



## CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

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EDMUND G. BROWN JR.  
Governor

MARYBEL BATJER  
Secretary, Government Operations Agency

NICOLAS MADUROS  
Director

July 20, 2018

Dear Interested Party:

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

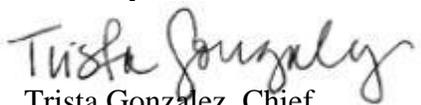
**August 2, 2018**  
**Room 122 at 10:00 a.m.**  
**450 N Street, Sacramento, CA**

If you would like to participate by teleconference, call 1-888-822-7517 and enter access code 5038418. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at [Trista.Gonzalez@cdtfa.ca.gov](mailto:Trista.Gonzalez@cdtfa.ca.gov) by August 17, 2018. You should submit written comments including proposed language if you have suggestions you would like considered during this process. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

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

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

Sincerely,

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

TG:rsw

Enclosures

cc: (all with enclosures)

Mr. Nicolas Maduros (MIC 104)  
Ms. Katie Hagen (MIC 104)  
Mr. Tad Egawa (MIC 83)  
Ms. Susanne Buehler (MIC 43)  
Ms. Michele Pielsticker (MIC 105)  
Mr. Jason Mallet (MIC 25)  
Mr. Wayne Mashihara (MIC 47)  
Mr. Todd Gilman (MIC 70)  
Mr. Randy Silva (MIC 100)  
Mr. James Dahlen (MIC 57)  
Ms. Debra Kalfsbeek (MIC 62)  
Mr. Kevin Hanks (MIC 49)  
Mr. Damon Nelson (MIC 67)  
Mr. Robert Tucker (MIC 82)  
Mr. Jeff Vest (MIC 85)  
Mr. Bradley Heller (MIC 82)  
Mr. Jeff Angeja (MIC 85)  
Mr. David Levine (MIC 85)  
Ms. Dana Brown (MIC 85)  
Ms. Casey Tichy (MIC 85)  
Mr. Rick Zellmer (MIC 85)  
Ms. Monica Silva (MIC 82)  
Mr. Stephen Smith (MIC 82)  
Ms. Lisa Sherrod (MIC31)  
Ms. Sandy Barrow (MIC 31)  
Ms. Kirsten Stark (MIC 50)  
Ms. Lynn Whitaker (MIC 50)  
Mr. Joe Fitz (MIC 67)  
Mr. Marc Alviso (MIC 104)  
Ms. Karina Magana (MIC 47)  
Mr. Bradley Miller (MIC 92)  
Mr. Alfred Buck (MIC 70)  
Ms. Jennifer Hawkins (MIC 31)  
Ms. Tracie West (MIC 31)  
Ms. Vania Skikos (MIC 31)  
Mr. Robert Prasad (MIC 50)  
Mr. Robert Wilke (MIC 50)

# DISCUSSION PAPER

## Proposed Rulemaking with Respect to Cannabis Taxes

### Issue

Whether the California Department of Tax and Fee Administration (CDTFA) should amend and permanently adopt Cannabis Tax Regulation 3700, *Cannabis Excise and Cultivation Taxes*; permanently adopt Cannabis Tax Regulation 3701, *Collection and Remittance of the Cannabis Excise Tax*; and adopt Cannabis Tax Regulation 3702, *California Cannabis Track-and-Trace*, as an emergency regulation.

### 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 (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). 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.

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 amended Part 14.5 to ease and streamline cannabis tax collection and remittance to the CDTFA. As relevant here, SB 94: (1) changes the law throughout to be the Cannabis Tax Law (CTL) instead of Marijuana Tax Law; (2) revises the cannabis excise tax to be imposed upon purchasers at a rate of 15 percent of the average market price, instead of retail selling price, to be collected by a distributor from a cannabis retailer; (3) requires a distributor or a manufacturer to collect the cultivation tax from a cultivator, and a manufacturer to remit any cultivation tax collected from a cultivator to a distributor, for distributor remittance of those taxes to the CDTFA; and (4) makes other 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

# DISCUSSION PAPER

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on the purchase invoice that the cannabis cultivation tax is included in the total amount of the invoice; and authorize the CDTFA 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 CDTFA to relieve a person of the penalty for failure to pay the cannabis cultivation and excise tax if the CDTFA 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.

### General Overview<sup>1</sup> of the Cannabis Tax Law

#### Definitions

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

“Arm’s length transaction” shall mean a sale entered into in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction.

“Average market price” shall mean:

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

“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.

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<sup>1</sup> In many instances, the statutes provide that the CDTFA has the authority to, or “may” prescribe certain actions or rules. In this section, the use of the word “may” was used as specified by the text of the statute. It is not necessarily indicative that the CDTFA is planning to, or will take such action.

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

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

“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 complete and comply with a quality assurance review 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

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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. 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 CDTFA 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 CDTFA 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 CDTFA.

#### *Receipts from Distributors*

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

#### Sales and Use Tax Exemption

On and after November 9, 2016, 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.

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### 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 once 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 CDTFA may adjust the tax rate for cannabis leaves annually to reflect fluctuations in the relative price of cannabis flowers to cannabis leaves.

The CDTFA may from time to time establish other categories of harvested cannabis, categories for unprocessed or frozen cannabis or immature plants, or cannabis that is shipped directly to manufacturers. These categories shall be taxed at their relative value compared with cannabis flowers. Regulation 3700 established a category for fresh cannabis plant which is subject to a tax rate of one dollar and twenty-nine cents per ounce.

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

#### *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

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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 CDTFA 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; the associated unique identifier of the cannabis; the amount of cultivation tax; and any other information deemed necessary by the CDTFA. The CDTFA may authorize other forms of documentation.

#### *Debt to the State*

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

#### *Excess Tax Collected*

A distributor or manufacturer that has collected any amount of tax in excess of the amount of tax imposed by the CTL and actually due from a cultivator or cannabis retailer, may refund such amount to the cultivator or cannabis retailer, even though such tax amount has already been paid to the CDTFA and no corresponding credit or refund has yet been secured. The distributor 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 CDTFA 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 CDTFA may adopt regulations prescribing procedures for the refund of cultivation tax collected on cannabis or cannabis product that fails quality assurance, inspection, and testing as described in Section 26110 of the BPC.

#### *Indicia for Cultivation Tax Paid*

The CDTFA may prescribe by regulation a method and manner for payment of the cultivation tax that utilizes tax stamps and/or state-issued product bags that indicate that all required tax has been paid on the product to which the tax stamp is affixed or in which the cannabis is packaged.

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If the CDTFA utilizes tax stamps, the tax stamps and product bags shall be of the designs, specifications, and denominations as may be prescribed by the CDTFA and may be purchased by any licensee under Division 10 (commencing with Section 26000) of the BPC. Furthermore, the tax stamps and product bags shall be capable of being read by a scanning or similar device and must be traceable utilizing a track and trace system pursuant to Section 26068 of the BPC. Subsequent to the establishment of a tax stamp program, the CDTFA may by regulation provide that cannabis shall not be removed from a licensed cultivation facility or transported on a public highway unless in a state-issued product bag bearing a tax stamp in the proper denomination.

#### Administration

##### *Permits*

All distributors must obtain a cannabis tax permit from the CDTFA pursuant to regulations adopted by the CDTFA. No fee shall be charged to any person for issuance of the permit. Any person required to obtain a permit who engages in business as a distributor without a permit or after a permit has been canceled, suspended, or revoked, and each officer of any corporation which so engages in business, is guilty of a misdemeanor.

##### *Security Deposit*

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

The CDTFA may waive any security requirement it imposes for good cause, as determined by the CDTFA. "Good cause" includes, but is not limited to, the inability of a distributor, retailer, cultivator, microbusiness, nonprofit, or other person required to be licensed to obtain security due to a lack of service providers or the policies of service providers that prohibit service to a cannabis business. A person may not commence or continue any business or operation relating to cannabis cultivation until any surety required by the CDTFA with respect to the business or operation has been properly prepared, executed and submitted. In fixing the amount of any security required by the CDTFA, the CDTFA shall give consideration to the financial hardship that may be imposed on licensees as a result of any shortage of available surety providers.

##### *Reporting*

The cannabis excise tax and cultivation tax is due and payable to the CDTFA quarterly on or before the last day of the month following each quarterly period of three months. A return for the preceding quarterly period shall be filed with the CDTFA by each distributor using electronic media by the last day of the month following each quarterly period. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the CDTFA.

##### *Alternate Reporting*

Existing law authorizes the payment of the amount due and the filing of returns for periods other than the period or periods specified in the tax and fee laws administered under the Fee Collections Procedure Law (FCPL) (commencing with RTC section 55001). In addition, the

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CTL authorizes the CDTFA to adopt regulations prescribing the due date for returns and remittances of the cannabis excise tax collected by a distributor in an arm's length transaction. If the cultivation tax is paid by stamp pursuant to RTC subsection 34012(d) the CDTFA may, by regulation, determine when and how the tax shall be paid.

#### *Supplemental Reports*

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

If the CDTFA 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 CDTFA a statement, under penalty of perjury, setting forth the facts upon which he or she bases his or her claim for relief. The CDTFA shall establish criteria that provide for efficient resolution of requests for relief.

#### *Inspections*

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

Any person who fails or refuses to allow an inspection shall be guilty of a misdemeanor. Each offense shall be punished by a fine not to exceed five thousand dollars (\$5,000), or imprisonment

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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.

The CDTFA or a law enforcement agency are authorized to seize cannabis or cannabis products when there is no evidence of tax payment or when the cannabis is not securely packaged. Any cannabis or cannabis products seized by a law enforcement agency or the CDTFA shall, within seven days, be deemed forfeited. The CDTFA shall comply with the procedures set forth in RTC sections 30436 through 30449 with respect to the seizure, forfeiture, release or recovery of the cannabis or cannabis products.

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

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

#### *Deposit of Funds*

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

The revenues in the California Cannabis Tax Fund will fund: \$10 million grant for a public university to research and evaluate the implementation and effects of 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 CDTFA, Department of Consumer Affairs, CDFA, CDPH, Department of Fish and Wildlife, Department of Water Resources, Department of Pesticide Regulation, Controller, Department of Finance, Legislative Analyst's Office, and the Divisions of Labor Standards and Enforcement and Occupational Safety and Health within the Department of Industrial Relations for reasonable costs.

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

#### **General Overview of Track and Trace**

The CDFA, in consultation with the Bureau, is required to establish a track and trace program for reporting the movement of cannabis and cannabis products throughout the distribution chain that utilizes a unique identifier, secure packaging, and is capable of providing information that captures, at a minimum, all of the following: the licensee receiving the product; the transaction

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date; and the cultivator from which the product originates, the associated unique identifier of the cannabis pursuant to section 26069 of the BPC.

The CDFA, in consultation with the CDTFA is also required to create an electronic database containing the electronic shipping manifests to facilitate the administration of the track and trace program, which shall include, but not be limited to, the following information: the variety and quantity or weight of products shipped; the estimated times of departure and arrival; the variety and quantity or weight of products received; the actual time of departure and arrival; a categorization of the product; and the license number and the unique identifier pursuant to section 26069 of the BPC issued by the licensing authority for all licensees involved in the shipping process, including, but not limited to, cultivators, manufacturers, distributors, and dispensaries.

The CDFA, in consultation with the Bureau, and the CDTFA, must ensure that the track and trace program can also track and trace the amount of the cultivation tax due pursuant to Part 14.5 (commencing with section 34010) of Division 2 of the RTC. The track and trace program shall include an electronic seed to sale software tracking system with data points for the different stages of commercial activity, including, but not limited to, cultivation, harvest, processing, distribution, inventory, and sale.

The California Cannabis Track-and-Trace (CCTT) system is the program used statewide to record the inventory and movement of cannabis and cannabis products through the commercial cannabis supply chain from cultivation to sale. The state's contracted service provider for the CCTT system is the technology company Franwell, Inc., and they are using the METRC software program. The same program is currently used in Colorado, Oregon, Alaska, and Nevada for their cannabis programs.

All state-issued annual cannabis licenses are required to use the CCTT-METRC system to record, track, and maintain information about their cannabis and cannabis-product inventories and activities. Temporary cannabis licensees are not required to use the system, nor will they be provided access to it. Instead, the State's emergency regulations require temporary licensees to document all sales and transfers of cannabis and cannabis products between temporary licensees, or between temporary licensees and annual licensees, by manually using paper sales invoices or shipping manifests. Until January 1, 2019, a licensing authority may, in its sole discretion, issue a temporary license. The temporary license shall be valid for a period of 120 days and may be extended for additional 90-day periods at the discretion of the licensing authority.

The Bureau is to have 24-hour access to the electronic database administered by the CDFA. The CDTFA is to have read-access to the electronic database for the purpose of taxation and regulation of cannabis and cannabis products.

#### **Discussion**

##### *Authority for Rulemaking*

The CTL provides that the collection and administration of both the cannabis excise tax and the cultivation tax shall be in accordance with the FCPL. The CTL also authorizes the CDTFA to

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

CDTFA staff held an interested parties meeting on August 2, 2017, to discuss rulemaking to interpret, clarify, and make specific the CTL. Following the interested parties meeting the CDTFA promulgated two Cannabis Tax Regulations (Regulations 3700 and 3701) through the emergency rulemaking process, as further discussed below.

#### Current Cannabis Tax Regulations

##### *Regulation 3700*

Cannabis Tax Regulation 3700, *Cannabis Excise and Cultivation Taxes*, was promulgated as an emergency regulation pursuant to Government Code (GC) section 11346.1 to ensure that essential guidance was available to the cannabis industry when the CTL became operative on January 1, 2018. Regulation 3700 was approved by the OAL, filed with the Secretary of State and effective on December 21, 2017. The regulation, amongst other things, defines or further defines key terms, including cannabis flowers; establishes a new category and rate for fresh cannabis plant with respect to the cultivation tax; and specifies that the penalty imposed under RTC section 34013(e) is mandatory and is 50 percent of the amount of the unpaid cannabis excise or cultivation tax. As further explained in this discussion section, staff proposes amendments to Regulation 3700 to provide additional guidance to the cannabis industry. Staff recommends that the proposed amendments and the remaining text of the regulation be adopted through the regular rulemaking process so that the regulation, including the proposed amendments, would become permanent.

##### *Regulation 3701*

Cannabis Tax Regulation 3701, *Collection and Remittance of the Cannabis Excise Tax*, was also promulgated as an emergency regulation pursuant to GC section 11346.1 to further clarify the imposition, collection, reporting, and remittance of the cannabis excise tax, including guidance with respect to inventory acquired prior to January 1, 2018. Regulation 3701 was approved by the OAL, filed with the Secretary of State, and effective on December 28, 2017. Staff is considering whether or not to adopt Regulation 3701 as a permanent regulation. (See Exhibit 1.)

#### Proposed Amendments to Regulation 3700

##### *Definition of Cannabis Flowers*

Pursuant to the CTL, “cannabis flowers” shall mean the dried flowers of the cannabis plant as defined by the CDTFA. Regulation 3700 defines cannabis flowers to mean 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,

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concentrated cannabis, or an edible or topical product containing cannabis or concentrated cannabis and other ingredients. The term “cannabis flowers” excludes leaves and stems.

With respect to the application of the cannabis cultivation tax, staff understands that there may be some confusion as to whether an untrimmed flower would fall under the category of cannabis flowers or cannabis leaves. This is because an untrimmed cannabis flower may contain leaves and the definition of cannabis flowers excludes leaves. Staff has determined that an untrimmed flower should be categorized into the category for which it is predominately composed of, that is, cannabis flower. This will ensure that the cannabis flower is taxed at the appropriate tax rate for cannabis flowers, even though such flowers may contain a minimal amount of leaves. To reduce any confusion as to the categorization of an untrimmed cannabis flower and to ensure that cultivators and distributors are paying and reporting the appropriate tax for cannabis flowers, staff proposes to amend the definition of cannabis flowers to specify that the term cannabis flowers includes trimmed or untrimmed flowers, but excludes the leaves and stems that are removed from the cannabis flower prior to transfer or sale. (See Exhibit 2, renumbered subdivision (a)(2).)

#### *Definition of Fresh Cannabis Plant*

Staff understands that there may be confusion as to when a cultivator can use the “fresh cannabis plant” category that was established through CDTFA’s emergency regulations when selling or transferring fresh cannabis plant to a manufacturer or distributor. There have been numerous inquiries from industry on how CDTFA can determine and enforce if a fresh cannabis plant was weighed within two hours of harvesting, as required in Regulation 3700. CDTFA staff understands the limitations to enforcing the two hour requirement; therefore, staff recommends clarifying that in order for the cannabis to qualify as “fresh cannabis plant,” the cultivator must enter the fresh cannabis plant into track and trace as such, and the cannabis must be manifested and invoiced stating the cannabis is being sold or transferred as “fresh cannabis plant.” Industry also inquired if “fresh cannabis plant” can be frozen once it is weighed and invoiced as “fresh cannabis plant.” (See Exhibit 2, renumbered subdivision (a)(6).) Staff welcomes all suggested input on the “fresh cannabis plant” category and how the category is or is not helpful to industry.

#### *Cultivation Tax Categories*

The CTL authorizes the CDTFA to 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. Staff understands that cultivators may sell cannabis in a form that does not directly fall under one of the three cultivation tax categories specified in subdivision (c) of Regulation 3700. Staff remains open to considering amending the requirements to the “fresh cannabis plant” category or adding new cultivation tax categories based on common industry practices. In that regard, staff welcomes input as to the common forms in which cannabis is sold for the purpose of evaluating whether any new categories of cannabis should be established. Since CDTFA would also need to determine a cultivation tax rate for any new categories, staff requests industry specific data as to the relative value of any suggested new category to the value of cannabis flowers.

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#### *Receipts from Cannabis Retailers for Cannabis Excise Tax Paid*

The cannabis excise tax rate is 15 percent of the average market price of any retail sale by a cannabis retailer. 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 (currently 60%), as determined by the CDTFA. The mark-up rate that is determined by the CDTFA is not intended to be used to determine the amount for which each party sells their products. The mark-up rate determined by CDTFA is only used to calculate the average market price to determine the amount of excise tax due in an arm's length transaction. Each party in the supply chain can use any mark-up they would like to establish their selling price.

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. 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 CTL authorizes the CDTFA 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.

A cannabis retailer is no longer required to separately itemize the cannabis excise tax when making sales of cannabis or cannabis products, but must provide the following statement "The cannabis excise taxes are included in the total amount of this invoice."<sup>2</sup> It has come to staff's attention that retailers may be calculating the cannabis excise tax on the total retail sales price of the cannabis or cannabis products and separately stating it on the sales invoice. Staff notes that if the retailer were to compute and separately itemize or charge the cannabis excise tax on the total retail sales price of the cannabis or cannabis product acquired in an arm's length transaction, the cannabis retailer could potentially be collecting more or less cannabis excise tax than what the retailer paid to the distributor. The over or under collection would occur in those transactions in which the retailer's actual mark-up on those products was more or less than the 60% mark-up determined by the CDTFA. Staff further recognizes that the over or under collection of the excise tax is likely not an issue in a non-arm's length transaction. However, for purposes of consistency, proper collection, and ease of administration of the cannabis excise tax, staff proposes amendments to Regulation 3700 to specify that a retailer is not allowed to separately state the cannabis excise tax on any retail sale of cannabis or cannabis products acquired by the retailer in an arm's length transaction. (See Exhibit 2, proposed subdivision (f).)

#### *Distributor to Distributor Sales*

Distributors are required to collect the applicable cannabis excise tax for cannabis or cannabis products sold to a cannabis retailer. The distributors are also required to provide a receipt or

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<sup>2</sup> AB 133 removed the requirement that the retailer separately state the excise tax from the list price of the cannabis or cannabis products, and added the required statement that excise taxes are included in the total amount of the invoice.

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invoice to the retailer that identifies the licensee receiving the cannabis or cannabis product, the distributor from which the cannabis originates, the unique identifier of the cannabis, the amount of the cannabis excise tax, and any other information necessary to calculate the excise tax. The distributors are liable for the cannabis excise tax that is due for the cannabis or cannabis products that they supply to the retailer and the distributors are required to remit the cannabis excise tax that is due to CDTFA by the due date.

Staff recognizes that licensed distributors may purchase cannabis or cannabis products from another licensed distributor. In these instances, the distributor making the sale is not liable for collecting the cannabis excise tax. It is the distributor that sells or transfers the cannabis or cannabis products to the retailer who is responsible for collecting the cannabis excise tax from the retailer and reporting and paying it to the CDTFA. Staff also recognizes that a distributor may sell or transfer cannabis or cannabis products to a person that is licensed as both a distributor and cannabis retailer. In such instances, it may not be clear as to whether the responsibility for reporting and paying the cannabis excise tax is that of the person making the distribution or the distributor/retailer making the purchase and subsequent retail sale.

Staff has determined that a person who holds multiple cannabis licenses to operate as both a distributor and retailer (distributor/retailer), or that is licensed as a microbusiness that is authorized to act as a distributor, is subject to the same cannabis excise tax collection and reporting requirements as an independent, third party distributor. In other words, the distributor/retailer may choose to purchase the product as a distributor for subsequent sale or transfer to its retail portion of the business. In this instance, the distributor/retailer is responsible for reporting and paying the cannabis excise tax on the cannabis and cannabis products transferred to its retail sales area or activity of its business.

For administrative purposes, staff proposes to add regulatory guidance to specify the records necessary to document that one licensed distributor is selling cannabis or cannabis products to another licensed or authorized distributor and no cannabis excise tax was remitted or collected. (See Exhibit 2, renumbered subdivision (h).)

#### *Documenting Transfers of Cannabis and Cannabis Products to Distributors and Manufacturers*

A distributor is responsible for collecting the cultivation tax from the cultivator based on the weight and category (flowers, leaves, or fresh cannabis plant) of the cannabis on all harvested cannabis that enters the commercial market. If the cannabis is first transferred or sold to a manufacturer, the manufacturer is required to collect the cultivation tax from the cultivator based on the weight and category (flowers, leaves, or fresh cannabis plant) of the cannabis. The manufacturer is then required to remit the tax collected from the cultivator to a distributor when the manufacturer transfers the cannabis product to the distributor for quality assurance and testing.

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 of the cannabis; the

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amount of cultivation tax; and any other information deemed necessary by the CDTFA. The CDTFA may authorize other forms of documentation.

A distributor that is required to report and remit the cultivation tax due to CDTFA does so based on the weight and category of the cannabis that entered the commercial market. It is imperative that the distributor reporting the cannabis cultivation tax know the weight and category of the cannabis that entered the commercial market, as well as the weight and category of the cannabis used to manufacture cannabis products that entered the commercial market. To enable a distributor to comply with its reporting obligations with respect to the cannabis cultivation tax, staff proposes that every invoice, receipt, manifest, or other document for sales or transfers of cannabis or cannabis products amongst cultivators, distributors, and manufacturers include the weight and category of the cannabis that is sold or transferred along with any other information required by the MAUCRSA. (See Exhibit 2, proposed subdivision (d).)

#### *Cannabis or Cannabis Products Sold with Cannabis Accessories*

Staff recognizes that the CTL does not explicitly state how the cannabis excise tax applies to the sale of cannabis or cannabis products when sold with cannabis accessories, such as vape cartridges. The cannabis excise tax is imposed on purchasers of cannabis or cannabis products. The cannabis distributor that supplies retailers with cannabis or cannabis products calculates and collects the cannabis excise tax from the retailers based on the average market price of the cannabis or cannabis products.

Pursuant to the CTL and section 11018 of the HSC, cannabis means all parts of the plant *Cannabis sativa* L., whether growing or not; the seeds thereof; the resin extracted from any part of the plant; and every compound, manufacture, salt, derivative, mixture, or preparation of the plant, its seeds or resin. Cannabis does not include industrial hemp or the weight of any other ingredient combined with cannabis to prepare topical or oral administrations, food, drink, or other product. Pursuant to the CTL and section 11018.1 of the HSC, cannabis products means cannabis that has undergone a process whereby the plant material has been 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. Pursuant to section 26001 of the BPC and section 11018.2 of the HSC cannabis accessories is defined as any equipment, products or materials of any kind which are used, intended for use, or designed for use in planting, propagating, cultivating, growing, harvesting, manufacturing, compounding, converting, producing, processing, preparing, testing, analyzing, packaging, repackaging, storing, smoking, vaporizing, or for ingesting, inhaling, or otherwise introducing cannabis or cannabis products into the human body.

Based on the above references, cannabis accessories, such as vape cartridges, are not considered cannabis or cannabis products and are therefore not subject to the 15 percent cannabis excise tax. For purposes of applying or calculating the proper amount of cannabis excise tax and ease of administration, staff proposes a requirement that the price of the cannabis accessory and cannabis or cannabis product be separately stated on the invoice from the seller or distributor of the cannabis or cannabis products to the retailer. And, if the invoice or receipt to the retailer does not separately list the price of the cannabis accessories from the cannabis or cannabis products, then for determining the average market price for an arm's length transaction, the distributor

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would utilize the total amount on the invoice for determining the average market price of the cannabis or cannabis products. (See Exhibit 2, proposed subdivision (g).)

#### *Penalty*

The CTL 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. Regulation 3700, subdivision (f)(1), entitled “[l]ate Payments,” specifies that “. . . 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.” Staff recognizes that as written with the term “late payment” there may be confusion regarding applying the penalty to an audit which covers a period for which a person underreported and paid or failed to file and pay their tax liability for a period within the audit. As such, staff proposes to amend Regulation 3700 to remove the reference to “late” payment. This is because the underlying statutes provide that the penalty shall apply to taxes not paid. (See Exhibit 2, renumbered subdivision (i).)

#### Proposed Regulation 3702, *Track and Trace*

The CDTFA is authorized to prescribe, adopt, and enforce regulations with respect to the administration and enforcement of the cannabis tax statutes, including reporting. With respect to the cannabis excise tax, the CDTFA is also required to determine a mark-up to be added to the retailer’s wholesale cost of the cannabis or cannabis products sold or transferred to a cannabis retailer for purposes of calculating the average market price for which the 15% cannabis excise tax applies in an arm’s length transaction. The mark-up is to be determined every six months.

While there are many variables to consider when determining a mark-up for purposes of calculating the average market price, the key input variables include the retailer’s wholesale cost and retail selling price of cannabis or cannabis products. With the responsibility of determining a mark-up to be used by the cannabis distributor to calculate the average market price for cannabis or cannabis products, staff believes having actual data regarding wholesale costs and retail selling prices from the California cannabis industry is imperative. Such data would enable staff to review mark-up percentages from various cannabis or cannabis products, such as flower and manufactured products (edibles, extracts, etc.).

As noted herein, the track and trace program shall include an electronic seed to sale software tracking system with data points for the different stages of commercial activity, including inventory and sale. Having the wholesale cost and retail sales prices for cannabis or cannabis products is an essential component of determining a mark-up, therefore staff suggests that such information be required to be entered into the track and trace program. Such data would then be readily available to CDTFA. While having such data may not eliminate the overall need for CDTFA to request informational reports from the licensees, as authorized by the cannabis statutes; it would certainly reduce or eliminate the need to request information for purposes of determining a mark-up. Staff believes this would ease compliance for the cannabis industry.

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Staff recommends the adoption of proposed Regulation 3702, as shown in Exhibit 3 to: (1) specify that in addition to the information required to be entered into track and trace by the Bureau, a cannabis distributor is required to input the retailer's wholesale cost as defined in Regulation 3700, of cannabis or cannabis products; and (2) specify that a cannabis retailer is required to input their wholesale cost as defined in Regulation 3700, of the-cannabis or cannabis products and the retail sales price of those cannabis or cannabis products when sold to its customers. Staff is open to input from interested parties as to whether the definition of wholesale cost found in Regulation 3700, subdivision (a)(9), requires amendments.

As many of the temporary licenses previously issued by the Bureau are due to expire in the near future, staff further recommends that the proposed Regulation 3702 be submitted to the OAL as an emergency regulation, in accordance with GC section 11346.1. This will ensure that the regulation is effective prior to the full implementation of the track and trace program, or as soon as possible thereafter. Following this emergency rulemaking process, staff will commence with the regular rulemaking processes to adopt proposed Regulation 3702 as a permanent regulation after the required notice and comment period. 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.

#### **Summary**

Staff welcomes any comments, suggestions, and input from interested parties on the proposed rulemaking with respect to the cannabis taxes. Staff also invites and encourages interested parties to participate in the August 2, 2018, interested parties meeting. If you plan to attend via teleconference, please let staff know and an agenda or other material(s) for the meeting will be emailed to you in the morning on the day of the meeting. The deadline for interested parties to provide written responses regarding this discussion paper is August 17, 2018.

Staff recognizes that there may be additional areas that warrant further consideration and looks forward to continue working with interested parties to develop necessary guidance so that everyone affected by the CTL can easily understand and comply with their obligations with respect to the collection and payment of the cannabis taxes.

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

Current as of July 20, 2018

CannabisDP072018.docx

(Staff is considering whether or not to adopt Regulation 3701 as a permanent regulation.)

**Regulation 3701. Collection and Remittance of the Cannabis Excise Tax.**

(a) In General. On and after January 1, 2018, a cannabis retailer shall not make a retail sale of cannabis or a cannabis product, unless the purchaser has paid the cannabis excise tax to the retailer at the time of the sale.

(b) Cannabis Retailer's Remittance to a Distributor – General. If a distributor sells or transfers cannabis or cannabis product to a cannabis retailer on or after January 1, 2018, then the retailer shall remit the cannabis excise tax due on the cannabis or cannabis product based on the average market price to the distributor that sold or transferred the cannabis or cannabis product to the retailer.

(c) Cannabis Retailer's Remittance to a Distributor – Exception.

(1) A cannabis retailer that possesses or controls cannabis or a cannabis product at 12:01 a.m. on January 1, 2018, and makes a retail sale of that cannabis or cannabis product on or after January 1, 2018, shall remit the cannabis excise tax due based on the average market price to a distributor licensed pursuant to division 10 (commencing with Section 26000) of the Business and Professions Code that the retailer purchased or acquired cannabis or cannabis product from on or after January 1, 2018. The cannabis excise tax shall be remitted by the cannabis retailer to the licensed distributor on or before the fifteenth day of the calendar month following the close of the calendar month in which the tax was collected.

(2) Upon collecting the cannabis excise tax from a cannabis retailer as set forth in subdivision (c)(1), a distributor shall provide the cannabis retailer with an invoice, receipt, or other similar document that contains all of the following:

(A) Date of execution of the invoice, receipt, or other similar document,

(B) Name of the distributor,

(C) Name of the cannabis retailer,

(D) The amount of cannabis excise tax,

(E) The number of the seller's permit held by the cannabis retailer, and

(F) The number of the seller's permit held by the distributor. If the distributor is not required to hold a seller's permit because the distributor makes no sales, the distributor must include a statement to that effect on the receipt in lieu of a seller's permit number.

(d) Distributor's Reporting and Remittance – General. Unless as otherwise provided in subdivision (e), a distributor shall report and remit the cannabis excise tax due in accordance with subdivision (e) of section 3700 of this chapter.

(e) Distributor's Reporting and Remittance – Exception. A distributor shall report and remit the cannabis excise tax collected from the cannabis retailer pursuant to subdivision (c) with the distributor's first return subsequent to receiving the cannabis excise tax from the cannabis retailer.

Note: Authority cited: Section 34013, Revenue and Taxation Code. Reference: Sections 34011 and 34015, Revenue and Taxation Code.

**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 accessories" shall have the same meaning as set forth in section 11018.2 of the Health and Safety Code.

~~(2)~~ "Cannabis flowers" means the flowers of the plant *Cannabis sativa* L. that have been harvested, dried, trimmed or untrimmed, 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 removed from the cannabis flowers prior to the cannabis flowers being transferred or sold.

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

~~(4)~~ "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.

~~(5)~~ "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.

~~(6)~~ "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, and must be entered into track and trace, manifested, and invoiced as "fresh cannabis plant." If track and trace is not available, the paper manifest or invoice shall indicate "fresh cannabis plant" is being sold or transferred.

~~(7)~~ "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.

(87) "Ounce" means 28.35 grams.

(98) "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.

(109) "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) Cultivation Tax Invoicing Requirements. A cultivator is liable for the cultivation tax imposed pursuant to section 34012 of the Revenue and Taxation Code. A cultivator's liability for the cultivation tax is not extinguished until the cultivation tax has been paid to the State, except as otherwise provided in subdivision (h) of Revenue and Taxation Code section 34012.

(1) The distributor shall provide to the cultivator, or to the manufacturer if the cannabis was first sold or transferred to a manufacturer, an invoice, receipt, or similar document that identifies the licensee receiving the product, the originating cultivator, associated unique identifier of the cannabis, the amount of cultivation tax, and the weight and category of the cannabis. The weight and category of the cannabis identified on the invoice shall equal the weight and category of the cannabis entered into the track and trace system.

(2) The manufacturer shall provide to the cultivator when a cultivator sells or transfers cannabis to a manufacturer, an invoice, receipt, or similar document that identifies the licensee receiving the product, the originating cultivator, the associated unique identifier of the cannabis, the amount of cultivation tax, and the weight and category of the cannabis. The weight and category of the cannabis identified on the invoice shall equal the weight and category of the cannabis entered into the track and trace system.

(3) The manufacturer shall include on the sales invoice or manifest to the distributor or the next party in the transaction, the associated weight and category of the cannabis used to produce the cannabis products. This associated cultivation tax and the weight and category of the cannabis used to produce a cannabis product shall follow the cannabis product from one party to the next until it reaches a distributor for quality assurance and testing, as described in Section 26110 of the Business and Professions Code.

~~(e)~~ 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.

(f) Receipts for Excise Tax Paid to Cannabis Retailers. A purchaser of cannabis or cannabis products is liable for the cannabis excise tax imposed pursuant to section 34011 of the Revenue and Taxation Code. A purchaser's liability for the cannabis excise tax is not extinguished until the cannabis excise tax has been paid to the State, except as otherwise provided in subdivision (f)(2).

(1) Each cannabis retailer is required to provide a purchaser of cannabis or cannabis products 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."

(2) An invoice, receipt, or other document with the required statement set forth in subdivision (f)(1) obtained from the cannabis retailer is sufficient to relieve the purchaser of the cannabis excise imposed on the purchase of the cannabis or cannabis product.

(3) A cannabis retailer may not make a separately stated charge for the cannabis excise tax when the cannabis or cannabis products are sold to a purchaser.

(g) Cannabis or Cannabis Products Sold with Cannabis Accessories. 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. Unless as otherwise provided below, the cannabis excise tax does not apply to cannabis accessories.

(1) When cannabis or cannabis products are sold with cannabis accessories (e.g., vape cartridges), a sales price segregation must be made if the seller or distributor of the cannabis or cannabis products has documentation that would establish the individual cost of the cannabis or cannabis products and the cannabis accessories. When a seller or distributor separately states the price of the cannabis or cannabis products from the cannabis accessories, the cannabis excise tax applies to the average market price of the cannabis or cannabis products, and not to the cannabis accessories.

(2) When the seller or distributor of the cannabis or cannabis products does not have documentation that would establish the cost of the cannabis or cannabis products and the cannabis accessories and the price of the cannabis or cannabis products is not separately stated from the cannabis accessories, the cost of the cannabis accessories shall be included in the wholesale cost for purposes of determining the average market price to which the cannabis excise tax applies.

(h) 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.

(1) A person that holds both a retailer and distributor license or a microbusiness that is authorized to act as a distributor, is subject to the same cannabis excise tax collection and reporting requirements as an independent distributor.

(2) A distributor that sells or transfers cannabis or cannabis products to another distributor is not responsible for collecting the cannabis excise tax from the other distributor or microbusiness authorized to distribute.

(3) Transactions between two distributors shall document that no cannabis excise tax was collected or remitted on the invoice between the two distributors. Documentation shall identify the selling distributor, the selling distributor's license number, the purchasing distributor, and the purchasing distributor's license number.

(4) The distributor or microbusiness that supplies a retailer with cannabis or cannabis products is responsible for collecting the cannabis excise tax from the retailer based on the average market price of the cannabis or cannabis products supplied to the retailer.

(~~if~~) Penalties.

(1) ~~Late Payments~~ Penalty for Unpaid Taxes. 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 of the cannabis excise tax or cannabis cultivation tax 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 (~~if~~)(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.

(New regulation to be added to chapter 8.7 of division 2 of title 18 of the California Code of Regulations)

**Regulation 3702. California Cannabis Track-and-Trace.**

(a) When cannabis or cannabis products are sold or transferred to a retailer, a cannabis distributor that has obtained an annual distributor license shall, in addition to the requirements established by the Medicinal and Adult-Use Cannabis Regulations and Safety Act (MAUCRSA) (commencing with section 26000 of the Business and Professions Code), enter into California Cannabis Track-and-Trace system (CCTT) information used to calculate the cannabis excise tax, including, but not limited to the following:

- (1) The originating seller (cultivator, manufacturer, or distributor) of the cannabis or cannabis products,
- (2) The retailer that is purchasing the cannabis or cannabis products,
- (3) Unique identifier of the cannabis or cannabis products supplied to the retailer, and
- (4) The retailer's wholesale cost, as defined in Regulation 3700, of the cannabis or cannabis products.

(b) A cannabis retailer that has obtained an annual license shall, in addition to the requirements established by the MAUCRSA, enter into CCTT its wholesale cost, as defined in Regulation 3700, of the cannabis or cannabis product and the retail selling price of cannabis or cannabis products when the cannabis or cannabis products is sold in a retail sale.

(c) A microbusiness that is authorized to distribute cannabis and sell cannabis at retail shall adhere to the same CCTT requirements of a licensed cannabis distributor and a licensed cannabis retailer pursuant to this regulation.

Note: Authority cited: Section 34013, Revenue and Taxation Code. Reference: Sections 34011 Revenue and Taxation Code and 26067 Business and Professions Code.