any person who possesses, sells or offers to sell, or buys or offers to buy, any false or fraudulent evidence of the cultivation tax or marijuana excise tax imposed by this part in a dollar amount of less than ____ dollars (\$____) is guilty of a misdemeanor, punishable by a fine not to exceed five thousand dollars (\$5,000) or imprisonment not exceeding one year in a county jail, or by both the fine and imprisonment.
- 87) States that any person who possesses, sells or offers to sell, or buys or offers to buy, any false or fraudulent evidence of the cultivation tax or marijuana excise tax imposed by this part in a dollar amount of ____ dollars (\$____) or greater, is guilty of a misdemeanor, punishable by a fine not to exceed fifty thousand dollars (\$50,000) or imprisonment not exceeding one year in a county jail, or by both the fine and imprisonment.
- 88) Authorizes the Board to destroy any evidence of the cultivation tax or marijuana excise tax seized.
- 89) States that any person who knowingly possesses, or keeps, stores, or retains for the purpose of sale, or sells or offers to sell, any marijuana flowers, marijuana leaves, marijuana, marijuana products, and any other product subject to tax under this part to which there is no evidence of the cultivation tax or marijuana excise tax authorized to be made upon secure packaging under this part, or on which tax is due but has not been paid, when those products have been obtained from any source whatever, is guilty of a misdemeanor and shall for each offense be fined an amount not to exceed twenty-five thousand dollars (\$25,000), or be imprisoned for a period not to exceed one year in the county jail, or, at the discretion of the court, be subject to both fine and imprisonment in the county jail.
- 90) Exempts a permitted cultivator that possesses, keeps, stores, or retains marijuana flowers, marijuana leaves, or any other product subject to tax before the necessary evidence of cultivation tax is affixed from the provisions outlined above.

- 91) Authorizes the Board to revoke all permits issued to any cultivator, retailer, or wholesaler who is convicted.
- 92) Specifies that any person who violates the provisions in this measure with intent to defeat or evade the determination of an amount due required by law to be made is guilty of a felony when the amount of tax liability aggregates twenty-five thousand dollars (\$25,000) or more in any 12-consecutive-month period. The determination shall be approved by the executive director or his or her designee. Each offense shall be punished by a fine of not less than five thousand dollars (\$5,000) and not more than twenty thousand dollars (\$20,000), or imprisonment for 16 months, two years, or three years, or by both the fine and imprisonment in the discretion of the court.
- 93) Specifies that any person convicted of a crime under the provisions in this measure may be charged the costs of investigation and prosecution at the discretion of the court.
- 94) Specifies that restitution orders or any other amounts imposed by a court of competent jurisdiction for criminal offenses upon a person or any other entity that are due and payable to the Board may be collected by the Board in any manner provided by law for collection of a delinquent cultivation tax or marijuana excise tax liability, including, but not limited to, issuance of an order and levy in the manner provided for earnings withholding orders for taxes.
- 95) Specifies that amounts imposed by a court of competent jurisdiction as an order of restitution for criminal offenses shall be treated as final and due and payable to the State of California on the date that amount is established on the records of the Board.
- 96) Specifies that a refund or credit shall not be allowed for any amounts paid or payments.
- 97) Specifies that the amount authorized to be collected may accrue interest at the greater of the rate applicable to the amounts being collected or from and after the date the amounts are established on the records of the Board.
- 98) Specifies that any portion of the amounts authorized to be collected under this section that remain unsatisfied may be collected by the recording of a notice of state tax lien. The Board may record or extend a recorded notice of state tax lien at any time until the amount due, including any accrued interest, is paid in full.
- 99) Specifies that the Controller shall disburse from the Tax Fund reasonable costs incurred by the Board for administering and collecting the taxes imposed by this measure, including enforcement activity costs incurred by the Board through participation in the Cannabis Criminal Enforcement Team provided, however, such costs shall not exceed 4 percent of tax revenues received.
- 100) States the following: “The Legislature finds and declares that this act furthers the purposes and intent of the Control, Regulate and Tax Adult Use of Marijuana Act (Act) by providing the Board with the authority and resources necessary to collect the taxes imposed by the Act and thereby protecting the Act’s anticipated funding for education, public health programs, law enforcement training, environmental cleanup, and marijuana business licensing. By providing the Board with the authority and resources, this act will simplify compliance with the Act’s tax laws, arrest sales of marijuana by criminal operations, level the playing field for

marijuana businesses complying with the laws, prevent marijuana businesses from going underground, and further the Act's purposes of curbing illegal growing, distribution, and retail sales of marijuana, while also driving out the illicit market.”

FISCAL EFFECT: Unknown. This bill is keyed fiscal by the Legislative Counsel.

COMMENTS:

Purpose. This bill is sponsored by the **Honorable Jerome Horton, member of the Board of Equalization**. According to the author, “AB 963 seeks to create an ease of tax collection and enforce accountability for cannabis by centralizing tax collection and creating a Cannabis Criminal Enforcement Team to audit the collection. This will be done by requiring the cultivation tax and a prepayment of the retail tax to be collected by the distributor. By centralizing the tax collection it creates a more efficient way of reporting and paying tax on cannabis.”

Background. *Proposition 64: Adult Use of Marijuana Act (AUMA)*. In 2016, the voters approved Proposition 64, which legalizes cannabis for adults 21 and older, regulates nonmedical cannabis, and imposes an excise tax of 15 percent on retail sales of cannabis, and a cannabis cultivation tax of \$9.25 per ounce of flowers and \$2.75 per ounce of leaves.

Currently, significant income, payroll and sales tax evasion exist within the medical cannabis industry, as well as the cannabis underground economy. According to the author, there are a number of problems with current law as outlined below:

- 1) *Tax Compliance.* California law lacks sufficient tax compliance competencies, specifically, a separation of duties, checks and balances, and detailed legislative tax administration requirements to ensure the collection of over \$1 billion in tax revenue forecasted for recreational cannabis to protect California's infrastructure.
- 2) *Medical Cannabis Market Noncompliance.* California has been losing \$73.3 million annually, since 2000, in sales, use, income and payroll taxes from the sale of medical cannabis due to the lack of voluntary compliance by legitimate businesses operating in the medical cannabis industry.

Indicative of the noncompliance in Los Angeles County, 51 percent of the cannabis entities are not registered with any California taxing agencies. Criminal cannabis businesses continue to pay zero taxes.

- 3) *Recreational Cannabis Market Noncompliance.* Based on other states' experiences, when Proposition 64 is implemented in January of 2018, it is estimated that only 15 to 20 percent of the illegal businesses will convert to legitimate businesses in the State of California. However, without adequate policies, regulations, and enforcement funding in place it will be impossible for the Board to audit, investigate, and enforce the tax laws. Accordingly, it is estimated that there will be 40 to 60 percent noncompliance with provisions in Proposition 64.
- 4) *Criminal Market Noncompliance.* Criminals who have little incentive to comply with California law are still unlikely to comply resulting in losing an additional \$341 million

in sales tax and \$624 million in cannabis excise tax on cannabis sales, assuming an 80 percent non-compliance rate on industrywide black market transactions.

- 5) *Track and Trace System.* While the track and trace system will allow the tracking of a single plant from the cultivator to the dispensary/retailer, as the one plant becomes many products and these products move along the track and trace distribution chain, it will become more difficult to definitively trace back to the source cultivator and/or specific plant, and the opportunity for tax evasion will increase. Recent cannabis retail sales data from Colorado and Washington indicate that alternative methods of consumption (edibles, oils, vaporizers, beverages, etc.) are outpacing traditional flower sales.
- 6) *Regulatory Processes.* Because the Federal Government has not decriminalized cannabis, California taxpayers in the cannabis industry avoid proper reporting and payment of tax, and lack access to traditional banking services typical of other government sanctioned businesses resulting in cash based transactions, and cash aggregation- circumstances susceptible to criminal activity.

According to the author, the established regulatory framework in this measure designs a system to move the cannabis industry from an industry operating predominantly underground, to an industry that operates in the open market. This is accomplished via the following provisions in the bill:

- 1) Requires a "wholesaler," which this bill would define as a person that makes a sale or distribution of cannabis or cannabis products to a retailer, to collect prepayments of both the cannabis excise and sales taxes on the cannabis or cannabis products processed for sale at retail;
- 2) Provides for the suspension or revocation of permits to businesses within the cannabis industry, and would authorize the Board to deny an application for a permit if the applicant had previously been issued a permit that was suspended or revoked, among other reasons, and would set forth the process for appealing permit suspensions, revocations, and application denials;
- 3) Imposes specific criminal penalties, including fines and imprisonment, for certain violations of the provisions relating to the cultivation and excise taxes on cannabis; prohibits permit transfers between related parties; allows the Board to recoup Marijuana Tax Law criminal investigation costs; and provides the Board with the authority to collect and deposit an order of restitution;
- 4) Establishes the Cannabis Criminal Enforcement Team within the Board in cooperation with Revenue Recovery and Collaborative Enforcement Team Act (RRACE) for the purpose of combating criminal tax evasion associated with cannabis, cannabis products, and cannabis accessories;
- 5) Provides that the prepaid taxes collected as part of a transaction between the "wholesaler" and retailer is a debt to the state at the time the transaction occurs;
- 6) Moves the sales and use tax exemption from the Marijuana Tax Law to the Sales and Use Tax Law to maintain statutory consistency;

- 7) Clarifies that the Board administration costs includes the enforcement activities associated with the Cannabis Criminal Enforcement Team; and,
- 8) Permits the Board to prescribe by regulation that a wholesaler may collect and remit the cultivation tax.

Diesel Fuel and Cigarette Product Tax Collection. This measure is modeled after provisions in Senate Bill 840 (Presley, Chapter 912, Statutes of 1994), AB 71 (Horton, Chapter 890, Statutes of 2003), and AB 576 (V.M. Perez, Chapter 576, Statutes of 2013). These measures were created to address the problem of criminal cartels which were selling billions in illegal cigarette and diesel products without paying the excise and sales tax. These measures required prepayment of the sales tax at a centralized point where the product is processed to prevent tax fraud and provide an effective audit trail. Additionally, the RRACE was created to require all California taxing agencies to collaborate on the enforcement of criminal sales in the black market.

IMPLEMENTATION ISSUES FOR CONSIDERATION:

Board Staff Analysis. An analysis of this measure was published on April 5, 2017 by staff of the Board. In the analysis, a number of questions regarding the implementation feasibility of provisions of this measure are raised including the following:

- 1) *Qualified Patient.* Existing RTC § 34011 requires the “qualified patient” or “primary caregiver” to provide the seller with both their medical marijuana identification card and a valid government-issued identification card to qualify for the sales and use tax exemption. However, HSC § 11362.7 defines a “qualified patient” to mean a person who is entitled to certain specified protections, *but who does not have an identification card.* Since the person must provide the seller with his or her medical marijuana identification card to qualify for the sales tax exemption, the law should correctly refer to a “person with an identification card” rather than a “qualified patient.”
- 2) *Tax Prepayment.* Since individuals who cultivate illegally operate outside the legitimate distributions structure, it is unclear to Board staff how the tax prepayments proposed by this measure will address tax evasion by underground cultivators and retailers.

This provision requires sales and excise tax prepayments from a wholesaler, who is also the retailer. In other words, the wholesaler would be collecting the prepayment from their retail-arm based on wholesale cost. Does the author intend for a person that is both a wholesaler and retailer to prepay the sales and excise tax on distributions to themselves?

- 3) *Wholesaler License.* As amended, the bill creates a wholesaler category for prepayment and cultivation tax purposes. However, current law does not reference that term as a licensee. Adding an additional person for tax purposes that does not conform to current law could cause confusion and result in unregistered taxpayers and unreported tax. The Board staff suggests using the terms “distributor” and “microbusiness,” established licensed categories, which would distribute marijuana and marijuana products to a dispensary or retailer after presale quality assurance, testing, and inspection.
- 4) *Cultivation Tax Collection.* Typically, Board staff recommends that excise taxes and fees be imposed as high in the distribution chain as possible, since there are fewer taxpayers and therefore less potential for tax evasion. This concern is magnified with respect to the

cannabis industry, as historically it has been unregulated with a low rate of tax compliance. The highest point in the marijuana distribution chain is the cultivator. As such, the cultivation tax collection at the distributor/wholesaler level may be more appropriate.

- 5) *Weight-Based Cultivation Tax.* Since the wholesaler may receive the marijuana in a processed form in addition to dry-weight ounces of flowers and leaves, how would wholesalers determine and collect the weight-based cultivation tax?
- 6) *RRACE Team Oversight.* Existing law established the RRACE Team to combat criminal tax evasion. The law does not limit the RRACE Team's investigations to specific tax programs, but they must be associated with the underground economy. Therefore, it appears that existing law already allows the RRACE Team to investigate criminal tax evasion associated with marijuana, marijuana products, and marijuana accessories.

Legislative Analyst Office Audit Report. The Board reports that approximately 40 percent of taxes on medical cannabis are not reported. This measure's intent is to increase tax collection by addressing illegal marketplace activity. The provisions of this measure are intended to go into effect commencing **January 1, 2018** or **July 1, 2018**. However, it is important to note that part of the provisions of the AUMA state that the Legislative Analyst should create a report by **January 1, 2020** with recommendations to the Legislature for adjustments to the tax rate to "achieve the goals of undercutting illicit market prices and discouraging use by persons younger than 21 of age while ensuring sufficient revenues are generated." The Committee may wish to ask the author to explain why this measure is needed prior to the release of the Legislative Analyst's study. Would it be more useful to see the results of the Legislative Analyst's study before implementing the changes proposed via this measure?

REGISTERED SUPPORT:

The Honorable Diane Harkey
California District Attorneys Association
California Teamsters
California State Council of Laborers

REGISTERED OPPOSITION:

None on file.

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