



## CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

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EDMUND G. BROWN JR.  
Governor

MARYBEL BATJER  
Secretary, Government Operations Agency

NICOLAS MADUROS  
Director

July 21, 2017

Dear Interested Party:

Enclosed is the Discussion Paper on proposed emergency regulations with respect to cannabis taxes. Staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, an interested parties meeting is scheduled as follows:

**August 2, 2017**  
**Room 121 at 10:00 a.m.**  
**450 N Street, Sacramento, CA**

If you would like to participate by teleconference, call 1-888-808-6929 and enter access code 7495412. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at [Trista.Gonzalez@cdtfa.ca.gov](mailto:Trista.Gonzalez@cdtfa.ca.gov) by August 16, 2017. You should submit written comments including proposed language if you have suggestions you would like considered during this process. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

Effective July 1, 2017, the State Board of Equalization has been restructured to better serve taxpayers. The California Department of Tax and Fee Administration (CDTFA) has assumed all previous statutory tasks of the Board including the handling of most taxes and fees previously collected by the Board of Equalization. As a result of this restructuring, we have modified our rulemaking process.

If you are interested in other Business Taxes Committee topics refer to the CDTFA webpage at (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of discussion papers and calendars of current and prior issues.

Thank you for your consideration. Staff looks forward to your comments and suggestions. Should you have any questions, please feel free to contact Business Taxes Committee staff member Mr. Robert Wilke at 1-916-445-2137, who will be leading the meeting.

Sincerely,

A handwritten signature in cursive script that reads "Trista Gonzalez".

Trista Gonzalez, Chief  
Tax Policy Bureau  
Business Tax and Fee Division

TG:rsw  
Enclosures

cc: (all with enclosures)

Mr. Nicolas Maduros (MIC 104)  
Mr. David Botelho (MIC 104)  
Mr. Tad Egawa (MIC 83)  
Ms. Susanne Buehler (MIC 43)  
Mr. Wayne Mashihara (MIC 47)  
Mr. Todd Gilman (MIC 70)  
Mr. Richard Parrot (MIC 57)  
Ms. Debra Kalfsbeek (MIC 62)  
Mr. Kevin Hanks (MIC 49)  
Mr. Mark Durham (MIC 67)  
Mr. Robert Tucker (MIC 82)  
Mr. Jeff Vest (MIC 85)  
Mr. Bradley Heller (MIC 82)  
Mr. Jeff Angeja (MIC 85)  
Mr. David Levine (MIC 85)  
Ms. Dana Brown (MIC 85)  
Ms. Casey Tichy (MIC 85)  
Ms. Nikki Mozdyniewicz (MIC 85)  
Mr. Rick Zellmer (MIC 85)  
Mr. Stephen Smith (MIC 82)  
Ms. Monica Silva (MIC 82)  
Ms. Kirsten Stark (MIC 50)  
Ms. Lynn Whitaker (MIC 50)  
Mr. Joe Fitz (MIC 67)  
Mr. Bill Benson (MIC 67)  
Mr. Marc Alviso (MIC 104)  
Mr. Chris Lee (MIC 104)  
Ms. Karina Magana (MIC 47)  
Mr. Bradley Miller (MIC 92)  
Mr. Kaiji Wang (MIC 70)  
Mr. Paul Camky (MIC 50)  
Mr. Robert Wilke (MIC 50)

# DISCUSSION PAPER

## Proposed Rulemaking with Respect to Cannabis Taxes

### Issue

Whether the California Department of Tax and Fee Administration<sup>1</sup> (CDTFA), formerly known as the Board of Equalization, should initiate rulemaking to interpret, clarify, and make specific the Cannabis Tax Law (CTL), as amended by Senate Bill 94 (Stats. 2017, ch. 27) (SB 94).

### Background

In 2015, the Legislature enacted the Medical Marijuana Regulation and Safety Act (MMRSA), a package of legislation that establishes a comprehensive licensing and regulatory framework for the cultivation, manufacturing, transportation, distribution, and sale of medical marijuana. The MMRSA consists of three bills: SB 643 (Ch. 719, McGuire), AB 243 (Ch. 688, Wood), and AB 266 (Ch. 689, Bonta).

Among its provisions, the MMRSA establishes the Bureau of Medical Marijuana Regulation<sup>2</sup> (Bureau) within the Department of Consumer Affairs to oversee and enforce the state's medical marijuana regulations, in collaboration with the California Department of Public Health (CDPH) and the California Department of Food and Agriculture (CDFA).

On November 8, 2016, California voters approved Proposition 64 which establishes the *Control, Regulate and Tax Adult Use of Marijuana Act* (the Adult Use of Marijuana Act) (AUMA). Among other things, AUMA added Division 10 (commencing with Section 26000) to the Business and Professions Code (BPC), *Marijuana Regulation and Safety* (MRS), which establishes nonmedical marijuana regulatory and licensing provisions, and added Part 14.5, *Marijuana Tax*, to Division 2 of the Revenue and Taxation Code (RTC) (commencing with RTC section 34010).

In 2017, SB 94 repealed the MCRSA, included certain provisions from MCRSA into MRS, now known as the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), and made further amendments to AUMA. With respect to taxes, SB 94, section 162, amended Part 14.5 to ease and streamline cannabis tax collection and remittance to the CDTFA. As relevant here, SB 94: (1) changes the law throughout to be the Cannabis Tax Law instead of Marijuana Tax Law; (2) revises the cannabis excise tax to be imposed upon purchasers at a rate of 15 percent of the average market price, instead of retail selling price, to be collected by a distributor from a cannabis retailer; (3) requires a distributor or a manufacturer to collect the cultivation tax from a cultivator, and a manufacturer to remit any cultivation tax collected from a cultivator to a distributor, for distributor remittance of those taxes to the CDTFA; and (4) makes other

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<sup>1</sup> Assembly Bill 102 (Stats. 2017, ch. 16) established the California Department of Tax and Fee Administration to perform the various duties, powers, and responsibilities of the State Board of Equalization relating to the administration of various taxes and fees except for those duties, powers, and responsibilities imposed or conferred upon the Board by the California Constitution. Pursuant to RTC section 15570.24, whenever any reference to the Board appears in any statute, regulation, or contract, or in any other code, with respect to any of the functions transferred to the CDTFA pursuant to RTC section 15570.24, it shall be deemed to refer to the CDTFA. For purposes of this paper, statutory references to the Board have been changed to CDTFA.

<sup>2</sup> MMRSA and the Bureau of Medical Marijuana Regulation were subsequently changed to the Medical Cannabis Regulation and Safety Act (MCRSA) and the Bureau of Cannabis Control.

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corrections and other conforming changes.

This paper provides a general overview of the CTL followed by staff's initial suggested regulatory language to be considered for proposed emergency rulemaking.<sup>3</sup> (See Exhibit 1.)

### General Overview of the Cannabis Tax Law

#### Definitions

For purposes of Part 14.5, *Cannabis Tax*, RTC section 34010 specifies the following definitions:

“Arm’s length transaction” shall mean a sale entered into 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.

“Average market price” shall mean:

- In an arm’s length transaction, the average market price means the average retail price determined by the wholesale cost of the cannabis or cannabis products sold or transferred to a cannabis retailer, plus a mark-up, as determined by the CDTFA on a biannual basis in six-month intervals.
- In a nonarm’s length transaction, the average market price means the cannabis retailer’s gross receipts from the retail sale of the cannabis or cannabis products.

“Board” shall mean the State Board of Equalization or its successor agency.

“Bureau” shall mean the Bureau of Cannabis Control within the Department of Consumer Affairs.

“Tax Fund” means the California Cannabis Tax Fund created by Section 34018.

“Cannabis” shall have the same meaning as set forth in Section 11018 of the Health and Safety Code (HSC) and shall also mean medicinal cannabis.

“Cannabis products” shall have the same meaning as set forth in Section 11018.1 of the HSC and shall also mean medicinal concentrates and medicinal cannabis products.

“Cannabis flowers” shall mean the dried flowers of the cannabis plant as defined by the CDTFA.

“Cannabis leaves” shall mean all parts of the cannabis plant other than cannabis flowers that are sold or consumed.

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<sup>3</sup> Any subsequent legislation with respect to the Cannabis Tax Law will be addressed in this interested parties process to the extent that it affects critical issues that need to be clarified through the emergency rulemaking process.

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“Cannabis retailer” shall mean a person required to be licensed as a retailer, microbusiness, or nonprofit pursuant to Division 10 (commencing with Section 26000) of the BPC.

“Cultivator” shall mean all persons required to be licensed to cultivate cannabis pursuant to Division 10 (commencing with Section 26000) of the BPC.

“Distributor” shall mean a person required to be licensed as a distributor pursuant to Division 10 (commencing with Section 26000) of the BPC.

“Enters the commercial market” shall mean cannabis or cannabis product that has completed and complies with all quality assurance, inspection, and testing, as described in Section 26110 of the BPC.

“Microbusiness” shall have the same meaning as set forth in paragraph (3) of subdivision (a) of Section 26070 of the BPC.

“Nonprofit” shall have the same meaning as set forth in Section 26070.5 of the BPC.

“Sale” and “purchase” shall mean any change of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, for consideration.

“Transfer” shall mean to grant, convey, hand over, assign, sell, exchange, or barter, in any manner or by any means, with or without consideration.

“Unprocessed cannabis” shall include cannabis flowers, cannabis leaves, or other categories of harvested cannabis, categories for unprocessed or frozen cannabis or immature plants, or cannabis that is shipped directly to manufacturers.

“Gross receipts,” “person,” and “retail sale” shall have the same meaning as set forth in RTC sections 6012, 6005, and 6007, respectively.

#### Cannabis Excise Tax

##### *General*

On and after January 1, 2018, a cannabis excise tax is imposed upon purchasers of cannabis or cannabis products sold in this State at the rate of 15 percent of the average market price of any retail sale by a cannabis retailer. The cannabis excise tax is in addition to the sales and use tax imposed by the state and local governments. Gross receipts from the sale of cannabis or cannabis products for purposes of assessing the sales and use tax under the Sales and Use Tax Law include the cannabis excise tax. Cannabis or cannabis products shall not be sold to a purchaser unless the excise tax required by law has been paid by the purchaser at the time of sale.

##### *Purchaser’s Liability for the Cannabis Excise Tax*

A purchaser’s liability for the cannabis excise tax is not extinguished until the cannabis excise tax has been paid to this State, except that an invoice, receipt, or other document from a cannabis retailer given to the purchaser is sufficient to relieve the purchaser from further liability for the

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tax to which the invoice, receipt, or other document refers.

#### *Receipts from Cannabis Retailers*

Each cannabis retailer is required to provide a purchaser with an invoice, receipt, or other document that displays the cannabis excise tax separately from the list price, the price advertised in the premises, the marked price, or other price and includes a statement that reads: “The cannabis cultivation and excise taxes are included in the total amount of this invoice.”

#### *Collection and Remittance of the Cannabis Excise Tax*

A distributor in an arm’s length transaction shall collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer. A distributor in a nonarm’s length transaction shall collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer, or at the time of retail sale by the cannabis retailer, whichever is earlier. A distributor shall report and remit the cannabis excise tax to the CDTFA pursuant to Section 34015. A cannabis retailer is responsible for collecting the cannabis excise tax from the purchaser and remitting the cannabis excise tax to the distributor in accordance with rules and procedures established under law and any regulations adopted by the CDTFA.

#### *Receipts from Distributors*

A distributor shall provide an invoice, receipt, or other similar document to the cannabis retailer that identifies the licensee receiving the product, the distributor from which the product originates, including the associated unique identifier, the amount of cannabis excise tax, and any other information deemed necessary by the CDTFA. The CDTFA may authorize other forms of documentation.

#### Sales and Use Tax Exemption

On and after November 9, 2016, the sales and use taxes do not apply to retail sales of medical cannabis, medical cannabis concentrate, edible medical cannabis products or topical cannabis as those terms are defined in Division 10 (commencing with Section 26000) of the BPC when a qualified patient or primary caregiver for a qualified patient provides his or her card issued under Section 11362.71 of the HSC and a valid government-issued identification card.

#### Cultivation Tax

##### *General*

On and after January 1, 2018, a cultivation tax is imposed upon cultivators on all harvested cannabis that enters the commercial market. The tax is due after the cannabis is harvested and enters the commercial market. Cannabis shall not be sold unless the tax has been paid. All cannabis removed from a cultivator’s premises, except for plant waste, shall be presumed to be sold and thereby taxable under RTC section 34012.

##### *Cultivation Tax Rate*

The cultivation tax rate for cannabis flowers shall be nine dollars and twenty-five cents (\$9.25) per dry-weight ounce. The tax rate for cannabis leaves shall be set at two dollars and seventy-

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five cents (\$2.75) per dry-weight ounce. The CDTFE may adjust the tax rate for cannabis leaves annually to reflect fluctuations in the relative price of cannabis flowers to cannabis leaves.

The CDTFE may from time to time establish other categories of cannabis, categories for unprocessed or frozen cannabis or immature plants, or cannabis that is shipped directly to manufacturers. These categories shall be taxed at their relative value compared with cannabis flowers.

Beginning January 1, 2020, the cultivation tax rates imposed on cannabis flowers, cannabis leaves, and any other categories of cannabis established by the CDTFE shall be adjusted by the CDTFE annually thereafter for inflation.

#### *Exemption for Personal Use*

The cultivation tax shall be imposed on all cannabis cultivated in the State pursuant to rules and regulations promulgated by the CDTFE, but shall not apply to cannabis cultivated for personal use under Section 11362.1 of the HSC or cultivated by a qualified patient or primary caregiver in accordance with the Compassionate Use Act of 1996 (Section 11362.5 of the HSC).

#### *Cultivator's Liability for the Cultivation Tax*

A cultivator's liability for the tax is not extinguished until the tax has been paid to this State except that an invoice, receipt, or other document from a distributor or manufacturer given to the cultivator is sufficient to relieve the cultivator from further liability for the tax to which the invoice, receipt, or other document refers. Cultivators are responsible for payment of the cultivation tax pursuant to regulations adopted by the CDTFE.

#### *Collection and Remittance of the Cultivation Tax*

A distributor shall collect the cultivation tax from a cultivator upon entry into the commercial market, unless a cultivator is not required to send, and does not send, the harvested cannabis to a distributor.

A manufacturer shall collect the cultivation tax from a cultivator on the first sale or transfer of unprocessed cannabis by a cultivator to a manufacturer. The manufacturer shall remit the cultivation tax collected on the cannabis product sold or transferred to a distributor for quality assurance, inspection, and testing, as described in Section 26110 of the BPC. All cultivation tax applicable to a unique identifier shall be paid upon the first sale or transfer of cannabis or cannabis product with an associated unique identifier. This paragraph shall not apply where a distributor collects the cultivation tax from a cultivator pursuant to the paragraph above.

#### *Alternative Methods for Collection and Remittance*

The CDTFE may prescribe a substitute method and manner for collection and remittance of the cultivation tax, including a method and manner for collection of the cultivation tax by a distributor.

#### *Receipts from Distributor or Manufacturer*

A distributor or manufacturer shall provide to the cultivator, and a distributor that collects the

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cultivation tax from a manufacturer shall provide to the manufacturer, an invoice, receipt, or other similar document that identifies the licensee receiving the product, the cultivator from which the product originates, including the associated unique identifier, the amount of cultivation tax, and any other information deemed necessary by the CDTFA. The CDTFA may authorize other forms of documentation.

#### *Debt to the State*

The cultivation tax and cannabis excise tax required to be collected by the distributor, or required to be collected by the manufacturer, and any amount unreturned to the cultivator or cannabis retailer that is not tax but was collected from the cultivator or cannabis retailer under the representation by the distributor or the manufacturer that it was tax, constitute debts owed by the distributor or the manufacturer to this State.

Furthermore, any tax collected from a cultivator or cannabis retailer that has not been remitted to the CDTFA shall be deemed a debt owed to the State by the person required to collect and remit the tax.

#### *Excess Tax Collected*

A distributor or manufacturer that has collected any amount of tax in excess of the amount of tax imposed by the CTL and actually due from a cultivator or cannabis retailer, may refund such amount to the cultivator or cannabis retailer, even though such tax amount has already been paid to the CDTFA and no corresponding credit or refund has yet been secured. The distributor or manufacturer may claim credit for that overpayment against the amount of tax that is due upon any other quarterly return, providing that credit is claimed in a return dated no later than three years from the date of overpayment.

#### *Refund Procedures for Product Failure*

The CDTFA may adopt regulations prescribing procedures for the refund of cultivation tax collected on cannabis or cannabis product that fails quality assurance, inspection, and testing as described in Section 26110 of the BPC.

#### *Indicia for Cultivation Tax Paid*

The CDTFA may prescribe by regulation a method and manner for payment of the cultivation tax that utilizes tax stamps and/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 cannabis is packaged.

If the CDTFA utilizes tax stamps, the tax stamps and product bags shall be of the designs, specifications, and denominations as may be prescribed by the CDTFA and may be purchased by any licensee under Division 10 (commencing with Section 26000) of the BPC. Furthermore, the tax stamps and product bags shall be capable of being read by a scanning or similar device and must be traceable utilizing a track and trace system pursuant to Section 26068 of the BPC.

Subsequent to the establishment of a tax stamp program, the CDTFA may by regulation provide that cannabis shall not be removed from a licensed cultivation facility or transported on a public highway unless in a state-issued product bag bearing a tax stamp in the proper denomination.



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## **Proposed Rulemaking with Respect to Cannabis Taxes**

### Administration

#### *Permits*

All distributors must obtain a separate permit from the CDTFA pursuant to regulations adopted by the CDTFA. 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 distributor 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.

#### *Security Deposit*

The CDTFA may require every licensed distributor, retailer, cultivator, microbusiness, nonprofit, or other person required to be licensed, to provide security to cover the liability for taxes imposed by State law on cannabis produced or received by the retailer, cultivator, microbusiness, nonprofit, or other person required to be licensed in accordance with procedures to be established by the CDTFA.

Notwithstanding anything herein to the contrary, the CDTFA may waive any security requirement it imposes for good cause, as determined by the CDTFA. “Good cause” includes, but is not limited to, the inability of a distributor, retailer, cultivator, microbusiness, nonprofit, or other person required to be licensed to obtain security due to a lack of service providers or the policies of service providers that prohibit service to a cannabis business. A person may not commence or continue any business or operation relating to cannabis cultivation until any surety required by the CDTFA with respect to the business or operation has been properly prepared, executed and submitted.

In fixing the amount of any security required by the CDTFA, the CDTFA shall give consideration to the financial hardship that may be imposed on licensees as a result of any shortage of available surety providers.

#### *Reporting*

The cannabis excise tax and cultivation tax is due and payable to the CDTFA 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 CDTFA by each distributor using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the CDTFA.

#### *Alternate Reporting*

Existing law authorizes the payment of the amount due and the filing of returns for periods other than the period or periods specified in the tax and fee laws administered under the Fee Collections Procedure Law (FCPL) (commencing with RTC section 55001). In addition, the CTL authorizes the CDTFA to adopt regulations prescribing the due date for returns and remittances of the cannabis excise tax collected by a distributor in an arm’s length transaction.

If the cultivation tax is paid by stamp pursuant to RTC subsection 34012(d) the CDTFA may by regulation determine when and how the tax shall be paid.

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#### *Supplemental Reports*

The CDTFA may require every person engaged in the cultivation, distribution, manufacturing, or retail sale of cannabis and cannabis products required to be licensed pursuant to Division 10 (commencing with Section 26000) of the BPC to file, on or before the 25th day of each month, a report using electronic media respecting the person's inventory, purchases, and sales during the preceding month and any other information as the CDTFA may require to carry out the purposes of the cannabis taxes. Reports shall be authenticated in a form or pursuant to methods as may be prescribed by the CDTFA.

#### *Penalties*

Any person required to be licensed pursuant to Division 10 (commencing with Section 26000) of the BPC who fails to pay the cannabis excise tax or the cultivation tax, in addition to owing the taxes not paid, is subject to a penalty of at least one-half the amount of the taxes not paid, and shall be subject to having its license revoked pursuant to Section 26031 of the BPC. The CDTFA may bring such legal actions as are necessary to collect any deficiency in the tax required to be paid, and, upon the CDTFA's request, the Attorney General shall bring the actions.

Any person who renders a false or fraudulent report is guilty of a misdemeanor and subject to a fine not to exceed one thousand dollars (\$1,000) for each offense. Any violation of any provisions of the CTL, except as otherwise provided, is a misdemeanor and is punishable as such.

#### *Inspections*

Any peace officer or certain designated CDTFA employees granted limited peace officer status, upon presenting appropriate credentials, is authorized to enter and conduct inspections at any place at which cannabis or cannabis products are sold to purchasers, cultivated, or stored, or at any site where evidence of activities involving evasion of tax may be discovered. Inspections shall be performed in a reasonable manner and at times that are reasonable under the circumstances, taking into consideration the normal business hours of the place to be entered. Inspections shall be requested or conducted no more than once in a 24-hour period.

Any person who fails or refuses to allow an inspection shall be guilty of a misdemeanor. Each offense shall be punished by a fine not to exceed five thousand dollars (\$5,000), or imprisonment not exceeding one year in a county jail, or both the fine and imprisonment. The court shall order any fines assessed be deposited in the California Cannabis Tax Fund.

Upon discovery by the CDTFA or a law enforcement agency that a licensee or any other person possesses, stores, owns, or has made a retail sale of cannabis or cannabis products, without evidence of tax payment or not contained in secure packaging, the CDTFA or the law enforcement agency shall be authorized to seize the cannabis or cannabis products. Any cannabis or cannabis products seized by a law enforcement agency or the CDTFA shall within seven days be deemed forfeited and the CDTFA shall comply with the procedures set forth in RTC sections 30436 through 30449, inclusive.

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### **Proposed Rulemaking with Respect to Cannabis Taxes**

#### *Authority to Examine Books and Records*

The CDTFA may make examinations of the books and records of any person licensed, or required to be licensed, pursuant to Division 10 (commencing with Section 26000) of the BPC, as it may deem necessary in carrying out the CTL.

#### *Deposit of Funds*

The CTL creates a California Cannabis Tax Fund in the State Treasury. The Tax Fund will consist of all taxes, interest, penalties, and other amounts collected and paid to the CDTFA under the CTL, less payment of refunds. The purpose of the special trust fund is solely to carry out the purposes of AUMA and all revenues deposited into the Tax Fund, together with interest or dividends earned by the fund, are hereby continuously appropriated for the purposes of AUMA without regard to fiscal year and shall be expended only in accordance with the provisions of the CTL and its purposes.

The revenues in the California Cannabis Tax Fund will fund: \$10 million grant for a public university to research and evaluate the implementation and effects of MAUCRSA and make recommendations to the legislature and/or governor as appropriate to possibly amend AUMA; \$3 million to the Highway Patrol; \$10 million to GOBiz; \$2 million to University of California San Diego Center for Medicinal Cannabis Research; and Reimbursement for the CDTFA, Department of Consumer Affairs, CDFA, CDPH, Department of Fish and Wildlife, Department of Water Resources, Department of Pesticide Regulation, Controller, Department of Finance, Legislative Analyst's Office, and the Divisions of Labor Standards and Enforcement and Occupational Safety and Health within the Department of Industrial Relations for reasonable costs.

Beginning with 2018-19 fiscal year, the remaining excise and cultivation tax revenues will be allocated as follows: 60% to the Youth Education, Prevention, Early Intervention and Treatment Account; 20% to the Environmental Restoration and Protection Account; and 20% to State and Local Government Law Enforcement Account.

#### *Authority for Rulemaking*

The CTL provides that the collection and administration of both the cannabis excise tax and the cultivation tax shall be in accordance with the FCPL. The CTL also authorizes the CDTFA to prescribe, adopt, and enforce regulations relating to the administration and enforcement of the CTL, including collections, reporting, refunds, and appeals. Until January 1, 2019, the CDTFA may prescribe, adopt, and enforce any emergency regulations as necessary to implement, administer, and enforce its duties. The CTL further specifies that any emergency regulation prescribed, adopted, or enforced by the CDTFA is deemed an emergency and shall be considered by the Office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety, and general welfare. Pursuant to the CTL, the emergency regulations adopted by the CDTFA may remain in effect for two years from adoption.

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### **Discussion**

#### *Rulemaking*

With the responsibilities of administering a new program with respect to the cannabis taxes, staff believes it is necessary to consult with interested parties and promulgate regulations through the emergency rulemaking process. Since emergency regulations approved by the Office of Administrative Law (OAL) are effective on the date they are initially filed with OAL, the emergency rulemaking will ensure that guidance is in place when provisions of the CTL become operative on January 1, 2018. For the emergency rulemaking, staff is focused on drafting proposed regulatory language to implement, clarify, and make specific the provisions of CTL that staff and interested parties believe are most critical with respect to the administration of the cannabis excise and cultivation taxes. Staff outlines its initial suggested issues in further detail in the following sections.

Following the emergency rulemaking process, staff will commence with the regular interested parties meeting and rulemaking processes to adopt the emergency regulation(s) as a permanent regulation or regulations after the required notice and comment period. During the regular interested parties process, staff will also work with interested parties on clarifying any outstanding issues. Staff notes that should there be a persuasive reason for doing so, it may amend any emergency regulation that may be promulgated.

Staff would also like to note that while banking and the acceptance of cash payments are important issues to the cannabis industry; these issues are outside the scope of this emergency rulemaking process.

#### *Definitions*

Staff believes that it's important to make clear the applicable meaning of key statutory terms and other terms used within the regulations. Staff also believes it may be helpful to include definitions from the statutes in the regulation for ease of reference, so that the readers of the regulation will not have to refer back to the underlying statute for the meaning of such terms. To begin, staff understands that with respect to the weighing of cannabis, it may be common industry practice that an ounce consists of 28 grams. However, for purposes of implementing the cultivation taxes imposed on harvested cannabis, staff believes it is important to clarify that "dried-weight ounce" is in reference to the metric unit of mass equivalent to 28.349 grams rounded to the nearest hundredth (28.35). Staff believes rounding to the nearest hundredth of a place is reasonable with the understanding that it is likely that cultivators package and sell the harvested cannabis in greater quantities. (See Exhibit 1, subdivision (a) for staff's proposed definitions.)

Staff also believes it is helpful to define cannabis flowers to clarify that the cultivation tax is to be imposed on the dry-weight ounce prior to converting the plant material into a different form. Staff further believes it may be helpful to include the definition of cannabis leaves for ease of reference, so that the readers of the regulation will not have to refer back to the underlying statute for the meaning of the term.

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#### *Average Market Price*

The cannabis excise tax is imposed at the rate of 15 percent of the average market price of any retail sale by a cannabis retailer. RTC section 34010(b)(2) specifies that in a nonarm's length transaction, the average market price means the cannabis retailer's gross receipts from the retail sale of the cannabis or cannabis products. RTC section 34010(b)(1) specifies that in an arm's length transaction the average market price means the average retail price determined by the wholesale cost of the cannabis or cannabis products sold or transferred to a cannabis retailer, plus a mark-up, as determined by the CDTFA on a biannual basis in six-month intervals. It is staff's understanding that the wholesale cost plus the markup should be equal to the retailer's gross receipts for the sale of the cannabis or cannabis products.

The term wholesale cost is not defined in the statute. Without clarification defining wholesale cost, staff believes there could be confusion and it may make it difficult for distributors and retailers to collect and pay the applicable excise tax. Therefore, staff proposes to define wholesale cost in the proposed regulation as the amount paid by the retailer for the cannabis or cannabis products, including transportation charges and adding back in any discounts or trade allowances. (See Exhibit 1, subdivision (a)(5).)

Pursuant to BPC section 26110(h), a licensee is not required to sell cannabis or cannabis products to a distributor and may directly contract for sale with a licensee authorized to sell cannabis and cannabis products to purchasers. Staff understands this provision to allow sales of cannabis by a cultivator directly to a cannabis retailer, and sales of cannabis products by a manufacturer directly to a cannabis retailer. Staff further understands that the cannabis and cannabis products in such instances are required to be transported by a distributor and the distributor has the obligation to collect the cannabis excise tax.

With respect to determining wholesale cost when a distributor is only providing transportation, staff understands that the cost will be made available to the distributor, pursuant to the invoice and receipt requirements of BPC section 26161. For reference, BPC section 26161 specifies that "every sale *or transport* of cannabis or cannabis products from one licensee to another licensee must be recorded on a sales invoice or receipt" and the sales invoice shall include, amongst other information, the names of the seller and purchaser, as well as the cost to the purchaser, together with any discount applied to the price as shown on the invoice. Staff welcomes interested parties input as to whether it would be helpful to include clarification within CDTFA's regulations.

As noted, the other input in calculating the average market price for arm's length transactions, is a CDTFA determined mark-up. Staff anticipates this "mark-up" will be a specified percentage of the wholesale cost of the product. This will ensure that when one follows the calculation of the average market price as specified in the statute (wholesale cost, *plus* mark-up), the result would be the average market price. Staff notes that an equivalent calculation would be to multiply the wholesale cost by a markup factor equal to one plus the Department determined markup. Staff further anticipates that once the markup is determined that it will be published on the Department's website. Staff is in the process of gathering market data with respect to the costs and retail selling prices of cannabis and cannabis products to use as a basis for determining the average market price. Staff encourages and welcomes industry input in that regard.

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#### *Reporting and Remitting the Excise Tax*

With respect to an arm's length transaction, a distributor is required to collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer. In a nonarm's length transaction, the distributor is required to collect the cannabis excise tax from the cannabis retailer on or before 90 days after the sale or transfer of cannabis or cannabis product to the cannabis retailer, or at the time of retail sale by the cannabis retailer, whichever is earlier. In general, a distributor is required to report and remit the cannabis excise tax to the Department quarterly on or before the last day of the month following each quarterly period of three months.

Staff believes the periods of time in which a distributor is required to collect the excise tax from the cannabis retailer is clear, and that a distributor will generally report quarterly. However, it is not entirely clear whether, in an arm's length transaction, the distributor will report the tax collected with the quarterly return for the period in which the transfer or sale to the cannabis retailer takes place or when the excise tax is actually collected from the cannabis retailer. Likewise, it not entirely clear when a distributor would report the tax in a nonarm's length transaction.

Staff is open to input on ways to clarify a distributor's reporting obligation and believes it is imperative to draft regulatory guidance that will ease administration, be consistent with industry practices, and interplay with the developing track and trace system. Staff looks forward to discussing this item at the upcoming interested parties meeting.

#### *Cultivation Tax Rates*

The rate of the cultivation tax is nine dollars and twenty-five cents (\$9.25) per dry-weight ounce of cannabis flowers, and two dollars and seventy-five cents (\$2.75) per dry-weight ounce of cannabis leaves. Staff believes that it is likely that a cultivator's harvested cannabis may not weigh in whole ounces and there may be uncertainty as to whether the cultivation tax applies or what the correct rate would be in such circumstances. As such, staff proposes to clarify that the cultivation tax imposed on the dried-weight ounce of cannabis and cannabis flowers is to be at a proportionate rate for quantities that are a fraction of an ounce. (See Exhibit 1, subdivision (c).)

#### *Other Cultivation Categories and Tax Rates*

As specified in RTC section 34012(c), the CDTFA may from time to time establish other categories of harvested cannabis, categories for unprocessed or frozen cannabis or immature plants, or cannabis that is shipped directly to manufacturers. The other categories are to be taxed at their relative value compared with cannabis flowers. Currently, the CTL provides two categories for taxation: cannabis flowers and cannabis leaves. The cultivation tax rate for these categories is based on the dry-weight ounce.

Staff acknowledges that there may be circumstances in which a cultivator's sales of cannabis do not clearly fall into either of the two categories established by the statute. Staff further understands that the cannabis sold by a cultivator may be in a form which is not dry. With the authority to establish new categories and rates, staff welcomes input from interested parties as to

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which other category or categories the CDTFA should establish, as well as data to determine the new category's relative value compared to cannabis flowers.

#### *Cultivation Tax Collection / Enters the Commercial Market*

A distributor shall collect the cultivation tax from a cultivator upon entry into the commercial market, unless a cultivator is not required to send, and does not send, the harvested cannabis to a distributor. Cannabis or cannabis product enters the commercial market once it has completed and complies with all quality assurance, inspection, and testing, as described in Section 26110 of the BPC. Pursuant to BPC section 26070(1), beginning January 1, 2018, a licensee may sell cannabis or cannabis products that have not been tested for a limited and finite time as determined by the Bureau.

Since the statute allows the Bureau to allow licensees to sell untested cannabis and cannabis products for a limited and finite time, staff believes there may be some confusion as to when the cannabis and cannabis products enter the commercial market when the Bureau waives the testing requirements. Staff therefore proposes to specify that when the testing requirement is waived pursuant to BPC section 26070(1), the cultivation tax shall be collected by the distributor when the cannabis or cannabis products is transferred or sold to a distributor. Staff notes that this collection point is similar to that as when a cultivator transfers or sells cannabis and cannabis products to a manufacturer. (See Exhibit 1, subdivision (b).)

#### *Presumption - Removal from Cultivator's Premises*

Pursuant to RTC section 34012(i), all cannabis removed from a cultivator's premises, except for plant waste, is presumed to be sold and thereby taxable under section 34012. The term "plant waste" is not defined within the statutes pertaining to the cannabis tax. Therefore, staff proposes to define plant waste so that it is clear as to what "plant waste" is not subject to the presumption that removal from the cultivator's site is sold and taxable. Staff notes that the term "cannabis waste" is defined within the CDFA's proposed regulation 8305, *Cannabis Waste Management*. Staff proposes a definition of plant waste to mirror the definition of "cannabis waste" because it believes that maintaining consistency with CDFA will help to ensure understanding and compliance within the industry. (See Exhibit 1, subdivision (a)(4).)

With respect to the presumption, staff also believes there may be some circumstances in which cannabis may be removed from a cultivator's premise for valid purposes other than for sale. However, staff has not reviewed any specific fact patterns with respect to the removal of cannabis from a cultivator's premise for other than sale. Therefore, during the interested parties process, staff is looking to obtain input from cultivators, as well as other interested parties, to determine if there may be instances when the presumption could be rebutted and, if so, whether clarification needs to be provided in a regulation with respect to the types of evidence that may be used to rebut the presumption.

#### *Penalties for Failure to Pay the Taxes Due*

Pursuant to RTC section 34015, the cannabis excise tax and cultivation tax are due and payable to the CDTFA 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

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for the preceding quarterly period shall be filed with the CDTFA by each distributor using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the CDTFA. Pursuant to RTC section 55041.1, the CDTFA may require the payment of the amount due and the filing of returns for periods other than the period or periods set forth in the tax and fee laws administered under the FCPL.

RTC section 34013(e) specifies that any person required to be licensed pursuant to Division 10 (commencing with Section 26000) of the BPC who fails to pay the cannabis excise tax or the cultivation tax, in addition to owing the taxes not paid, is subject to a penalty of at least one-half the amount of the taxes not paid, and shall be subject to having its license revoked pursuant to BPC Section 26031.

RTC section 55086 provides that all amounts determined to be due by the CDTFA under Article 2 (commencing with Section 55061) are due and payable at the time they become final, and if not paid when due and payable, a penalty of 10 percent of the amount determined to be due shall be added to the amount due and payable.

With respect to the penalty imposed by RTC section 34013(e), the statute specifies that the penalty shall apply to the amount of taxes not paid. Staff understands this to mean that the penalty is mandatory. However, staff notes that under the FCPL the penalty may be relieved when the failure to pay is due to reasonable reliance on written advice and in some circumstance to relieve the penalty imposed on a spouse. The CDTFA may also extend the due date for specified periods for good cause or in the event of a disaster. Staff proposes regulatory language to clarify that the penalty should be applied to amounts not paid by the due date of a return or by the due date of amounts determined by the CDTFA.

Because the statute does not specify the amount of the penalty, staff proposes to specify the percentage of the penalty by regulation to ensure that the amount of the penalty is consistently applied amongst taxpayers who fail to pay the cannabis excise tax or the cultivation tax. Staff also understands that since the statute provides that the penalty is at least one-half of the amount of taxes not paid, it appears that the CDTFA may be limiting the statute if it had a single penalty percentage. Therefore, staff believes it is necessary to specify that the CDTFA may impose penalties of varying amounts provided that they are at least one-half of the taxes not paid. Staff proposes to specify penalty amounts of 50, 60, and 75 percent. Staff believes an amount of 50 percent is the minimum amount required by statute. Staff determined the amounts of 60 and 75 percent by adding 10 and 25 percent to the minimum penalty amount. The incremental amounts were based on penalty provisions in the FCPL. Pursuant to the FCPL, a penalty of 10 percent may be applied to determinations when there is evidence of negligence or intentional disregard of the law or regulations. In addition, a 25 percent penalty may be applied when there is fraud or intent to evade the law or regulation. While these FCPL provisions were used as a basis for determining the penalty amounts, staff would like to note that it does not consider a late payment, in and of itself, to be an indication of either negligence or fraud.

Staff further proposes regulatory language to provide guidelines for when certain penalty amounts would apply based on whether it was a taxpayer's first, second, or third (or more) offense of making an untimely payment. In establishing these guidelines, staff recognizes that



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there may be circumstances in which a second or third late payment would not warrant a penalty amount above 50 percent. For example, a taxpayer who has been in operation for many years may have a second or third late payment several years after the previous late payment. In such instances, staff does not feel it is equitable to apply the higher penalty amounts. In the alternative, there may be circumstances in which a taxpayer has several late payment within a short period of time in which staff believes warrants the increased penalty amounts. As such, staff's proposed regulation contains an "18-month look back window" for the purpose of determining whether the 60 or 75 percent penalty should apply. This means that when a taxpayer makes a late payment, staff will review its account history. If a late payment or payments were made in the previous 18 months, staff will apply the 60 or 75 penalty based on whether it was the taxpayer's second or third offense. (See Exhibit 1, subdivision (d).)

#### **Summary**

Staff looks forward to working with interested parties to develop guidance so that everyone affected by the legislation can easily understand and comply with their obligations with respect to the collection and payment of the cannabis taxes. While staff has prepared initial guidelines, staff recognizes that there may be additional areas that may warrant further consideration and welcomes any comments, suggestions, and input from interested parties on this issue. Staff also invites and encourages interested parties to participate in the August 2, 2017, interested parties meeting. If you plan to attend via teleconference, please let staff know and an agenda or other material(s) for the meeting will be emailed to you in the morning on the day of the meeting. The deadline for interested parties to provide written responses regarding this discussion paper is August 16, 2017.

Prepared by the Tax Policy Bureau, Business Tax and Fee Division.

Current as of July 20, 2017

Cannabis DP.docx

(New chapter and regulation to be added to the California Code of Regulations)

**New Chapter X.X, Cannabis Tax Regulations**  
**Regulation XXXX. Cannabis - Excise and Cultivation Taxes.**

(a) Definitions. For purposes of this chapter (Cannabis Tax Regulations, commencing with Regulation XXXX), the definition of terms in Part 14.5, Cannabis Tax, (commencing with section 34010) of Division 2 of the Revenue and Taxation Code shall apply, unless otherwise defined below.

(1) "Dry-weight ounce" means 28.35 grams.

(2) "Cannabis flowers" means the flowers of the plant *Cannabis sativa* L. that have been harvested, trimmed, dried, and cured, and prior to any processing whereby the plant material is transformed into a concentrate, including, but not limited to, concentrated cannabis, or an edible or topical product containing cannabis or concentrated cannabis and other ingredients. The term "cannabis flowers" excludes leaves and stems.

(3) "Cannabis leaves" means all parts of the plant *Cannabis sativa* L. other than cannabis flowers that are sold or consumed.

(4) "Plant waste" means waste of the plant *Cannabis sativa* L. that is not hazardous waste, as defined in section 40141 of the Public Resources Code, and is solid waste, as defined in section 40191 of the Public Resources Code, that has been made unusable and unrecognizable. For the purpose of this subdivision, plant waste is deemed "unusable and unrecognizable" when it is ground and incorporated with other ground material so that the resulting mixture is at least fifty percent non cannabis material by volume.

(5) "Wholesale cost" means the amount paid by the retailer for the cannabis or cannabis product, including transportation charges. Discounts and trade allowances must be added back when determining wholesale cost.

For purposes of this subdivision, "discounts or trade allowances" are price reductions, or allowances of any kind, whether stated or unstated, and include, without limitation, any price reduction applied to a supplier's price list. The discounts may be for prompt payment, payment in cash, bulk purchases, related-party transactions, or "preferred-customer" status.

(b) Collection of Cultivation Tax When Testing Requirement is Waived. For purposes of the cultivation tax imposed on all harvested marijuana that enters the commercial market pursuant to section 34012 of the Revenue and Taxation Code, when the testing requirement is waived pursuant to section 26070(1) of the Business and Professions Code, a distributor shall collect the cultivation tax from a cultivator when the cannabis is transferred or sold to a distributor.

(c) Cultivation Tax Rates. For transactions made on and after January 1, 2018, the rate of the cultivation tax is as follows:

- (1) Nine dollars and twenty-five cents (\$9.25) per dry-weight ounce of marijuana flowers, and at a proportionate rate for any other quantity.
- (2) Two dollars and seventy-five cents (\$2.75) per dry-weight ounce of marijuana leaves, and at a proportionate rate for any other quantity.

(d) Penalty for Taxes Not Paid. In addition to any other penalty imposed pursuant to the Fee Collection Procedures Law (commencing with section 55001 of the Revenue and Taxation Code or any other penalty provided by law) a penalty, as set forth in paragraphs (1)-(3) of this subdivision, applies to the amount of cannabis excise tax or cannabis cultivation tax not paid in whole or in part within the time required pursuant to sections 34015, 55041.1, and 55086, of the Revenue and Taxation Code.

- (1) The first failure to timely pay the cannabis excise tax or cultivation tax by the due date, within an 18-month period, shall incur a penalty of 50 percent of the amount of the unpaid taxes.
- (2) The second failure to timely pay the cannabis excise tax or cultivation tax by the due date, within an 18-month period, shall incur a penalty of 60 percent.
- (3) The third or subsequent failure to timely pay the cannabis excise tax or cultivation tax by the due date, within an 18-month period, shall incur a penalty of 75 percent.