STATE OF CALIFORNIA

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EDMUND G. BROWN JR
Governor

MARYBEL BATJER
Secretary, Government Operations Agency

NICOLAS MADUROS
Director

November 20, 2017

Dear Interested Party:

The California Department of Tax and Fee Administration (CDTFA) adopted proposed Regulation 3700, *Cannabis Excise and Cultivation Taxes*, as recommended by staff in the enclosed Formal Issue Paper. CDTFA staff will now begin the formal rulemaking process in accordance with the California Administrative Procedures Act's (commencing with section 11340 of the Government Code) rulemaking requirements.

Interested Parties on our distribution list for regulatory issues related to cannabis will receive notice of the proposed emergency action, as will every person who has filed a request for notice of regulatory action with CDTFA. To be added to our distribution list for regulatory issues related to cannabis, please send your contact information to BTFD-BTC.InformationRequests@cdtfa.ca.gov. Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

For our latest information on cannabis, see our Tax Guide for Cannabis Businesses. If you are interested in other Business Taxes Committee (BTC) topics, refer to the CDTFA BTC webpage for copies of discussion papers and calendars of current and prior issues.

Thank you for your input on these issues. Should you have any questions, please feel free to contact Business Taxes Committee staff member Mr. Robert Wilke at 1-916-445-2137.

Sincerely,

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

TG:rsw

Enclosures

cc: (all with enclosures)
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Issue Paper Number **Proposed Emergency Regulation 3700, *Cannabis Excise and Cultivation Taxes***

CALIFORNIA DEPARTMENT OF
TAX AND FEE ADMINISTRATION
KEY AGENCY ISSUE

Proposed Emergency Regulation 3700, *Cannabis Excise and Cultivation Taxes*

I. Issue

Whether the California Department of Tax and Fee Administration[1] (Department), 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) and Assembly Bill 133 (Stats. 2017, ch. 253).

II. Staff Recommendation

Staff recommends that the Executive Director approve the adoption of proposed Regulation 3700, *Cannabis Excise and Cultivation Taxes*, as set forth in Exhibit 2, for placement in a new Chapter 8.7, *Cannabis Tax Regulations*, in the California Code of Regulations, Title 18, Division 2. Staff also recommends that the proposed regulation be promulgated as an emergency regulation pursuant to Government Code section 11346.1. The proposed emergency regulation will ensure that essential guidance is available to the cannabis industry when the CTL becomes operative on January 1, 2018.

Staff will conduct additional interested parties meetings in the year 2018 to obtain further input to address any outstanding concerns or issues. For a more detailed explanation of –Staff's Recommendation, refer to section VI of this paper.

III. Other Alternative(s) Considered

None.

[1] 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 Government Code (GC) 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 GC section 15570.22, it shall be deemed to refer to the CDTFA.

IV. Background

In 2015, the Legislature enacted the Medical Marijuana Regulation and Safety Act (MMRSA), a package of legislation that established 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 established the Bureau of Medical Marijuana Regulation[2] (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 established 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 Department. 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 Department; and (4) makes other corrections and other conforming changes.

The CTL was further amended by AB 133 in 2017 to, in part: remove the requirement that a cannabis retailer display the cannabis excise tax separately from the price of cannabis and cannabis products when sold to consumers; remove the requirement that a cannabis retailer state on the purchase invoice that the cannabis cultivation tax is included in the total amount of the invoice; and authorize the Department to prescribe other means to display the cannabis excise tax on an invoice, receipt, or other document from a cannabis retailer given to the purchaser. AB 133 also defines manufacturer and authorizes the Department to relieve a person of the penalty for failure to pay the cannabis cultivation and excise tax if the Department finds that the person's failure to make a timely payment is due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect.

For reference, staff has included the text of the underlying statutes (RTC sections 34010, 34011, 34012, and 34013) which are the basis for the proposed regulation (Exhibit 3).

General Overview of the Cannabis Tax Law

Definitions

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

[2] 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.

"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 department 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.

"Department" shall mean the California Department of Tax and Fee Administration 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 Department.

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

"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, except for immature cannabis plants and seeds, that has completed and complies with all quality assurance, inspection, and testing, as described in Section 26110 of the BPC.

"Manufacturer" shall mean a person required to be licensed as a manufacturer pursuant to Division 10 (commencing with Section 26000) 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 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 includes a statement that reads: "The cannabis excise taxes are included in the total amount of this invoice." The Department may prescribe other means to display the cannabis excise tax on an invoice, receipt, or other document from a cannabis retailer given to the purchaser.

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 Department pursuant to RTC 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 Department.

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 Department. The Department may authorize other forms of documentation.

Sales and Use Tax Exemption

On and after November 9, 2016, sales and use tax does not apply to retail sales of medicinal cannabis, medicinal cannabis concentrate, edible medicinal 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 is nine dollars and twenty-five cents ($9.25) per dry-weight ounce. The tax rate for cannabis leaves is two dollars and seventy-five cents ($2.75) per dry-weight ounce. The Department may adjust the tax rate for cannabis leaves annually to reflect fluctuations in the relative price of cannabis flowers to cannabis leaves.

The Department 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. 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 Department shall be adjusted by the Department annually thereafter for inflation.

Exemption for Personal Use

The cultivation tax shall be imposed on all harvested cannabis cultivated in the State pursuant to rules and regulations promulgated by the Department, 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 Department.

Collection and Remittance of the Cultivation Tax

A distributor shall collect the cultivation tax from a cultivator on all harvested cannabis that enters 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. 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 Department 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 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 Department. The Department 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.

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

Refund Procedures for Product Failure

The Department 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 Department 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 Department utilizes tax stamps, the tax stamps and product bags shall be of the designs, specifications, and denominations as may be prescribed by the Department 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 Department 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.

Administration

Permits

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

The Department may waive any security requirement it imposes for good cause, as determined by the Department. "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 Department with respect to the business or operation has been properly prepared, executed and submitted. In fixing the amount of any security required by the Department, the Department 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 Department 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 Department by each distributor using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the Department.

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 Department 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 Department may by regulation determine when and how the tax shall be paid.

Supplemental Reports

The Department 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 Department 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 Department. 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.

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 Department may bring such legal actions as are necessary to collect any deficiency in the tax required to be paid, and, upon the Department's request, the Attorney General shall bring the actions.

If the Department finds that a person's failure to make a timely payment is due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person may be relieved of the penalty for failing to pay the cannabis excise tax or cultivation tax. Any person seeking to be relieved of the penalty shall file with the Department a statement, under penalty of perjury, setting forth the facts upon which he or she bases his or her claim for relief. The Department shall establish criteria that provide for efficient resolution of requests for relief.

Inspections

Any peace officer or certain designated Department 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 Department 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 Department 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 Department shall within seven days be deemed forfeited and the Department shall comply with the procedures set forth in RTC sections 30436 through 30449, inclusive.

Authority to Examine Books and Records

The Department 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 Department 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 AUMA 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 Department, 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 Department 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 Department 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 Department 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 Department may remain in effect for two years from adoption.

V. Discussion

Rulemaking

With the responsibilities of administering a new program with respect to the cannabis taxes, staff conducted an interested parties meeting on August 2, 2017 to obtain input from interested parties with respect to the Department's draft emergency regulation. Staff explained its intention to promulgate the regulation through the emergency rulemaking process to ensure that guidance is in place when provisions of the CTL become operative on January 1, 2018. During the interested parties' process, staff 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. Following the interested parties meeting, staff received written comments from a number of interested parties, including cannabis growers, distributors, manufacturers, retailers, and industry associations. (See Exhibits 4 through 22.)

Following this emergency rulemaking process, staff will commence with the regular interested parties meeting and rulemaking processes to adopt the emergency regulation as a permanent regulation after the required notice and comment period. During the regular interested parties' process, staff will continue to 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, or promulgate additional emergency regulations.

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. For example, because MAUCRSA specifically allows for vertical integration of commercial cannabis cultivation, manufacturing, distribution and retail sales under a single microbusiness license, staff has included a microbusiness in the definitions of cultivator, distributor and manufacturer, respectively, to clarify that a microbusiness is required to pay, collect, and remit the cannabis excise tax and cultivation tax when it engages in activity as a licensed cultivator, distributor, or manufacturer. Staff 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 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. For example, staff believes it may be helpful to include the definition of cannabis leaves.

Staff understands that with respect to the weighing of cannabis, it may be common industry practice that an ounce consists of 28 grams. For purposes of implementing the cultivation taxes imposed on harvested cannabis that enters the commercial market, staff's July 21, 2017 Discussion Paper proposed to define "dried-weight ounce" to clarify that the term "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. Staff received a submission from Boveda, Inc. (Boveda) (Exhibit 4), in which Boveda expressed concern that cultivators may over-dry flowers to reduce the amount of cultivation tax owed. Boveda further suggested that the definition of "dry-weight ounce" specify that it is 28.35 grams "at a Water Activity at or between .65 and .55." Staff appreciates the concern and is of the understanding that acceptable water activity levels and moisture content of cannabis flowers will be set forth in the regulations promulgated by the Bureau of Cannabis Control (Bureau) with respect to testing. Therefore, staff does not believe it necessary to specify the water activity levels in a "dry-weight ounce" and further notes that doing so would have the potential risk of conflicting with the Bureau's regulations. In addition, as discussed in this paper, staff is proposing to add a new cultivation tax category for fresh cannabis, which is not dry. As such, staff recommends defining "ounce" as that term would be applicable to both dry and fresh product.

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 Department on a biannual basis in six-month intervals.

The term "wholesale cost" is not defined in the statute. Without clarification defining wholesale cost, staff believes there could be confusion and it may be difficult for distributors and retailers to collect and pay the appropriate amount of excise tax. In the Discussion Paper, staff proposed defining 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. Staff received written comments from Berkeley Patients Group (BPG) (Exhibit 5), in which BPG questioned whether gross receipts in a nonarm's length transaction would include the cannabis taxes imposed by the City of Berkeley (city tax). BPG further suggested that the definition of wholesale cost exclude locally imposed taxes and distribution/transportation fees and expenses.

With respect to gross receipts, the CTL specifies that gross receipts shall have the same meaning as set forth in RTC section 6012. In relevant part, gross receipts means the total amount for which tangible personal property

is sold, without any deduction for the cost of the property sold, any expenses, and certain costs for transportation. Staff also notes that RTC section 6012 specifically excludes from gross receipts any sales or use taxes imposed by any city, county or rapid transit district. Other locally-imposed taxes, such as the business license tax the City of Berkeley imposes on cannabis businesses, are not excluded from gross receipts. Accordingly, staff does not recommend any changes to its initial proposed definition of wholesale cost.

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. In the July 21, 2017 Discussion Paper staff explained that it is not entirely clear whether, in an arm's length transaction, the distributor will report and remit the cannabis excise 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 is not entirely clear when a distributor would report and remit the tax in a nonarm's length transaction.

Staff received written comments from several interested parties on this issue. Written comments from CCIA, Kiva Confections, Therapy Tonics & Provisions LLC, International Cannabis Farmers Association, and Consortium Management Group/Caliva (Exhibits 6-10, respectively) suggested that the excise tax be reported in the quarter following the quarter in which the distributor transfers or sells the product to the retailer. Written comments from Weedmaps and Pacific Expeditors (Exhibits 11 and 12, respectively) suggested that the excise tax be due with the quarterly return for the period in which the excise tax was collected. Written comments from Oakland Distribution Company, Inc., and Service Employees International Union, Local 100 (Exhibits 13 and 14, respectively) recommended that the distributor should report the excise tax with the quarterly return in which the distributor sells or transfers the cannabis and cannabis products to the retailer.

Staff believes it is imperative to draft regulatory guidance that will ease administration, interplay with the developing track and trace system, and is consistent with reporting transactions for sales and use tax purposes on an accrual basis, since distributors will also file sales and use tax returns. Therefore, staff recommends that the proposed regulation specify that a distributor shall report and remit the cannabis excise tax due with the quarterly return for the period in which the distributor sells or transfers the cannabis or cannabis products to a cannabis retailer.

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. In addition, as further explained below, staff proposes a cultivation tax rate of one dollar and twenty-nine cents ($1.29) per ounce of fresh cannabis plant. 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 shall be at a proportionate rate for quantities that are a fraction of an ounce.

Other Cultivation Categories and Tax Rates

As specified in RTC section 34012(c), the Department 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 sought input from interested parties as to which other category or categories the Department should establish, as well as data to determine the new category's relative value compared to cannabis flowers.

The California Growers Association (CGA) submitted written comments (Exhibit 15) suggesting that the Department establish categories for fresh (wet) products to be taxed at the rate of ten percent of the dry-weight rate. CGA further suggests that the products be weighed within six hours in order to be eligible for the fresh rate. CGA also suggested a new category for whole plants and a composite rate that is 30 percent flower and 70 percent leaf (rounded to $4.75 per ounce). Weedmaps' written comments (Exhibit 11) suggested that the Department consider a category for wet or frozen cannabis. Weedmaps stated that the value of wet or frozen cannabis would likely be less than dried cannabis flowers because they can have a moisture content of greater than 80 percent. Weedmaps further acknowledged that determining the rate for the new category would be difficult to determine and suggested that the Colorado Department of Revenue's recently released excise tax rates for "Wet Whole Plant Rate" may provide some insight. Weedmaps also believes that immature plants and clones, as well as seeds, are not subject to the cultivation tax but are subject to the excise tax. Front Range Biosciences Inc. (Front Range) (Exhibit 16) submitted written comments expressing Front Range's opinion that a new category for immature plants or clones should be established with clarification that the immature plants or clones are not subject to the cultivation tax.

Staff has considered the comments and recommends establishing and defining a category of "fresh cannabis plant" for purposes of the cultivation tax. Staff's proposed definition will be inclusive of fresh flowers, fresh leaves, and fresh whole plants. Staff further suggests the rate for such plants be $1.29 per ounce based on its research and analysis. In addition, staff proposes that the fresh plant be weighed within two hours to qualify for the "fresh" category. Staff understands that the two hour requirement is used in other states for taxation purposes and understands that a considerable amount of drying can occur within six hours. Staff will continue to work with growers and other interested parties to establish new categories or further define the proposed category. While staff has not proposed a new category for immature plants, clones, or seeds, it notes that these categories are currently not subject to the cultivation tax because only cannabis that "enters the commercial market" is subject to the cultivation tax, and the term "enters the commercial market" specifically excludes immature cannabis plants (including clones) and seeds.

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(l), 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(l), 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 when a cultivator transfers or sells cannabis and cannabis products to a manufacturer.

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" was defined within the CDFA's proposed regulation 8305, *Cannabis Waste Management*, with respect to Medical Cannabis Regulation and Safety Act. Staff proposed 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. Weedmaps submitted written comments (Exhibit 11) in which they expressed agreement with mirroring the definition of "cannabis waste" to be consistent with CDFA; however, Weedmaps also expressed concern with the requirement of mixing cannabis with non-cannabis material as it does not necessarily add health or safety protection and would increase the volume of plant waste. Weedmaps suggested that the Department eliminate the requirement to mix the cannabis with non-cannabis material and leverage track and trace and inspections. Staff appreciates the concern, but believes maintaining consistency with CDFA's definition of "cannabis waste" should prevail at this time. As CDFA has announced its plans to withdraw its proposed "medical" regulations, staff plans to review CDFA's new proposed regulation once CDFA moves forward with one regulatory package for both medicinal and adult-use cannabis. Staff also believes that track and trace is an important element to consider; however, since the track and trace system is not yet in place and staff does not yet know how it will address plant waste, staff is recommending to define plant waste as it was initially proposed. Staff will consider future amendments as more information becomes available.

With respect to the presumption, staff believes there may be some circumstances in which cannabis may be removed from a cultivator's premises for valid purposes other than for sale. While staff has not reviewed any specific fact patterns with respect to the removal of cannabis from a cultivator's premises for other than sale, staff sought 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. Several interested parties provided examples of when the presumption may be rebutted. Based on the input received, staff recommends clarifying in the proposed regulation that the presumption that removal from a cultivator's premises is rebuttable and including examples of when the removal is not subject to the cultivation tax. Reasons include fire, flood, pest control, processing, and testing. Staff notes that it received written comments from CFAM Managements Group, Inc. (Exhibit 17) suggesting that the storage of harvested cannabis is a potential reason for cannabis to be removed from a cultivator's premises for non-sale purposes. Staff acknowledges that storage may be a valid reason to remove cannabis, but to the extent that such cannabis has completed and complied with the required quality assurance review and testing, the cannabis has entered the commercial market and is subject to the cultivation tax. Therefore, staff proposes that storage is a valid reason only if it is prior to the required testing.

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 Department 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 Department by each distributor using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the Department. Pursuant to RTC

section 55041.1, the Department 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. In addition, RTC section 55086 provides that all amounts determined to be due by the Department 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. Staff also 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 circumstances to relieve the penalty imposed on a spouse. The Department 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 Department.

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 or cultivation tax. In its Discussion Paper, staff proposed specifying that the Department may impose penalties of varying amounts provided that they are at least one-half of the taxes not paid. Staff received input from the CCIA (Exhibit 6) explaining that CCIA believed the penalty was discretionary and should apply when a taxpayer knowingly fails to pay the cannabis taxes. Staff also received input from other interested parties expressing their opinions that the suggested penalty amounts were excessive. Based on the input received and further consideration, staff understands that the emerging cannabis industry may face significant hurdles to paying the cannabis taxes timely and delayed payments may occur despite a taxpayers good faith efforts to pay timely. Some of those hurdles include the lack of banking services, limited facilities to accept cash payments, evolving industry regulations, and remoteness of some commercial cannabis operators. Staff appreciates the industry input, and after additional consideration, proposes the penalty be specified at 50% for the late payment, without varying amounts. With regard to the requirement that the penalty must be "at least "one-half the amount of taxes not paid," staff notes that the penalty amounts may vary to the extent that a taxpayer was determined to be negligent or fraudulent. For example, any part of a deficiency for which a determination of an additional amount is due to negligence or intentional disregard, a penalty of 10 percent of the amount of the determination will be added. Staff also understands the overall opposition to excessive penalties, and believes that the provisions in AB 133 which provide for relief from penalty for reasonable cause may eliminate or reduce much of the industry's concern. Staff further recommends the proposed regulation include a provision regarding penalty relief so that taxpayers know they may be relieved of the late payment penalty provided the taxpayer files a statement under penalty of perjury setting forth the facts upon which the claim for relief is based.

VI. Staff Recommendation

A. Description of Staff Recommendation

Staff recommends the Department approve and authorize publication of the proposed emergency Regulation 3700, Cannabis Excise and Cultivation Taxes, as set forth in Exhibit 2, to:

- Define key terms including cannabis flowers, cannabis leaves, cultivator, distributor, fresh cannabis plant, manufacturer, ounce, plant waste, and wholesale cost;

- Explain when the cultivation tax should be collected when the testing requirement is waived pursuant to BPC section 26070(l);
- Specify the cultivation tax rates per ounce and clarify that the rates apply at a proportionate rate for any other quantity;
- Establish a new category and rate for fresh cannabis plant with respect to the cultivation tax because fresh or wet products do not fall within the statutory categories (cannabis flowers and leaves) that are taxed on a dry-weight basis;
- Clarify that the presumption that all cannabis removed from the cultivator's premises, except for plant waste, is sold and thereby taxable pursuant to section 34012 of the Revenue and Taxation Code is rebuttable;
- Provide examples of reasons for which cannabis may be removed from a cultivator's premises and not subject to the cultivation tax on that removal including, but are not limited to, fire, flood, pest control, storage (prior to testing), and testing;
- Specify that a distributor shall report and remit the cannabis excise tax due with the quarterly return for the period in which the distributor sells or transfers the cannabis or cannabis products to a cannabis retailer;
- Clarify that the penalty imposed under RTC section 34013(e) is mandatory and applies when the cannabis excise or cultivation tax is not paid timely;
- Specify that the amount of the penalty imposed under RTC section 34013(e) is 50 percent of the amount of the unpaid cannabis excise or cultivation tax; and
- Explain that a person seeking relief from the late payment penalty must file with the Department a statement under penalty of perjury setting forth the facts upon which the claim for relief is based.

Staff further recommends that the proposed regulation be promulgated as an emergency regulation pursuant to Government Code section 11346.1. to ensure that essential guidance is available to the cannabis industry when the CTL becomes operative on January 1, 2018.

B. Pros of Staff Recommendation

Staff's recommendation will help the emerging regulated cannabis industry understand their collection and reporting obligations under the CTL. The addition of a new category and rate with respect to the cultivation tax will ensure that the tax rates are not prohibitive for products made with fresh plant material. Specifying how the late payment penalty applies and how relief can be requested will ensure uniform and consistent application.

Staff's plan to conduct additional interested parties and regular rulemaking in 2018 will enable staff and interested parties to address issues and concerns that have not been addressed in the emergency rulemaking.

C. Cons of Staff Recommendation

The recommendation may not address the application of tax to all of the unique scenarios or issues that may emerge in the cannabis industry.

D. Statutory or Regulatory Change for Staff Recommendation

No statutory change is required. However, staff's recommendation will require the commencement of the formal rulemaking process.

E. Operational Impact of Staff Recommendation

None.

F. Administrative Impact of Staff Recommendation

1. Cost Impact

The workload associated with publishing the regulation is considered routine. Any corresponding cost will be absorbed within the Department's existing budget. However, the costs associated with the overall implementation of Proposition 64, as amended by SB 94 and AB 133, are substantive; the Department is addressing these costs through the Budget Change Proposal process.

2. Revenue Impact

See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Staff Recommendation

The proposed regulation will provide clarity for taxpayers so that they can comply with the provisions of the CTL. Interested parties will have the opportunity to provide input or discuss outstanding concerns when additional interested parties meetings are held in 2018.

H. Critical Time Frames of Staff Recommendation

Pursuant to the CTL, the Department has until January 1, 2019, to prescribe, adopt, and enforce any emergency regulations as necessary to implement, administer, and enforce its duties under Division 2 of the Revenue and Taxation Code, which includes the Cannabis Tax Law, Fee Collections Procedures Law, and Sales and Use Tax Law. The CTL also specifies that the emergency regulations adopted by the Department may remain in effect for two years from adoption. An emergency regulation is automatically deemed to be repealed when its effective periods expire, but can become permanent if the agency adopts the emergency regulation through the regular rulemaking process within the time period the emergency regulation is in effect. Staff plans to submit the emergency regulation to the Office of Administrative Law with sufficient time to allow for its approval prior to January 1, 2018.

Preparer/Reviewer Information

Prepared by: Tax Policy Bureau, Business Tax and Fee Division

Current as of: October 25, 2017

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

REVENUE ESTIMATE

PROPOSITION 64 CANNABIS REVENUES

Revenue Summary

Proposition 64 will allow any adult aged 21 years or older to purchase cannabis in California, effective January 1, 2018. Cannabis will be taxed in three ways: (1) A cannabis excise tax of 15 percent of retail sales; (2) a cultivation tax on all harvested cannabis that enters the commercial market, at rates of $9.25 per ounce for flowers and $2.75 per ounce for leaves; and (3) applicable state and local sales and use tax. Medical cannabis identification cardholders will be exempt from sales and use tax.

Table 1 summarizes California revenue estimates related to Proposition 64 for fiscal years 2017-18 and 2018-19. Staff estimates that total revenues related to Proposition 64 cannabis sales will be about $1.725 billion in fiscal year 2018-19, the first fiscal year in which Proposition 64 is in effect the entire time.

Table 1
Proposition 64 Revenue Summary (Millions of Dollars)

Tax	2017-18 *	2018-19
Excise Tax	327	934
Cultivation Taxes	71	203
Flowers	64	182
Leaves	7	21
Sales and Use Taxes	206	588
Total	$603	$1,725

* Proposition 64 in effect for half the fiscal year.

Background, Methodology, and Assumptions

Commercial cannabis sales to the general public and use of cannabis on private property by adults over age 21 have been legal under Colorado law since January 1, 2014.[1] The Colorado Department of Revenue has reported cannabis revenues since that time.[2] Staff's understanding is that Colorado has more published recreational cannabis tax revenue data than any other state.

[1] Source: Colorado Department of Public Health and Environment, https://goodtoknowcolorado.com/laws?utm_source=ReachLocal&utm_medium=PPC&utm_campaign=instateGTK

[2] Colorado Department of Revenue *Annual Report, 2015-16*, https://www.colorado.gov/pacific/revenue/annual-report

Staff made the following major assumptions.

1. Cannabis prices in both Colorado and California average about $220 per ounce. This price is based on cumulative data reported over many years from priceofweed.com for both states.

2. Relative differences in physical units of cannabis use per capita between Colorado and California prior to legalization in both states is approximated by past month cannabis use by persons over age 12 (defined as the prevalence rate), as reported by the U.S. Substance Abuse and Mental Health Services Administration (SAMHSA).[3]

3. California cannabis use (measured in physical units, such as ounces), after adjusting for differences prior to legalization in Colorado, will increase proportionately to that observed in Colorado.

4. Regulation of cannabis and administration of California cannabis taxes will be similar to Colorado.

5. California tax law compliance among growers, distributors and retailers will be similar to Colorado.

6. California's medical cannabis cardholders will not increase significantly from numbers reported in fiscal year 2015-16.[4]

7. Sales and use tax revenues for medical cannabis identification cardholders are negligible in relation to total legal cannabis sales. This assumption is based on information from the California Department of Public Health, which indicates that there were 6,667 medical cannabis identification cardholders in fiscal year 2015-16. As shown in Table 2, these cardholders account for 0.1 percent of total expected cannabis sales in fiscal year 2018-19, assuming they are average cannabis consumers.

8. All cannabis taxes are passed on to consumers

9. The price elasticity of demand for cannabis is -0.25.

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[3] *National and State-level Marijuana Trends From 2002–2014,* https://www.samhsa.gov/samhsa-data-outcomes-quality/major-data-collections/national-state-level-marijuana-trends

2014-2015 National Surveys on Drug Use and Health: Model-Based Estimated Totals, (in Thousands) (50 States and the District of Columbia)
https://www.samhsa.gov/data/sites/default/files/NSDUHsaePercents2015.pdf

[4] Source: California Department of Public Health,
http://www.cdph.ca.gov/programs/MMP/Pages/MMPCardDATA.aspx

Table 2
Estimated Cannabis Sales Made to Medical Cannabis Identification Cardholders (MMICS)

Cardholders (MMICS) Issued, FY 2015-16	6,667
Estimated Per Capita Sales (Including Cultivation and Excise Taxes), FY 2018-19	$180
Estimated CA Prevalence Rate of Cannabis Users, FY 2018-19	13%
Factor to convert per capita sales to sales per cardholder (One divided by the prevalence rate)	7.7
Medical Cannabis Sales per User (Cardholder)	$1,379
Total Cardholder Sales (Sales x number of cardholders, $ Millions)	$9
Estimated FY 2018-19 Legal Sales ($ Millions)	$7,057
Percentage of Sales by Taxpayers with MMICS	0.1%

Source: California Department of Public Health
http://www.cdph.ca.gov/programs/MMP/Pages/MMPCardDATA.aspx

According to *The Economic Impact of Marijuana Legalization in Colorado*, cannabis sales in Colorado were $699 million in 2014 and $996 million in 2015.[5] These figures appear to be reasonable when compared to sales implied by revenues reported in the Colorado Department of Revenue *2015-16 Annual Report.* Using the U.S. Census Bureau population data for July 1, 2016 (the most recent year available), Colorado sales were $126 and $180 per capita.[6]

The next step in staff's revenue estimation process was to adjust Colorado per capita cannabis sales in the first two years of legalization to reflect differences in California cannabis consumption from Colorado. Staff assumed these sales for the first two years of legal cannabis sales in California. Proportionate differences in prevalence rates between the two states were used as an adjustment factor.

Federal government agency Substance Abuse and Mental Health Services Administration (SAMHSA) data for the period fiscal year 2002-03 through 2012-13 (cited earlier) indicate that Colorado cannabis use prevalence rates averaged 2.0 percent above those for California. This time period was before Colorado legalized cannabis, so the California and Colorado prevalence rate surveys represent comparable legal conditions regarding cannabis use. In 2014-15 (the most recent time period) the prevalence rate for Colorado was 16.6 percent. Staff estimates that if cannabis were legal in California at this time, the prevalence rate would have been 2.0 percent less, or 14.6 percent.

In addition to adjusting for differences in consumption between California and Colorado, staff adjusted for differences between the two tax systems. Data from the Colorado Department of Revenue indicate that cannabis taxes (including sales taxes) add about 11.5 percent to cannabis prices. California cannabis taxes (including sales taxes) add about 28.6 percent. Staff adjusted California consumption downward by about three percent, calculated by applying a price elasticity of demand of -0.25. [7]

[5] Marijuana Policy Group, October 2016, http://mjpolicygroup.com/

[6] Source:https://www.census.gov/data/tables/2016/demo/popest/state-total.html

[7] The general price elasticity of demand formula is: e p = (Q1 - Q2) / ((Q1 + Q2) /2) / (P1 - P2) / ((P1 +P2)/2), where P = price and Q = sales.

Tailoring the Colorado data to California resulted in a 15 percent total downward adjustment, 12 percent from differences in prevalence rates and three percent from higher prices resulting from different tax rates.

Applying a 15 percent reduction in Colorado per capita sales referenced earlier ($126 and $180) resulted in estimated California per capita cannabis sales of $107 in 2018 and $153 in 2019. Multiplying July 1, 2016 California population (39,250,017) by these two figures yields estimates of legal cannabis sales (recreational and medical) of $2.106 billion (half-year) for fiscal year 2017-18 and $6.021 billion for fiscal year 2018-19. (Calculations made using the figures cited above may differ because of rounding.) Adding cultivation taxes (discussed later) brings the cannabis excise tax base up to $2.177 billion in fiscal year 2017-18 and $6.224 billion in fiscal year 2018-19.

Table 3 shows cannabis excise taxes associated with these sales. Sales taxes are calculated including both cultivation taxes and cannabis excise taxes in the sales price. Table 4 shows related state and local sales and use tax revenues.

Table 3
Cannabis Excise Tax Revenue

	FY 2017-18 *	FY 2018-19
Per Capita Sales (Dollars)	107	153
Total Sales ($ Millions)	2,106	6,021
Cultivation Taxes	71	203
Excise Tax Base (Sales and Cultivation Taxes)	2,177	6,224
Excise Tax Revenues ($Millions)	$327	$934
Sales and Use Tax Base (Includes Excise Taxes)	2,504	7,158
Per Capita Sales and Use Tax Base (Includes Excise Taxes)	128	182

* Proposition 64 in effect for half the fiscal year.

Table 4
Proposition 64 Sales and Use Tax Revenues

Tax	Rate	2017-18 *	2018-19
State (Basic)	3.94%	99	282
Local Revenue 2011	1.06%	27	76
Local Revenue 1991	0.50%	13	36
Public Safety Fund	0.50%	13	36
Bradley Burns	1.25%	31	89
Special Districts	0.96%	24	69
Total	**8.21%**	**$206**	**$588**

* Proposition 64 in effect for half the fiscal year.

Dividing total sales (before taxes) shown in Table 3 by an average price of $220 per ounce and converting ounces to tons results in 298 tons of legal sales subject to cultivation taxes in 2018 and 856 tons in 2019. (These calculations also include downward adjustments to take into account the effects on consumption of higher California cannabis taxes compared to Colorado.) Studies indicate that flowers typically constitute about 72 percent of harvested plant material and leaves comprise the

remaining 28 percent. Applying these percentages and tax rates of $9.25 per ounce for leaves and $2.75 per ounce for flowers yields cultivation tax revenues shown in Table 5.

Table 5
Proposition 64 Cultivation Taxes

	FY 2017-18	FY 2018-19
Total Tons Subject to Cultivation Taxes	299	855
Flowers (72%)	215	616
Leaves (28%)	84	239
Revenues (Millions of Dollars)	**$71**	**$203**
Flowers	**$64**	**$182**
Leaves	**$7**	**$21**

* Proposition 64 in effect for half the fiscal year.

Using California Department of Finance population projections (interpolated population over age 21 in 2018) and expected prevalence rates based on the Colorado experience, staff estimates annual cannabis sales (before all taxes) to average $1,253 per user and pay total cannabis taxes of $359 per user.

QUALIFYING REMARKS

Few sources of reliable recreational cannabis sales or revenue data are available, and no known data is available for California. Additionally, some data sources conflict at times. Even small changes in any one of the seven assumptions noted can have potentially large impacts on revenues. Interactions between sales and prices in California's legal and illegal cannabis markets are challenging to forecast. Future federal policy regarding medical and recreational cannabis is unclear.

These estimates are highly uncertain and vary greatly depending on the staff's data sources and assumptions. Furthermore, staff continues to research the medical and recreational cannabis industry in the US and abroad, and these estimates are subject to change to the extent that more accurate data is obtained.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

PREPARATION

Joe Fitz, Chief Economist, prepared this revenue estimate. For additional information, please contact Mr. Fitz at (916) 323-3802.

Current as of September 20, 2017.

(New chapter and regulation to be added to division 2 of title 18 of the California Code of Regulations)

New Chapter 8.7. Cannabis Tax Regulations

Regulation 3700. Cannabis Excise and Cultivation Taxes.

(a) Definitions. For purposes of this chapter (Cannabis Tax Regulations, commencing with Regulation 3700), the definitions of terms in part 14.5, Cannabis Tax, (commencing with section 34010) of division 2 of the Revenue and Taxation Code shall apply and the following terms are defined or further defined below.

(1) "Cannabis flowers" means the flowers of the plant Cannabis sativa L. that have been harvested, 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.

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

(3) "Cultivator" means all persons required to be licensed to cultivate cannabis pursuant to division 10 (commencing with section 26000) of the Business and Professions Code, including a microbusiness that cultivates cannabis as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code.

(4) "Distributor" means a person required to be licensed as a distributor pursuant to division 10 (commencing with section 26000) of the Business and Professions, including a microbusiness that acts as a licensed distributor as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code.

(5) "Fresh cannabis plant" means the flowers, leaves, or a combination of adjoined flowers, leaves, stems, and stalk from the plant Cannabis sativa L. that is either cut off just above the roots, or otherwise removed from the plant.

To be considered "fresh cannabis plant," the flowers, leaves, or combination of adjoined flowers, leaves, stems, and stalk must be weighed within two hours of the plant being harvested and without any further processing, including any artificial drying such as increasing the ambient temperature of the room or any other form of drying, curing, or trimming.

(6) "Manufacturer" means a person required to be licensed as a manufacturer pursuant to division 10 (commencing with section 26000) of the Business and Professions Code, including a microbusiness that acts as a licensed manufacturer as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code.

(7) "Ounce" means 28.35 grams.

(8) "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.

(9) "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 cannabis that enters the commercial market pursuant to section 34012 of the Revenue and Taxation Code, when the testing requirement is waived pursuant to subdivision (l) of section 26070 of the Business and Professions Code, a distributor shall collect the cultivation tax from cultivators when cannabis is transferred or sold to the 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 cannabis flowers, and at a proportionate rate for any other quantity.

(2) Two dollars and seventy-five cents ($2.75) per dry-weight ounce of cannabis leaves, and at a proportionate rate for any other quantity.

(3) One dollar and twenty-nine cents ($1.29) per ounce of fresh cannabis plant, and at a proportionate rate for any other quantity.

(d) Cannabis Removed from a Cultivator's Premises is Presumed Sold.

(1) Unless the contrary is established, it shall be presumed that all cannabis removed from the cultivator's premises, except for plant waste, is sold and thereby taxable pursuant to section 34012 of the Revenue and Taxation Code.

(2) The presumption in subdivision (d)(1) may be rebutted by a preponderance of the evidence demonstrating that the cannabis was removed for purposes other than for entry into

the commercial market. Reasons for which cannabis may be removed and not subject to tax on that removal include, but are not limited to, the following:

(A) Fire,

(B) Flood,

(C) Pest control,

(D) Processing,

(E) Storage prior to the completion of, and compliance with, the quality assurance review and testing, as required by Business and Professions Code section 26110, and

(F) Testing.

(e) Reporting the Cannabis Excise Tax. A distributor shall report and remit the cannabis excise tax due with the return for the quarterly period in which the distributor sells or transfers the cannabis or cannabis products to a cannabis retailer.

(f) Penalties.

(1) Late Payments. 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 of 50 percent of the amount of the unpaid cannabis excise tax or cannabis cultivation tax shall be added to the cannabis excise tax and cultivation tax not paid in whole or in part within the time required pursuant to sections 34015 and 55041.1 of the Revenue and Taxation Code.

(2) Relief from Late Payment Penalty for Reasonable Cause. If the Department finds that a person's failure to make a timely payment is due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person may be relieved of the penalty provided by subdivision (f)(1) for such failure.

Any person seeking to be relieved of the penalty shall file with the Department a statement under penalty of perjury setting forth the facts upon which the claim for relief is based.

Note: Authority cited: Sections 34013, Revenue and Taxation Code. Reference: Sections 34010, 34011, 34012, 34013, 34015, and 55044 Revenue and Taxation Code.

Revenue and Taxation Code - RTC
DIVISION 2. OTHER TAXES [6001 - 60709] (*Heading of Division 2 amended by Stats. 1968, Ch. 279.*)
PART 14.5. Cannabis Tax [34010 - 34021.5] (*Heading of Part 14.5 amended by Stats. 2017, Ch. 27, Sec. 161.*)

34010.

For purposes of this part:

(a) “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.

(b) “Average market price” shall mean:

(1) 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 department on a biannual basis in six-month intervals.

(2) 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.

(c) “Department” shall mean the California Department of Tax and Fee Administration or its successor agency.

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

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

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

(g) “Cannabis products” shall have the same meaning as set forth in Section 11018.1 of the Health and Safety Code and shall also mean medicinal concentrates and medicinal cannabis products.

(h) “Cannabis flowers” shall mean the dried flowers of the cannabis plant as defined by the board.

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

(j) “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 Business and Professions Code.

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

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

(m) “Enters the commercial market” shall mean cannabis or cannabis product, except for immature cannabis plants and seeds, that complete and comply with a quality assurance review and testing, as described in Section 26110 of the Business and Professions Code.

(n) “Gross receipts” shall have the same meaning as set forth in Section 6012.

(o) “Microbusiness” shall have the same meaning as set forth in paragraph (3) of subdivision (a) of Section 26070 of the Business and Professions Code.

(p) “Nonprofit” shall have the same meaning as set forth in Section 26070.5 of the Business and Professions Code.

(q) “Person” shall have the same meaning as set forth in Section 6005.

(r) “Retail sale” shall have the same meaning as set forth in Section 6007.

(s) “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.

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

(u) “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.

(v) “Manufacturer” shall mean a person required to be licensed as a manufacturer pursuant to Division 10 (commencing with Section 26000) of the Business and Professions Code.

(*Amended by Stats. 2017, Ch. 253, Sec. 16. Effective September 16, 2017. Note: This section was amended on Nov. 8, 2016, by initiative Prop. 64.*)

34011.

(a) (1) Effective January 1, 2018, a cannabis excise tax shall be 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. 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 pursuant to this subdivision is sufficient to relieve the purchaser from further liability for the tax to which the invoice, receipt, or other document refers.

(2) Each cannabis retailer shall provide a purchaser with an invoice, receipt, or other document that includes a statement that reads: "The cannabis excise taxes are included in the total amount of this invoice."

(3) The department may prescribe other means to display the cannabis excise tax on an invoice, receipt, or other document from a cannabis retailer given to the purchaser.

(b) (1) 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 department pursuant to Section 34015. A cannabis retailer shall be 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 department.

(2) 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 department. The department may authorize other forms of documentation under this paragraph.

(c) The excise tax imposed by this section shall be in addition to the sales and use tax imposed by the state and local governments.

(d) Gross receipts from the sale of cannabis or cannabis products for purposes of assessing the sales and use tax under Part 1 (commencing with Section 6001) shall include the tax levied pursuant to this section.

(e) 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.

(f) The sales and use taxes imposed by Part 1 (commencing with Section 6001) shall not apply to retail sales of medicinal cannabis, medicinal cannabis concentrate, edible medicinal cannabis products, or topical cannabis as those terms are defined in Division 10 (commencing with Section 26000) of the Business and Professions Code when a qualified patient or primary caregiver for a qualified patient provides his or her card issued under Section 11362.71 of the Health and Safety Code and a valid government-issued identification card.

(*Amended by Stats. 2017, Ch. 253, Sec. 17. Effective September 16, 2017. Note: This section was amended on Nov. 8, 2016, by initiative Prop. 64.*)

34012.

(a) Effective January 1, 2018, there is hereby imposed a cultivation tax on all harvested cannabis that enters the commercial market upon all cultivators. The tax shall be due after the cannabis is harvested and enters the commercial market.

(1) The tax for cannabis flowers shall be nine dollars and twenty-five cents ($9.25) per dry-weight ounce.

(2) The tax for cannabis leaves shall be set at two dollars and seventy-five cents ($2.75) per dry-weight ounce.

(b) The department may adjust the tax rate for cannabis leaves annually to reflect fluctuations in the relative price of cannabis flowers to cannabis leaves.

(c) The department 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. These categories shall be taxed at their relative value compared with cannabis flowers.

(d) The department 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 cannabis is packaged.

(e) The tax stamps and product bags shall be of the designs, specifications, and denominations as may be prescribed by the department and may be purchased by any licensee under Division 10 (commencing with Section 26000) of the Business and Professions Code.

(f) Subsequent to the establishment of a tax stamp program, the department 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.

(g) The tax stamps and product bags shall be capable of being read by a scanning or similar device and must be traceable utilizing the track and trace system pursuant to Section 26068 of the Business and Professions Code.

(h) Cultivators shall be responsible for payment of the tax pursuant to regulations adopted by the department. 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 pursuant to paragraph (3) is sufficient to relieve the cultivator from further liability for the tax to which the invoice, receipt, or other document refers. Cannabis shall not be sold unless the tax has been paid as provided in this part.

(1) A distributor shall collect the cultivation tax from a cultivator on all harvested cannabis that enters the commercial market. This paragraph shall not apply where a cultivator is not required to send, and does not send, the harvested cannabis to a distributor.

(2) (A) 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 Business and Professions Code. This paragraph shall not apply where a distributor collects the cultivation tax from a cultivator pursuant to paragraph (1).

(B) Notwithstanding subparagraph (A), the department may prescribe a substitute method and manner for collection and remittance of the cultivation tax under this paragraph, including a method and manner for collection of the cultivation tax by a distributor.

(3) A distributor or manufacturer shall provide to the cultivator, and a distributor that collects the cultivation tax from a manufacturer pursuant to paragraph (2) 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 department. The department may authorize other forms of documentation under this paragraph.

(4) The department 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 Business and Professions Code.

(i) All cannabis removed from a cultivator's premises, except for plant waste, shall be presumed to be sold and thereby taxable under this section.

(j) The tax imposed by this section shall be imposed on all cannabis cultivated in the state pursuant to rules and regulations promulgated by the department, but shall not apply to cannabis cultivated for personal use under Section 11362.1 of the Health and Safety Code or cultivated by a qualified patient or primary caregiver in accordance with the Compassionate Use Act of 1996 (Section 11362.5 of the Health and Safety Code).

(k) Beginning January 1, 2020, the rates set forth in subdivisions (a), (b), and (c) shall be adjusted by the department annually thereafter for inflation.

(l) The Department of Food and Agriculture is not responsible for enforcing any provisions of the cultivation tax.

(*Amended by Stats. 2017, Ch. 253, Sec. 18. Effective September 16, 2017. Note: This section was amended on Nov. 8, 2016, by initiative Prop. 64.*)

34013.

(a) The board shall administer and collect the taxes imposed by this part pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001)). For purposes of this part, the references in the Fee Collection Procedures Law to "fee" shall include the taxes imposed by this part, and references to "feepayer" shall include a person required to pay or collect the taxes imposed by this part.

(b) The board may prescribe, adopt, and enforce regulations relating to the administration and enforcement of this part, including, but not limited to, collections, reporting, refunds, and appeals.

(c) The board shall adopt necessary rules and regulations to administer the taxes in this part. Such rules and regulations may include methods or procedures to tag cannabis or cannabis products, or the packages thereof, to designate prior tax payment.

(d) Until January 1, 2019, the board may prescribe, adopt, and enforce any emergency regulations as necessary to implement, administer, and enforce its duties under this division. Any emergency regulation prescribed, adopted, or enforced pursuant to this section shall be adopted in accordance with Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and, for purposes of that chapter, including Section 11349.6 of the Government Code, the adoption of the regulation is 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. Notwithstanding any other provision of law, the emergency regulations adopted by the board may remain in effect for two years from adoption.

(e) Any person required to be licensed pursuant to Division 10 (commencing with Section 26000) of the Business and Professions Code who fails to pay the taxes imposed under this part shall, in addition to owing the taxes not paid, be 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 Business and Professions Code.

(f) The board may bring such legal actions as are necessary to collect any deficiency in the tax required to be paid, and, upon the board's request, the Attorney General shall bring the actions.

(*Amended by Stats. 2017, Ch. 27, Sec. 166. Effective June 27, 2017. Note: This section was amended on Nov. 8, 2016, by initiative Prop. 64.*)

Boveda
THE GLOBAL LEADER IN 2-WAY HUMIDITY CONTROL

August 15, 2017
California Department of Tax and Fee Administration
450 N Street, MIC: 66
Sacramento, CA 95814

To Whom It May Concern,

I represent Boveda, Inc., a manufacturer of humidity control technology designed specifically for cannabis flower, and I am submitting this letter as follow up to the comment letter I previously submitted, dated August 7, 2017. After reviewing Exhibit 1 of the California Department of Tax and Fee Administration's Discussion Paper on proposed emergency regulations with respect to cannabis taxes, we feel there is a need for the proposed regulations to provide a more specific definition of "dry-weight ounce." As detailed in our previous comment letter, A_w levels correlate to the dryness of cannabis.

Without a defined range of A_w levels, the opportunity exists for cultivators to reduce weight by over-drying flower, thereby reducing the amount of cultivation tax owed. We believe it is important for regulators to define an acceptable range for A_w levels at which cannabis should remain at all times; from its first packaging upon completion of curing until the consumer opens the product packaging after purchase. This will establish a standard by which the department can ensure proper taxation by weight is occurring.

Based on research and our field experience with A_w levels, it is our recommendation that the following changes, which have been bolded below, be made to the regulation language found in Exhibit 1, Section (a) Definitions:
(1)"Dry-weight ounce" means 28.35 grams **at a Water Activity at or between .65 and .55**.

(2)"Cannabis flowers" means the flowers of the plant Cannabis sativa L. that have been harvested, trimmed, dried, and cured **to a Water Activity at or between .65 and .55**, 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.

This range ensures the cannabis is safe from microbial overgrowth while maintaining the quality and therapeutic value of the cannabis. By adding this defined A_w level range to the definition of "dry-weight ounce" the department can have certainty that all weight measurements for taxation are standardized.

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We thank the department for taking into consideration our comment on this matter. We are available to meet and discuss the importance of this recommendation. Please feel free to contact me at (952) 745-2905 or charles.rutherford@bovedainc.com.

Sincerely,

Charlie Rutherford
Business Development Director
Boveda, Inc.

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8/24/17

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
405 N Street
Sacramento, CA 95814

Re: Comments to California Department of Tax and Fee Administration proposed emergency regulations on cannabis taxes.

Dear Chief Gonzalez:

Berkeley Patients Group (BPG) is the oldest, continuously operating dispensary in the country. BPG was one of the first operations to be locally licensed and has been actively involved in policy reform for nearly twenty years.

We would like to thank you for all of your hard work and are grateful for your efforts to establish a regulatory framework for cannabis taxes. We have reviewed the CDTFA Discussion Paper and your proposed tax structure. We have provided our comments below and have included concerns and policy recommendations for designing a workable regulatory framework in response to your July 21st discussion paper.

The suggested exclusions from average market price, wholesale cost rates and the suggested definition listed below is intended to minimize the black market and encourage compliance by cannabis operators, including small businesses. If the taxes on wholesale costs includes state cultivation taxes and high local cultivation or manufacturing tax rates, distribution fees, etc, then the price point at the retail level will be extraordinarily high, which, in turn, could potentially drive customers to the black market.

Regulatory guidelines should be established that clearly explain how the "Average Market Price" is computed. The applicable regulation should explain how the computation is carried out, including a description of what costs the markup should be applied to, and how the tax is computed therefrom. We believe it would be significantly beneficial to provide at least one example of how the average market price is computed, and how it flows into the

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tax computation. There is a lot of confusion on this issue in the industry and clear guidelines are needed to enable greater compliance.

RTC Section 6012(c)(5) states that "Gross Receipts" shall not include "The amount of any tax imposed by any city, county, city and county, or rapid transit district within the State of California upon or with respect to retail sales of tangible personal property measured by a stated percentage of sales price or gross receipts whether imposed upon the retailer or the consumer." This standard should also be applied to the determination of the cost of wholesale cannabis product.

Section 34011(d) of SB 94 already states that "*Gross receipts from the sale of cannabis or cannabis products for purposes of assessing the sales and use tax under Part 1 (commencing with Section 6001) shall include the tax levied pursuant to this section.*" This statute already includes a tax on a tax. Therefore, it is in the best interest of the state and the operators to exclude the tax additions when calculating average market price via wholesale cost. In addition, with no standard federal business deduction allowances provided to any of these businesses, it is even more important that the determination of wholesale cost be strictly applied to basic cost of goods sold.

Example of supply chain tax burden on a retail operation --- Berkeley

- Berkeley cannabis tax (based on gross sales 2.5%
- Berkeley vendor tax (base on wholesale) --- 2.5%
- Berkeley adult-use cannabis tax - (tbd <10%)
- Stat cultivatio ta flowers --- $9.25/oz [new]
- Stat cultivatio ta leave --- $2.75/oz [new]
- State excise tax 15% [new]
- State sales ta 7.25%

Nonarms Transaction

- Excise tax would be 15% of gross receipts of retai sales
    - Does this include local sales/cannabi tax?
- This could penalize vertical integration because vertical integration will end up with a larger excise tax because gross receipts of retail sales determine nonarm's length transaction.

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Armslength Transaction --- 15% of average market price. Average market price = average retail price "determined by wholesale cost sold or transferred to a retailer + markup (as determined by CDTFA)"

- Wholesale cost should not include local cannabis, or sales tax paid by vendor or distributor.
- Wholesale cost should be a cost of the good to be sold for deductibility under standard federal busines deductions.
    - Average market price should exclude cultivatio taxes

- **Suggested definition of wholesale cost** --- "*Wholesale cost shall mean cos of goods sold, excluding any local or state cannabis tax, as well as distribution or transportation fees an expenses.*"

We understand that this is an incredibly challenging effort, and we appreciate the thoughtfulness you are putting into the development of these regulations. Thank you for your time and consideration.

Best Regards,

Sabrina Fendrick

Sabrina Fendrick
Director of Government Affairs
Berkeley Patients Group

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August 24, 2017

Ms. Trista Gonzalez, Chief
California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092 VIA: Email: Trista.gonzalez@cdtfa.ca.gov

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you for providing us with the opportunity to make this submission on behalf of the California Cannabis Industry Association (CCIA). This submission is being made in response to the Discussion Paper issued on July 21, 2017, and the interested parties meeting which was held on August 2, 2017.

We would like to express our appreciation for you and your staff's concerted efforts to establish regulatory guidelines that will help enable the cannabis industry to comply with the new and complex tax laws.

The California Cannabis Industry Association (CCIA) was formed to unite the cannabis industry in California and to allow it to speak with one voice at the state and local levels. CCIA strives to educate and act as a resource to lawmakers and regulatory agencies regarding all areas of the cannabis industry. It is CCIA's mission to promote the growth of a responsible and legitimate cannabis industry and work for a favorable social, economic, and legal environment for our industry in the state of California. Representing hundreds of businesses, they are the unified voice of the cannabis industry in California.

As the leading association in the cannabis industry, CCIA is significantly interested in doing its part to help make certain that clear and comprehensive regulations are established. CCIA's goal is to work alongside the California Department of Tax and Fee Administration (CDTFA) to help lay the groundwork for guidelines that will enable its members and the industry as a whole to achieve a very high level of voluntary compliance. To that end, we offer the following comments and suggestions.

I. Penalty established under Revenue and Taxation Code (RTC) section 34013, subdivision (e).

Based on our reading of the law, the intent of Proposition 64, Senate Bill 94, other related bills, and from communications with the framers of the cannabis law, it our opinion that the penalty provided for under RTC section 34013 is discretionary, and that it should be limited to 50 percent. Further, we believe the penalty should only apply when a person knowingly fails to pay the tax, not when there is a failure to pay *timely* and/or an unintentional error in reporting.

RTC section 34013, subdivision, (e) provides:

> "Any person who fails to pay the taxes imposed under this part shall, in addition to owing the taxes not paid, **be 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 Business and Professions Code or pursuant to Chapter 3.5 (commencing with Section 19300) of Division 8 of the Business and Professions Code." (Emphasis added)

CDTFA's July 21, 2017, rule making discussion paper provides proposed regulatory language for the penalty as follows:

> "(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." (Emphasis added)

By its language, the proposed regulation imposes a penalty on people that fail to "**timely**" pay the tax. Under the proposed regulation, a person that attempts to comply, but fails to pay its tax timely due to unforeseen or unanticipated circumstances by one day, would receive a penalty of at least 50 percent. The language of the statute, however, does *not* state that the penalty will apply to people that do not pay "within the time" prescribed law, it states that "[a]ny person who fails to pay the taxes," will be subject to a penalty.

We believe there is a difference between a person that fails to pay the tax altogether and a person that intends to pay the tax, but does so late or makes an unintentional error in reporting. A person that pays, albeit late, does not involve a failure to pay the tax, there is merely a failure to do so timely. If there was an intent to punish any person that failed to pay the tax "within the time" prescribed by law, we believe the law would have referenced "time," in some manner. (See, e.g., RTC §§ 6476, 6477 [which clearly address the failure to "timely" pay the tax].) Because such a factor could have been easily incorporated into the law, as it is in other late payment penalty tax statutes, but was not, we believe the rules of statutory construction support that a failure to pay ***timely*** should not be read into the law. Including a timeliness factor in the regulation unnecessarily and impermissibly expands the law to include virtually any failure, which simply does not make sense considering the severity of the penalty.

Moreover, RTC section 34013, subdivision (a), provides that the cannabis tax shall be administered in accordance with the Fee Collection Procedures Law (FCPL), RTC section 55001, et seq. The FCPL contains RTC section 55042 which imposes a penalty of 10 percent for the failure to pay the tax "within the time required." By referencing the FCPL, RTC section 34013, subdivision (a), establishes a penalty of 10 percent for a failure to pay "within the time required." (RTC § 55042, subd. (a).) Therefore, it is incongruous to conclude the same code section establishes a separate penalty for the same exact thing, i.e., failure to pay "within the time required." There is no reasonable basis to conclude the law intended to create two separate late payment penalties within the same code section.

According to a plain reading of the statute, we believe the words "subject to," mean that a person is susceptible to the penalty, i.e., it is discretionary. Making a person "subject to" a penalty does mean the penalty "must" or "shall" apply. The BTC's interpretation of the words "subject to" in Code section 34013, as it pertains to a license revocation, also supports that it

does not mean the penalty is mandatory. Code section 34013, subdivision (e), states that a person shall be "subject to having its license revoked." But, there is no claim that a person "must" or "shall" have its license revoked if it inadvertently underreports its tax obligation or if it fails to file a timely return. The same meaning should be applied to the penalty.

A review of other mandatory penalties under in the RTC are instructive and further support that the penalty established under section 34013 is not intended to be mandatory. Mandatory penalty statutes contain language that make it clear the penalty is mandatory, e.g., by stating that a person "shall pay a penalty of 6 percent," or "shall pay a penalty of 10 percent of the amount of tax." (RTC §§ 6477, 30281, subd. (b).) Further, every known penalty that exceeds 25 percent requires an element of knowledge. (See RTC §§ 30211, 6485, 6485.1, 6597.) Penalties for late payments or unintentional errors are generally limited to 10 percent. (See RTC §§ 6476, 6477, 6478 6480.4, 30281.) The amount of the penalty, in itself, supports that it is intended to apply to people that knowingly do not pay the tax.

We believe the penalty is designed to deter people from operating outside of the framework of the law and to punish those that intentionally fail to pay. Under the proposed regulation, our concern is that only those people that actually attempt to comply, but fail to do so notwithstanding good faith efforts, will be subject to the exorbitant penalty. Ultimately, it will be those that register and attempt to comply that will be most likely to have encounters with the CDTFA and thereby be subject to the imposition of the penalty.

We propose the following regulatory language for the penalty established under RTC section 34015 (e):

> "Penalty for Taxes Not Paid. In addition to owing the taxes not paid, a person shall pay a penalty of 50 percent if it is determined the person knowingly failed to pay the taxes due."

We believe the other penalties provided for under the Fee Collection Procedures Law should also be clearly described in a regulation, rather than merely referenced, since most people will have difficulty cross-referencing and understanding different sections of the law. Sales and Use Tax Regulation 1703, provides a good example of a regulation that describes multiple penalties that may apply, in addition to guidelines for available relief. We encourage the BTC to draft a regulation for penalties associated with the cannabis tax law that is similar to Regulation 1703. Doing so will help to put people on notice of the penalties they are subject to and it will provide needed guidelines for obtaining available relief.

II. Timing of the remittance of retail cannabis tax in consideration of the option to collect the tax from a retailer within 90 days after the sale or transfer in an arm's length transaction. (RTC §§ 34011, subd. (b)(1), 34015, subds. (a), (c).)

RTC section 34011, subdivision (a), imposes a tax "upon purchasers" at the rate of 15 percent. RTC section 34011, subdivision (b)(1), provides a distributor with the option of collecting the 15 percent retail excise tax 90 days after its sale. RTC section 34015, subdivision (a), establishes a quarterly reporting and payment basis "[u]nless otherwise prescribed by the board pursuant to subdivision (c)." RTC section 34015, subdivision (c), provides the CDTFA with the authority to prescribe different due dates for reporting taxes applied in an arm's length transaction.

First, it is important to recognize that the retail cannabis tax is imposed upon purchasers and retailers are required to collect and pay it over to a distributor for submission to the CDTFA. (RTC §§ 34011, subds. (a), (b) 34015.) There are significant concerns that a distributor and/or retailer will not have the ability to pay the tax prior to the time that it is actually imposed upon and collected from a purchaser. The virtually exclusive use of cash as a means of payment by the industry and the inability to use banking and financing institutions heightens this issue and concern. RTC sections 34011 and 34015 address this concern. If a distributor exercises its legal right to collect the tax 90 days after its sale, it should be permitted to report the tax in the period in which the tax is collected. Therefore, we request that the CDTFA exercise its authority granted under RTC section 34015, subdivision (c), and establish a regulation which requires a distributor to report the excise tax imposed on arm's length transactions in the quarter following the quarterly period in which the sale is made, i.e., 90 days following its sale to the retailer.

To maintain clarity for reporting purposes, the reporting timeframe should not vary for arm's length transactions. In other words, if a distributor or manufacturer contracts to collect the tax *prior to* 90 days on some transactions and at 90 days for others, to maintain consistency and ease in the reporting requirements, all of the subject tax should be due in the quarter following the period in which the sale occurs.

III. Timing of the due date of the cultivation tax vs. the presumption of sale and taxability upon removal from a cultivation site.

RTC section 34012, subdivision (a), states that the cultivation "tax shall be due *after* the cannabis is harvested *and enters the commercial market*." (Emphasis added) Enters the commercial market means the cannabis "has completed and complies with all quality assurance, inspection, and testing." (RTC § 34010, subd. (m).) A distributor shall collect the cultivation tax upon entry into the commercial market. (RTC § 34012, subd. (h)(1).)

In summary, the forgoing provisions establish that the cultivation tax is due and subject to collection *after* it has been tested and approved for commercial sale. But, RTC section 34012, subdivision (i), establishes a presumption of taxability for "[a]ll cannabis removed from a cultivator's premises." The question becomes, what happens when a distributor is inspected and it has possession of untaxed cannabis that it removed from a cultivator's premises without collecting or reporting tax, because it is waiting for samples of the cannabis to be tested? The cannabis may be subject to seizure under RTC section 34016, subdivision (c). Thus, it is recommended that the presumption of taxability be clearly identified in a regulation as being rebuttable. The regulation should explain that prior to presuming that tax applies, it must be established that it has "entered the commercial market," i.e., has completed and complies with all quality assurance, inspection, and testing. A person should not be forced to prove a negative in order to avoid the presumption of taxability. In other words, a person should not be forced to prove that cannabis has *not* completed and complies with all quality assurance, inspection, and testing, since doing so may be virtually impossible.

IV. Average Market Price computation.

RTC section 34010, subdivision (b) defines average market price. Regulatory guidelines should be established that clearly explain how the "Average Market Price" is computed. The applicable regulation should explain how the computation is carried out, including a description of what costs the markup should be applied to, and how the tax is computed therefrom. We believe it would be significantly beneficial to provide *at least one* example of how the average market price is computed, and how it flows into the tax computation. There is a lot of confusion on this issue in the industry and clear guidelines are needed to enable greater compliance.

V. Markup Percentages

RTC section 34011, subdivision (a), imposes an excise tax of 15 percent on the "average market price" of cannabis or cannabis product sold in the state. RTC section 34010, subdivision (b)(1), defines "average market price" as the following:

> "In an arm's length transaction, the <u>average market price</u> 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 bi-annual basis in six-month intervals." (emphasis added)

CDTFA's establishment of the mark-up is of significant importance to CCIA. An overstated mark-up, even if only in place for six-months, will have a potentially crippling effect on the industry since actual margins are anticipated to be very low.

Based upon various discussions with numerous members of CCIA, it is anticipated that the average mark-up for cannabis products in this newly formed market will be *no greater than* 20 percent. CCIA members anticipate that the average wholesale cost of cannabis will be higher than what has been reflected in past cannabis sales because there will be significantly higher costs to comply with what will likely be the most heavily regulated industry in the state. There is also a concern with a lack of supply, as a result of there being a lack of licensed distributors and cultivators in the market initially (creating a choke point in the supply chain), which will drive wholesale costs higher. Further, it is anticipated that the average retail selling price will be driven down through more prevalent competition at the retail level. The net result will be a lower average markup than what has existed historically.

Ultimately, data gathered from actual recreational transactions after January 1, 2018, will permit the CDTFA to compute a more accurate markup percentage going forward. For the first six months, however, the best information available to CCIA supports that the average mark-up for cannabis products will be *no greater than* 20 percent.

In addition, CCIA suggests establishing multiple product categories with associated mark-ups for different varietals of cannabis because different grades and types of cannabis products may carry different mark-ups. Examples of different mark-up categories may include: manufactured products (edibles), different grades of cannabis (low, medium, high), and cannabis oils. CCIA is hoping to work with the CDTFA in the future to help establish these different product categories and related mark-ups.

VI. Form of Invoices, Receipts and Other Documents

RTC section 3401, subdivision (a), instructs a retailer of cannabis to provide a purchaser with a receipt that lists includes the following statement, "the cannabis cultivation and excise taxes are included in the total amount of this invoice."

One interpretation of this statute that was discussed at the interested parties meeting was that the dollar value of the 15 percent excise tax had to be listed on the receipt itself. If a retailer is required to separately state the amount of excise tax it paid to its distributor for the product being sold, a competitor will be able to establish the retailer's cost of that product by dividing the amount of excise tax shown on the receipt by 15 percent. That knowledge could undermine the marketplace because competitors would be able to determine the wholesale costs and the mark-ups applied to various products. That information, in turn, could create problems and disputes with suppliers.

We suggest that the regulatory language simply instruct the retailer to include the required statement, "The cannabis cultivation and excise taxes are included in the total amount of this invoice", on the receipt, invoice or other document.

In the alternative, the 15 percent excise tax could be separately stated but based on the retailer's retail selling price of the product. However, this would give rise to a difference in the amount of tax due and the amount collected. For that reason, we believe the best alternative is to only require the above statement.. This would satisfy the requirement for a purchaser to obtain proof of the taxes paid and permit retailers to operate without disclosing confidential information.

Further, it would be beneficial to everyone in the industry if there were examples provided by the CDTFA of receipts, invoices and other documents involving transactions and transfers between the following parties:

- Cultivator and Distributor/Manufacturer
- Manufacturer and Distributor
- Distributor acting solely as a transporter of cannabis
- Distributor and Retailer
- Retailer and Customer

Such samples may be more appropriately issued in a pamphlet or website guide that is specific to the cannabis industry. CCIA remains available for input on creating sample documents that are acceptable to the CDTFA.

VII. Guidelines for Refunds of Overpaid Tax

"The board may prescribe, adopt, and enforce regulations relating to the administration and enforcement of this part, including, but not limited to, collections, reporting, **refunds**, and appeals." (RTC 34013, subd. (b).) RTC section 34012.5, subdivision (b), establishes that a distributor or a manufacturer may refund undue or excess taxes collected from a cultivator or retailer and that the distributor or manufacturer may claim a credit for the refund on its return. This includes cultivation taxes that were collected on cannabis that fails quality assurance, inspection, and testing. (RTC § 34012, subd. (h)(4).) We believe a separate line item should be added to the cannabis tax return for "credits for overpaid taxes on a prior return." Further, guidelines should be established in a regulation which clearly describe the procedures for taking a credit on a return or filing a claim for refund, and the documents which may be used to support the credit or refund.

VIII. Security Requirements

RTC section 34014, subdivision (b), provides that the CDTFA "may require" cannabis businesses to provide security to cover the liability for taxes. The statute goes on to state that the

"[CDTFA] may waive any security requirement it imposes for good cause," and that good cause "includes, but is not limited to, the inability of a [person] to obtain security due to a lack of service providers…" "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 licenses as a result of any shortage of available surety providers."

Because the requirement for security is clearly permissive, we believe the CDTFA should not impose a requirement for security unless there is a failure to timely remit taxes due. In the event security is deemed to be required by the CDTFA, it should seek to set the amounts low, at least for the first two years (2018-2019), to make sure an undue hardship is not created. To the extent a cannabis business can show it has been unable to obtain a surety bond, the CDTFA should consider such inability to be "good cause" to waive the security requirement. Evidence to show a business is unable to obtain a surety bond should consist of a letter of denial from a surety provider.

IX. Sales and Use Tax Compliance

Cannabis businesses will also be subject to sales and use tax compliance requirements. While such requirements may not be appropriately addressed within cannabis excise tax regulations, the BTC should issue written guidelines to the industry to describe the relevant sales and use tax compliance requirements. Guidelines should include, but not be limited to, the following:

- Registration requirements;
- Reporting requirements;
- Proper support for sales for resale, i.e., timely and complete resale certificates accepted in good faith;
- Proper support for sales of medical cannabis;
- Use tax obligations for purchases of assets and supplies;
- Application of tax to delivery charges.

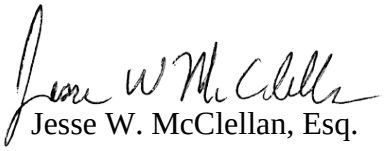
X. Factors not considered or addressed by the industry in the emergency rulemaking process.

Participation by the cannabis industry is vital to the success of the rulemaking process. Because a complete set of regulations have not been drafted by the CDTFA prior to the emergency regulation comment period, issues may arise in the regulation drafting process that were not considered or addressed by the industry. To help ensure any such issues are properly addressed in the impending regulations, we encourage the CDTFA to send requests for submissions by interested parties for input prior to submitting a final draft of the proposed

regulations to the Office of Administrative Law. Alternatively, regulatory guidelines on issues that have not been considered should be held in abeyance pending the final rulemaking process.

Thank you for the consideration given to our suggestions and concerns and please do not hesitate to contact me should you have any questions.

Very truly yours,



Jesse W. McClellan, Esq.
James Dumler, CPA
McClellan Davis
On behalf of CCIA

Cc: CCIA

KIVA
· CONFECTIONS ·

August 24, 2017

Ms. Trista Gonzalez, Chief
California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092 VIA: Email: Trista.gonzalez@cdtfa.ca.gov

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you for providing us with the opportunity to make this submission on behalf of Kiva Confections. This submission is being made in response to the Discussion Paper issued on July 21, 2017, and the interested parties meeting held on August 2, 2017.

We would like to express our appreciation for you and your staff's concerted efforts to establish regulatory guidelines that will help enable the cannabis industry to comply with the new and complex tax laws.

As a major stakeholder in the cannabis industry, performing manufacturing and distribution activities, we are providing feedback the we hope will provide valuable insight to the administration.

I. Penalty established under Revenue and Taxation Code (RTC) section 34013, subdivision (e).

Based on our reading of the law, the intent of Proposition 64, Senate Bill 94 and related bills, and from communications with the framers of the cannabis law, it our opinion that the penalty provided for under RTC section 34013 is discretionary, and that it should be limited to 50 percent. Further, we believe the penalty should only apply when a person knowingly fails to pay the tax, not when there is a failure to pay timely and/or an unintentional error in reporting.

RTC section 34013, subdivision, (e) provides:

> "(e) Any person who fails to pay the taxes imposed under this part shall, in addition to owing the taxes not paid, be 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 Business and Professions Code or pursuant to Chapter 3.5 (commencing with Section 19300) of Division 8 of the Business and Professions Code." (Emphasis added)

CDTFA's July 21, 2017, rule making discussion paper provides proposed regulatory language for the penalty as follows:

> "(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."

By its language, the proposed regulation seeks to impose the penalty on people that fail to pay the tax "in whole or in part," timely. Under the proposed regulation, a person that attempts to comply, but fails to pay its tax timely due to unforeseen or unanticipated circumstances by one day, would receive a penalty of at least 50 percent. The language of the statute, however, does not state that the penalty will apply to people that do not pay "within the time" prescribed law, it states that "[a]ny person who fails to pay the taxes," will be subject to a penalty.

We believe there is a difference between a person that fails to pay the tax altogether and a person that intends to pay the tax, but does so late or makes an unintentional error in reporting. Technically, a person that pays late does not involve a failure to pay the tax, there is merely a failure to do so timely. If there was an intent to punish any person that failed to pay the tax "within the time" prescribed by law, we believe the law would have referenced "time," in some manner. Because such a factor could have been easily incorporated into the law, but was not, we believe the rules of statutory construction support that a failure to pay *timely* should not be read into the law. Including a timeliness factor in the regulation unnecessarily expands the law to include virtually any failure, which simply does not make sense considering the severity of the penalty.

According to a plain reading of the statute, we believe the words "subject to," mean that a person is susceptible to the penalty, i.e., it is discretionary. Making a person "subject to" a penalty does mean the penalty "must" or "shall" apply. The BTC's interpretation of the words "subject to" in Code section 34013, as it pertains to a license revocation, also supports that it does not mean the penalty is mandatory. Code section 34013, subdivision (d), states that a person shall be "subject to having its license revoked." But, there is no claim that a person "must" or "shall" have its license revoked if it inadvertently underreports its tax obligation or if it inadvertently fails to file a timely return. The same meaning should be applied to the penalty.

A review of other mandatory penalties under in the RTC is instructive and further supports that the penalty established under section 34013 is not intended to be mandatory. Mandatory penalties contain language that make it clear the penalty is mandatory, e.g., by stating that a person "shall pay a penalty of 6 percent," or "shall pay a penalty of 10 percent of the amount of tax." (RTC §§ 6477, 30281, subd. (b).) Further, there is no known penalty that exceeds 25 percent where an element of knowledge is not required. (See RTC §§ 30211, 6485, 6485.1, 6597.) Penalties for late payments or unintentional errors are generally limited to 10 percent. (See RTC §§ 6476, 6477, 6478 6480.4, 30281.) The amount of the penalty, in itself, supports that it is intended to apply to people that knowingly do not pay the tax.

We believe the penalty is designed to deter people from operating outside of the framework of the law and to punish those that intentionally fail to comply. Under the proposed regulation, our concern is that only those people that actually attempt to comply, but fail to do so notwithstanding good faith efforts, will be subject to the exorbitant penalty. Ultimately, it will be those that register and attempt to comply that will be most likely to have encounters with the CDTFA and thereby be subject to the imposition of the penalty. We propose the following regulatory language for the penalty:

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In summary, the forgoing provisions establish that the cultivation tax is due and subject to collection *after* it has been tested and approved for commercial sale. But, RTC section 34012, subdivision (i), establishes a presumption of taxability for "[a]ll cannabis removed from a cultivator's premises." The question becomes, what happens when a distributor is inspected and it has possession of untaxed cannabis that it removed from a cultivator's premises without collecting or reporting tax, because it is waiting for samples of the cannabis to be tested? It may be subject to seizure under the reading of the law. (RTC § 34016, subd. (c).) Thus, it is recommended that the presumption of taxability be clearly identified as being rebuttable in a regulation. The regulation should explain that prior to presuming that tax applies, it must be established that it has "entered the commercial market," i.e., has completed and complies with all quality assurance, inspection, and testing. A person should not be forced to prove a negative in order to avoid the presumption of taxability. In other words, a person should not be forced to prove cannabis has *not* completed and complies with all quality assurance, inspection, and testing, since doing so may be virtually impossible.

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…

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Very truly yours,
Kristi Knoblich Palmer

Kristi Knoblich Palmer, Co-Founder
Kiva Confections
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August 24, 2017

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California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092 VIA: Email: Trista.gonzalez@cdtfa.ca.gov

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RTC section 34011, subdivision (a) imposes a tax "upon purchasers" at the rate of 15 percent. RTC section 34011, subdivision (b)(1) provides a distributor with the option of collecting the 15 percent retail excise tax 90 days after its sale. RTC section 34015, subdivision (a), establishes a quarterly reporting and payment basis "[u]nless otherwise prescribed by the board pursuant to subdivision (c)." RTC section 34015, subdivision (c), provides the CDTFA with the authority to prescribe different due dates for reporting taxes applied in an arm's length transaction.

First, it is important to recognize that the retail cannabis tax is imposed upon purchasers, a distributor is required to collect and remit the tax. (RTC § 34011, subd. (a).) There are significant concerns with the ability to pay the tax prior to the time that it is actually imposed upon and collected from a purchaser. The use of cash by the industry and the inability to use banking and financing institutions heightens this issue and concern. RTC sections 34011 and 34015 address this concern. If a distributor exercises its legal right to collect the tax 90 days after its sale, it should be permitted to report the tax in the period in which the tax is collected. Therefore, we request that the CDTFA exercise its authority granted under RTC section 34015, subdivision (c), and establish a regulation which requires a distributor to report the excise tax imposed on arm's length transactions in the quarter following the quarterly period in which the sale is made, i.e., 90 days following its sale to the retailer.

To maintain clarity for reporting purposes, the reporting timeframe should not vary for arm's length transactions. In other words, if a distributor or manufacturer contracts to collect the tax *prior to* 90 days on some transactions and at 90 days for others, to maintain consistency and ease in the reporting requirements, all of the subject tax should be due in the quarter following the period in which the sale occurs.

III. Timing of the due date of the cultivation tax vs. the presumption of sale and taxability upon removal from a cultivation site.

RTC section 34012, subdivision (a), states that the cultivation "tax shall be due *after* the cannabis is harvested *and enters the commercial market*." (Emphasis added) Enters the commercial market means the cannabis "has completed and complies with all quality assurance, inspection, and testing." (RTC § 34010, subd. (m).) A distributor shall collect the cultivation tax upon entry into the commercial market. (RTC § 34012, subd. (h)(1).)

In summary, the forgoing provisions establish that the cultivation tax is due and subject to collection *after* it has been tested and approved for commercial sale. But, RTC section 34012, subdivision (i), establishes a presumption of taxability for "[a]ll cannabis removed from a cultivator's premises." The question becomes, what happens when a distributor is inspected and it has possession of untaxed cannabis that it removed from a cultivator's premises without collecting or reporting tax, because it is waiting for samples of the cannabis to be tested? It may be subject to seizure under the reading of the law. (RTC § 34016, subd. (c).) Thus, it is

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recommended that the presumption of taxability be clearly identified as being rebuttable in a regulation. The regulation should explain that prior to presuming that tax applies, it must be established that it has "entered the commercial market," i.e., has completed and complies with all quality assurance, inspection, and testing. A person should not be forced to prove a negative in order to avoid the presumption of taxability. In other words, a person should not be forced to prove cannabis has *not* completed and complies with all quality assurance, inspection, and testing, since doing so may be virtually impossible.

IV. Average Market Price computation.

Regulatory guidelines should be established that clearly explain how the "Average Market Price" is computed. The applicable regulation should explain how the computation is carried out, including a description of what costs the markup should be applied to, and how the tax is computed therefrom. We believe it would be significantly beneficial to provide at least one example of how the average market price is computed, and how it flows into the tax computation. There is a lot of confusion on this issue in the industry and clear guidelines are needed to enable greater compliance.

Furthermore, as a manufacturer that has travelled throughout the state, it is clear there exists a wide variation in market prices related to geolocation. Thus, the whole concept of "Average Market Price" would place an unfair burden on cultivators in areas of the state where saturation, access, or competition has driven the price lower than any "Average Market Price," regardless of how it is computed. This would result in cultivators that are already burdened by lower margins to be responsible for a larger percent of tax relative to their actual market price, as dictated by their unique circumstance. It would the equivalent of taxing income of all Californians based not on their actual income, but on a state average.

Computational accommodations need to be made to address the geo-specific outliers to ensure the tax is levied appropriately.

…

Thank you for the consideration given to our suggestions and concerns and please do not hesitate to contact me should you have any questions.

Very truly yours,

Christopher Coggan
CEO/Founder
Therapy Tonics & Provisions, LLC

August 25, 2017

Ms. Trista Gonzalez, Chief
California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092

VIA: Email: Trista.gonzalez@cdtfa.ca.gov

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you for providing us with the opportunity to make this submission. This submission is being made in response to the Discussion Paper issued on July 21, 2017, and the interested parties meeting held on August 2, 2017.

We would like to express our appreciation for you and your staff's concerted efforts to establish regulatory guidelines that will help enable the cannabis industry to comply with the new and complex tax laws.

the International Cannabis Association (ICFA) was formed by farmers, scientists, stakeholders and other thoughtful supporters to establish the science, data and consumer education necessary to break down barriers and promote the quality and benefits of traditionally farmed Cannabis and Cannabis-derived products.

As the leading association in the sun grown cannabis industry, ICFA is significantly interested in doing its part to help make certain that clear and comprehensive regulations are established. ICFA's goal is to work alongside the California Department of Tax and Fee Administration (CDTFA) to help lay the groundwork for guidelines that will enable its members and the industry as a whole to achieve a very high level of voluntary compliance. To that end, we offer the following comments and suggestions.

I. Penalty established under Revenue and Taxation Code (RTC) section 34013, subdivision (e).

Based on our reading of the law, the intent of Proposition 64, Senate Bill 94 and related bills, and from communications with the framers of the cannabis law, it our opinion that the penalty provided for under RTC section 34013 is discretionary, and that it should be limited to 50

percent. Further, we believe the penalty should only apply when a person knowingly fails to pay the tax, not when there is a failure to pay timely and/or an unintentional error in reporting.

RTC section 34013, subdivision, (e) provides:

> "(e) Any person who fails to pay the taxes imposed under this part shall, in addition to owing the taxes not paid, be 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 Business and Professions Code or pursuant to Chapter 3.5 (commencing with Section 19300) of Division 8 of the Business and Professions Code." (Emphasis added)

CDTFA's July 21, 2017, rule making discussion paper provides proposed regulatory language for the penalty as follows:

> "(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."

By its language, the proposed regulation seeks to impose the penalty on people that fail to pay the tax "in whole or in part," timely. Under the proposed regulation, a person that attempts to comply, but fails to pay its tax timely due to unforeseen or unanticipated circumstances by one day, would receive a penalty of at least 50 percent. The language of the statute, however, does

not state that the penalty will apply to people that do not pay "within the time" prescribed law, it states that "[a]ny person who fails to pay the taxes," will be subject to a penalty.

We believe there is a difference between a person that fails to pay the tax altogether and a person that intends to pay the tax, but does so late or makes an unintentional error in reporting. Technically, a person that pays late does not involve a failure to pay the tax, there is merely a failure to do so timely. If there was an intent to punish any person that failed to pay the tax "within the time" prescribed by law, we believe the law would have referenced "time," in some manner. Because such a factor could have been easily incorporated into the law, but was not, we believe the rules of statutory construction support that a failure to pay *timely* should not be read into the law. Including a timeliness factor in the regulation unnecessarily expands the law to include virtually any failure, which simply does not make sense considering the severity of the penalty.

According to a plain reading of the statute, we believe the words "subject to," mean that a person is susceptible to the penalty, i.e., it is discretionary. Making a person "subject to" a penalty does mean the penalty "must" or "shall" apply. The BTC's interpretation of the words "subject to" in Code section 34013, as it pertains to a license revocation, also supports that it does not mean the penalty is mandatory. Code section 34013, subdivision (d), states that a person shall be "subject to having its license revoked." But, there is no claim that a person "must" or "shall" have its license revoked if it inadvertently underreports its tax obligation or if it inadvertently fails to file a timely return. The same meaning should be applied to the penalty.

A review of other mandatory penalties under in the RTC is instructive and further supports that the penalty established under section 34013 is not intended to be mandatory. Mandatory penalties contain language that make it clear the penalty is mandatory, e.g., by stating that a person "shall pay a penalty of 6 percent," or "shall pay a penalty of 10 percent of the amount of tax." (RTC §§ 6477, 30281, subd. (b).) Further, there is no known penalty that exceeds 25 percent where an element of knowledge is not required. (See RTC §§ 30211, 6485, 6485.1, 6597.) Penalties for late payments or unintentional errors are generally limited to 10 percent. (See RTC §§ 6476, 6477, 6478 6480.4, 30281.) The amount of the penalty, in itself, supports that it is intended to apply to people that knowingly do not pay the tax.

We believe the penalty is designed to deter people from operating outside of the framework of the law and to punish those that intentionally fail to comply. Under the proposed regulation, our concern is that only those people that actually attempt to comply, but fail to do so notwithstanding good faith efforts, will be subject to the exorbitant penalty. Ultimately, it will be those that register and attempt to comply that will be most likely to have encounters with the CDTFA and thereby be subject to the imposition of the penalty. We propose the following regulatory language for the penalty:

> "Penalty for Taxes Not Paid. In addition to owing the taxes not paid, a person shall pay a penalty of 50 percent if it is determined the person knowingly failed to pay the taxes due."

We believe the other penalties provided for under the Fee Collection Procedures Law should also be clearly described in a regulation, rather than merely referenced, since most people will have difficulty cross-referencing and understanding different sections of the law. Sales and Use Tax Regulation 1703, provides a good example of a regulation that describes multiple penalties that may apply, in addition to guidelines for available relief. We encourage the BTC to draft a regulation for penalties associated with the cannabis tax law that is similar to Regulation 1703. Doing so will help to put people on notice of the penalties they are subject to and will provide needed guidelines for obtaining available relief.

II. Timing of the remittance of retail cannabis tax in consideration of the option to collect the tax from a retailer within 90 days after the sale or transfer in an arm's length transaction. (RTC §§ 34011, subd. (b)(1), 34015, subds. (a), (c).)

RTC section 34011, subdivision (a) imposes a tax "upon purchasers" at the rate of 15 percent. RTC section 34011, subdivision (b)(1) provides a distributor with the option of collecting the 15 percent retail excise tax 90 days after its sale. RTC section 34015, subdivision (a), establishes a quarterly reporting and payment basis "[u]nless otherwise prescribed by the board pursuant to subdivision (c)." RTC section 34015, subdivision (c), provides the CDTFA with the authority to prescribe different due dates for reporting taxes applied in an arm's length transaction.

First, it is important to recognize that the retail cannabis tax is imposed upon purchasers, a distributor is required to collect and remit the tax. (RTC § 34011, subd. (a).) There are significant concerns with the ability to pay the tax prior to the time that it is actually imposed upon and collected from a purchaser. The use of cash by the industry and the inability to use banking and financing institutions heightens this issue and concern. RTC sections 34011 and 34015 address this concern. If a distributor exercises its legal right to collect the tax 90 days after its sale, it should be permitted to report the tax in the period in which the tax is collected. Therefore, we request that the CDTFA exercise its authority granted under RTC section 34015, subdivision (c), and establish a regulation which requires a distributor to report the excise tax imposed on arm's length transactions in the quarter following the quarterly period in which the sale is made, i.e., 90 days following its sale to the retailer.

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In summary, the forgoing provisions establish that the cultivation tax is due and subject to collection *after* it has been tested and approved for commercial sale. But, RTC section 34012, subdivision (i), establishes a presumption of taxability for "[a]ll cannabis removed from a cultivator's premises." The question becomes, what happens when a distributor is inspected and it has possession of untaxed cannabis that it removed from a cultivator's premises without collecting or reporting tax, because it is waiting for samples of the cannabis to be tested? It may be subject to seizure under the reading of the law. (RTC § 34016, subd. (c).) Thus, it is recommended that the presumption of taxability be clearly identified as being rebuttable in a regulation. The regulation should explain that prior to presuming that tax applies, it must be established that it has "entered the commercial market," i.e., has completed and complies with all quality assurance, inspection, and testing. A person should not be forced to prove a negative in order to avoid the presumption of taxability. In other words, a person should not be forced to prove cannabis has *not* completed and complies with all quality assurance, inspection, and testing, since doing so may be virtually impossible.

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Thank you for the consideration given to our suggestions and concerns and please do not hesitate to contact me should you have any questions.

Sincerely,

Kristin Nevedal
Chair / International Cannabis Farmers Association

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August 25, 2017

Ms. Trista Gonzalez, Chief
California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092

Dear Ms. Gonzalez,

On behalf of Consortium Management Group/Caliva, we would like to offer comments relative to the cannabis taxation discussion paper released by the department last month.

Caliva is the state's largest vertically integrated medical cannabis operator, located in San Jose. The facility is one of the most advanced pharmaceutical-grade cannabis cultivating, manufacturing and dispensing facilities in the country and is a model for energy efficiency, safe access and compliance. Caliva's leaders come from industries outside of cannabis that are heavily regulated and deeply experienced in tax obligations and compliance.

We appreciate that the California Cannabis Industry Association is submitting more comprehensive comments, and Caliva supports those comments as well. However, we would like to bring one particular issue to your attention.

We are concerned that the department's reading of current law relative to penalties for failure to pay taxes is more excessive than is necessary. Section 34013 of the Revenue and Taxation Code gives discretion to the department, both in terms of whether a penalty shall be assessed and what that penalty shall be. The term "subject to" gives the department the necessary authority to determine that the penalty as described is not necessary or appropriate. If the Legislature had meant to require a specific penalty, it would have used language that clearly requires the assessment of that penalty. Since it did not, it just as clearly meant to let the department make the determination.

We anticipate that there will be a number of cannabis businesses, not experienced in being part of a now legal business, that will make mistakes in fulfilling their tax obligations. They will be a day late, they will miscalculate their tax obligation or they will misunderstand what does and does not apply to them. We believe the department has authority to determine whether that person has failed to pay some or all of their taxes due to unforeseen circumstances or a mistake and accommodate the taxpayer who recognizes his or her obligations and seeks to find a way to pay.

We also recognize that there may very well be the taxpayer who fundamentally refuses to pay. In that case, we can understand the department's desire to employ robust penalties as a means to compel a recalcitrant taxpayer to fulfill his or her obligation. We assert that it is that situation the Legislature was attuned to in crafting this section.

We suggest that a floor of a 50% penalty for a taxpayer who makes a mistake is extreme. It far exceeds comparable penalties in the Revenue and Taxation Code; we believe you have the authority to harmonize penalty levels with other taxpayers who fail to pay.

In pursuing the broad legalization of a heretofore illegal activity, the strategy of the Administration and the Legislature has been to develop a substantive and rational regulatory framework that bestows business legitimacy and encourages existing cannabis entities to become licensed; that strategy is also sensitive to not taking actions that make a continuing black market an option for cannabis operators. This requires the state to engage in a delicate balancing act.

The effect of excessive penalties for tax compliance mistakes is to upset that balance and discourage some cannabis entities from coming into the light, especially when these entities – many of which are struggling to survive – are facing potentially crushing penalties. We submit that it is the responsibility of every department to help achieve this balancing act.

Caliva is an entity that is experienced and sophisticated in tax compliance, although even the most experienced can make a mistake. However, we are deeply concerned about the impact on businesses that have less experience. On the one hand, we seek to assist our allies in this industry. On the other, we and the rest of the industry could suffer if the implementation of California's cannabis legalization laws goes off the rails because regulation of an emerging industry is more excessive than the industry can handle.

We appreciate your consideration of these concerns and encourage you to craft regulations that are sensitive to the unique situation the industry and the people of California find themselves in.

Sincerely,

Rand Martin

August 16, 2017

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
405 N Street
Sacramento, CA 95814

Re: Comments to California Department of Tax and Fee Administration proposed emergency regulations on cannabis taxes.

Dear Chief Gonzalez:

Founded in 2008, Weedmaps is the oldest and largest cannabis technology company in the world and has been the leading innovator in developing software and platforms that drive the cannabis industry. Our core platform connects people with local cannabis dispensaries, delivery services, doctors, deals, brands, lab data and real-time menus. Weedmaps' full suite of business-to-business and business-to-consumer software includes lab data integration, point-of-sale and medical practice management.

Beyond providing the software and advertising solutions that underpin the industry, Weedmaps has been advocating for measured growth and responsible policy to guide the modernization of the industry for nearly a decade. Weedmaps is working collaboratively with all levels of government and stakeholder organizations to encourage reforms and establish regulatory frameworks capable of ensuring safe and reliable access to cannabis.

Weedmaps is committed to working with the California Department of Tax and Fee Administration (CDTFA), state and local agencies, industry participants, non-governmental organizations and trade groups to organize comprehensive cannabis policy solutions that accommodate existing medical cannabis businesses, enable industry growth and address public safety, health, tax and community reinvestment goals.

We commend your work and are very appreciative of your efforts to establish a regulatory framework for cannabis taxes. We have reviewed CDTFA's Discussion Paper and proposed cannabis regulations issued on July 21, 2017 and would like to provide our feedback. Below we have summarized and prioritized our concerns and provided policy recommendations on designing a workable regulatory framework.

Penalties for Failure to Pay the Taxes Due

The proposed increasing penalty structure for late tax payment is too high and could put many operators in the cannabis industry out of business for minor violations. In addition to paying the amount of taxes due, the CDTFA is proposing an additional late payment penalty of 50 percent of total taxes for the first offense, 60 percent on the second offense and 75 percent on the third offense.

The Discussion Paper notes that CDTFA used the Fee Collection and Procedure Law (FCPL) as the basis for the proposed penalty increases and states the following:

> *"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**" (page 14).*

While the FCPL provides there must be evidence of negligence or fraud for penalty increases to be applied, the text of CDFTA proposed regulations increase penalties solely for "*failure to timely pay*" cannabis taxes.

CDTFA notes in the Discussion Paper that "there may be circumstances in which a second or third late payment would not warrant a penalty above 50 percent" and establishes an "18-month look back window" for the purposes of determining additional late penalties. However, the text of the proposed regulation provides that operators "**shall incur**" penalties for second and third violations.

Considering (1) the lack of banking services, (2) the limited number of facilities that will be able to accept cash tax payments, (3) evolving industry regulations and (4) remoteness of some commercial cannabis operators there are significant hurdles to paying cannabis taxes and delayed payments may occur despite an operator's good faith effort to make a timely payment. CDTFA should ensure the flexibility mentioned in the Discussion Paper is reflected in the text of the regulations.

Recommendations:

We recommend amending subdivision (d) to reflect the minimum penalty required in the Cannabis Tax Law for late cannabis tax payments (one-half the amount of the taxes not paid) and impose any additional penalties based on structures in place within existing laws and/or regulations. Specifically, we recommend subdivision (d) be amended as follows:

> **(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~~ **A** penalty, as set forth in paragraphs (1)~~ (3)~~ **and (2)** 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 f~~ **F**ailure 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~~ **A subsequent** failure to timely pay the cannabis excise tax or cultivation tax by the due date, within an 18-month period, ~~shall~~ **may** incur ~~a penalty of 60 percent~~ **additional penalties 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)**.
>
> (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~~ **Upon the showing of reasonable cause and good faith or undue hardship due to lack of access to banking the department in its discretion may abate any penalties assessed pursuant to this section.**

If the proposed penalty structure is to remain in place, we recommend at a minimum making the second and third penalties permissive and providing authority to the CDTFA to waive any tax penalty if there is evidence of reasonable cause and good faith or undue hardship due to lack of access to banking.

Average Market Price – Determining the Mark-Up

The cannabis excise tax will be imposed at the rate of 15 percent of the average market price of any retail sale by a cannabis retailer. The average market price in an arm's length transaction will be determined by adding two inputs: (1) the wholesale cost of the cannabis or cannabis products sold or transferred to a cannabis retailer and (2) a mark-up, as determined by the CDTFA on a biannual basis in six-month intervals.

Recommendations:

Create different mark-ups by category of product: The mark-up retailers apply vary by the type of products being sold.

For example, the industry standard mark-up for cannabis concentrates tends to move in a tight band that differs from that of cannabis flower or edible products.

The mark-up for cannabis flower can be very different and is influenced by a variety of factors like how the cannabis is grown (indoor, outdoor, or mixed light), the region the cannabis is grown and the region the cannabis is sold. Cannabis flowers grown indoor are on average more expensive than cannabis flowers grown outdoor or in mixed light greenhouses. Retail mark-ups of cannabis flowers can also be influenced by popularity of certain strains or brands.

Considering the variety of cannabis products and how they are priced, we recommend CDTFA determine mark-ups for the flowing categories:

- Indoor cannabis flowers
- Outdoor cannabis flowers
- Cannabis concentrates
- Edible products
- Immature plants (e.g. clones)
- Seeds

Consider setting the mark-up relatively low until we have better data: Once commercial cannabis licenses are issued and statewide regulations are implemented the price of cannabis will fluctuate, and this occurs rapidly in post legalization markets. This trend has been observed in every state that has established a commercial cannabis licensing and/or permitting program. Current California market metrics should inform the CDFTA determined mark-up, but the Department should also consider the impact new taxes, fees and regulations will have on pricing. Using data and average market pricing from other states may also help inform policy decisions, however this data should not be the basis for CDTFA's determined mark-up. California's cannabis market is much larger than the markets in other legalized states and the cannabis and cannabis products grown and sold here are generally of better quality.

We recommend that CDFTA set the initial mark-up conservatively at this critical juncture to avoid exacerbating the illegal market. This will help bring more operators into the regulated market and keep product prices somewhat stable until the state has accurate price data on the regulated market.

Consider adjusting mark-up on more than a six-month basis: In other states that have legalized cannabis sales, pricing has fluctuated dramatically, particularly in the first year. These fluctuations are

driven by the impact of regulation on business operations, taxation and supply increases or decreases among other factors. Accordingly, to the extent allowed under state law the CDTFA should adjust the mark-up every quarter rather than every six months, particularly in the first two to three years of California's regulated market. This can ensure the mark-up reflects more accurate market conditions, that licensees are not being over taxed and the state is optimizing revenue collection in the volatile post-legalization market.

Other Cultivation Categories and Tax Rates

For cultivation tax purposes, categories that may fall outside of cannabis flowers and cannabis leaves include the following: (1) wet or frozen cannabis, (2) immature plants or clones and (3) seeds.

Wet/Frozen Cannabis: Wet or frozen cannabis is used to produce live resin concentrates. Live resin typically has higher terpene content compared to concentrates produced from dried cannabis flower or leaves. Terpenes are a class of chemical compounds responsible for the complex scent and taste of cannabis flowers and tend to degrade during the drying and curing process.

The value of wet/frozen cannabis compared to cannabis flower is very difficult to determine. Live resin concentrates are generally more valuable compared to other concentrates. At the same time this is a relatively new product in the cannabis market. A pound of wet/frozen cannabis will likely be less expensive compared to a pound of dried cannabis flower because wet/frozen flowers can have moisture content greater than 80 percent.

The Colorado Department of Revenue recently released their recommended average market rates for collection of excise taxes and included a "Wet Whole Plant Rate."[1] While these recommendations are for purposes of calculating retail excise taxes and market data specific to California is needed, they do provide some insight as to the comparative value of wet/frozen cannabis.

Immature Plants and Clones: Immature plant are cannabis plants that are not flowering. A clone is an exact copy of a specific cannabis plant, which means clones share the same genes and will grow very similarly to each other and their mother plant. These products should not be subject to a cultivation tax. If an immature plant or clone is used by a cultivator to grow cannabis, the flowers and leaves produced will eventually be assessed the cultivation tax. If an immature plant or clone is sold directly to a consumer by a retailer, it will be assessed the retail excise tax and subsequently used for personal cultivation, which is not subject to tax.

Seeds: Like immature plants and clones, seeds should not be subject to the cultivation tax. The cannabis flowers and leaves produced from seeds will be subject to the cultivation tax and to the extent seeds are sold at retail, they will be subject to the retail excise tax.

Presumption - Removal from Cultivator's Premises Penalties

Pursuant to Revenue and Taxation Code 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.

With respect to this presumption, we recommend the department at a minimum include testing and emergencies as circumstances in which cannabis may be removed from a cultivator's premise for valid

[1] Information on Colorado's cannabis excise tax is available at https://www.colorado.gov/Tax/marijuana-taxes-file.

purposes other than for sale. If a cultivator suspects a pest infestation, they may need to test their product outside of the quality assurance requirements specified in state law to determine the problem and how to address it. Cultivators should also be allowed to remove plants in case of emergency like fire or flood.

We agree with the CDFTA's approach to mirroring their definition of "cannabis waste" to definition the California Department of Food and Agriculture (CDFA) adopts for that term. With respect to the definition of "cannabis waste" in CDFA's proposed regulations, we identified the following policy concern and solution in our public comments to CDFA:

> **Policy Concern:** While it may be appropriate to quarantine waste that has residual solvent levels from manufacturers, other licensees may need to dispose of waste sooner. The requirement that all cannabis waste be mixed with at least 50 percent non-cannabis material may also be burdensome and not necessarily add any additional health or safety protection for certain types of cannabis waste. Additionally, given the size and scope of the cannabis market, increasing the volume of cannabis waste by a 2x factor will burden landfills and present issues with finding sufficient quantities of ground mixing material. No other state has a similar requirement, as this is the point of inspections and track-and-trace systems.
>
> **Solution:** Waste management practices should be tailored more specifically to the type of licensee and waste. Eliminate the requirement to mix cannabis waste with other materials and instead leverage track-and-trace and inspections.

Reporting and Remitting the Excise Tax

The Discussion Paper notes that 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 collected from the cannabis retailer. Likewise, it not entirely clear when a distributor would report the tax in a non-arm's length transaction.

In both cases, we recommend that the tax should be reported on a distributor's quarterly return at the time the tax is collected. This will provide for better cash flow, increase predictability and limit interruption in billing. With track and trace and invoice requirements in state law there is a high degree of transparency and traceability with respect to tax collection.

Thank you for the opportunity to provide public comments and contribute to the regulatory process. We look forward to working with CDFA to create an effective regulatory system for the cannabis industry.

Respectfully,

Christopher Beals
President and General Counsel

Dustin McDonald
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PACEX
PACIFIC EXPEDITORS

August 23, 2017

California Department of Tax and Fee Administration (CDTFA)
450 N Street, MIC: 66
Sacramento, CA 95814

To Whom It May Concern,

As a representative of Pacific Expeditors, Inc., a cannabis distribution business in California, I am writing to express concerns we have regarding the need for additional clarity within the regulatory language on the distributor's obligations for quarterly tax payments, as well as the penalty fees for late tax payments on excise and cultivation taxes as proposed by CDTFA in their draft Cannabis Tax Regulations and Discussion Paper.

Through the signing of SB 94 into law by Governor Brown in June, Section 34015(a) of the Revenue and Taxation Code (RTC) has been amended to require a quarterly filing and payment of cultivation tax and excise tax, specifically by distributors. But there is no clarifying language to indicate that this tax is due strictly on the amounts which have been physically collected by the distributor during that quarter, or that it excludes outstanding excise tax balances still owed by retailers within their 90-day grace period to the distributors for quarterly filing and payment requirement. It also does not address the cultivation taxes that are in the possession of manufacturers at the time of filing. Additionally, there appears to be no reporting and remittance guidance within Section 34015 of the RTC for cultivators who do not require the use of distributors, like Type 12 microbusiness license types; the regulation only mentions the *distributor's* obligation to report and pay tax quarterly.

According to Section 34011 of the RTC, retailers are responsible for collecting excise tax from purchasers and remitting the excise tax to distributors on or before 90-days from sale or transfer of cannabis and cannabis products from the distributor to the retailer. But it does not clarify whether or not the excise tax the distributor is required to report and remit quarterly, as prescribed by Section 34015, is calculated on the transfers and sales to retailers for that quarter - meaning the distributor will be covering the cost of the tax liability for retailers in some cases; or if it applies only for actual collections within that period - meaning the retailer still holds responsibility of debt to the State until the excise tax is remitted to the distributor. Similarly, Section 34012 of the RTC holds cultivators liable for payment of the cultivation tax unless they have a receipt of cultivation tax collection from a distributor or manufacturer. This section and Section 34015 also fail to provide clarity on the distributor's tax reporting and payment obligation on cultivation tax that is in the possession of a manufacturer at the close of a filing quarter, as well as what reporting and payment is required of a cultivator who does not use a distributor.

In the majority of instances, it will be the distributor who is in possession of cultivation and excise taxes; but at any given moment in time, there will be excise and cultivation taxes which will be in the possession of licensees other than distributors. Based on the inevitability of the above-mentioned circumstances, we ask that the CDTFA include language in their cannabis tax regulations which address these scenarios and better define the distributor's reporting and payment obligations. Specifically, we feel that the only excise and cultivation taxes that distributors should be responsible to report and pay one month after the close of each quarter are those taxes which were physically collected by the distributor during the quarter in question. Placing the burden of assuming the tax responsibility on distributors for the retailer's debt for excise tax not yet remitted to the distributor, or that the retailer failed to pay the distributor by the due date crates business circumstances prone to unnecessary complications, such as large tax liabilities on the distributor's part with no existing mechanism for recompense. The same applies for cultivation taxes being held by manufacturers on the closing dates of the quarters. It must be made clear that cultivators, manufacturers, and retailers maintain responsibility for the debt owed on cultivation and excise taxes in their possession until such time as they are remitted to a distributor and a receipt of each remittance is received; even if there are no filing requirements for these other license types.

Distributors are being put in a position of high liability by serving as the primary collectors and remitters of cultivation and excise tax for the state. The penalties proposed in the draft regulations seem unnecessarily punitive. This newly regulated industry is destined to be highly taxed as it is, and we believe the proposed penalty rates to be excessively high. Particularly when compared to other industries.

Currently, the CDTFA is proposing a 50% penalty fee for late payment of cultivation and excise tax on first offenses in any 18-month period of time that precedes a late payment. If a second late payment should occur within an 18-month period of the first offense, the penalty applied in the second instance is 60%; and a third offense within any 18-month period results in a 75% late payment penalty fee. With tax payments due every three months, penalty rates this steep can accrue quickly and bankrupt a business. When you compare the graduated late payment penalty rates of 50%-75% for cannabis to the late payment penalty rate of only 10% flat fee per incident for alcoholic beverages,[1] it becomes apparent that there is a significant extra incumbrance being placed on distributors in the cannabis industry, which has the capacity to ruin a business instantly.

We argue that the minimum penalty fee of 50% of tax owed, which was determined by the signing of SB 94 into law, could be a significant enough sum for some companies to be bankrupted by a single first offense. It is a large enough penalty that it alone is enough to deter repeat offenses, and no business would willingly choose to incur these hefty fines. As such, we argue that there is no need to have increasing additional penalties with repeat offenses. Applying 10% and 25% additional penalty on what is already a substantial penalty seems an excessive application of Fee Collection Procedure Law (FCPL); particularly in light of the fact that these FCPL laws are not applied to late payments of excise tax in other comparable industries, like wine and liquor.[1] We suggest that the CDTFA remove the incremental increases of penalty rates on repeat offenses of late payments and apply the stipulated minimum penalty of 50% to all late payment offenses. We additionally suggest a 30-day to 60-day grace period be

[1] Revenue and Taxation Code, Section 32252(a)

given on first offenses, since the penalty is potentially financially devastating to some businesses.

We ask the CDTFA to take our comments and suggestions into consideration when drafting emergency regulations. If you have any questions regarding our comments, please contact me at chris@pacificexpeditors.com or (707)328-8732.

Sincerely,

Chris Coulombe
Chief Executive Officer
Pacific Expeditors, Inc.

PATRICK FINNEGAN CPA

Ms. Trista Gonzalez, Chief August 15, 2017
Tax Policy Bureau
Re: Response to interested parties meeting on cannabis taxes
Dear Ms. Gonzalez:

I am pleased to provide my input on the proposed regulations specific to cannabis taxation. The following are my suggestions for regulating the implementation of tax on cannabis and it's related products.

15% excise tax
Currently the proposed language for collection and remittance of the Cannabis excise tax states that a distributor 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. This language is intended to favor the dispensary that is vertically integrated and has it's own distribution license. However, a large segment of cannabis retailers are delivery companies. It makes little sense to require independent distribution companies to bill the retailer for the cultivation tax and wait up to 90 days to collect the excise tax. In addition, as a former Board auditor, I recognize the difficulty of auditing two separate tax transactions on a single invoice. I strongly recommend that the excise tax is due upon the transfer of cannabis from the distributor to the retailer, the 90 day grace period is difficult to manage for distributors as it creates a secondary collection.

CDTFA establishment of other categories of cannabis:
Current legislation allows CDTFA to establish other categories of cannabis. I strongly recommend that CDTFA establish a separate average market cost for cannabis trim utilized in the manufacturing process. Please review Colorado's computation of separate categories of average market costs as this taxing methodology has been successfully implemented.

Indicia for cultivation tax paid:
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. I recommend that CDTFA utilize a tax stamp and product bag that corresponds with the product weight required of a cultivator for cannabis testing. Specifically, if the Department of Pesticide Regulation determines that each 10 lbs of cannabis be subject to testing, the product bags should correspond to holding 10 lbs of cannabis and the tax stamp should total $1,480 ($9.25oz*16oz*10 lbs). This prevents requiring additional bagging of product for testing and taxation purchases. I also believe that CDTFA have $148 tax stamps for one pound containers as well to accommodate those cultivators that sell cannabis in smaller units.

Thank you for the opportunity of expressing my recommendation on cannabis taxation. All the best,

Patrick Finnegan CPA, Folsom, CA

112 PAWTUCKET COURT, FOLSOM, CA 95630 | (916) 718-1068 | PJFINNEGAN@HOTMAIL.COM

LOCAL 1000
SEIU
Stronger Together

Sent via email and fax to: Trista.Gonzalez@cdtfa.ca.gov, (916) 322-4530

August 16, 2017

Trista Gonzalez, Chief
Tax Policy Bureau, Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street
Sacramento, CA 95814

Re: Comments on Proposed Rulemaking with Respect to Cannabis Taxes

Ms. Gonzalez:

The Service Employees International Union (SEIU), Local 1000, submits these comments in response to the California Department of Tax and Fee Administration's (CDTFA) proposed emergency regulations involving cannabis taxes.

As you know, the passage of Proposition 64 in 2016, and the enactment of the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA) in 2017, established a robust licensing, regulatory and tax administration framework that will bring cannabis out of the black market. This new industry, which includes both medical and nonmedical use, is expected to generate approximately $6.5 billion in statewide economic activity by 2020.

CDTFA has the opportunity to create a robust tax administration system for this burgeoning market that reflects the intent of Prop. 64 and MAUCRSA, and ensures that all the taxes owed are properly collected from cannabis sales.

Accordingly, Local 1000 asks that CDTFA take into consideration the following recommendations prior to drafting the final emergency regulation package:

SERVICE EMPLOYEES
INTERNATIONAL UNION

1808 14th Street
Sacramento, CA 95811
Member Resource Center
866.471.SEIU (7348)
www.seiu1000.org

1. CDTFA should use the "Other Tobacco Products" method when calculating the "average market price."

2. Cannabis retailors should be required to list the sales tax collected on the sales invoices. This will ensure price transparency to the consumer, and will allow the Department to accurately determine that the appropriate amount of sales tax has been collected for each transaction.

3. When a cannabis distributor sells to a cannabis retailer, the sales invoice should include the amount of excise tax paid, and if there remains an unpaid balance, the invoice should clearly state that the balance of excise tax is due within 90 calendar days.

4. The cannabis retailer sales invoices should state if the sale was a Medical or Adult sale. SB 94 allowed for the co-location of medicinal and recreational use cannabis sales. We believe that including this information would assist the State in tracking medicinal vs. recreational use sales, and ultimately, facilitate accurate and complete tax collection.

5. The cannabis distributor sales invoice to a cannabis retailer should indicate whether the sale was an "arms-length" transaction or a "non-arm's length" transaction.

6. We recommend cannabis distributors report all sales transactions with the return for the quarter. The return should also reflect the amount of uncollected excise taxes.

7. The Department should provide a method for cannabis distributors to make payments modeled after the Sales and Use Taxes Payment method, including the acceptance of pre-payments.

8. The Department should revise the penalty for "Tax Not Paid" to remove the 18-period time waiver of a higher rate for any person who files a false or fraudulent report.

9. Finally, we encourage the Department to begin the process of developing tax stamps for cannabis packages. Similar to tax stamps required for cigarettes, we believe a similar style stamp will aid the Department's efforts in ensuring tax compliance.

For the above-state reasons, Local 1000 respectfully asks the Tax and Fee Administration to incorporate the above elements. Moreover, Local 1000 is committed to continuing to work with the Tax and Fee Administration and stakeholders to develop regulations that implement the intent of Proposition 64 and MAUCRSA and facilitate the accurate and complete collection of cannabis taxes.

Sincerely,

YVONNE R. WALKER
President

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915 L STREET C413
SACRAMENTO CA 95814

August 25, 2017

To: Trista Gonzalez, Chief Tax Policy Bureau Business Tax and Fee Division
RE: Comments on Discussion Paper on proposed emergency regulations with respect to cannabis taxes.

On behalf of more than 1100 members we are pleased to submit these comments today. We thank you for this opportunity to comment as well as ongoing opportunities to meet and discuss with CDTFA staff over recent weeks and BOE staff over recent months.

Collection of Cultivation Tax

SB 94 specifically amended Proposition 64 to ensure that tax "shall be due after the cannabis is harvested and enters the commercial marketplace" rather than "after the marijuana is harvested" as required by the initiative. This change was our organizations highest priority throughout the development and passage of SB 94 and we remain gravely concerned about the impact if taxes are due before products have passed tests. Thankfully that does not appear to be on the table in the discussion paper.

We appreciate the clarification on page 5 that "A distributor shall collect the cultivation tax from a cultivator upon entry into the commercial market." This is consistent with the intent of SB 94, that no taxes would be due until products have "has completed and complies with all quality assurance, inspection, and testing,"

New Product Categories

We strongly encourage CDTFA to exercise authority granted in Section 34012 (c) to "establish other categories of harvested cannabis, categories for unprocessed or frozen cannabis or immature plants, or cannabis that is shipped directly to manufacturers."

We propose several new product categories:

1. Wet weight: current tax rates are in dry weight. This is problematic for products that are manufactured using fresh (wet) products. Fresh products are significantly heavier than dry products and the tax rate for dry products would be prohibitive for products made with fresh plant matter. We propose that the rate for "wet" products be 10 percent of the dry weight rate. Products should be weighted within 6 hours of harvest in order to be eligible for this rate.
2. Whole plant: current tax rates are set for leaf and flower. This is problematic for products that are manufactured using whole plants. Whole plants include both flowers and leaves, as well as stems and other plant matter. We suggest a composite rate that is 30 percent flower and 70 percent leaf. We have rounded this to our proposal of $4.75 per ounce for

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whole plants. In order to be eligible for this rate a plant must have minimal processing completed prior to sale.

Given the emergent nature of the regulated cannabis marketplace in California we look forward to working with CDTFA staff on the regular rulemaking process that will follow the emergency process. We strongly encourage everyone at the agency to be prepared to make changes as we work through the inevitable bugs in the system. This is a dynamic and complicated situation and flexibility and open, collaborative dialogue will be key to successful implementation of this important tax program.

Sincerely,

HD Allen

Hezekiah D. Allen, Executive Director

Front Range Biosciences Inc

1224 Commerce Ct. | Lafayette, CO 80026 | www.frontrangebio.com

August 23, 2017

California Department of Tax and Fee Administration (CDTFA)
450 N Street, MIC: 66
Sacramento, CA 95814

To Whom It May Concern,

I represent Front Range Biosciences, Inc., an agricultural biotechnology company specializing in cannabis tissue culture clone production and scientific horticultural breeding. We are writing you today to comment on the California Department of Tax and Fee Administration's Discussion Paper on proposed emergency regulations with respect to cannabis taxes. Specifically, we would like discuss the need to create a category of cannabis for "clones," a form of immature plant, and clarify its tax status for cultivation and excise tax. This categorization and clarification is necessary to ensure Type 4 cultivation nursery licensees are taxed appropriately.

Clones, or immature plants, are already a type of cannabis product available on the medicinal use cannabis market. With the inception of the adult use market in California, personal cultivation and the demand for immature cannabis plants is expected to increase significantly. There is no doubt that the department will need to create a category for clones. We believe it is a unique category that needs to be defined immediately so that how it is taxed can be appropriately clarified in the regulatory language. What makes it unique is the fact that other agricultural cannabis product types, namely "flower" and "leaves," have uses as a directly consumable good as well as a manufacturable good. The immature plants, however, only hold value as a potentially cultivatable product. It is also unique in that it will be a product type that will be sold wholesale business to business, as well as made commercially available for personal use at the retail level, all before it is in its mature and harvested state.

Type 4 licensees operating clone nurseries will be working with a form of cannabis that does not fit in to the cultivation tax definition as it has been defined by the passing of SB 94 in June. Section 34012(a) of the Revenue and Taxation Code (RTC) has been amended to read, "Effective January 1, 2018 there is hereby imposed a cultivation tax on all harvested cannabis that enters the commercial market upon all cultivators..." We understand this to mean the cultivation tax does not apply to clones as they are not "***harvested*** cannabis." Additionally, we would like to point out that clones that are sold to cultivation businesses will result in cultivation tax later in the supply chain, and the same plant should not be taxed twice for the same category of taxation. Similarly, once clones are sold on the retail market for personal use cultivation tax no longer applies according to Section 34012(j) of the RTC. Ultimately, there appears to be no valid reason why Type 4 cultivation nursery licensees should pay cultivation tax on clones. We feel language clarifying that cultivation tax does not apply to clones should be added to this section to avoid confusion.

Since Type 4 licensees selling clones have no reason to pay cultivation tax, they should also not be required to hold a State issued seller's permit because the product they work with has no applicable taxes placed on it for which a seller's permit is necessary. Section 26051.5(a)(6) of the Business and Professions Code requires all state license applicants to provide a valid seller's permit, but Type 4 cultivation nurseries have no need to possess one. They will only be selling their product wholesale.

Front Range Biosciences

A noteworthy point to be made is that the removal of clones from the Type 4 cultivator's nursery premises also creates an exception to Section 34012(j) of the RTC which states, "All cannabis removed from a cultivator's premises, except for plant waste, shall be presumed to be sold and thereby taxable under this section." Though the product is sold, it is not taxable under this section based on the arguments presented in this letter.

Creating the clone product category, and defining its tax status is a necessary step in the current regulatory process. Type 4 licensed business will not be able to function properly in the tax system without this categorization and the associated clarifications. We urge the CDTFA to rectify this situation before licenses become available.

Should you have any questions regarding our comments, I am available to meet and discuss the importance of our recommendation. Please feel free to contact me at (303) 709-7947 or jvaught@frontrangebio.com.

Sincerely,

Jonathan Vaught, PhD
Chief Executive Officer
jvaught@frontrangebio.com
303-709-7947

CFAM
MANAGEMENT GROUP, INC.

August 22, 2017

California Department of Tax and Fee Administration (CDTFA)
450 N Street, MIC: 66
Sacramento, CA 95814

To Whom It May Concern,

On behalf of CFAM Management Group, Inc., a medicinal cannabis agricultural business based on the central coast of California, I am writing to give CDTFA commentary which they requested from cultivators in their recent Discussion Paper on the draft Cannabis Tax Regulations. Specifically, I would like to address the issue of instances in which cannabis would leave a cultivator's premises for purposes other than sales.

The signing of SB 94 in to law in June has resulted in the amendment of the Revenue and Taxation Code (RTC) Section 34012, paragraph (j) to state, "All cannabis removed from a cultivator's premises, except for plant waste, shall be presumed to be sold and thereby taxable under this section." We would like to argue that CDTFA should not make this assumption about cannabis based solely on its removal from the cultivator's premises. CDTFA staff acknowledges that there may be reasons why cannabis would be removed from the cultivator's premises, and has asked the industry for examples. As large scale medicinal cannabis cultivators with years of experience in the industry and an understanding of what compliance issues the upcoming licensing poses for cultivators, we would like to provide you with two legitimate reasons why we would foresee removal of cannabis for non-sale purposes.

The first reason is a very valid compliance-based issue. The California Department of Food and Agriculture (CDFA) is creating a license type for agricultural processing activities. A "processor" will be, "a cultivation site that conducts only trimming, drying, curing, grading or packaging of cannabis and nonmanufactured cannabis products."[1] The reality is not every locality is permitting processing to occur on cultivation sites, and not every cultivation site is going to have the space or local zoning clearance to maintain a building structure for processing activities. And for licensees with multiple cultivation sites, it may simply be more efficient and logical to have a single processing facility offsite to serve the needs of all their grows. Regardless of the reason why a cultivator may choose to use a processing facility, the fact is that they will exist and they will be used. This means there is at least one reason that harvested cannabis would leave a cultivator's premises for a purpose other than sales.

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[1] California Department of Food and Agriculture Text Of Proposed Regulations (2017) California Code of Regulations, Title 3. Food and Agriculture, Division 8. Medical Cannabis Culitvation, Chapter 1. Medical Cannabis Cultivation Program. p 21-22.

CFAM
MANAGEMENT GROUP, INC.

The second reason would be for storage of harvested cannabis for sale in the future. There are methods for packaging and storing cannabis so that it is preserved for sale in the future, and it is a practice within the industry for some cultivators in certain circumstances. Much like a building for conducting processing activities, not every cultivator will have the luxury of having a storage facility on site. This is another potential reason cannabis would be removed from a cultivation site for a non-sale purpose.

As cultivators, we want to ensure we are not taxed for activities where cannabis is removed from our premises for a reason other than a sale of the material. We suggest the CDTFA uses these examples to create exceptions to RTC Section 34012(j). If you have any questions on these comments please contact me at charlie@cfammanagement.com.

Sincerely,

Charlie Ngo
Corporate Secretary
CFAM Management Group, Inc.

FLOW KANA

Ms. Trista Gonzalez, Chief
California Department of Tax and Fee Administration
Tax Policy Division (MIC 92)
450 N Street
Sacramento, CA 94279-0092

VIA: Email: Trista.gonzalez@cdtfa.ca.gov

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you for providing Flow Kana with the opportunity to submit comments on behalf of the ourselves and the hundred-plus cannabis farmers we are contracted with. Our submission today is made in response to the Discussion Paper issued on July 21, 2017, and the interested parties meeting held on August 2, 2017.

Flow Kana is a state-wide distributor of sustainable, sun-grown cannabis grown by small farmers in two of California's most well-known cannabis counties. We partner with, and give scale to the artisan farmers of Mendocino County and Southern Humboldt who are responsible for CA's world-renowned cannabis quality.

At Flow Kana, we believe strongly that small farmers are the backbone of the California cannabis industry. Over the past century these skilled cultivators have worked in partnership with the land and the environment to develop the finest cannabis products in the world. We are proud to have existing contracts with about 100 farms and expect hundreds more as the California market structure becomes hospitable.

In the buildup to CA's adult use market, Flow Kana is one of the few to provide a scalable platform that allows the small farmer to distribute their product statewide, compete with big cannabis agri-business, and keep the value they create within their local communities. Just as a small coffee farmer grows beans all year round and takes them to a centralized facility to get dried, roasted, processed and packaged at scale, Flow Kana's 80-acre, 85,000-industrial-square-foot Flow Cannabis Institute just north of Ukiah provides a centralized location for independent cannabis farmers to test, dry, cure, trim, process, package, manufacture and distribute farm products cost effectively, and at massive scale.

Summary

Our comments to the CDTFA's Discussion paper and proposed implementation for cannabis taxation are based on our interest in the success of the small farmer. Taxation was a part of the deal we welcomed to end prohibition in California. We believe it can be done in a way that minimizes cost, complexity and consequences for those willing to be a part of this plant's transition into a mainstream regulated product. Flow Kana greatly appreciates the extension of time granted by CDTFA for this comment period.

The CDTFA proposal in its current state is not workable for the small farmers who are the most responsible for the emergence of this new industry in CA. We at Flow Kana greatly hope that as a voice for the farmers we have executed contracts with, and for the over 50,000 other small farmers in

existence in the Emerald Triangle, those at CDTFA will welcome our comments and seek additional conversations so that together we can design a taxation regime that is workable for the rural farmer.

Overall, we feel that the CDTFA proposal is overly complicated, results in more effort than is necessary, and tends to treat participants in this industry as "guilty until proven innocent". Many of the issues we find with the way CDTFA proposes to implement the cultivation tax can be overcome by relying on the state's track and trace program to enforce payment for product in the commercial market. We also believe that most of the issues we find with the excise tax can be solved by asking licensed retailers to apply a 15% tax to each purchase, regardless of discount, mark up, or wholesale cost. Lastly, we encourage CDTFA to anticipate "good actors" and not "bad actors". The bad actors are those who prefer the black market and choose not to engage with the regulated industry. It is the good actors who are willingly engaging in this process, investing in compliance, and are planning to remit taxes for commercial products.

We understand that some portions of the taxation structure proposed are statutory and cannot be amended through regulation. We commit to working with CDTFA to craft the most workable structure possible, and request CDTFA to adopt use of modern technology and respect the challenges faced by distance, infrastructure, and the financial abilities of rural farmers.

Cultivation Tax

a. Tax Collection/Enters the Commercial Market

The CDTFA proposal to apply the cultivation tax prior to passage of lab testing is simply untenable. The state's track and trace program will carefully identify all volume from harvest to retail sale and can better identify whether the cultivation tax has been paid or not. Applying the cultivation tax prior to lab testing creates a significant and perhaps unresolvable challenge for the cultivator and the distributor: disagreement over who bears responsibility for taxes on cannabis that will potentially be rejected due to failure to pass. This "cart before the horse" situation creates a bizarre need for unnecessary and complicated accounting for over-payment of the cultivation tax. The result will be friction between business partners and between the regulated community and CDTFA.

Recommendation: CDTFA should rely on the state's track and trace program to track and enforce the cultivation tax. Rather than applying at point of cultivation Flow Kana instead recommends CDTFA apply the cultivation tax prior to a distributor selling packaged cannabis or cannabis products to a retailer. In this way, only cannabis that is clean and has passed lab testing is taxed and only cannabis that has been sold and in the commercial market is taxed. With full transparency as to where every ounce of harvested cannabis is in the supply chain, it should be simple to also identify that cultivation taxes have been paid before it is transferred to a licensed retailer.

b. Presumption – Removal from Cultivators Premises

Flow Kana appreciates CDTFA's invitation to offer justification for moving product off cultivation sites other than for a sale. In the Emerald Triangle of California where the majority of the historical outdoor (or "sun grown") cannabis comes from, thousands of cannabis farmers have purposefully located themselves down many miles of dirt roads in difficult locations to access. Here, licensed cultivators without processing or packaging licenses must bring their harvested cannabis to a centralized

processing facility for grading, sorting, packaging, storing, and eventual distribution into the California adult use or medical market.

Prior to transfer of ownership from the cultivator to the distributor the product must first pass state-mandated laboratory tests for health and safety. Flow Kana currently has contracts with over 100 farms in the Emerald Triangle region and expects hundreds more as the market matures. Product that arrives at our centralized processing/packaging/storage/distribution facility near Ukiah is stored during lab testing and only after passing lab tests will it be bought, processed, and packaged.

Flow Kana recommendation: Transport of cannabis from a licensed cultivator to a licensed Manufacturer or Distributor must be done legally, via a licensed Distributor or other state-authorized manner. However, CDTFA should not be concerned with movement or sale of harvested cannabis to so long as the cultivation tax is paid prior to a licensed Distributor's sale of packaged cannabis or cannabis products to a licensed Retailer. As recommended above, CDTFA should rely on the state's track and trace program rather than inject artificial taxation points based on one-size-fits-all physical status.

c. Cultivation Tax Rate

Dry weight taxation:

In a vertically integrated supply chain the company has the ability to dry harvested cannabis on site, prior to the point of taxation. However, in a virtual vertically integrated supply chain like that which Flow Kana is creating and which is necessary for the thousands of individual farmers in the Emerald Triangle this is much more difficult. In most cases the cultivator can earn more revenue when product is harvested and immediately brought to a centralized processing facility where it can be dried under perfect conditions and then sorted, graded, packaged, and stored for distribution.

Because numerous situations exist where cannabis is used prior to it being dried it will be critical that a taxation rate for wet cannabis be created. This is an imperfect solution because it may invite a point of comparison regarding whether taxation would be greater or lesser if a given harvest is taxed while wet or once dry.

Flow Kana recommendation: CDTFA should create a tax rate for wet cannabis that is approximately 1/10th the rate/pound for current dry weight tax rates.

$9.25/ounce of flower:

Flow Kana understands that the cultivation tax rate is set in statute and that the CDTFA can only consider modifying it in the year 2020. However, we will take this opportunity to stress to the CDTFA that the cultivation tax and the excise tax are not the only points of taxation for this product. Each county or local jurisdiction with a Cannabis Business Ordinance is also applying some sort of gross receipts tax such that the state risks not providing a good or attractive standard of living for smaller licensed cultivators or other licensed small businesses along the supply chain.

Indicia for Cultivation Tax Paid:

A tax stamp or special bag is a totally unnecessary step in enforcing taxation that will undoubtedly disrupt intrastate commerce. The CDTFA Discussion paper identifies that CDTFA will verify tax payment with use of the product's unique identifier as assigned for track and trace purposes. We live in a digital society where all forms of commerce can be tracked and the status of each batch recorded digitally and known universally. Cannabis is no different and it should not be treated differently.

Flow Kana recommends: The CDTFA should use the unique identifier associated with the state's track and trace program to track, verify, and enforce the cultivation tax and not require the use of a tax stamp or bag or other physical indicia.

Excise Tax

Average Market Price:

The excise tax process is overly complicated and as a result will add cost and confusion to an already fragile system. The process as described in the Discussion Paper, while being statutory, is not clearly described. Flow Kana understand the average market price will be calculated based on reported wholesale prices plus assumed mark-up plus adding back any discounts.

This proposal causes problems because the Retailer and Distributor will always haggle about who pays the tax on the "added-back discounts". This will result in a greater likelihood of improper tax remittance. This portion of the proposal should be stricken.

The average market price is a confusing term – it is really the average mark-up applied to the wholesale price. Estimating a mark-up is a bad practice for the state to employ because it in effect sets the price retailers can offer. Has the state considered whether this mark-up is assumed to be the same for all products, or will there be differentiation between the mark-up on average quality products vs. top-shelf products?

Flow Kana recommends: To solve this it is appropriate that clean-up language be included in pending legislation and to modify the approach to simply ask retailers to add 15% to their retail price and remit that amount, plus a record of the transaction including the retail price, to the Distributor for payment to the state. No disagreement between Distributor and Retailer about the right amount. Also no inadvertent price setting by the state.

Reporting and Remitting the Excise Tax:

Accuracy:

The Distributor will desire to be confident that they are remitting all of the tax required. However, the calculation of what is owed is flawed. The Distributor is not in a position to calculate whether the Retailer properly used the assumed mark-up rate and properly charged the customer 15% including added back discounts. Simpler taxation and reporting methods can be employed.

Flow Kana recommends: The Retailer could be required during the first two weeks of the 4th, 7th, 10th and 1st month to provide Distributors whom it purchased product from with clean accounting of what product in inventory was sold, at what price, and provide the 15% excise tax payment to them. This also would eliminate the need for overly complicated reporting of wholesale costs which would need to be categorized into specific metrics such as grams, units, mg of THC, doses of edibles, etc.

Frequency of tax payment:

Flow Kana believes that quarterly payment is reasonable, but that window to pay the tax and the penalty for late payment is unreasonable. A 30 day window to remit taxes to the state is unnecessarily short. Flow Kana recommends that taxes may be paid anytime before the next taxation period ends. Despite a statutory requirement that the Distributor pay at least 50% of the taxes owned

as a penalty, the CDTFA should interpret this to avoid market disruption. An increase in the penalty for late tax payment should not include increasing fines, but rather should include a potential use of a Security Deposit.

Flow Kana recommends: CDTFA should adopt a large window for payment to avoid fines. Taxes paid anytime before the next taxation period ends should be enough. CDTFA should only enforce a penalty when payment has not been made and no contact has been made by the Distributor to the state communicating the reason for late payment. If the Distributor cannot pay, for whatever reason, it should contact the state and the state should work with the Distributor on a custom payment plan.

Form of payment:

CDTFA should acknowledge that that payment of taxes in cash is both likely and acceptable. It should also use a portion of the CA Cannabis Tax Fund to either fund armored car dispatch to Distribution businesses with over $100,000 in taxes due and who use cash for payment. While fixing the cannabis industry's banking challenges may not be in scope for this rulemaking the challenges are still real and CDTFA and the state must work to limit negative ramifications from efforts to pay taxes in cash.

Miscellaneous Issues

Security Deposit:

What other industries in CA are required to pay into a tax payment security deposit? This is an example of treating the industry as "guilty until proven innocent". Of course, a security deposit is a reasonable tool that could be used for businesses that are otherwise in good standing but are challenged to pay taxes on time. However, it does not need to be a one-size fits all requirement.

Inspection:

The cannabis industry is guilty of nothing but working tirelessly to attempt to bring this industry out of the shadows. Any inspection authority provided to Police and special CDTFA staff must follow due process. There must always be the need for evidence and the possession of a warrant to enter and inspect a place of business, or the books its finances are based upon. Treating this industry as if probable cause already exists to commit tax evasion will only promote the criminal activity the state seeks to wipe out.

Thank you very much for the consideration given to these suggestions and concerns and please do not hesitate to contact me should you have any questions.

Kind regards,

Michael Wheeler

VP of Policy for Flow Kana

August 16, 2019

Trista Gonzalez
Chief
Tax Policy Bureau
Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street
Sacramento, CA 95814

RE: Comments by Golden Systems on Proposed Rulemaking with Respect to Cannabis Taxes

Dear Ms. Gonzalez:

On behalf of Golden Systems, we want to thank you for providing us the opportunity to provide comments on the Proposed Rulemaking with Respect to Cannabis Taxes.

General Overview of the Cannabis Tax Law

We believe the concept of average market price you present is flawed. The best way to address this is like the state of California does with alcoholic beverages, where there is a single wholesale market price that drives everything. The benefits of this are multi-fold:

1. Keying on the wholesale price eliminates need for continual measurement and averaging of the retail environment.
2. Having a single unified price for all customers in a given market enables the monthly publication of this price to the entire supply chain, which promotes transparency. It also provides structure for the industry and helps less sophisticated players understand the market they exist in.
3. The wholesale price is much harder to manipulate, given its routine use by all players.
4. It would be unreasonable to expect all retailers to have the same mark-up, and vast differences will appear in the same market. The wholesale price for products, however, will be fairly constant, as distributors will likely have exclusive rights to given products in specific markets.

Collection and Remittance of the Cannabis Excise Tax

In an arm's length transaction, smart distributors will try to collect taxes from retailers during the initial purchase transaction. This saves a transaction step and makes the industry more efficient. Retailers will likely only push back until they convince distributors to give them credit terms.

We believe sophisticated distributors are likely to avoid non-arm's length transactions. For example, we would specifically avoid producer customers who do not sell us product but instead want us to provide

transportation, tax payment, and testing services. Perhaps there will be businesses set up to do only these things, but we believe this is not likely.

Sales and Use Tax Exemption

It is not clear what is a qualified patient? How is this different from someone who gets a doctor's recommendation? How do you intend to prevent retailers from violating the law?

Cultivation Tax Rate

There are two basic products in the cannabis industry: flower and concentrate. The tax program should mirror this by assigning an excise tax to each of these basic products, not the trim. The tax on flower is set. The tax on concentrate should come from determining how much trim is needed to create a fluid ounce of concentrate and multiplying this by the $2.75 per dry ounce trim tax.

Collection and Remittance of the Cultivation Tax

In the first paragraph, you state, "A distributor shall collect the cultivation tax from a cultivator upon entry into the commercial market, ..." When a cultivator sells his or her product to another licensee (manufacturer) is this considered entry into the commercial market? We believe this is the point of entry into the marketplace. If you concur, then then it is the distributor who transports the product from one licensee to another.

The first paragraph goes on to state, ". . . unless a cultivator is not required to send, and does not send, the harvested cannabis to a distributor. We view this as confusing. We ask that the Department please explain when a cultivator is not required to send cannabis to a distributor. The only scenario where a cultivator can bypass a distributor is one where the cultivator and the retailer cohabitate. In such a situation, who is responsible for testing and tax payment?

The beginning of the second paragraph states, "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."

If the tax is assessed on the amount of concentrate created from trim, then the tax becomes a raw materials cost that is passed through the system. Thus, the manufacturer will include this in his or her cost when he or she prices the finished concentrate, as will the cultivator when he or she prices the trim to the manufacturer.

Alternative Methods for Collection and Remittance

We recommend the CDTFA should use this paragraph's latitude to simplify the tax collection system. Like alcoholic beverages, only distributors should be allowed to collect taxes. Loopholes provide ways for taxes to be skirted. We, therefore, recommend the Department to close all of loopholes by eliminating all of the impractical situations where other supply chain actors are given tasks that they are ill-suited for.

Debt to the State

Given the complication of non-taxable medical products, plus the challenge of collecting taxes for the first time in an industry unused to paying them, distributors should have 90 days from the due date of the tax to remit this tax. This will also provide more time to deal with the conversion of currency from cash into electronic payment.

Inspections

We believe these inspections could likely become the primary tool in the effort to shut down unlicensed retail stores.

Rulemaking

You state, "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." We recommend CDTFA seek to adopt regulations to help distributors deal with the cash payment issue, such as payment in arrears.

Definitions

You state, "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."

Since ~50% of the retail dollars in the industry come from concentrates, we recommend the CDTFA take time to develop a definition of concentrates. This issue is only briefly discussed in the document.

Average Market Price

You state, "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."

We concur. We recommend you define wholesale costs and begin a monthly periodical where these prices are published for every licensed manufacturer in each defined market. This will instantly serve to organize the industry and will likely garner support from distributors.

You further state, "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."

While BPC Section 26110 (h) describes a legal situation, it is not a practical one. The only way a producer can sell a product directly to a retailer is if he or she finds a distributor willing only to serve as a transporter, a taxpayer, and a test chaperone. As we commented above, this is an unattractive, low-margin business that is unfinanceable for an industry at this stage and therefore, not likely to occur. By regulating the way taxes are paid, the CDTFA can render this impractical situation moot.

You go on to state, "As noted, the other input in calculating the average market price for arm's length transactions, is a CDTFA determined mark-up."

Nearly all of the challenging tax questions revolve around situations where distributors are taken out of the system. It should be clear that a paramount job that distributors undertake in the system are collecting and paying taxes. Distributors will build their companies with this in mind and will work to ensure they are successful in doing so. As such, we recommend the CDTFA adopt regulations that reduce to zero the ways to avoid going through a distributor in order to promote the orderly payment of taxes.

Reporting and Remitting the Excise Tax

You state, "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."

We recommend the regulations require distributors pay taxes on a set date each quarter. We further recommend distributors pay all of the taxes whose retail transactions occurred in the previous quarter, not the current quarter.

You go on to state, "Likewise, it not entirely clear when a distributor would report the tax in a non-arm's length transaction."

If all taxes must be paid by a distributor, and if distributors must take possession of the product (vs. merely being transporters, taxpayers, and test chaperones), then there is only one non-arm's length transaction possible. It comes from a vertically integrated supply chain where the same company is the producer, the distributor, and the retailer.

Other Cultivation Categories and Tax Rates

You state, "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."

However, if the trim category is changed to concentrates, then all possible scenarios have been accounted for.

Marijuana is either sold in raw form or it is processed and sold in concentrated form. We recommend the two tax categories reflect the two product categories.

Cultivation Tax Collection / Enters the Commercial Market

You state, "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."

We recommend the CDTFA eliminate exceptions in order to ensure all product are tested and taxed. The distributors act as industry gatekeepers, and allowing them to be skirted will cause havoc to the system.

You go on to state, "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."

If all product must be purchased by a distributor, and the two categories of taxation become flower and concentrate then here is the answer to the highlighted quandary.

Further, entry into the commercial market never changes. It is always when the product is sold to the distributor. For the time when untested product can enter the system, it would be treated and taxed like all other products in the distributor's warehouse but labeled as "untested".

We want to again thank you for providing us the opportunity to provide comments on the Proposed Rulemaking with Respect to Cannabis Taxes. We look forward to continuing to work with the Department in developing a successful system to collect cannabis taxes.

Sincerely,

Eric Spitz
Golden Systems LLC

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street, Sacramento, CA

Subject: Proposed Rulemaking with Respect to Cannabis Taxes

Dear Ms. Gonzalez,

I am writing on behalf of the California Cannabis Courier Association (CCCA) to comment on the discussion document containing the proposed rulemaking with respect cannabis taxes. The CCCA is a coalition of cannabis delivery companies from across the state that advocate for safe, responsible, and common-sense policies.

The CCCA would like to thank CDTFA leadership and staff for working on this important issue. We recognize cannabis policy is complex and quickly-changing, and we hope that you will consider us a resource as you work through proposed tax regulations.

Overall, the level of taxation of the cannabis industry will be a burden beyond what other industries face. For example, a cannabis retail business in the City of Sacramento will pay 4% of gross receipts toward a city tax, 1% of gross receipts toward a neighborhood responsibility plan, as well as other sales and use taxes. This will be coupled with the state excise tax of 15% of the average market price of retail sale, and if the company also holds a cultivation license, a $9.25 per dry weight ounce cultivation tax. This will be in addition to the between $15,000 to $30,000 business operating permit fee, with an additional $13,000 to $27,000 yearly renewal fee. All of this to say, margins become increasingly small for these businesses, especially when staff, building space, insurance, and other operating costs are factored in. We wanted to provide this as context to our opposition of CDTFA's proposed fee structure for late penalties.

RTC section 34013(e) states that any licensee who fails to pay the cannabis excise or cultivation taxes, 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. According to the CDTFA's discussion document, staff proposes that the CDFA "may impose penalties of varying amounts provided that they are at least one-half of the taxes not paid…penalty amounts of 50, 60, and 75 percent". During the stakeholder meeting, the CCCA's representation asked about the rationale behind this proposal, and whether or not there is a precedent for penalties of this magnitude in any other industry. Staff responded that the proposal is solely based on the interpretation of the words "at least" in statute, and that there was not another industry that they could think of with fees of this magnitude.

We feel the presence of the words "at least" in statute provides insufficient reason to justify the mark up of late penalties, particularly when fees of that magnitude appear to be unprecedented. We are strictly opposed to a fee structure that will further impede small businesses in an industry that is already disproportionately affected by taxes and fees. We hope the CDTFA will remove this recommendation and rely only on the language provided in statute.

Sincerely,

Macai Polansky, Vice President
California Cannabis Courier Association (CCCA)

MUNISERVICES
Discover. Recover. Prosper.

Government Relations Office
1400 K Street, Suite 301
Sacramento, CA 95814

August 8, 2017

Ms. Trista Gonzalez, Chief
Tax Policy Bureau, Business Tax Fee Division
California Department of Tax and Fee Administration
450 N Street, PO Box 942879
Sacramento, CA 94279-0092

Subject: *MuniServices' Comments Regarding Proposed Emergency Regulations - Cannabis Taxes*

Dear Ms. Gonzalez,

MuniServices appreciates the opportunity to provide comments in response to the July 21, 2017 Discussion Paper and August 2, 2017 interested parties meeting on proposed regulations with respect to cannabis taxes. Representatives from MuniServices attended the in-person meeting and appreciates the clarity provided by Staff.

Request for Clarification on the Tax Exemption Determination for Holders of Medical Marijuana Cards

An area of concern for MuniServices and its local government clients is with the respect to the determination that sales of medical cannabis to those who have a medical marijuana identification card are exempt from sales and use taxes.

Background

The plain reading of the Sales and Use Tax exemption language in Proposition 64 and subsequently in SB 94, clearly provides for a partial exemption for medical cannabis that only applies to several components of the State portion of the Sales and Use Tax. Local and District Sales and Use Taxes should continue to apply to sales of medical cannabis. Because SB 94 did not include clarification language, it appears that the intent of Proposition 64 was to only to provide a State level exemption on sales of medical cannabis.

Proposition 64 (2016) Control, Regulate and Tax Adult Use of Marijuana Act (the Adult Use of Marijuana Act)

Revenue and Taxation Code (RTC) Section 34011 (g) [page 42]: "The sales and use tax imposed by Part 1 of this division shall not apply to retail sales of medical cannabis, medical cannabis concentrate, edible medical cannabis products or topical cannabis as those terms are defined in Chapter 3.5 of Division 8 of the Business and Professions Code when a qualified patient (or primary caregiver for a qualified patient) provides his or her card issued under Section 11362.71 of the Health and Safety Code and valid government-issued identification card."

Senate Bill 94 (Chapter 27, Statutes of 2017) Cannabis: Medicinal and Adult Use

Sec. 163. RTC Section 34011 (f): "The sales and use taxes imposed by Part 1 (commencing with Section 6001) shall not apply to retail sales of medicinal cannabis, medicinal cannabis concentrate, edible medicinal cannabis products, or topical cannabis as those terms are defined in Division 10 (commencing with Section 26000) of the Business and Professions Code when a qualified patient or primary caregiver for a qualified patient provides his or her card issued under Section 11362.71 of the Health and Safety Code and a valid government-issued identification card." In a News Release dated November 17, 2016, the BOE provides that the exemption from all Sales and Use Tax. (https://www.boe.ca.gov/news/2016/92-16-G.htm)

Part 1 of the RTC references Sales and Use Taxes sections 6001-7176; Part 1.5 of the RTC references Uniform Local Sales and Use Taxes (Bradley-Burns) sections 7200-7226; and Part 1.6 of the RTC references Transactions and Use Taxes (District) sections 7251-7279.6

The following is detailed description of the Sales and Use Tax rate from the CDTFA website. The highlighted taxes are imposed by RTC Part 1 (Sections 6001-7176). The taxes imposed by the State Constitution and under Part 1.5 (Bradley-Burns) would not be subject to the exemption. Additionally, taxes imposed under Part 1.6 (District) would also not be subject to the exemption. Accordingly, it appears that the exemption provided in Proposition 64 would be a partial exemption that would only impact the tax components (highlighted in blue) below.

Rate	Jurisdiction	Purpose	Authority
3.6875%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051, 6201
0.25%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051.3, 6201.3 (Inoperative 1/1/01 – 12/31/01)
0.50%	State	Goes to Local Public Safety Fund to support local criminal justice activities (1993)	Section 35, Article XIII, State Constitution
0.50%	State	Goes to Local Revenue Fund to support local health and social services programs (1991 Realignment)	Revenue and Taxation Code Sections 6051.2, 6201.2
1.0625%	State	Goes to Local Revenue Fund 2011	Revenue and Taxation Code Sections 6051.15 and 6201.15
1.25%	Local	0.25% Goes to county transportation funds 1.00% Goes to city or county operations	Revenue and Taxation Code Section 7203.1 (Operative 7/1/04)
7.25%	**State/Local**	**Total Statewide Base Sales and Use Tax Rate**	

The current determination, significantly reduces the tax revenue previously received by local jurisdictions on the sale of medical cannabis. MuniServices respectfully requests clarification and basis for the determination.

MuniServices looks forward to the continued collaboration with the CDTFA on the development of regulations with respect to cannabis taxes. Please contact Larry Bergkamp at Larry.Bergkamp@MuniServices.com or 530.301.2564 if you have specific technical questions regarding MuniServices' comments and request.

Respectfully,

Brenda Narayan

Brenda Narayan, Director of Government Relations
916.261.5147 or brenda.narayan@muniservices.com

August 25, 2017

Trista Gonzalez
Chief, Tax Policy Bureau Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street
Sacramento, CA 942879-0092

Re: Cannabis Tax Regulations Discussion Paper

Dear Tax Policy Bureau Chief Gonzalez:

On behalf of the United Cannabis Business Alliance Trade Association (UCBA), we respectfully are submitting comments in response to the Cannabis Discussion Paper on proposed emergency tax regulations that has been distributed by the California Department of Tax and Fee Administration (CDTFA).

UCBA represents Measure D compliant cannabis businesses in the City of Los Angeles that strive to provide the highest quality medicine to their patients and to raise awareness about the medical cannabis industry and its benefits. Many of the members of UCBA are also engaged in commercial cannabis activity in other parts of the State of California. UCBA brings together the pioneers of this constantly evolving industry to serve as a voice for this often-misrepresented trade through advocacy, education, and innovation.

UCBA has the following concerns and clarifying questions on the cannabis discussion paper:

- Retailers or cultivators should be able to pay their own excise taxes to CDTFA. CDTFA should not be concerned about retailers not paying their excise taxes since currently they pay sales taxes directly. Requiring retailers to pay a distributor would create an unnecessary requirement, increase the amount of paperwork associated with each payment, and increase the number of individuals who have access to the funds that will likely be in the form of cash.
- As far as the average market price definition, will there be a distinction in strains and will the average market price vary depending on the type of cannabis sold?
- On purchaser's liability, the discussion paper insinuates that patients/members may be liable for the excise tax unless they have a copy of a receipt/invoice. Does CDTFA plan on extending liability to individual members? This is a problem with medicinal licensees since they can't disclose patient information to the CDTFA.
- This entire structure where cultivator has to remit taxes to the manufacturer and the manufacturer to distributor is extremely convoluted which needs to be clarified to avoid

confusion and make compliance easy.

- The BOE/CDTFA Compliance Policy and Procedure Manual states that security deposits are not required from taxpayers applying for a permit with BOE unless security is mandated by law. The state is already requiring a surety bond as part of the application process. Accordingly, requiring additional security is unreasonable, excessive, and can really delay a distributor, manufacturer, and cultivator from starting operations.
- Are supplemental reports discretionary? How does the CDTFA determine who has to file these reports?
- CDTFA's penalties are excessive. A first violation should not result in license revocation. First violation should be a monetary penalty, second should be suspension, and third can be revocation. The cannabis industry should be regulated like any other business and not penalized excessively. Most penalties for businesses today are 10% therefore setting penalties higher than that is excessive.
- The false/fraudulent report language should be clarified to exclude errors, mistakes etc.
- UCBA supports inspections to determine compliance; the current discussion papers states that inspections can be done once every 24-hour period. There should be a limit to how many consecutive inspections can be conducted.
- The "seizure of cannabis products" upon discovery that a licensee is not paying taxes or using secure packaging language is a concern in that it contemplates seizure without due process. There has to be some sort a proceeding and a finding of failure to pay taxes before the CDTFA ora law enforcement agency can seize the cannabis or cannabis products. Forfeiture is an extreme remedy that will cripple the licensee's ability to pay taxes.

We respectfully request that you address our concerns. For any questions please contact Marvin F. Pineda at 916-446-7843.

Sincerely,

Marvin F. Pineda
Legislative Advocate
Capitol Strategies Group