



CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

TAX POLICY BUREAU

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August 8, 2024

Dear Interested Party:

Enclosed is the Discussion Paper on whether to certify emergency Regulation 3802, Gross Receipts from Sales of Cannabis and Cannabis Products through the regular rulemaking process. We 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 29, 2024
at 10:00 a.m.
(Microsoft Teams)

You may join us on your computer or mobile app through [Microsoft Teams](#) or by calling 1-916-535-0987 and then entering the phone conference identification number 365 922 32#. You are also welcome to submit your written suggestions or comments, including any proposed regulatory language, to me at the address or fax number in this letterhead or via email at BTFD-BTC.InformationRequests@cdtfa.ca.gov by September 12, 2024. Copies of the materials you submit may be provided to other interested parties; therefore, please ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others who may be interested in participating in the meeting or presenting their suggestions or 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. We look forward to your participation. Should you have any questions, please contact Business Taxes Committee team member Sarah Smith at 1-916-309-5292.

Sincerely,

Aimee Olhiser, Chief

Tax Policy Bureau

Business Tax and Fee Division

AO:sps

Enclosures

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Regulation 3802, *Gross Receipts from Sales of Cannabis and Cannabis Products*

Issue

Whether the California Department of Tax and Fee Administration (Department) should propose to certify emergency Regulation 3802, Gross Receipts from Sales of Cannabis and Cannabis Products, by adopting it through the regular rulemaking process. Emergency Regulation 3802 became effective December 15, 2023, and a Certificate of Compliance must be transmitted to the Office of Administrative Law (OAL) by December 15, 2025, or the emergency language will be repealed by operation of law on the following day.

Background

Gross Receipts

Subdivision (a) of Revenue and Taxation Code (RTC) section 34011.2 in the Cannabis Tax Law (CTL) (commencing with RTC section 34010) provides that on and after January 1, 2023, a cannabis excise tax shall be imposed upon purchasers of cannabis or cannabis products sold in this state at 15 percent of the gross receipts of any retail sale by a cannabis retailer. Subdivision (n) of RTC section 34010 provides that “gross receipts,” as used in RTC section 34011.2, has the same meaning as set forth in RTC section 6012 in the Sales and Use Tax Law (SUTL) (commencing with RTC section 6001). RTC section 6012 provides that, for sales and use tax purposes:

(a) “Gross receipts” mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of any of the following:

(1) The cost of the property sold. However, in accordance with any rules and regulations as the [Department¹] may prescribe, a deduction may be taken if the retailer has purchased property for some other purpose than resale, has reimbursed his or her vendor for tax which the vendor is required to pay to the state or has paid the use tax with respect to the property, and has resold the property prior to making any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business. If that deduction is taken by the retailer, no refund or credit will be allowed to his or her vendor with respect to the sale of the property.

(2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.

¹ The administration of the SUTL, CTL, and Fee Collection Procedures Law (FCPL) (commencing with RTC section 55001) was transferred from the State Board of Equalization (Board) to the Department, operative July 1, 2017, by Assembly Bill No. (AB) 102 (Stats. 2017, ch. 16) and references to the “Board” in the SUTL, CTL, and FCPL statutes discussed in this Discussion Paper mean the “Department” pursuant to Government Code section 15570.24 and RTC section 20.

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(3) The cost of transportation of the property, except as excluded by other provisions of this section.

(4) The amount of any tax imposed by the United States upon producers and importers of gasoline and the amount of any tax imposed pursuant to Part 2 (commencing with Section 7301) of this division.

(b) The total amount of the sale or lease or rental price includes all of the following:

(1) Any services that are a part of the sale.

(2) All receipts, cash, credits and property of any kind.

(3) Any amount for which credit is allowed by the seller to the purchaser.

(c) "Gross receipts" do not include any of the following:

(1) Cash discounts allowed and taken on sales.

(2) Sale price of property returned by customers when that entire amount is refunded either in cash or credit, but this exclusion shall not apply in any instance when the customer, in order to obtain the refund, is required to purchase other property at a price greater than the amount charged for the property that is returned. For the purpose of this section, refund or credit of the entire amount shall be deemed to be given when the purchase price less rehandling and restocking costs are refunded or credited to the customer. The amount withheld for rehandling and restocking costs may be a percentage of the sales price determined by the average cost of rehandling and restocking returned merchandise during the previous accounting cycle.

(3) The price received for labor or services used in installing or applying the property sold.

(4) (A) The amount of any tax (not including, however, any manufacturers' or importers' excise tax, except as provided in subparagraph (B)) imposed by the United States upon or with respect to retail sales whether imposed upon the retailer or the consumer.

(B) The amount of manufacturers' or importers' excise tax imposed pursuant to Section 4081 or 4091 of the Internal Revenue Code for which the purchaser certifies that he or she is entitled to either a direct refund or credit against his or her income tax for the federal excise tax paid or for which the purchaser issues a certificate pursuant to Section 6245.5.

(5) 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.

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(6) The amount of any tax imposed by any city, county, city and county, or rapid transit district within the State of California with respect to the storage, use or other consumption in that city, county, city and county, or rapid transit district of tangible personal property measured by a stated percentage of sales price or purchase price, whether the tax is imposed upon the retailer or the consumer.

(7) Separately stated charges for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, but the exclusion shall not exceed a reasonable charge for transportation by facilities of the retailer or the cost to the retailer of transportation by other than facilities of the retailer. However, if the transportation is by facilities of the retailer, or the property is sold for a delivered price, this exclusion shall be applicable solely with respect to transportation which occurs after the sale of the property is made to the purchaser.

(8) Charges for transporting landfill from an excavation site to a site specified by the purchaser, either if the charge is separately stated and does not exceed a reasonable charge or if the entire consideration consists of payment for transportation.

(9) The amount of any motor vehicle, mobilehome, or commercial coach fee or tax imposed by and paid to the State of California that has been added to or is measured by a stated percentage of the sales or purchase price of a motor vehicle, mobilehome, or commercial coach.

(10) (A) The amount charged for intangible personal property transferred with tangible personal property in any technology transfer agreement, if the technology transfer agreement separately states a reasonable price for the tangible personal property.

(B) If the technology transfer agreement does not separately state a price for the tangible personal property, and the tangible personal property or like tangible personal property has been previously sold or leased, or offered for sale or lease, to third parties at a separate price, the price at which the tangible personal property was sold, leased, or offered to third parties shall be used to establish the retail fair market value of the tangible personal property subject to tax. The remaining amount charged under the technology transfer agreement is for the intangible personal property transferred.

(C) If the technology transfer agreement does not separately state a price for the tangible personal property, and the tangible personal property or like tangible personal property has not been previously sold or leased, or offered for sale or lease, to third parties at a separate price, the retail fair market value shall be equal to 200 percent of the cost of materials and labor used to produce the tangible personal property subject to tax. The remaining amount charged under the technology transfer agreement is for the intangible personal property transferred.

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(D) For purposes of this paragraph, “technology transfer agreement” means any agreement under which a person who holds a patent or copyright interest assigns or licenses to another person the right to make and sell a product or to use a process that is subject to the patent or copyright interest.

(11) The amount of any tax imposed upon diesel fuel pursuant to Part 31 (commencing with Section 60001).

(12) (A) The amount of tax imposed by any Indian tribe within the State of California with respect to a retail sale of tangible personal property measured by a stated percentage of the sales or purchase price, whether the tax is imposed upon the retailer or the consumer.

(B) The exclusion authorized by subparagraph (A) shall only apply to those retailers who are in substantial compliance with this part.

For purposes of the sales tax, if the retailers establish to the satisfaction of the [Department] that the sales tax has been added to the total amount of the sale price and has not been absorbed by them, the total amount of the sale price shall be deemed to be the amount received exclusive of the tax imposed. Section 1656.1 of the Civil Code shall apply in determining whether or not the retailers have absorbed the sales tax.

Sales and Use Tax Annotations (Annotations)² 295.0647 (10/18/96), 295.0730 (10/4/76), and 295.1675 (5/13/94) summarize the long-standing opinions of the Department’s Legal Division that:

- Charges for services are included in the gross receipts from the sale of tangible personal property under RTC section 6012 when a purchaser must purchase the services to obtain the tangible personal property; and
- Charges for optional services, such as optional warranties, that are sold with tangible personal property, are not included in the gross receipts from the sale of the tangible personal property under RTC section 6012.

Also, the provisions regarding warranties in subdivision (b)(3) of Regulation 1546, Installing, Repairing, Reconditioning in General, incorporate that long-standing distinction between charges for mandatory and optional warranties.

Annotation 295.1187 (12/13/95) summarizes the Legal Division’s long-standing opinions that local and district sales and use taxes imposed in accordance with the Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with RTC section 7200) or Transactions and Use Tax Law

² “Annotations” are summaries of the conclusions reached in selected legal rulings of counsel. Annotations do not embellish or interpret the legal rulings of counsel which they summarize and do not have the force and effect of law. (Reg. 35101, subd. (a)(1).)

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(commencing with RTC section 7251) are excluded from gross receipts under subdivisions (c)(5) and (6) of RTC section 6012. However, amounts a purchaser of tangible personal property must pay to compensate or reimburse a retailer for other taxes imposed on the retailer by a city, county, city and county, or rapid transit district, including, but not limited to, business taxes measured by a business's gross receipts, are not excluded from gross receipts under subdivisions (c)(5) and (6) of RTC section 6012. This is because the Legal Division's opinion is that local taxes are only imposed "upon or with respect to retail sales of tangible personal property measured by a stated percentage of sales price or gross receipts," under subdivision (c)(5), if they are imposed on individual retail sales of tangible personal property and expressly measured by a stated percentage of "sales price" or "gross receipts," as defined in RTC sections 6011 and 6012, respectively.

In addition, Regulation 1628, Transportation Charges, currently clarifies when separately stated charges for transportation are excluded from "gross receipts" under subdivision (c)(7) of RTC section 6012, and not subject to sales or use tax. Subdivision (a) of Regulation 1628 clarifies when charges for transportation by a carrier are excluded from gross receipts and subdivision (b) of Regulation 1628 clarifies when charges for delivery by facilities of the retailer are excluded from gross receipts. Also, Annotation 557.0640 (12/2/64) summarizes the Legal Division's long-standing opinion that transportation by a retailer's employee is transportation by facilities of the retailer for purposes of applying subdivision (b) of Regulation 1628.

Furthermore, division 10 (commencing with section 26000) of the Business and Professions Code (BPC) defines "package" to mean any container or receptacle used for holding cannabis or cannabis products (BPC section 26001, subd. (aq)) and requires cannabis or cannabis products to be labeled and placed in a tamper-evident, child-resistant package, prior to delivery or sale at a cannabis retailer. (BPC section 26120, subd. (a).) The Department of Cannabis Control (DCC) has adopted regulations that further clarify that "package" or "packaging" means any container or wrapper that may be used for enclosing or containing any cannabis or cannabis product but does not include a shipping container or outer wrapping used solely for the transport of cannabis or cannabis products in bulk quantity to a licensed premises. (DCC Regulation 15000, subd. (yy).) DCC has also adopted regulations that further clarify division 10's packaging requirements. (DCC Regulations 17401, 17411, and 17412.) Also, Annotation 295.1387 (11/15/91) summarizes the Legal Division's long-standing opinion that amounts a purchaser of tangible personal property must pay to compensate or reimburse a retailer for the cost of labor or materials used to package an item are generally included in taxable gross receipts under RTC section 6012.

Proposition 64

On November 8, 2016, California voters approved Proposition 64 (Prop. 64). As relevant here, Prop. 64 added the CTL to the RTC and imposed a marijuana excise tax, effective January 1, 2018. As added by Prop. 64, RTC section 34010 provided that "gross receipts" has the same meaning as set forth in RTC section 6012. Subdivision (a) of RTC section 34011 provided that "Effective January 1, 2018, a marijuana excise tax shall be imposed upon purchasers of marijuana or marijuana products sold in this state at the rate of 15 percent of the gross receipts of any retail sale

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by [specified retailers required to be licensed under specific provisions of the BPC].” Subdivision (b) of RTC section 34011 provided that “Except as otherwise provided by regulation, the tax levied under this section shall apply to the full price, if nonitemized, of any transaction involving both marijuana or marijuana products and any other otherwise distinct and identifiable goods or services, and the price of any goods or services, if a reduction in the price of marijuana or marijuana products is contingent on purchase of those goods or services.” Therefore, for purposes of the marijuana excise tax originally imposed by Prop. 64, taxable “gross receipts” included charges for marijuana or marijuana products and other goods or services under specified circumstances.

Also, as added by Prop. 64, subdivision (c) of RTC section 34011 required the specified retailers to collect the marijuana excise tax from purchasers and remit it to the Department. RTC section 34015 also required the specified retailers to remit the marijuana excise taxes they were required to collect to the Department quarterly on or before the last day of the month following each quarterly period of three months with returns subject to audit by the Department.

Senate Bill No. 94

In 2017, the Legislature enacted Senate Bill No. (SB) 94 (Stats. 2017, ch. 27). As relevant here, SB 94 replaced the references to “marijuana” with references to “cannabis” throughout the CTL. It replaced subdivision (b) of RTC section 34011 (quoted above), which clarified the meaning of gross receipts, with a new subdivision (b) that required a distributor that sold or transferred cannabis or cannabis products to a cannabis retailer to collect the cannabis excise tax from the cannabis retailer, sometimes before the cannabis or cannabis products were purchased from the cannabis retailer in a retail sale. It amended RTC section 34015 to require distributors to remit the cannabis excise taxes they were required to collect from cannabis retailers to the Department quarterly on or before the last day of the month following each quarterly period of three months with returns subject to audit by the Department. It also amended RTC section 34015 so that cannabis retailers were no longer required to remit cannabis excise tax to the Department or file returns subject to audit by the Department.

SB 94 also made it easier to calculate the amount of cannabis excise tax to be collected when a distributor sold or transferred cannabis or cannabis products to a cannabis retailer in an arm’s length transaction. This was done by amending subdivision (a) of RTC section 34011 so that the cannabis excise tax was imposed upon purchasers of cannabis or cannabis products at a rate of 15 percent of the “average market price of any retail sale by a cannabis retailer.” This was also done by amending RTC section 34010 to define “average market price” to mean:

- 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, in an arm’s length transaction; and
- The cannabis retailer’s gross receipts from the retail sale of the cannabis or cannabis products in a nonarm’s length transaction.

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Therefore, after the amendments made by SB 94, the amount of cannabis excise tax due on a retail sale of cannabis or cannabis products depended entirely on the retailer's wholesale cost when the cannabis or cannabis products were sold or transferred to the retailer in an arm's length transaction.

However, SB 94 did not make it easier for a distributor to calculate the amount of cannabis excise tax to be collected when a distributor sold or transferred cannabis or cannabis products to a cannabis retailer in a nonarm's length transaction. This is because a cannabis retailer's gross receipts from a retail sale of cannabis or cannabis products are indeterminable until the retail sale occurs. Also, SB 94 was silent about how a distributor was supposed to determine a retailer's gross receipts from a subsequent retail sale, particularly when the sale had not occurred before the distributor was required to collect the cannabis excise tax on that sale from the cannabis retailer.

Regulation 3700

The Department previously determined that there was an issue regarding how the cannabis excise tax imposed by RTC section 34011, as amended by SB 94, applied to the sale of cannabis or cannabis products with cannabis accessories, such as vaping devices, which was not explicitly addressed in the CTL after SB 94 replaced subdivision (b) of RTC section 34011. The Department determined that the application of tax depended upon how the distributor sold or transferred the cannabis or cannabis products to the retailer, based upon the way SB 94 changed the imposition, collection, and remittance of cannabis excise tax. The Department also determined that the cost of cannabis accessories was included in the average market price to which the cannabis excise tax applied when a distributor sold or transferred cannabis or cannabis products to a cannabis retailer with cannabis accessories for a lump-sum charge. However, when a distributor separately stated the price of the cannabis or cannabis products from the cannabis accessories, the cannabis excise tax applied to the average market price of the cannabis or cannabis products, and not to the separately stated charge for the cannabis accessories.

In 2019, the Department adopted subdivisions (a)(2) and (i) of Regulation 3700, Cannabis Excise and Cultivation Tax, to clarify the meaning of the "average market price of any retail sale by a cannabis retailer," as used in RTC section 34011, when a distributor sold or transferred cannabis or cannabis products to cannabis retailers with cannabis accessories. Subdivision (a)(2) provides that "cannabis accessories" has the same meaning as provided in Health and Safety Code (HSC) section 11018.2, which states that "cannabis accessories" means 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 containing cannabis, or for ingesting, inhaling, or otherwise introducing cannabis or cannabis products into the human body. Subdivision (i) provides that the cost of cannabis accessories is included in the average market price to which the cannabis excise tax applies when cannabis or cannabis products are sold or transferred to a cannabis retailer with cannabis accessories for a lump-sum charge. However, when a distributor separately states the price of the cannabis or cannabis products from the cannabis accessories, the cannabis excise tax applies to the average

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market price of the cannabis or cannabis products, and not to the separately stated charge for the cannabis accessories. Regulation 3700 does not further clarify how a distributor is supposed to determine a cannabis retailer's gross receipts from a retail sale in the case of a nonarm's length transaction.

AB 195

On June 30, 2022, the Legislature enacted AB 195 (Stats. 2022, ch.56). As relevant here, AB 195 added RTC section 34011.2 and amended RTC sections 34011 and 34015 to:

- Change the cannabis excise tax so it is “imposed upon purchasers of cannabis or cannabis products sold in this state at 15 percent of the gross receipts of any retail sale by a cannabis retailer,” on and after January 1, 2023 (RTC section 34011.2, subd. (a)).
- Remove the requirement for the distributor to collect the cannabis excise tax from the cannabis retailer on cannabis or cannabis products sold or transferred to the cannabis retailer on or after January 1, 2023.
- Require cannabis retailers to remit the cannabis excise tax imposed on and after January 1, 2023, directly to the Department with a return subject to audit by the Department. (RTC sections 34011.2, subd. (c), 34015).

However, the Legislature did not add a provision to the CTL to further clarify how the cannabis excise tax imposed by RTC section 34011.2 applies to the retail sale of cannabis or cannabis products with cannabis accessories, such as vaping devices, on and after January 1, 2023.

RTC sections 55061 and 55302

Subdivision (a) of RTC section 34013 provides that the Department shall administer and collect the taxes imposed by the CTL pursuant to the FCPL. As relevant here, RTC section 55302 in the FCPL, as incorporated into the CTL by subdivision (a) of RTC section 34013, authorizes the Department to examine the books and records of any person liable for the payment of the cannabis excise taxes imposed by RTC section 34011 or 34011.2 as it may deem necessary in carrying out the administration and collection of such taxes. Also, RTC section 55061 in the FCPL authorizes the Department to compute and determine the amount of cannabis excise tax to be paid under RTC sections 34011 and 34011.2, based upon any information available, and issue deficiency determinations (or billing) for the collection of unreported, underreported, or unpaid cannabis excise tax.

Discussion

The Department determined that there was an issue regarding how the cannabis excise tax imposed by RTC section 34011.2 applies to charges for other tangible personal property purchased with cannabis or cannabis products in a retail sale, which is not explicitly addressed in the CTL or

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subdivision (i) of Regulation 3700, which clarifies the application of RTC section 34011, not RTC section 34011.2. The Department also determined that the provisions of subdivision (i) of Regulation 3700 were not consistent with RTC section 34011.2 because that section does not require distributors to collect cannabis excise tax and the transaction in which a distributor sells or transfers cannabis or cannabis products to the retailer is not relevant to the imposition, collection, remittance, or reporting of the current cannabis excise tax. This is also because RTC section 34011.2 does not require charges for cannabis, cannabis products, or other tangible personal property sold with cannabis or cannabis products to be separately stated.

The Department determined that whether the cannabis excise tax imposed by RTC section 34011.2 applies to charges for other tangible personal property sold with cannabis or cannabis products depends upon how the cannabis retailer sold the cannabis or cannabis products to the purchaser in the taxable retail sale, based upon subdivision (a) of RTC section 34011.2, which makes the “gross receipts of any retail sale by a cannabis retailer” the measure of the tax. The Department also determined that when a cannabis retailer requires a purchaser to purchase specific tangible personal property as a condition of the retail sale of cannabis or cannabis products, then the charges for the tangible personal property are included in the cannabis retailer’s gross receipts from the sale of the cannabis or cannabis products, subject to cannabis excise tax, under subdivision (a) of RTC section 34011.2. However, when a cannabis retailer does not require a purchaser to purchase specific tangible personal property as a condition of the retail sale of cannabis or cannabis products, then when a purchaser purchases that tangible personal property with the cannabis or cannabis products the amount charged for that optional tangible personal property is not included in the cannabis retailer’s gross receipts from the sale of the cannabis or cannabis products subject to cannabis excise tax under subdivision (a) of RTC section 34011.2.

In addition, the Department determined that there was an issue because some cannabis retailers were following the guidance provided in subdivision (i) of Regulation 3700 when determining whether their charges for cannabis accessories, including packaging, are included in their gross receipts for purposes of the cannabis excise tax imposed by RTC section 34011.2. The Department also determined that there may be issues regarding whether cannabis retailers’ charges for services, taxes, and transportation are included in their gross receipts for purposes of the cannabis excise tax imposed by RTC section 34011.2. Therefore, the Department prepared a draft of emergency Regulation 3802 for the specific purpose of addressing those issues.

Draft Emergency Regulation

As relevant here, draft emergency Regulation 3802 incorporated the definition of “gross receipts” from RTC section 6012 by providing that gross receipts from the sale of cannabis or cannabis products for purposes of the cannabis excise tax imposed by RTC section 34011.2 has the same meaning as gross receipts from the sale of tangible personal property as set forth in RTC section 6012. It also clarified that, in general, amounts that are included in gross receipts for sales and use tax purposes are included in gross receipts for cannabis excise tax purposes, amounts that are not deductible from gross receipts for sales and use taxes purposes are not deductible from gross

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receipts for cannabis excise tax purposes, and amounts excluded from gross receipts for sales and use taxes purposes are excluded from gross receipts for cannabis excise tax purposes.

Draft emergency Regulation 3802 clarified that, for purposes of the cannabis excise tax imposed by RTC section 34011.2, the “total amount of the sale price,” as used in RTC section 6012, includes any amount the purchaser is required to pay to purchase cannabis or cannabis products, regardless of how the amount is denominated or labeled on the invoice, receipt, or other document provided to the purchaser. It also clarified that the total amount of the sale price, specifically includes any amount the purchaser is required to pay for any of the following:

- (1) Services that are incidental to or part of the sale of the cannabis or cannabis products, including, but not limited to, service and convenience charges or fees.
- (2) Taxes imposed by any city, county, city and county, or rapid transit district on the sale of the cannabis or cannabis products, except as otherwise provided below.
- (3) Transportation of the cannabis or cannabis products, including, but not limited to, delivery charges or fees, except as otherwise provided below.
- (4) Tangible personal property sold with the cannabis or cannabis products, except as otherwise provided below.

Draft emergency Regulation 3802 clarified that, for purposes of the cannabis excise tax imposed by RTC section 34011.2, the total amount of the sale price does not include local taxes imposed in accordance with the Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with RTC section 7200) or Transactions and Use Tax Law (commencing with RTC section 7251). However, other amounts a purchaser of cannabis or cannabis products must pay to compensate or reimburse a cannabis retailer for taxes imposed on the cannabis retailer by a city, county, city and county, or rapid transit district, including, but not limited to, cannabis business taxes measured by a cannabis retailer’s gross receipts, are not excluded from the sale price charged for cannabis or cannabis products to make the regulation consistent with Annotation 295.1187.

Draft emergency Regulation 3802 clarified that, for purposes of the cannabis excise tax imposed by RTC section 34011.2, the total amount of the sale price does not include charges for transportation that are not subject to sales and use tax, as provided in Regulation 1628. It clarified that transportation by the retailer’s employee is “transportation by facilities of the retailer” for purposes of Regulation 1628 to make the regulation consistent with Annotation 557.0640. It also clarified that charges a purchaser of cannabis or cannabis products must pay a cannabis retailer for delivery by facilities of the retailer are taxable unless they satisfy the requirements of subdivision (b)(2) of Regulation 1628.

Draft emergency Regulation 3802 also clarified that, for purposes of the cannabis excise tax imposed by RTC section 34011.2, the total amount of the sale price does not include a reasonable amount charged for optional packaging or other optional tangible personal property sold with

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cannabis or cannabis products as a unit or for a lump sum price in a retail sale regardless of whether those amounts are separately stated on the invoice, receipt, or other document provided by the cannabis retailer to the purchaser. It established a rebuttable presumption that that packaging and other tangible personal property sold with cannabis or cannabis products as a unit or for a lump sum price are not optional. It clarified that it is the cannabis retailer's burden to maintain and make available records to establish that packing or other tangible personal property sold with cannabis or cannabis products is optional. It also clarified that it is the cannabis retailer's burden to maintain and make available records to establish that the amount charged for optional packaging and other optional tangible person property is reasonable to prevent retailers from shifting prices to avoid cannabis excise tax.

Comments from Interested Parties

The Department distributed draft emergency Regulation 3802 to the interested parties with a Discussion Paper dated October 2, 2023. The Department also conducted an interested parties meeting on October 12, 2023, to discuss the draft emergency regulation and accepted written comments.

In their oral and written comments, the interested parties generally agreed that the measure of the cannabis excise tax imposed by RTC section 34011.2 includes any amount the purchaser is required to pay to purchase cannabis or cannabis products. They generally agreed that charges for services that are part of the sale of cannabis or cannabis products are included in the measure of the cannabis excise tax imposed by RTC section 34011.2. They also generally agreed that the emergency regulation should be rewritten to clarify that subdivision (c)(7) of RTC section 6012 provides an exclusion from gross receipts for specified transportation charges.

Some interested parties also raised a general concern that draft emergency Regulation 3802 may go beyond what Prop. 64 allows in terms of taxation. Some interested parties said they thought the way draft emergency Regulation 3802 incorporated RTC section 6012 expanded the base of the cannabis excise tax imposed by RTC section 34011.2 beyond cannabis and cannabis products to include items that are generally subject to sales and use tax. Some interested parties said that the provisions, which provided that the measure of the cannabis excise tax includes charges for "services that are incidental to . . . the sale of the cannabis or cannabis products, including, but not limited to, service and convenience charges or fees," were unclear and should be deleted or further clarified to avoid taxing charges for nontaxable services. Some interested parties disagreed with the way draft emergency Regulation 3802 incorporated the Legal Division's opinion regarding the meaning of subdivisions (c)(5) and (6) of RTC section 6012. They said they thought the provisions were inconsistent with subdivision (c)(5) of RTC section 6102, which refers to "any tax." They also said they thought the Department lacked the authority to adopt those provisions under RTC section 34013 because they generally fell within the realm of the SUTL.

In addition, some interested parties said they interpreted RTC section 34011.2, subdivision (i) of Regulation 3700, and the definitions of "cannabis," "cannabis products," and "cannabis

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accessories” in HSC sections 11018, 11018.1, and 11018.2 as excluding charges for cannabis accessories from the cannabis excise tax imposed by RTC section 34011.2. Some interested parties said they did not think there is a sufficient distinction between RTC sections 34011 and 34011.2 to support including charges for cannabis accessories in gross receipts subject to the cannabis excise tax imposed by RTC section 34011.2. Some interested parties said that Annotations 295.0647, 295.0730, 295.1675 did not support the optional requirement because the Annotations relate to services, and that the emergency regulation should not include a requirement that tangible personal property sold with cannabis or cannabis products be optional. Also, some of the interested parties’ comments indicated that they were having some difficulty understanding the optional requirements in draft emergency Regulation 3802 because they were not sufficiently clear.

Changes to the Emergency Regulation

As a result, the Department reconsidered the provisions included in draft emergency Regulation 3802. The Department also determined that it was necessary to revise emergency Regulation 3802 to address many of the issues raised by the interested parties.

The Department did not intend for draft emergency Regulation 3802 to expand the base of the cannabis excise tax imposed by RTC section 34011.2 to generally include all gross receipts from sales of tangible personal property subject to sales and use tax. Therefore, the Department revised emergency Regulation 3802 so that it does not incorporate the definition of “gross receipts” from RTC section 6012, which gave some interested parties that impression.

The Department agreed with the interested parties’ comments regarding charges for services and transportation. Therefore, the Department revised emergency Regulation 3802’s provisions regarding those charges accordingly.

The Department agreed that it did not have the authority under RTC section 34013 to adopt emergency regulations generally relating to the SUTL. The Department also determined that it was not necessary to incorporate the Legal Division’s long-standing opinion regarding the meaning of subdivisions (c)(5) and (6) of RTC section 6012 into emergency Regulation 3802 because Annotation 295.1187 still provides sufficient notice. Therefore, the Department deleted the local tax provisions from emergency Regulation 3802 to avoid any issue regarding the scope of the emergency regulation. However, their deletion does not change the Legal Division’s long-standing opinion and the Department may propose to incorporate that opinion into a sales and use tax regulation if it becomes necessary to do so in the future.

The Department also determined that it was necessary to clarify emergency Regulation 3802’s provisions regarding charges for optional tangible personal property sold with cannabis or cannabis products in the same retail sale to avoid potential confusion. Therefore, the Department revised emergency Regulation 3802 so that it clearly defines the term “optional tangible personal property” and provides examples illustrating when items, such as pipes, lighters, and vaping devices, that are commonly sold with cannabis or cannabis products, are optional tangible personal

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property. The Department revised emergency Regulation 3802 so that it clarifies that, for purposes of the cannabis excise tax imposed by RTC section 34011.2, gross receipts do not include a reasonable amount charged for optional tangible personal property purchased with cannabis or cannabis products in the same retail sale. The Department also deleted the rebuttable presumption from emergency Regulation 3802 because the Department determined that it was unnecessary to add the rebuttable presumption to the provisions regarding the burden of proof.

Adoption of Emergency Regulation 3802

The Department adopted emergency Regulation 3802 for the purpose of addressing the issues regarding how the cannabis excise tax imposed by RTC section 34011.2 applies to cannabis retailers' charges for services, transportation, and other tangible personal property purchased with cannabis or cannabis products in a retail sale (discussed above). Additionally, the Department adopted emergency amendments to clarify that subdivision (i) of Regulation 3700 is inoperative on and after January 1, 2023, for the purpose of addressing the issue regarding how the cannabis excise tax imposed by RTC section 34011.2 applies to cannabis retailers' charges for other tangible personal property purchased with cannabis or cannabis products in a retail sale.

Subdivision (a) of emergency Regulation 3802 clarifies that for purposes of the cannabis excise tax imposed by RTC section 34011.2 gross receipts from the retail sale of cannabis or cannabis products include any amount the purchaser is required to pay to purchase the cannabis or cannabis products, regardless of how the amount is denominated or labeled on the invoice, receipt, or other document provided to the purchaser. Subdivision (a) clarifies that gross receipts do not include amounts that are excluded or deductible from gross receipts pursuant to RTC section 6012 or a regulation implementing that section.

Subdivision (a) further clarifies that gross receipts specifically include, but are not limited to any amount the purchaser is required to pay for:

- Services that are part of the sale of the cannabis or cannabis products. For example, when a cannabis retailer requires a purchaser to pay a fee to reimburse itself for the cost of processing the purchaser's credit card payment for the purchase of cannabis, the fee is included in the gross receipts from the sale of the cannabis; and
- Tangible personal property, including packaging, the purchaser is required to purchase as condition of the sale of the cannabis or cannabis products. For example, if a purchaser is required to purchase a plastic bag or jar as a condition of the retail sale of the cannabis, the amount the purchaser is required to pay for the plastic bag or jar is included in the gross receipts from the sale of the cannabis. If a purchaser is required to purchase a cartridge as a condition of the retail sale of the cannabis product contained in the cartridge, the amount the purchaser is required to pay for the cartridge is included in the gross receipts from the sale of the cannabis product. Also, if a purchaser is required to purchase a cartridge and vaping device as a condition of the retail sale of the cannabis product

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contained in the cartridge, the amount the purchaser is required to pay for the cartridge and vaping device is included in the gross receipts from the sale of the cannabis product.

Subdivision (b)(1) of the emergency regulation clarifies that, for purposes of the cannabis excise tax, gross receipts from the retail sale of cannabis or cannabis products does not include a reasonable amount charged for optional tangible personal property purchased with cannabis or cannabis products in the same retail sale regardless of whether those amounts are separately stated on the invoice, receipt, or other document provided by the cannabis retailer to the purchaser and regardless of whether the optional tangible personal property is purchased with the cannabis or cannabis products as a unit.

Subdivision (b)(1)(A) of the emergency regulation clarifies that “optional tangible personal property” means tangible personal property that a purchaser is not required to purchase as a condition of the sale of the cannabis or cannabis product because the purchaser could purchase that cannabis or cannabis product or the same kind of cannabis or cannabis product, as defined in subdivision (b)(1)(B), from the cannabis retailer without purchasing the tangible personal property.

Subdivision (b)(1)(B) of the emergency regulation further provides that for purposes of subdivision (b)(1)(A), “same kind of cannabis” means cannabis that is the same brand, quantity, strain, and type (e.g., flower, pre-roll, shake) as the cannabis purchased and “same kind of cannabis product” means cannabis product that is the same brand, quantity, strain, and type (e.g., beverage, capsule, concentrate, edible, tincture, topical, cannabis oil) as the cannabis product purchased.

Subdivision (b)(1)(C) provides examples to further illustrate these points and clarify that emergency Regulation 3802 does not generally include all charges for tangible personal property, other than cannabis or cannabis products, in the base subject to the cannabis excise tax. The subdivision provides that when a cannabis retailer sells seven-gram jars of XYZ brand Hawaiian Punch strain cannabis flower separately from lighters or pipes so that purchasers are not required to purchase the lighters or pipes as a condition of the sale of the cannabis, then a lighter or pipe is optional tangible personal property when a purchaser chooses to purchase one with a seven-gram jar of XYZ brand Hawaiian Punch strain cannabis flower in the same retail sale. Also, when a cannabis retailer sells one-gram cartridges of XYZ brand Hawaiian Punch strain cannabis oil separately from vaping devices so that purchasers are not required to purchase the vaping devices as a condition of the sale of the cannabis products, then a vaping device is optional tangible personal property when a purchaser chooses to purchase one with a one-gram cartridge of XYZ brand Hawaiian Punch strain cannabis oil in the same retail sale.

Subdivision (b)(2) of the emergency regulation clarifies that the cannabis retailer has the burden to maintain and make available to the Department records that establish that tangible personal property purchased with cannabis or cannabis products in a retail sale was optional tangible personal property. If the Department determines that tangible personal property purchased with cannabis or cannabis products in a retail sale was not optional tangible personal property, the entire

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amount charged for the tangible personal property shall be included in the gross receipts from the retail sale of the cannabis or cannabis products pursuant to subdivision (a).

Subdivision (b)(3) of the emergency regulation clarifies that the cannabis retailer also has the burden to maintain and make available to the Department records that establish that the amount charged for optional tangible personal property purchased with cannabis or cannabis products in a retail sale was reasonable. If the Department determines that any amount charged for optional tangible personal property exceeds a reasonable charge, the excess amount shall be included in the gross receipts from the sale of the cannabis or cannabis products pursuant to subdivision (a). The factors the Department may consider in determining whether the amount charged for optional tangible personal property is reasonable, include, but are not limited to:

- (A) The wholesale cost of optional tangible personal property.
- (B) The size of the markup added to the wholesale cost of the optional tangible personal property.
- (C) The amount charged for the cannabis or cannabis products sold with the optional tangible personal property in the same retail sale.

Finally, subdivision (c) of the emergency regulation clarifies that for purposes of the cannabis excise tax, gross receipts from the retail sale of cannabis or cannabis products excludes certain transportation charges as provided in RTC section 6012 and Regulation 1628, Transportation Charges.

Comments from Interested Parties

Some interested parties submitted written comments to the OAL during the public comment period for the adoption of emergency Regulation 3802. In their written comments, interested parties continued to raise a general concern that the emergency regulation goes beyond what Prop. 64 allows in terms of taxation. They also questioned the necessity, consistency, and clarity of the emergency regulation.

Summary

The Department is considering whether to certify emergency Regulation 3802 by adopting it through the regular rulemaking process. The Department considered the issues raised in the interested parties' comments submitted to the OAL and determined additional revisions were not needed before certifying the emergency regulation. We are open to more discussion. We welcome any comments, suggestions, and input from interested parties on this issue. We also invite interested parties to participate in the August 29, 2024, interested parties meeting. The deadline for interested parties to provide their written submissions regarding this discussion paper will be September 12, 2024. The Department will decide whether to certify the emergency regulation with or without changes after considering the interested parties' comments.

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Current as of July 31, 2024

Proposed Text of California Code of Regulations

Title 18. Public Revenues

Division 2. California Department of Tax and Fee Administration –

Business Taxes

Chapter 8.8. Cannabis Excise Tax Effective on and after January 1, 2023

Section 3802. Gross Receipts from Sales of Cannabis and Cannabis Products.

Regulation 3802. Gross Receipts from Sales of Cannabis and Cannabis Products.

(a) For purposes of the cannabis excise tax imposed by Revenue and Taxation Code (RTC) section 34011.2 (cannabis excise tax) “gross receipts” from the retail sale of cannabis or cannabis products include any amount the purchaser is required to pay to purchase the cannabis or cannabis products, regardless of how the amount is denominated or labeled on the invoice, receipt, or other document provided to the purchaser, unless the amount is excluded or deductible from “gross receipts” pursuant to RTC section 6012. “Gross receipts” specifically include, but are not limited to, any amount the purchaser is required to pay for:

(1) Services that are part of the sale of the cannabis or cannabis products. For example, when a cannabis retailer requires a purchaser to pay a fee to reimburse itself for the cost of processing the purchaser’s credit card payment for the purchase of cannabis, the fee is included in the gross receipts from the sale of the cannabis.

(2) Tangible personal property, including packaging, the purchaser is required to purchase as a condition of the sale of the cannabis or cannabis products. For example, if a purchaser is required to purchase a plastic bag or jar as a condition of the retail sale of the cannabis, the amount the purchaser is required to pay for the plastic bag or jar is included in the gross receipts from the sale of the cannabis. If a purchaser is required to purchase a cartridge as a condition of the retail sale of the cannabis product contained in the cartridge, the amount the purchaser is required to pay for the cartridge is included in the gross receipts from the sale of the cannabis product. Also, if a purchaser is required to purchase a cartridge and vaping device as a condition of the retail sale of the cannabis product contained in the cartridge, the amount the purchaser is required to pay for the cartridge and vaping device is included in the gross receipts from the sale of the cannabis product.

(b) (1) For purposes of the cannabis excise tax, “gross receipts” from the retail sale of cannabis or cannabis products does not include a reasonable amount charged for optional tangible personal property purchased with cannabis or cannabis products in the same retail sale regardless of whether those amounts are separately stated on the invoice, receipt, or other document

provided by the cannabis retailer to the purchaser and regardless of whether the optional tangible personal property is purchased with the cannabis or cannabis products as a unit.

(A) “Optional tangible personal property” means tangible personal property that a purchaser is not required to purchase as a condition of the sale of the cannabis or cannabis product because the purchaser could purchase that cannabis or cannabis product or the same kind of cannabis or cannabis product, as defined in subdivision (b)(1)(B), from the cannabis retailer without purchasing the tangible personal property.

(B) For purposes of subdivision (b)(1)(A), “same kind of cannabis” means cannabis that is the same brand, quantity, strain, and type (e.g., flower, pre-roll, shake) as the cannabis purchased and “same kind of cannabis product” means cannabis product that is the same brand, quantity, strain, and type (e.g., beverage, capsule, concentrate, edible, tincture, topical, cannabis oil) as the cannabis product purchased.

(C) For example, when a cannabis retailer sells seven-gram jars of XYZ brand Hawaiian Punch strain cannabis flower separately from lighters or pipes so that purchasers are not required to purchase the lighters or pipes as a condition of the sale of the cannabis, then a lighter or pipe is optional tangible personal property when a purchaser chooses to purchase one with a seven-gram jar of XYZ brand Hawaiian Punch strain cannabis flower in the same retail sale. Also, when a cannabis retailer sells one-gram cartridges of XYZ brand Hawaiian Punch strain cannabis oil separately from vaping devices so that purchasers are not required to purchase the vaping devices as a condition of the sale of the cannabis products, then a vaping device is optional tangible personal property when a purchaser chooses to purchase one with a one-gram cartridge of XYZ brand Hawaiian Punch strain cannabis oil in the same retail sale.

(2) The cannabis retailer has the burden to maintain and make available to the Department records that establish that tangible personal property purchased with cannabis or cannabis products in a retail sale was optional tangible personal property. If the Department determines that tangible personal property purchased with cannabis or cannabis products in a retail sale was not optional tangible personal property, the entire amount charged for the tangible personal property shall be included in the gross receipts from the retail sale of the cannabis or cannabis products pursuant to subdivision (a).

(3) The cannabis retailer also has the burden to maintain and make available to the Department records that establish that the amount charged for optional tangible personal property purchased with cannabis or cannabis products in a retail sale was reasonable. If the Department determines that any amount charged for optional tangible personal property exceeds a reasonable charge, the excess amount shall be included in the gross receipts from the sale of the cannabis or cannabis products pursuant to subdivision (a). The factors the

Department may consider in determining whether the amount charged for optional tangible personal property is reasonable, include, but are not limited to:

- (A) The wholesale cost of optional tangible personal property.
 - (B) The size of the markup added to the wholesale cost of the optional tangible personal property.
 - (C) The amount charged for the cannabis or cannabis products sold with the optional tangible personal property in the same retail sale.
- (c) For purposes of the cannabis excise tax, “gross receipts” from the retail sale of cannabis or cannabis products excludes certain transportation charges as provided in RTC section 6012 and Regulation 1628, Transportation Charges.

Note: Authority cited: Section 34013, Revenue and Taxation Code. Reference: Sections 6012, 34010, 34011.2, 55061 and 55302, Revenue and Taxation Code.