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STATE OF ARIZONA

TO: The Honorable Janice Brewer, Governor  
The Honorable Ken Bennett, Secretary of State  
The Honorable Russell Pearce, President of the Senate  
The Honorable Andy Tobin, Speaker of the House of Representatives

FROM: Thomas C. Horne, Attorney General

DATE: July 7, 2011

RE: Attorney General Opinion I11-004

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Attached is a copy of Attorney General Opinion I11-004, which concludes that the proceeds of medical marijuana sales are taxable under the retail classification of the transaction privilege tax, and that medical marijuana dispensaries cannot invoke a Fifth Amendment defense to a generally applicable requirement to file transaction privilege tax returns and pay the tax that is due.

#### Attachment

cc: The Honorable David Schapira, Minority Leader, State Senate  
The Honorable Chad Campbell, Minority Leader, House of Representatives  
Charmion Billington, Senate Secretary  
Cheryl Laube, House Chief Clerk



**STATE OF ARIZONA**  
**OFFICE OF THE ATTORNEY GENERAL**

<p>ATTORNEY GENERAL OPINION</p> <p>by</p> <p>THOMAS C. HORNE ATTORNEY GENERAL</p> <p>July 7, 2011</p>	<p>No. I11-004 (R11-001)</p> <p>Re: Transaction Privilege Tax Upon Medical Marijuana Sales</p>
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To: The Hon. Scott Bundgaard  
Arizona State Senate

**Questions Presented**

You have asked for an opinion on the following questions:

1. Does current law require the State to impose a transaction privilege tax upon the sale of medical marijuana in Arizona?
2. Do medical marijuana dispensaries have a valid Fifth Amendment defense for the failure to file transaction privilege tax returns and pay the tax that is due?

**Summary Answer**

1. Under current law, the proceeds of medical marijuana sales are taxable under the retail classification of the transaction privilege tax.

2. Even though the distribution of marijuana is a federal crime, medical marijuana dispensaries do not have a valid Fifth Amendment defense to a generally applicable requirement to file transaction privilege tax returns and pay the tax that is due.

### **Background**

In the November 2010 general election, Arizona voters approved Proposition 203, the Arizona Medical Marijuana Act (the “Act”), which legalized the sale of marijuana for use by individuals with “chronic or debilitating diseases” under specified circumstances. While both the distribution and possession of marijuana remain criminal offenses under the Controlled Substances Act (21 U.S.C. §§ 801 through 971), marijuana sales that comply with the requirements established under the Act are permitted under Arizona law.

### **Analysis**

#### **I. Medical Marijuana Sales Proceeds Are Taxable Under the Retail Classification of the Transaction Privilege Tax.**

The State of Arizona imposes a 6.6% transaction privilege tax on persons or entities engaged in taxable business classifications. Arizona Revised Statutes (“A.R.S.”) § 42-5010; Ariz. Const. art. IX, § 12.1. The retail classification of the transaction privilege tax, more commonly known as the “sales tax,” is established under A.R.S. § 42-5061, which in relevant part provides as follows:

The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.

The term “tangible personal property” is defined in A.R.S. § 42-5001(16) as “personal property which may be weighed, measured, felt or touched or is in any other manner perceptible to the senses.” There can be no doubt that marijuana, which can be weighed, measured, felt,

touched, seen, tasted and smelled, falls within the scope of this definition. Moreover, “selling at retail” means “a sale for any purpose other than for resale in the regular course of business in the form of tangible personal property.” A.R.S. § 42-5061(V)(3). Therefore, medical marijuana dispensaries will be engaged in “the business of selling tangible personal property at retail,” and unless an exemption applies, the proceeds of medical marijuana sales are taxable under the retail classification.<sup>1</sup>

While section 4 of the Act amended A.R.S. § 43-1201 to exempt medical marijuana dispensaries from income tax, there is no analogous provision in the Act exempting the proceeds of medical marijuana sales from the transaction privilege tax. Therefore, the Act itself does not shield these proceeds from sales tax.

Nor are these transactions exempt from sales tax under more generally applicable rules. In particular, medical marijuana sales proceeds do not constitute tax-exempt proceeds of income derived from the sale of prescription drugs under A.R.S. § 42-5061(8), because the Act does not contemplate prescriptions for medical marijuana. Instead, an individual applying for a registry identification card from the Arizona Department of Health Services must submit “written certification” from a physician specifying the patient’s debilitating medical condition and stating that in the physician’s professional opinion, the patient is likely to benefit from the medical use of marijuana. A.R.S. § 36-2801(18). Medical marijuana is not “prescribed” by a physician under these circumstances because the physician is not directing the patient to use marijuana. Moreover, in contrast to the fact pattern under which a physician writes a prescription that is

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<sup>1</sup> Nothing in A.R.S. § 42-5061 limits the retail classification to business activities that are lawful, and, as a general proposition, an unlawful activity may be subject to tax. *Marchetti v. United States*, 390 U.S. 39, 44 (1968) (noting that the unlawfulness of an activity does not prevent its taxation). Therefore, even illegal sales of marijuana are currently subject to transaction privilege tax under the retail classification. For obvious reasons, however, criminal enterprises do not voluntarily disclose their sales revenues or otherwise comply with tax obligations.

delivered to a pharmacy, medical marijuana certification is submitted to the Arizona Department of Health Services, rather than to an organization that dispenses medical marijuana.

The fact that licensed physicians are prohibited under federal law from prescribing “Schedule I” controlled substances (as defined in § 812 of the Controlled Substances Act), including marijuana, further supports the conclusion that medical marijuana certification submitted to the Arizona Department of Health Services does not amount to a “prescription” for purposes of the prescription drug exemption established under A.R.S. § 42-5061(8).<sup>2</sup> And, it is well-settled law that tax exemptions are narrowly construed; therefore, it is unlikely that a court would broaden the scope of the prescription drug exemption to include medical marijuana certification. *Ariz. Dep’t of Revenue v. Blue Line Distrib.*, 202 Ariz. 266, 266-67, ¶4, 43 P.3d 214, 214-15 (App. 2002) (“Tax exemption statutes are strictly construed against exemption.”).

The only other retail transaction privilege tax exemption that could potentially apply to medical marijuana sales is the exemption set forth under A.R.S. § 42-5061(4) for sales of tangible personal property made by a federally recognized § 501(c)(3) charitable organization. While section 3 of the Act provides that medical marijuana can be lawfully dispensed only by nonprofit entities, it states that “[a] registered nonprofit medical marijuana dispensary need not be recognized as tax-exempt by the Internal Revenue Service.” A.R.S. § 36-2806(A). This language implicitly recognizes that the distribution or dispensing of marijuana is a federal crime under the Controlled Substances Act, and it is therefore highly unlikely that the Internal Revenue

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<sup>2</sup> In addition to meeting state law requirements, every person who dispenses a federally controlled substance must obtain registration from the United States Drug Enforcement Administration. 21 C.F.R. § 1301.11. This registration is available only for dispensing controlled substances listed on Schedules II, III, IV and V. 21 C.F.R. § 1301.13. Under the Controlled Substances Act, marijuana is listed as a Schedule I drug. 21 U.S.C. § 812(c). Therefore, marijuana cannot be dispensed under a prescription. *See also* 21 U.S.C. § 829 (governing “prescriptions” for controlled substances and establishing requirements associated with schedule II through V drugs only); *United States v. Oakland Cannabis Buyers’ Co-op*, 532 U.S. 483, 492 n.5 (2001) (noting that Schedule I drugs cannot be dispensed under a prescription).

Service would grant § 501(c)(3) status to a medical marijuana dispensary. In the unlikely event, however, that (1) a medical marijuana dispensary invites federal scrutiny by applying to the Internal Revenue Service for § 501(c)(3) status, and (2) such an application is granted, the proceeds of medical marijuana sales at that dispensary would be exempt from transaction privilege tax under current Arizona law.

In summary, neither of the only two potentially applicable tax exemptions are likely to apply, and sales of medical marijuana should therefore be treated as taxable sales of tangible personal property sold at retail for purposes of A.R.S. § 42-5061.

## **II. Fifth Amendment Analysis.**

The Act does nothing to alter the fact that the distribution of marijuana for any purpose, including medical treatment, is a federal crime. It is therefore possible that a medical marijuana dispensary would take the position that a requirement to submit transaction privilege tax returns to the Arizona Department of Revenue amounts to compelled self-incrimination, which is prohibited under the Fifth Amendment edict that “[n]o person . . . shall be compelled in any criminal case to be a witness against himself.”

As discussed below, however, there is no valid Fifth Amendment defense to a generally applicable requirement to file transaction privilege tax returns.

### **A. The Fifth Amendment Applies Where There Is an Appreciable Threat of Prosecution.**

As a threshold issue, the Fifth Amendment privilege may be invoked only where there are substantial and real, and not merely trifling or imaginary, hazards of self-incrimination. *Marchetti*, 390 U.S. at 53; *Brown v. Walker*, 161 U.S. 591, 599-600 (1896) (quoting *Queen v. Boyes*, 1 B. & S. 311, 330 (Q.B. 1861) (“[T]he danger to be apprehended must be real and appreciable . . . not a danger of an imaginary and unsubstantial character, having reference to

some extraordinary and barely possible contingency, so improbable that no reasonable man would suffer it to influence his conduct.”)). Therefore, the Fifth Amendment privilege against self-incrimination may be invoked by the medical marijuana dispensaries only if the threat of federal prosecution is real and appreciable.

In a widely circulated memorandum dated October 19, 2009 (known as the “Ogden Memorandum”), the United States Department of Justice provided the following advice to federal prosecutors in states that have enacted laws authorizing the medical use of marijuana:

[T]he disruption of illegal drug manufacturing and trafficking networks continues to be a core priority in the Department’s efforts against narcotics and dangerous drugs, and the Department’s investigative and prosecutorial resources should be directed towards these objectives. As a general matter, pursuit of these priorities should not focus federal resources in your States on individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana. For example, prosecution of individuals with cancer or other serious illnesses who use marijuana as part of a recommended treatment regimen consistent with applicable state law, or those caregivers in clear and unambiguous compliance with existing state law who provide such individuals with marijuana, is unlikely to be an efficient use of limited federal resources. On the other hand, prosecution of commercial enterprises that unlawfully market and sell marijuana for profit continues to be an enforcement priority of the Department.<sup>3</sup>

While this memorandum may provide reassurance to medical marijuana users and their caregivers, it may not reflect an intent to permanently divert federal resources away from prosecuting medical marijuana clinics that are in compliance with state law, as indicated by the following language in a February 1, 2011, letter from the United States Department of Justice to the Oakland City Attorney:

The prosecution of individuals and organizations involved in the trade of any illegal drugs and the disruption of drug trafficking organizations is a core priority of the Department. This core priority includes prosecution of business enterprises

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<sup>3</sup> A copy of this memorandum may be found on the website of the United States Department of Justice at <http://blogs.usdoj.gov/blog/archives/192>. On May 2, 2011, Arizona U.S. Attorney Dennis Burke issued a letter to the director of the Arizona Department of Health Services, Will Humble, reiterating the position taken in the Ogden Memorandum.

that unlawfully market and sell marijuana. Accordingly, while the Department does not focus its limited resources on seriously ill individuals who use marijuana as part of a medically recommended treatment regimen in compliance with state law as stated in the October 2009 Ogden Memorandum, we will enforce the CSA vigorously against individuals and organizations that participate in unlawful manufacturing and distribution activity involving marijuana, even if such activities are permitted under state law.<sup>4</sup>

It therefore appears possible that medical marijuana dispensaries in Arizona may be at risk of federal prosecution under the Controlled Substances Act. Because it cannot be assumed that a court would rule that there is no appreciable risk of federal prosecution under these circumstances, the merits of a Fifth Amendment defense to the tax filing requirement should be considered. As discussed below, however, Fifth Amendment jurisprudence does not allow the privilege against self-incrimination to be invoked in order to avoid generally applicable reporting requirements that do not target inherently suspect activities.

**B. The Fifth Amendment Does Not Shield Medical Marijuana Dispensaries from a Generally Applicable Requirement to File Transaction Privilege Tax Returns.**

A generally applicable requirement to file tax returns cannot be avoided on the basis of the Fifth Amendment privilege against self-incrimination, even if the information submitted would tend to incriminate a taxpayer. In *United States v. Sullivan*, 274 U.S. 259 (1927), the taxpayer, who sold liquor in violation of the National Prohibition Act, was convicted of failing to file an income tax return, and the U.S. Supreme Court concluded that “[i]t would be an extreme if not extravagant application of the Fifth Amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime.” *Id.* at 263-64. While this 1927 opinion consists of only five paragraphs, it is directly on point, and it continues to be cited with approval by modern courts.

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<sup>4</sup> A copy of this letter is available on the website for the Arizona League of Cities and Towns at [http://www.azleague.org/event\\_docs/medical\\_marijuana0211/us\\_atty\\_letter.pdf](http://www.azleague.org/event_docs/medical_marijuana0211/us_atty_letter.pdf).

Similarly, in 1971 the U.S. Supreme Court held that the Fifth Amendment privilege against self-incrimination was not infringed by a generally applicable statute that required a motorist involved in an accident to stop at the scene and provide his name and address, where (1) the statute was regulatory and noncriminal, (2) self-reporting was indispensable, and (3) the burden was on the public at large, as opposed to a highly selective group inherently suspect of criminal activities. *California v. Byers*, 402 U.S. 424, 430-31 (1971). The Court distinguished cases in which the privilege had been upheld by noting that “[i]n all of these cases the disclosures condemned were only those extracted from a highly selective group inherently suspect of criminal activities and the privilege was applied only in an area permeated with criminal statutes—not in an essentially noncriminal and regulatory area of inquiry.” *Id.* at 430 (internal quotation marks omitted).

In *Marchetti*, for example, the U.S. Supreme Court held that the defendant’s assertion of the privilege against self-incrimination constituted a complete defense to prosecution for the failure to register and pay an occupational tax on wagering. In that case, the Court recognized that wagering was a crime in almost every state, and that the tax was not imposed in an essentially noncriminal and regulatory area, but directed to a selective group inherently suspect of criminal activities. *Marchetti*, 395 U.S. at 47; *see also Haynes v. United States*, 390 U.S. 85, 100 (1968) (upholding Fifth Amendment privilege as a defense to a registration requirement for sawed-off shotguns, where requirement was directed principally at persons who were inherently suspect of criminal activities); *Leary v. United States*, 395 U.S. 6, 18 (1969) (upholding Fifth Amendment defense to provisions of the Marihuana Tax Act requiring the defendant to identify himself as an unregistered transferee of marijuana, a selective group inherently suspect of criminal activities.)

Here, there is no suggestion that the sales tax imposed under A.R.S. § 42-5061 is designed to require the disclosure of incriminating information. The taxable classification is the business of selling tangible personal property at retail, and retailers can hardly be characterized as a “select group that is inherently suspect of criminal activities.” Instead, the requirement to file transaction privilege tax returns generally applies to taxable business classifications and is not associated with criminal law enforcement efforts. As noted by the U.S. Supreme Court in

*Byers*:

An organized society imposes many burdens on its constituents. It commands the filing of tax returns for income; it requires producers and distributors of consumer goods to file informational reports on the manufacturing process and the content of products, on the wages, hours, and working conditions of employees. Those who borrow money on the public market or issue securities for sale to the public must file various information reports; industries must report periodically the volume and content of pollutants discharged into our waters and atmosphere. Comparable examples are legion.

In each of these situations there is some possibility of prosecution—often a very real one—for criminal offenses disclosed by or deriving from the information that the law compels a person to supply. Information revealed by these reports could well be a link in the chain of evidence leading to prosecution and conviction. But under our holdings the mere possibility of incrimination is insufficient to defeat the strong policies in favor of disclosure called for by statutes like the one challenged here.

402 U.S. at 427-28. Therefore, notwithstanding the fact that transaction privilege tax returns filed by a medical marijuana dispensary might tend to incriminate the organization under federal law, the Fifth Amendment does not constitute a valid defense to a generally applicable requirement to report sales revenues and remit sales tax.

### **Conclusion**

Under current law, the proceeds of medical marijuana sales are taxable under the retail classification of the transaction privilege tax. Moreover, medical marijuana dispensaries cannot

invoke a Fifth Amendment defense to a generally applicable requirement to file transaction  
privilege tax returns and pay the tax that is due.

Thomas C. Horne  
Attorney General