STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION
TAX POLICY BUREAU
450 N STREET, SACRAMENTO, CA 95814
PO BOX 942879, SACRAMENTO, CA 94279-0092
1-916-324-2373 • FAX 1-916-322-4530
www.cdtfa.ca.gov

GAVIN NEWSOM
Governor

MARYBEL BATJER
Secretary, Government Operations Agency

NICOLAS MADUROS
Director

June 12, 2019

Dear Interested Party:

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

Interested Parties on our distribution list for regulatory issues related to Cannabis Taxes will receive notice of the proposed action(s), as will every person who has filed a request for notice of regulatory action with the CDTFA. To be added to our distribution list for regulatory issues related to Cannabis Taxes or to all topics in general, please send your contact information to BTFD-BTC.InformationRequests@cdtfa.ca.gov. Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue. If you are interested in other Business Taxes Committee (BTC) topics, refer to the CDTFA BTC webpage for copies of discussion papers and calendars of current and prior issues.

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

Sincerely,

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

TG:rsw

Enclosures

cc: (all with enclosures)
- Mr. Nicolas Maduros (MIC 104)
- Ms. Katie Hagen (MIC 104)
- Mr. Robert Tucker (MIC 83)
- Ms. Susanne Buehler (MIC 43)
- Ms. Michele Pielsticker (MIC 105)
- Mr. Jason Mallet (MIC 25)
- Mr. Wayne Mashihara (MIC 47)
- Mr. Alfred Buck (MIC 70)

Mr. James Dahlen (MIC 57)
Ms. Debra Kalfsbeek (MIC 62)
Mr. Kevin Hanks (MIC 49)
Mr. Jeff Vest (MIC 85)
Mr. Mike Loretta (MIC 100)
Mr. Bradley Heller (MIC 82)
Mr. David Levine (MIC 85)
Ms. Dana Brown (MIC 85)
Ms. Casey Tichy (MIC 85)
Ms. Monica Silva (MIC 82)
Ms. Leslie Ang (MIC 82)
Ms. Lisa Sherrod (MIC31)
Ms. Sandy Barrow (MIC 31)
Ms. Kirsten Stark (MIC 50)
Ms. Lynn Whitaker (MIC 50)
Mr. Gentian Droboniku (MIC 67)
Mr. Joe Fitz (MIC 67)
Mr. Marc Alviso (MIC 104)
Ms. Claudette Yang (MIC 104)
Ms. Karina Magana (MIC 47)
Mr. Bradley Miller (MIC 92)
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)

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

KEY AGENCY ISSUE

Proposed Rulemaking - Cannabis Tax Regulation 3700, “Cannabis Excise and Cultivation Taxes”

I. 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.”

II. Staff Recommendation

Staff recommends that the Director approve the proposed amendments to Regulation 3700, “Cannabis Excise and Cultivation Taxes,” as set forth in Exhibit 2. Staff also recommends that the Director commence the regular rulemaking process with respect to Regulation 3700, as proposed to be amended, so that the regulation may be adopted prior to December 22, 2019, the expiration of the emergency regulatory action.

For a more detailed explanation of staff’s recommendation, refer to section VI.

III. Other Alternative(s) Considered

None.

IV. Background

In 2015, the Legislature enacted the Medical Marijuana Regulation and Safety Act (MMRSA), a package of legislation that established a comprehensive licensing and regulatory framework for the cultivation, manufacturing, transportation, distribution, and sale of medical marijuana. The MMRSA consists of three bills: SB 643 (Stats. 2015, Ch. 719), AB 243 (Stats. 2015, Ch. 688), and AB 266 (Stats. 2015, Ch. 689). 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 were subsequently changed to the Medical Cannabis Regulation and Safety Act (MCRSA) and the Bureau of Cannabis Control (BCC).

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 established nonmedical marijuana regulatory and licensing provisions, and added Part 14.5 (commencing with Revenue and Taxation Code (RTC) section 34010), Marijuana Tax Law, to Division 2 of the RTC.

In 2017, SB 94 (Stats. 2017, Ch. 27) (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 the Marijuana Tax to ease and streamline cannabis tax collection and remittance to the CDTFA. As relevant here, SB 94: (1) substituted “cannabis” for “marijuana”; (2) revised the cannabis excise tax to be imposed upon purchasers at a rate of 15 percent of the average market price, instead of gross receipts, to be collected by a distributor from a cannabis retailer; (3) required 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) made other corrections and other conforming changes.

The Cannabis Tax Law (CTL) was further amended in 2017 by AB 133 (Stats. 2017, Ch. 253) (AB 133) to, in part: remove the requirement that a cannabis retailer display the cannabis excise tax separately from the price of cannabis and cannabis products when sold to consumers; remove the requirement that a cannabis retailer state on the purchase invoice that the cannabis cultivation tax is included in the total amount of the invoice; and authorize the 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 defined manufacturer and authorized 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. In 2018, SB 1289 (Stats. 2018, Ch. 92) made non-substantive changes in various provisions of the CTL to effectuate the recommendations made by the Legislative Counsel to the Legislature.

GENERAL OVERVIEW[1] OF THE CANNABIS TAX LAW

DEFINITIONS

Under existing CTL, RTC section 34010 defines the following terms:

"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 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 non-arm's length transaction, the cannabis retailer's gross receipts from the retail sale of the cannabis or cannabis products.

"Department" means the CDTFA or its successor agency.

"Bureau" means the Bureau within the Department of Consumer Affairs.

"Tax Fund" means the California Cannabis Tax Fund created by RTC section 34018.

"Cannabis" has the same meaning as set forth in section 11018 of the Health and Safety Code (HSC) and shall also mean medicinal cannabis.

"Cannabis products" has the same meaning as set forth in section 11018.1 of the HSC and shall also mean medicinal concentrates and medicinal cannabis products.

"Cannabis flowers" means the dried flowers of the cannabis plant as defined by the CDTFA.

[1] 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" is 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.

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

"Cannabis retailer" means a person required to be licensed as a retailer, microbusiness, or nonprofit pursuant to Division 10 (commencing with section 26000) of the BPC.

"Cultivator" means 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" means 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" means a person required to be licensed as a manufacturer pursuant to Division 10 (commencing with section 26000) of the BPC.

"Microbusiness" has the same meaning as set forth in BPC section 26070(a)(3).

"Nonprofit" has the same meaning as set forth in BPC section 26070.5.

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

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

"Unprocessed cannabis" includes 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" have the same meaning as set forth in RTC sections 6012, 6005, and 6007, respectively.

CANNABIS EXCISE TAX

GENERAL

On and after January 1, 2018, a cannabis excise tax is imposed upon purchasers of cannabis or cannabis products sold in this State at the rate of 15 percent of the average market price of any retail sale by a cannabis retailer. The cannabis excise tax is in addition to the sales and use tax imposed by the state and local governments. Gross receipts from the sale of cannabis or cannabis products for purposes of assessing the sales and use taxes under the Sales and Use Tax Law (SUTL)[2] include the cannabis excise tax. Cannabis or cannabis products shall not be sold to a purchaser unless the excise tax 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

[2] Part 1 (commencing with section 6001) of Division 2 of the RTC.

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 non-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, 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.

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 ($1.29) 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 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, which shall not apply where a distributor collects the cultivation tax from a cultivator.

ALTERNATIVE METHODS FOR COLLECTION AND REMITTANCE

The CDTFA may prescribe a substitute method and manner for collection and remittance of the cultivation tax by a manufacturer, 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 fail quality assurance, inspection, and testing as described in section 26110 of the BPC.

Indicia for Cultivation Tax Paid

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

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 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, the CDTFA shall consider 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 are due and payable to the CDTFA quarterly or monthly on or before the last day of the month following each reporting period. These returns must be filed using electronic media. Returns shall be authenticated in a form or pursuant to methods as may be prescribed by the CDTFA.

Alternate Reporting

Existing law authorizes the payment of the amount due and the filing of returns for periods other than the period or periods specified in the Fee Collections Procedure Law (FCPL)[3]. In addition, the CTL authorizes the CDTFA to adopt regulations prescribing the due date for returns and remittances of the cannabis excise tax collected by a distributor in an arm's length transaction. If the cultivation tax is paid by stamp pursuant to RTC section 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.

[3] Part 30 (commencing with RTC section 55001) of Division 2 of the RTC.

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

The CDTFA or a law enforcement agency is 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. Pursuant to RTC section 34016(c), 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 created the California Cannabis Tax Fund in the State Treasury. The California Cannabis Tax Fund consists 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 California Cannabis 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 are disbursed as follows: $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.

IV. 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 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 was authorized to 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.[4]

CURRENT CANNABIS TAX REGULATION 3700 AND 3701

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 Certificate of Compliance for this emergency regulatory action is due no later than December 21, 2019.

The regulation created a new harvested cannabis category (fresh cannabis plant), provided definitions for various terms, and reiterated the statutorily set penalties for failing to pay the cannabis excise and cultivation taxes. It also provided the cultivation tax rates for cannabis flowers, cannabis leaves, and fresh cannabis plants. It further defined when the cultivation tax is collected, when the cannabis is presumed sold, and when the distributor is required to report and remit the cannabis excise tax due.

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.

In the Discussion Paper distributed on July 20, 2018, staff explained that it was considering whether to adopt Regulation 3701 as a permanent regulation. During the August 2, 2018, interested parties meeting, staff proposed to let Regulation 3701 expire. Staff explained that it believed that by the time the regulation expired, the regulation would have provided the necessary guidance and clarification with respect to inventory acquired prior to January 1, 2018. There seemed to be a general sense of agreement with staff's proposal at the interested parties meeting. Staff did not receive any written comments subsequent to the meeting regarding this issue. Staff notes that the regulation would continue to apply to those transactions that occurred during the period in which the regulation was in effect. Therefore, staff recommends allowing Regulation 3701 to expire.

PROPOSED AMENDMENTS TO REGULATION 3700

Staff distributed a Discussion Paper on July 20, 2018, and held an interested parties meeting on August 2, 2018, to discuss proposed amendments to Regulation 3700. After discussing the proposed amendments to Regulation 3700 with interested parties and reviewing the interested parties' written comments, staff distributed a Second Discussion Paper on January 25, 2019, to propose further amendments. Staff held a second interested parties meeting on February 5, 2019, to obtain further input

[4] In December 2018, CDTFA also adopted Regulation 3702, California Cannabis Track-and-Trace through the emergency rulemaking process. The regulation specifies the information that must be entered in the California Cannabis Track-and-Trace system by a distributor or cannabis retailer. Staff will commence the regular rulemaking process with respect to Regulation 3702 in a process separate from this issue.

from interested parties. More information regarding staff's proposed amendments and input received from interested parties is provided in the sections that follow.

DEFINITION OF CALIFORNIA CANNABIS TRACK-AND-TRACE SYSTEM

The proposed amendments to Regulation 3700, as provided with the Second Discussion Paper distributed on January 25, 2019, included a proposed definition of California Cannabis Track-and-Trace system. During the February 5, 2019, interested parties meeting, staff explained that the proposed definition was added because Regulation 3700 made several references to information required to be entered into the track-and-trace system without having defined the track-and-trace system. No one expressed opposition regarding the proposed definition at the meeting or in the written comments received subsequent to the meeting. Staff recommends adding a definition of California Cannabis Track-and-Trace system in subdivision (a)(1) as shown in Exhibit 2.

DEFINITION OF CANNABIS FLOWERS

Pursuant to the CTL, "cannabis flowers" means 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, 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 explained in the Discussion Paper that it understood 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 contains leaves and the definition of cannabis flowers excludes leaves. To reduce confusion and ensure that cultivators and distributors are paying and reporting the appropriate tax for cannabis flowers, staff proposed 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.

Following the August 2, 2018, interested parties meeting, staff received comments from Ms. Shannon Hatton of Fiddler's Greens, Ms. Ruth Bergman of Deep Roots Farm, and Mr. Moe Abdelwahed, in which they expressed their objection to having the definition of cannabis flowers include both trimmed and untrimmed flower and suggested that untrimmed flower have its own category with respect to the application of the cultivation tax. (See Exhibits 3-5, respectively.) Ms. Bergman also explained that she will not be able to process the flowers on site, and she intends to sell her flowers to other entities for processing. Ms. Bergman believes that it is unfair to be taxed at the flower rate since the leaves will eventually be trimmed from the flower.

In the Second Discussion Paper, staff noted that cannabis removed from a cultivator's premises is presumed to be sold and is subject to the cultivation tax. However, cannabis removed from a cultivator's premises for processing by a person that also holds a cultivation license is not subject to the cultivation tax at that time. A "processor," which is a type of cultivation license, is responsible for paying the cultivation tax when it sells or transfers the cannabis to a distributor or manufacturer. Staff also explained that it believes it would be difficult to distinguish between a trimmed and untrimmed flower because the flowers could be trimmed to varying degrees and determining whether a flower is trimmed or not would be subjective, e.g., how many leaves need to remain to qualify as untrimmed. Staff did not make any further amendments to its initially proposed revised definition of cannabis flowers, as explained in the Second Discussion Paper and interested parties meeting held on February 5, 2019. Staff did not receive any written comments regarding the definition of cannabis flowers following the February 5, 2019, interested parties meeting. Accordingly,

staff recommends amending the definition of cannabis flowers, as initially proposed, 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)(3).)

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 recommended clarifying that in order for the cannabis to qualify as "fresh cannabis plant," the cultivator must enter the fresh cannabis plant into the California Track-and-Trace system as such, and the cannabis must be manifested and invoiced stating the cannabis is being sold or transferred as "fresh cannabis plant." Staff did not receive any written comments with respect to the definition of fresh cannabis plant following the first interested parties meeting.

In the Second Discussion Paper, staff explained that after additional consideration, staff proposed to remove from the definition of "fresh cannabis plant" the phrase "any further processing, including" and the term "trimming" because staff understood that minimal preparation or trimming may occur when harvesting the "fresh cannabis plant," as defined (the flowers, leaves, or whole plant). Staff noted the definition of fresh cannabis plant was originally mirrored on terminology used in the State of Colorado, which has a category for wet whole plant and the carryover of the phrase and term is not applicable to the fresh plant category. Following the interested parties meeting held on February 5, 2019, staff received comments in a letter dated October 30, 2018, and received by email on February 20, 2019, from Mr. Jonathon Gee on behalf of Cura Cannabis Solutions (Cura) requesting clarification as to whether there is any requirement that the fresh cannabis plant leave the place of harvest immediately and whether drying the fresh cannabis plant affects the taxable rate of the cannabis. (See Exhibit 6.) Staff has considered the comment and notes that while Regulation 3700, proposed subdivision (a)(7), does not explicitly impose any requirement that the fresh cannabis plant leave the place of harvest immediately, it does require the fresh cannabis plant to be weighed within two hours of harvest and prohibits artificial drying and any other form of drying. Regulation 3700, proposed subdivision (a)(7) further explains that to be considered fresh cannabis plant, it must be manifested and invoiced as such and entered into the California Track-and-Trace System. Therefore, a cultivator's drying of the fresh cannabis plant would exclude it from being considered fresh cannabis plant. Staff recommends revising subdivision (a)(7) as proposed in the Second Discussion Paper and shown in Exhibit 2, subdivision (a)(7).

DEFINITION OF PLANT WASTE

Pursuant to RTC section 34012(i), all cannabis removed from a cultivator's premises, except for plant waste, is presumed to be sold and thereby taxable under RTC section 34012. The term "plant waste" is not defined within the CTL. As explained in the Second Discussion Paper, the definition of plant waste in Regulation 3700, subdivision (a)(8), was mirrored from the definition of "cannabis waste" as defined within the CDFA's proposed Regulation 8305, "Cannabis Waste Management," with respect to the Medical Cannabis Regulation and Safety Act.

Staff further noted that when CDFA withdrew its proposed "medical" regulations and moved forward with one regulatory package for both medicinal and adult-use cannabis, the definition of cannabis waste in CDFA's regulations was no longer consistent with CDTFA's definition of plant waste. Staff believed that maintaining consistency with CDFA increases understanding and compliance amongst cannabis cultivators. As such, staff proposed to revise the definition of plant waste so that it references the CDFA's regulations rather than restating CDFA's definition. Staff believed the proposed revision was necessary to

ensure consistency with use of the term by CDTFA and CDFA now and in the future in the event CDFA makes further amendments to its regulations regarding cannabis waste management.

During the interested parties meeting held on February 5, 2019, there seemed to be general support for the revision. Staff did not receive any written comments following the interested parties meeting with respect to this proposed revision. Therefore, staff recommends revising the definition of plant waste as illustrated in Exhibit 2, renumbered subdivision (a)(10).

DEFINITION OF WHOLESALE COST

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

The term "wholesale cost" is not defined in the CTL. Without clarification defining wholesale cost, staff believed there would be confusion and it may be difficult for distributors and retailers to collect and pay the appropriate amount of excise tax. Staff's proposed definition of wholesale cost, subsequently adopted by CDTFA, specifies that the term mean the amount paid by the retailer for the cannabis or cannabis products, including transportation charges, and adding back in any discounts or trade allowances.

As staff continued to implement the CTL, staff recognized there may be some confusion as to what is considered a "discount," "trade allowance," or other similar reduction in price that must be added back to the amount paid by the retailer to determine wholesale cost. During the August 2, 2018, interested parties meeting, staff acknowledged this confusion and stated that it was open to input from interested parties as to whether the definition of wholesale cost requires amendments. Following the meeting, staff received comments from Ms. Sabrina Fendrick on behalf of Berkeley Patients Group (BPG), in an August 16, 2018, letter. (See Exhibit 7.) BPG explained its opinion that the only component of a product to be calculated for excise tax, or to fall within the definition of wholesale cost, should be the value of the weight of the actual cannabis or cannabis product, regardless of the hardware, packaging or other ingredients that are calculated into the total purchase price. Staff received a similar comment from Mr. Javier A. Bastidas, on behalf of Leland, Parachini, Steinberg, Matzger & Melnick, LLP, in an August 17, 2018, letter. (See Exhibit 8.) Staff also received comments from Mr. Jesse McClellan, on behalf of the California Cannabis Industry Association (CCIA), in an August 24, 2018, letter. (See Exhibit 9.) CCIA notes that CDTFA staff indicated the definition of wholesale cost was based on the Cigarette and Tobacco Products Tax Law[5] (CTPL). CCIA further explained that since the CTL does not mention discounts or trade allowances, there is no valid basis to use the definition from the CTPL to establish the wholesale cost for cannabis. CCIA recommended using the plain meaning of the term to establish the definition in the regulation as follows: "[w]holesale cost means the amount paid by the retailer for the cannabis or cannabis product, including transportation charges."

Staff considered the written comments and generally agreed that the current definition of wholesale cost based on the CTPL may not be best suited to the practices of the cannabis industry. With the goal of establishing a definition that will make it easier for the distributor to calculate the average market price, staff proposed to amend the definition of wholesale cost to generally conform to the CCIA's suggestion. Because staff's proposed revision to the definition of wholesale cost impacts the measure as to which the

[5] Part 13 (commencing with section 30001) of Division 2 of the RTC.

excise tax applies and to allow time for distributors to adjust their accounting practices, staff proposed that the revised definition apply prospectively and for illustrative purposes added a "placeholder" date as to when the revision would be operative.

During the February 5, 2019, interested parties meeting, staff welcomed input from interested parties with respect to the revised definition, as well as the prospective operative date. Staff noted that the "placeholder" operative date of January 1, 2020, would mostly likely be staff's proposed operative date, since staff plans to complete the rulemaking process prior to the expiration of the emergency regulation in December 2019. Following the interested parties meeting, staff received comments from Cura and Mr. Michael Rapanut on behalf of Flow Kana, expressing support for the proposed language. (See Exhibits 6 and 10, respectively.) Staff also received written comments from the Cannabis Distribution Association (CDA), in which CDA explained that to the extent that discount (slotting fees) and trade allowances reduce the average wholesale cost below fair market [value], these transactions should be considered non-arm's length transactions. CDA also stated that the determination for non-arm's length transaction needs to be more clearly defined as well as enforceable. (See Exhibit 11.)

Staff has considered the written comments and after receiving support from several interested parties, staff recommends the approval of the amendments, as shown in Exhibit 2, renumbered subdivision (a)(11). With respect to the operative date, staff recommends April 1, 2020. This is because while staff intends to complete the rulemaking process prior to the expiration of the emergency regulation, staff wants to ensure that it has sufficient time to give notice to those affected by the change and to allow those affected by the change sufficient time to adjust their accounting and billing practices. With respect to non-arm's length transactions, staff agrees that when cannabis or cannabis products are sold at a discounted price less than fair market value, such transactions may not be regarded as arm's length transactions. However, staff does not recommend any amendments to Regulation 3700 regarding non-arm's length transactions at this time, since any draft language has not been vetted through the interested parties process. Staff will consider whether to provide guidance by other means (e.g., industry guide, special notice) and may visit this issue in future interested parties' processes with respect to Regulation 3700.

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. As explained in the Second Discussion Paper, 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 Regulation 3700.

In addition to the written comments noted above suggesting CDTFA establish a category for untrimmed cannabis flower; staff also received comments from Pigeon Racer Farm requesting that CDTFA consider a category for small bud (sometimes referred to as popcorn flower). (See Exhibit 12.) In determining whether a new category is warranted, staff believes it is important to consider whether there is sufficient demand for the category, the feasibility of administering the application of tax to the new category, and whether the category is readily recognizable. Staff also recognizes that while other states may have multiple cannabis categories, those states' tax structures are not equivalent to the CTL.

After consideration of the written comments submitted following the August 2, 2018, interested parties meeting, staff did not and does not propose any new cultivation tax categories. Overall, at this time, staff believes there is inadequate information for sufficient demand, feasibility of administering, or the ability to readily recognize a new category.

CULTIVATION TAX RATES

Following the February 5, 2019, interested parties meeting, staff received written comments submitted by Ms. Sarah Armstrong on behalf of the Southern California Coalition in a February 20, 2019, letter. (See Exhibit 13.) SCC stated that the tax rate for fresh cannabis is too high and should be reduced by subtracting the water weight as a fixed percentage to the size of the plant so that what is taxed has value in the marketplace. Flow Kana proposed revising the cultivation tax rates to an 8% gross receipts tax for all plant material. (See Exhibit 10.) With respect to the tax rate for fresh cannabis plant, staff determined the tax rate pursuant to the CTL which provides that the tax rate for any new categories shall be relative to the value of cannabis flowers. With respect to a gross receipts tax for all plant material, staff does not have the statutory authority to make that change in the regulation. After consideration of the comments, staff does not recommend any changes to the cultivation tax rates themselves but does recommend deleting the cultivation tax rates from Regulation 3700, as further explained below.

Generally, all regulations issued by state agencies are required to be adopted pursuant to California's Administrative Procedures Act (commencing with Government Code section 11340) (APA), unless expressly exempted by statute. Pursuant to GC section 11340.9(g), a regulation that establishes or fixes rates, prices, or tariffs is not subject to the APA. 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.

Due to the fact that the cultivation tax rates are subject to an adjustment on an annual basis and to avoid perpetual rulemaking that is not required, staff recommends deleting the specific cultivation tax rates from Regulation 3700. CTDFA will continue to maintain the cultivation tax rates on its website and send notification to cannabis industry participants through special notice as is does for rate adjustments for other tax and fee programs.

While staff recommends deleting the cultivation tax rates, staff still believes that it is likely that a cultivator's harvested cannabis may not weigh in whole ounces and there may be uncertainty as to whether the cultivation tax applies or what the correct rate would be in such circumstances. As such, staff proposes to keep the regulatory language that clarifies that the cultivation tax imposed shall be at a proportionate rate for quantities that are a fraction of an ounce. In addition, staff believes identifying the categories of cannabis subject to the cultivation tax in the regulation would be helpful to the cannabis industry since CDTFA has the statutory authority to add new cultivation tax categories. Accordingly, staff proposes to continue to list the established cultivation tax categories. Staff's recommended revisions are shown in Exhibit 2, subdivision (c).

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 review and testing. The CTL specifies that "enters the commercial market" means cannabis or cannabis product, except immature cannabis plants and seeds, that complete and comply with a quality assurance review and testing, as described in section 26110 of the BPC.

Pursuant to the CTL, 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 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 the 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 enters the commercial market, as well as the weight and category of the cannabis used to manufacture cannabis products that enters the commercial market. In the initial Discussion Paper, staff explained that in order to enable a distributor to comply with its reporting obligations with respect to the cannabis cultivation tax, staff proposed 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. Following the Interested Parties meeting on August 2, 2018, River Distributing, in an August 16, 2018, letter, stated that it should be clear that the last distributor is responsible for the collection and remittance of the cultivation tax to CDTFA. (See Exhibit 14.) After consideration of the comment, staff proposed to add guidance to specify that the distributor who conducts the final quality assurance review once the cannabis or cannabis products passes the required testing is responsible for collecting and remitting the cultivation tax.

During the February 5, 2019, interested parties meeting, staff presented its proposed guidance regarding which distributor is responsible for remitting the cultivation tax and received input of varying opinions from interested parties. Following the interested parties meeting, staff received comments from CDA, explaining that the distributor who facilitates the required lab testing is also responsible for conducting the initial quality assurance review before distribution and the cannabis or cannabis products would be deemed to have entered the commercial market at that time. CDA also suggested proposed regulatory language that the cultivation tax should be remitted by the distributor that conducts compliance testing and the initial quality assurance review before the cannabis or cannabis products can be sold or transferred to a cannabis retailer or other distributor. (See Exhibit 11.) CCIA also submitted written comments concluding that if the industry and CDTFA agree that it is more efficient to have the first distributor remit the cultivation tax, then that should be the rule. (See Exhibit 15.)

In consideration of the comments, staff notes BPC section 26110(e) specifies that upon issuance of a certificate of analysis by the testing laboratory that the cannabis batch has passed the testing requirements, the distributor shall conduct a quality assurance review before distribution to ensure the labeling and packaging of the cannabis and cannabis products conform to the MAUCRSA requirements. BPC section 26110(g) states that after testing, all cannabis and cannabis products fit for sale may be transported only from the distributor's premises to the premises of another licensed distributor for further distribution, or to a licensed retailer, microbusiness, or nonprofit for retail sale.

BCC Regulation 5307, "Quality-Assurance Review," specifies that when a licensed distributor receives a certificate of analysis for regulatory compliance testing from the licensed testing laboratory or upon transfer from another licensed distributor stating that the batch meets specifications required by law, the licensed distributor shall ensure the following before transporting the cannabis goods, packaged as they will be sold at retail, to one or more licensed retailers or licensed microbusinesses authorized to engage in retail sales. Based on staff's review of Regulation 5307, staff understands that the quality assurance review is required to be conducted by the distributor transferring the cannabis or cannabis products to the cannabis retailer. Therefore, staff recommends adding subdivision (e) to Regulation 3700 to specify that the distributor required to conduct the quality assurance review prior to distributing the cannabis or cannabis products to

a cannabis retailer pursuant to Regulation 5307 is responsible for remitting the cultivation tax. (See Exhibit 2, subdivision (e).) This recommendation is consistent with the CTL, which provides that the cultivation tax shall be due after the cannabis or cannabis products have entered the commercial market.

CANNABIS REMOVED FROM A CULTIVATOR'S PREMISES IS PRESUMED SOLD

Following the August 2, 2018, interested parties meeting, staff received comments from Ms. Ruth Bergman of Deep Roots Farm, in which she expressed her objection to having the definition of cannabis flowers include both trimmed and untrimmed flower, explained that she will not be able to process the flowers on site, and intends to sell her flowers to other entities for processing. (See Exhibit 4.)

Staff noted that cannabis removed from a cultivator's premises is presumed to be sold and is subject to the cultivation tax. However, cannabis removed from a cultivator's premises for processing by a subsequent cultivator, is not subject to the cultivation tax at that time. After consideration of input at the August 2, 2018, interested parties meeting and written comments, staff proposed to remove the term "processing" under this section and replace it with "Processing by a cultivator such as trimming, drying, curing, grading, packaging, or labeling" because it appears to be confusing and contradicts the definition of "unprocessed cannabis" in the CTL.

During the February 5, 2019, interested parties meeting, there was discussion as to whether cannabis removed from the cultivator's premises and transferred to a manufacturer for further processing would qualify as an exception to the presumption that cannabis removed from the cultivator's premises is presumed sold. Following the meeting, Ms. Sequoya Hudson, in a February 20, 2019, email stated that the proposed regulatory language appears to be discounting the fact that manufacturers and distributors may also be required to take a product through further processing and should be entitled to the rebuttal for purposes of taxation. Ms. Hudson also suggested that staff consider adding language that excludes this rebuttal to other licensees. (See Exhibit 16.)

Staff has considered the comments and notes that when cannabis is first transferred or sold to a manufacturer, the manufacturer is required to collect the cultivation tax pursuant to RTC section 34012(h)(2). As such, staff does not believe that the removal from the cultivator's premises to manufacture cannabis products would be an example that would qualify as a reason to rebut the presumption. Staff also notes that the proposed processing activities listed (e.g., trimming, drying, curing, grading) are activities which require a cultivator's license and therefore does not believe extending those activities to other licensees for purposes of rebutting the presumption is consistent with other state licensing regulations. Further, staff notes that the examples listed in the subdivision are not intended to be the only examples for which the presumption could be rebutted. Staff recognizes that licensees may hold multiple licenses and there may be other examples based on the facts and circumstances of those cases which could rebut the presumption. Staff recommends amending subdivision (f)(2)(D) as proposed in the Second Discussion Paper and illustrated in Exhibit 2.

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 choose 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."[6] 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.

As explained in the July 20, 2018, Discussion Paper, staff became aware 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 noted 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 percent mark-up determined by the CDTFA. Staff further recognized 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 proposed 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.

During the August 2, 2018, interested parties meeting, several interested parties expressed their opposition to the proposed regulatory guidance prohibiting a cannabis retailer from separately stating the cannabis excise tax. Some interested parties explained that they prefer to separately state the tax so that their customers can identify the components that comprise the overall selling price of the cannabis and cannabis products. Staff explained that the recommended prohibition was intended to curtail situations in which a retailer is collecting excess excise tax. Following the August 2, 2018, interested parties meeting, staff received several written comments from interested parties, including CCIA, UCBA Trade Association (UCBA), Groundworks Industries, and Green Beach Ventures, in which they reiterated comments made at the interested parties meeting. (See Exhibits 9, 17-19, respectively.)

After consideration of the comments made during the August 2, 2018, interested parties meeting and the subsequent written comments, staff proposed to revise the regulation to remove the language that prohibits a cannabis retailer from separately stating the cannabis excise tax. In addition, staff proposed additional guidance specifying that a separate statement of the cannabis excise tax is permitted and shall be equal to the amount required to be paid to the distributor. Furthermore, staff proposed a new subdivision to define excess excise tax and explain the procedures to follow when excess cannabis excise tax has been collected. (See Exhibit 2, proposed subdivision (h).) This is because, while the CTL addresses excess tax collected by a distributor or manufacturer, it does not address excess collections by a cannabis retailer.

Staff presented the proposed amendments described in the preceding paragraph during the February 5, 2019, interested parties meeting. Following the meeting, staff received comments on behalf of Flow Kana and CDA in which each expressed support for the guidance provided in proposed subdivision (g). (See Exhibits 10 and 11, respectively.) After considering the comments, staff recommends amending Regulation 3700 to specify that a separate statement of the cannabis excise tax is permitted and shall be equal to the amount required to be paid to the distributor and provide guidance with respect to the procedures to follow when excess cannabis excise tax has been collected. (See Exhibit 2, proposed subdivisions (g) and (h).)

[6] 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.

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 vaping devices. 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 vaping devices, are not considered cannabis or cannabis products and are therefore not subject to the 15 percent cannabis excise tax. As explained in the Discussion Paper, for purposes of applying or calculating the proper amount of cannabis excise tax and ease of administration, staff proposed 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. In addition, 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 the distributor would utilize the total amount on the invoice for determining the average market price of the cannabis or cannabis products.

Following the August 2, 2018, interested parties meeting, staff received comments from several interested parties. Cura Cannabis Solutions (Cura) in an August 17, 2018, letter, expressed support for the proposed language. (See Exhibit 20.) Staff also received comments from CCIA expressing support for the proposed language; but adding that they wanted to be certain that a seller or distributor would be provided an opportunity to provide documentation to support the relevant costs, in the event that it mistakenly fails to separately state the relevant prices on the invoice. (See Exhibit 9.) Mr. Moe Abdelwahed explained that he did not believe there needs to be a separate statement and that if a vape cartridge is packaged with active cannabis, then it should be subject to the excise tax. Mr. Abdelwahed also noted that manufacturers and distributors might not want to make a separate statement due to proprietary information with respect to costs of materials. (See Exhibit 5.) UCBA also noted that items packaged with cannabis should be sold as cannabis products and the excise tax should not apply to cannabis accessories sold without any cannabis product. (See Exhibit 17.) The Southern California Coalition (SCC) submitted an August 13, 2018, letter explaining that the excise tax should apply to the quantity of cannabis oil in a vape pen and not to the materials composing the pen itself. (See Exhibit 21.)

LPS stated that the CDTFA does not have authority to tax non-cannabis items and that there needs to be one clear standard and process for determining the excise tax based upon the wholesale price of cannabis or cannabis products. LPS also noted that the use of the term "seller" might create ambiguity as to who should maintain records and suggests replacing with "manufacturer" as the manufacturer would be in a

better position to maintain such records. LPS further suggested that such records should be maintained for seven years. (See Exhibit 8.) BPG had similar comments as LPS and added that it supports mandating a separate statement of the cannabis accessories from cannabis or cannabis products. (See Exhibit 7.) River Distributing respectfully opposes any amendment to separately itemize cannabis products bundled with cannabis accessories. (See Exhibit 14.)

As noted in the Second Discussion Paper, staff reviewed and considered the comments and agreed that cannabis accessories sold without cannabis are not subject to the cannabis excise tax. Staff also agreed that there is a need to provide a clear standard for determining the cannabis excise tax due when cannabis or cannabis products are bundled and sold with cannabis accessories. With respect to the person that may be in the best position to support a segregation of costs, staff understands that the manufacturer may have such records; however, staff believes that for effective administration, the person responsible for maintaining documentation to support the separate statement of charges should be the person responsible for collecting and remitting the tax (i.e., a distributor). Moreover, after further consideration, staff believes that the reference to "seller" is no longer necessary, since the person responsible for collecting and remitting the excise tax is the distributor alone. In addition, staff does not believe a mandate to have a distributor separately state the charges for cannabis or cannabis products and cannabis accessories is feasible in instances when the cannabis or cannabis products transfers between several licensees (i.e., transferred between a manufacturer, or manufacturers, and one or more distributors). In effect, staff's proposed guidance would allow the option to separately state charges, but not create a mandate. With respect to record keeping requirements, staff does not believe mandating a retention requirement of seven years is warranted, since CDTFA's routine reviews of records generally consist of a three-year period, and the existing regulations[7] already require a record retention period of not less than four years. With respect to clarifying whether a person would have an opportunity to provide documentation to support the relevant costs, in the event that it mistakenly fails to separately state the relevant prices on the invoice, staff proposed to clarify that the charges must be separately stated at the time of the sale.

Following the February 5, 2019, interested parties meeting, Mr. Bill De Zenzo, on behalf of Taxnexus Inc. (Taxnexus), submitted written comments stating that Taxnexus understands that current POS systems do not provide a solution that offers different tax treatments for different parts of an item and the proposed amendments unnecessarily negatively impacts the taxpayer. (See Exhibit 22.) SCC submitted written comments stating that the excise tax should apply to the actual oil within the accessory and not the materials surrounding the cannabis product. (See Exhibit 13.) CCIA also submitted written comments stating that if a distributor does not separately state the sales price of the cannabis from the accessories, it shall be presumed that the accessories are included in the average market price; and the presumption is rebuttable by evidence which establishes the individual selling prices. (See Exhibit 15.) Flow Kana expressed support for the subdivision regarding cannabis accessories and the inclusion of a definition of cannabis accessories that aligns with the BCC's definition. (See Exhibit 10.)

Staff has considered the written comments and due to the lack of administrative feasibility, staff does not propose any further revisions to what it proposed in the Second Discussion Paper as discussed herein and illustrated in Exhibit 2, subdivision (i). Staff further notes that RTC section 34011(b), as enacted by Prop. 64, and subsequently amended, specified 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

[7] California Code of Regulations, Title 18, sections 3501 and 4901.

purchase of those goods or services. Staff believes the proposed amendments are consistent with the intent of the CTL and California voters.

Reporting the Cannabis Excise Tax for Distributor to Distributor Sales

Distributors are required to collect the applicable cannabis excise tax for cannabis or cannabis products sold or transferred to a cannabis retailer. The distributors are also required to provide a receipt or invoice to the retailer that identifies the licensee receiving the cannabis or cannabis products, 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 the 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 proposed 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, re-lettered subdivision (j).) Staff received written comments from River Distributing and UCBA expressing support for staff's proposed amendments. (See Exhibits 14 and 17, respectively.) The CDA submitted written comments in an August 27, 2018, letter, in which they suggest the regulation provide that when transferring or selling product to a microbusiness, the transferring distributor is responsible for collecting the cannabis excise tax unless the transfer is designated on the manifest as being transferred to the distribution portion of the microbusiness. (See Exhibit 23.) Staff considered the written comments and revised re-lettered subdivision (j)(3) to reflect that when a transaction is between a distributor and a microbusiness, the required documentation should indicate when the sale or transfer was to the microbusiness acting a distributor.

During the February 5, 2019, interested parties meeting, there seemed to be general support for the revision. Staff did not receive any written comments specific to this issue following the interested parties meeting. Therefore, staff recommends amending subdivision (j)(3) as discussed herein and illustrated in Exhibit 2.

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, re-lettered subdivision (k)(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 recognized 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 underpaid, or failed to file and pay, their tax liability for a period within the audit. As such, staff proposed to amend Regulation 3700 to remove the references to "late" payment. This is because the underlying statutes provide that the penalty shall apply to taxes not paid.

Following the August 2, 2018, interested parties meeting, staff received comments from CCIA explaining that it believes the penalty should only apply when a person knowingly fails to pay the taxes due and not when there is a failure to pay timely or an unintentional error. CCIA also recommends drafting a regulation to specify the penalties that may be imposed under the FCPL with respect to the CTL. (See Exhibit 9.) Mr. Moe Abdelwahed made a general comment regarding the unfairness of the penalty and questioned how it could be addressed and changed. (See Exhibit 5.) Staff also received comments from Ms. Juli Crocket and several other interested parties in which they claim the penalty is too severe. (See Exhibits 24-25.)

After consideration of the comments, staff did not recommend any further revisions to Regulation 3700 regarding the penalty. Staff's proposed language clarifies that the penalty of 50 percent shall apply to payments not received timely, as well as to those liabilities determined in an audit. While the penalty may be seen as severe, the RTC section 55044 allows for relief from the penalty due to reasonable cause and circumstances beyond a person's control. In addition, CDTFA is authorized to grant a person an extension to file and pay a return for good cause. Generally, the maximum length of time an extension may be granted under all programs is one month. Any request for an extension must be filed with the CDTFA no later than one month after the return due date. With respect to drafting a regulation which outlines the penalties that apply to the cannabis industry, staff does not recommend a regulation to describe such penalties. Staff notes that publication 75, "Interest, Penalties, and Fees," currently describes the penalties that apply under the SUTL and FCPL, both of which apply to cannabis distributors filing and making payments to CDTFA. Staff made a request to the appropriate CDTFA section to update publication 75 to reference and explain the penalty imposed pursuant to the CTL.

During the February 5, 2019, interested parties meeting, staff noted that it did not intend to make any further revisions regarding the application of the penalty. Staff did not receive any written comments following the interested parties meeting regarding the penalty. Therefore, staff recommends revising renumbered subdivision (k)(1) and (2), as shown in Exhibit 2, to remove the references to "late payment."

VI. Staff Recommendation

A. Description of Staff Recommendation

Staff recommends CDTFA approve the proposed amendments to Regulation 3700 and authorize publication of the Regulation 3700, "Cannabis Excise and Cultivation Taxes," as proposed to be amended and set forth in Exhibit 2, to:

- Define "California Cannabis Track-and-Trace system" to mean the system all persons licensed pursuant to Division 10 (commencing with section 26000) of the BPC are required to use to record the inventory and movement of cannabis and cannabis products through the commercial cannabis supply chain,
- Specify that the term "cannabis accessories" shall have the same meaning as set forth in section 11018.2 of the HSC,

- Clarify that the term "cannabis flowers" includes "trimmed and untrimmed" flowers and excludes leaves and stems "removed from the cannabis flowers prior to the cannabis flowers being transferred or sold,"
- Clarifying that in order for the cannabis to qualify as fresh cannabis plant, the cultivator must enter the fresh cannabis plant into the California Track-and-Trace system as such, and the cannabis must be manifested and invoiced as fresh cannabis plant,
- Remove the phrase "any further processing, including" and the term "trimming" from what may not occur to be considered fresh cannabis plant,
- Revise the definition of "plant waste" by referring to the waste of the plant Cannabis sativa L. that is managed pursuant to the cannabis waste management provisions of Chapter 1, Division 8 of Title 3 of the California Code of Regulations,
- Establish another definition of "wholesale cost" by deleting the reference to discounts and trade allowances and provide that the revised definition is operative April 1, 2020,
- Delete the cultivation tax rates,
- Specify the cultivation tax invoicing requirements with respect to sales or transfers of cannabis or cannabis products amongst cultivators, distributors, and manufacturers,
- Specify that the remittance of the cultivation tax is the responsibility of the distributor that conducts the quality assurance review before the cannabis or cannabis products can be sold or transferred to a cannabis retailer,
- Replace the non-specific term "processing" under the section regarding the cannabis removed from a cultivator's premises is presumed sold and replace it with "Processing by a cultivator, such as trimming, drying, curing, grading, packaging, or labeling,
- Provide guidance as to the information required on an invoice, receipt, or other document for the excise tax paid to cannabis retailers,
- Specify that a cannabis retailer may separately state the cannabis excise tax when cannabis or cannabis products are sold to a purchaser and the separately stated charge shall be equal to the excise tax required to be paid to a distributor,
- Explain excess excise tax collected and the procedures to report and remit the excess excise tax collected,
- Provide guidance with respect to the application of the cannabis excise tax to cannabis or cannabis products sold with accessories,
- Clarify the documentation required to support that cannabis excise tax was not collected when a distributor sells or transfers cannabis or cannabis products to another distributor or microbusiness acting as a distributor, and
- Clarify that a penalty of 50 percent applies to unpaid taxes.

Staff also recommends that the Director commence the regular rulemaking process with respect to Regulation 3700, as proposed to be amended, so that the regulation may be adopted prior to the expiration of the emergency regulatory action, commonly referred to as filing a "certificate of compliance."

B. Pros of Staff Recommendation

Staff's recommendation will help the emerging regulated cannabis industry understand their collection and reporting obligations under the CTL.

C. Cons of Staff Recommendation

The recommendation may not address the application of tax to all the unique scenarios or issues that may emerge in the cannabis industry. However, staff will continue to monitor issues that may need

regulatory guidance and engage in future interested parties' meetings as necessary.

D. Statutory or Regulatory Change for Staff Recommendation

No statutory change is required. However, staff's recommendation will require staff to proceed with the formal rulemaking process.

E. Operational Impact of Staff Recommendation

None.

F. Administrative Impact of Staff Recommendation

1. Cost Impact

The workload associated with publishing the regulation, updating the website, updating the necessary publications, and issuing special notices is considered routine. Any corresponding cost associated with these activities will be absorbed within CDTFA's existing budget. However, the costs associated with the overall implementation of Proposition 64, as amended by SB 94, AB 133 and SB 1289, are substantive; CDTFA is addressing these costs through the Budget Change Proposal process.

2. Revenue Impact

See Revenue Estimate (Exhibit 1). [pending]

G. Taxpayer/Customer Impact of Staff Recommendation

The proposed amendments will provide clarity for taxpayers so that they can easily understand and comply with the provisions of the CTL. In addition, the permanent adoption of Regulation 3700 will ensure that the necessary guidance will continue to be available and accessible to taxpayers and staff.

H. Critical Time Frames of Staff Recommendation

Regulation 3700 was adopted December 21, 2017, and will automatically be repealed on December 22, 2019, unless the CDTFA adopts the emergency regulation through the regular rulemaking process and submits a timely certificate of compliance to OAL prior to December 21, 2019. In addition, staff's recommended amendments with respect to the definition of wholesale cost contain an operative date of April 1, 2020.

Preparer/Reviewer Information

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

Current as of: May 14, 2019

REVENUE ESTIMATE STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF
TAX AND FEE ADMINISTRATION

REVENUE ESTIMATE

Regulation 3700: Cannabis Excise and Cultivation Taxes

I. 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."

II. Alternative 1 - Staff Recommendation

Staff recommends that the Director approve the proposed amendments to Regulation 3700, "Cannabis Excise and Cultivation Taxes," as set forth in Exhibit 2 of the Formal Issue Paper, "Proposed Rulemaking - Cannabis Tax Regulation 3700", "Cannabis Excise and Cultivation Taxes." For a more detailed explanation of staff's recommendation, refer to section VI of the Formal Issue Paper.

III. Other Alternative(s) Considered

Do not approve the proposed amendments to Regulation 3700.

Background, Methodology, and Assumptions

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 (Stats. 2015, Ch. 719), AB 243 (Stats. 2015, Ch. 688), and AB 266 (Stats. 2015, Ch. 689).

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 were subsequently changed to the Medical Cannabis Regulation and Safety Act (MCRSA) and the Bureau of Cannabis Control.

In 2017, SB 94 (Stats. 2017, Ch. 27) (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 the Marijuana Tax Law to ease and streamline cannabis tax collection and remittance to the CDTFA.

Revenue Summary

Alternative 1 – Staff Recommendation

Since the staff recommendation amendments consist of clarifying guidance, there are no revenue impacts.

Economic Impact

The revenue impact for this proposal is under $1 million, therefore, the California economic impact is likely minimal.

Joe Fitz

April 29, 2019

[Staff Note – Additions to the regulation are in blue with bold font. Deletions are in red with strikethrough.]

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) "California Cannabis Track-and-Trace system" means the system all persons licensed pursuant to division 10 (commencing with section 26000) of the Business and Professions Code are required to use to record the inventory and movement of cannabis and cannabis products through the commercial cannabis supply chain.

(2) "Cannabis accessories" shall have the same meaning as set forth in section 11018.2 of the Health and Safety Code.

(**3**~~1~~) "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**.

(**4**~~2~~) "Cannabis leaves" means all parts of the plant Cannabis sativa L. other than cannabis flowers that are sold or consumed.

(**5**~~3~~) "Cultivator" means all persons required to be licensed to cultivate cannabis pursuant to division 10 (commencing with section 26000) of the Business and Professions Code, including a microbusiness that cultivates cannabis as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code.

(**6**~~4~~) "Distributor" means a person required to be licensed as a distributor pursuant to division 10 (commencing with section 26000) of the Business and Professions **Code**, 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.

(**7**~~5~~) "Fresh cannabis plant" means the flowers, leaves, or a combination of adjoined flowers, leaves, stems, and stalk from the plant Cannabis sativa L. that is either cut off just above the roots, or otherwise removed from the plant.

To be considered "fresh cannabis plant," the flowers, leaves, or combination of adjoined flowers, leaves, stems, and stalk must be weighed within two hours of the plant being harvested and without any ~~further processing, including any~~ artificial drying such as increasing the ambient temperature of the room or any other form of drying, **or** curing, ~~or trimming~~**and must be entered into the California Cannabis Track-and-Trace system,**

manifested, and invoiced as "fresh cannabis plant." If the California Cannabis Track-and-Trace system is not available, or a licensee is not required to record activity, the paper manifest or invoice shall indicate "fresh cannabis plant" is being sold or transferred.

(**8**~~6~~) "Manufacturer" means a person required to be licensed as a manufacturer pursuant to division 10 (commencing with section 26000) of the Business and Professions Code, including a microbusiness that acts as a licensed manufacturer as set forth in paragraph (3) of subdivision (a) of section 26070 of the Business and Professions Code.

(**9**~~7~~) "Ounce" means 28.35 grams.

(**10**~~8~~) "Plant waste" means waste of the plant Cannabis sativa L. that is **managed pursuant to the cannabis waste management provisions of chapter 1, division 8 of title 3 of the California Code of Regulations**~~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~~.

(**11**~~9~~) "Wholesale cost" means**:**

(A) **Prior to April 1, 2020,** the amount paid by the **cannabis** retailer for the cannabis or cannabis product**s**, 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) On and after April 1, 2020, the amount paid by the cannabis retailer for the cannabis or cannabis products, including transportation charges.

(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~~**applies** as follows:

(1) ~~Nine dollars and twenty-five cents ($9.25) p~~**P**er dry-weight ounce of cannabis flowers, and at a proportionate rate for any other quantity.

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

(3) ~~One dollar and twenty-nine cents ($1.29) p~~**P**er 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 California Cannabis 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 California Cannabis Track-and-Trace system.

(3) The manufacturer shall include on the invoice, receipt, or similar document 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 review, as described in section 26110 of the Business and Professions Code.

(e) Remittance of Cultivation Tax. A distributor who conducts the required quality assurance review before the cannabis or cannabis products can be sold or transferred to a cannabis retailer pursuant to section 5307, of chapter 2, division 42 of title 16 of the California Code of Regulations, is responsible for the remittance of the cultivation tax based on the weight and category of the cannabis that enters the commercial market.

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

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

(2) The presumption in subdivision (**f**~~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 **by a cultivator**, **such as trimming, drying, curing, grading, packaging, or labeling,**

(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.

(g) Receipts for Cannabis 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 (g)(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 (g)(1) obtained from the cannabis retailer is sufficient to relieve the purchaser of the cannabis excise tax imposed on the purchase of the cannabis or cannabis product.

(3) A cannabis retailer may separately state a charge for the cannabis excise tax when the cannabis or cannabis products are sold to a purchaser and the separately stated charge shall be equal to the cannabis excise tax required to be paid to a distributor pursuant to section 34011 of the Revenue and Taxation Code.

(h) Excess Cannabis Excise Tax Collected by a Cannabis Retailer.

(1) Definition. When an amount represented by a cannabis retailer to a customer as constituting cannabis excise tax is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the cannabis retailer, the amount so paid is excess cannabis excise tax collected. Excess cannabis excise tax is charged when tax is computed on a transaction which is not subject to cannabis excise tax, when cannabis excise tax is computed on an amount in excess of the

amount subject to cannabis excise tax, when cannabis excise tax is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the cannabis excise tax on an invoice, receipt, or similar document.

(2) Procedure Upon the Determination of Excess Cannabis Excise Tax Collected. Whenever the Department determines that a person has collected excess cannabis excise tax, the person will be afforded an opportunity to refund the excess cannabis excise tax collection to the customer from whom they were collected.

(3) Evidence Sufficient to Establish that Excess Cannabis Excise Tax Amounts Have Been or Will Be Returned to the Customer.

(A) If a person already has refunded to each customer amounts collected as excess cannabis excise tax due, this may be evidenced by any type of record that can be verified by audit such as:

1. Receipts or cancelled checks.

2. Books of account showing that credit has been allowed the customer as an offset against an existing indebtedness owed by the customer to the person.

(B) If a person has not already made excess cannabis excise tax refunds to each customer but desires to do so rather than incur an obligation to the state, the person must:

1. Inform in writing each customer from whom an excess cannabis excise tax amount was collected that the excess cannabis excise tax amount collected will be refunded to the customer or that, at the customer's option, the customer will be credited with such amount, and

2. The person must obtain and retain for verification by the Department an acknowledgement from the customer that the customer has received notice of the amount of indebtedness of the person to the customer.

(C) In the event a cannabis retailer is unable to make such refunds to a customer, the cannabis retailer shall remit the excess cannabis excise tax to a distributor pursuant to paragraph 4 of this subdivision.

(4) Cannabis Retailer's Remittance of Excess Cannabis Excise Tax to a Distributor.

(A) Once a cannabis retailer determines that it has collected excess cannabis excise tax and is unable to make a refund to the customer, and has not previously paid the excess cannabis excise tax to a distributor, the cannabis retailer shall remit the excess cannabis excise tax to a distributor licensed pursuant to division 10 (commencing with section 26000) of the Business and Professions Code.

(B) Upon a cannabis retailer's remittance of the excess cannabis excise tax to a

distributor, as set forth in subdivision (h)(4)(A), a distributor shall provide the cannabis retailer with an invoice, receipt, or other similar document that contains all of the following:

1. Date of execution of the invoice, receipt, or other similar document,

2. Name of the distributor,

3. Name of the cannabis retailer,

4. The amount of excess cannabis excise tax,

5. The number of the seller's permit held by the cannabis retailer, and

6. 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.

(5) Distributor's Reporting and Remittance of the Excess Cannabis Excise Tax. A distributor shall report and remit the excess cannabis excise tax collected from the cannabis retailer pursuant to subdivision (h)(4) with the distributor's first return subsequent to receiving the excess cannabis excise tax from the cannabis retailer.

(i) 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 or transferred with cannabis accessories (e.g., vape cartridges) to a cannabis retailer, and a 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 separately stated charge for the cannabis accessories.

(A) A distributor that makes a sales price segregation must maintain supporting documentation used to establish the individual cost of the cannabis or cannabis products and the cannabis accessories.

(B) Charges will be regarded as separately stated only if they are separately set forth in the invoice, receipt, or other document issued to the purchaser contemporaneously with the sale. The fact that the charges can be computed from other records will not suffice as a separate statement.

(2) When cannabis or cannabis products are sold or transferred with cannabis accessories (e.g., vape cartridges) to a cannabis retailer, and a distributor does not separately state the sales price of the cannabis or cannabis products from the cannabis

accessories, the cost of the cannabis accessories shall be included in the average market price to which the cannabis excise tax applies.

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

(1) A person that holds both a cannabis retailer license and a 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 a person that holds only a distributor license.

(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.

(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. When the transaction is between a distributor and a microbusiness acting as a distributor, the documentation shall indicate that the microbusiness is acting as a distributor.

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

(k~~f~~) 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 (**k**~~f~~)(1) for such failure.

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

Note: Authority cited: Sections 34013, Revenue and Taxation Code. Reference: Sections 34010, 34011, 34012, 34013, 34015, **55041.1** and 55044 Revenue and Taxation Code**; Section 11018.2 Health and Safety Code**.

From: Fiddler's Greens <info@fiddlers-greens.com>
Sent: Friday, August 17, 2018 7:43:05 PM
To: Gonzalez, Trista
Subject: Feedback on Cannabis Tax Regulations

Good evening,
I am writing as an 'interested party' in reference to the discussion paper produced on July 20, 2018 by the CDTFA (https://www.cdtfa.ca.gov/taxes-and-fees/CannabisDPweb072018.pdf), and would like to make some recommendations to simplify the process of tax remittance and collection now that we have several months of 'real world' experience under our belts. We understand that taxation is necessary and that the state of California will benefit from the collection of these taxes, however, the cost of compliance is incredibly expensive and confusing, and is creating barriers to entry as well as an undue burden on the patients and consumers.

My recommendations include the following:

1. **Simplification of Excise Tax collection and remittance.**
   When the regulations were written, I don't think that anyone anticipated the number of distributors that might be involved in a single transaction. We now know that you might have several distributors involved in moving a single batch of cannabis. The record keeping involved in determining who has collected and remitted the tax is incredible labor intensive and subject to error.

   Proposed Solution
   Have retailers remit excise tax based on actual sales. This would mirror what is already occurring for sales and use tax and would reflect the actual selling price of the cannabis. This approach will make it easier for CDTFA to audit receipts and would simplify the flow of product through the supply chain. It would also eliminate the scenario where a retailer is collecting more or less excise tax that was remitted to CDTFA.

2. **Simplification of Cultivation Tax collection and remittance.**
   A similar issue exists for cultivation tax, depending on if the cannabis flowers and trim are being sold to a distributor or a manufacturer, if the cannabis has been processed by the cultivator, or a 3rd party processor, etc. When regulations were written, it was assumed that a cultivator would be doing their own processing, and would be selling 2 products: dried trimmed flowers or dried trimmed leaf. We now know that cannabis may be sold in many forms and to many different outlets.

Proposed Solution

Define a cultivation tax rate that is based on the cultivators gross receipts and make the cultivator responsible for remitting the taxes. This would align with the cultivation tax processes of most local jurisdictions and reduce errors made because cultivators, distributors, or manufacturers are unsure how to classify what is being sold. It also protects the cultivator from an overly burdensome tax percentage when the wholesale prices of cannabis fall as they no doubt will.

3. Refine definitions of types of cannabis that are sold (if cultivation cannabis tax collection is not modified to be based on gross receipts). Cannabis flowers should not be redefined to include both trimmed and untrimmed flowers and the $9.25 rate should not apply to untrimmed flowers. As much as 40% of a dried, untrimmed batch of flowers will be classified as 'trim' and should be subject to the $2.75 tax rate. A 3rd definition should be incorporated into the tax rates so that we have:
    a. Dried, trimmed flower - $9.25 / oz
    b. Dried, leaf/trim - $2.75 / oz
    c. Dried, untrimmed flower - $6.65 / oz (($9.25 *.6) + ($2.75 *.4))

   It appears that there is still some confusion within the CDTFA about how to define and tax 'fresh' and 'fresh frozen' cannabis and that there is concern that there are other types of 'cannabis' that might be sold. The solution of using a gross receipts tax would remedy this issue.

Other things that I ask that you consider:

1. Removing or reducing excise taxes for medical patients. We have nearly doubled the cost of medicine for sick people. Legal Cannabis in California was started out of compassion and we have completely lost that with the implementation of Prop 64. The reduction in revenue to the state will be offset by increased volume of sales because sick people to get safe, affordable medicine through a licensed dispensary instead of going to the black market or relying on street drugs or pharmaceuticals which add to the cost of public health.
2. Lowering the tax rates, in general. A $500 wholesale lb of dried, trimmed cannabis flowers is taxed at over $400 and this does not include any taxes imposed by local jurisdictions for cultivation, distribution, or additional retail taxes. We are never going to get rid of the black market if we can't compete with the black market.

Thank you for your consideration in making this a more streamlined and affordable process.

Sincerely,
Shannon Hattan
Fiddler's Greens

From:	Ruth Bergman
To:	Wilke, Robert
Subject:	Fwd: Comments regarding Cannabis Cultivation Tax
Date:	Thursday, August 23, 2018 3:54:33 PM
Attachments:	Cannabis Tax Proposed Rulemaking.pdf

---------- Forwarded message ---------
From: **Ruth Bergman** <paradisewithpurpose@gmail.com>
Date: Thu, Aug 23, 2018 at 3:38 PM
Subject: Comments regarding Cannabis Cultivation Tax
To: <Trista.Gonzalez@cdtfa.ca.gov>

I ask that you please take my following comments into consideration regarding the **cultivation tax on cannabis**. I have attached the document that was forwarded to me with text of proposed rule changes, etc. that also provided me with this email address to send comments to.

I only recently learned that my concerns about the cultivation tax should be addressed to the CDTFA with its different comment period ending date. Previously, I was under the understanding that all comments on the final draft of commercial cannabis regulations were due before August 27th.

Despite today's date, I'm taking the time to voice my comments and concerns because of how very important fair and just taxation is to my ability to succeed as a small grower. Please contact me to let me know if my comments have been received and considered.

I will soon be pursuing both a Specialty Cottage Mixed-Light Tier 1 and a Small Outdoor cultivation license with the state. As a small grower, keeping costs to a scale that is in accordance with my bottom line and prospects of a profit are an absolute and utmost priority.

I am concerned about how the CDTFA intends to tax whole, untrimmed flower at the same rate as trimmed ready for packaging flower.

In Humboldt county where my farm is situated, I will not be allowed to process on site because, due to being a small producer, I cannot afford to install the facilities required for processing, which include such things as a new ADA compliant bathroom among other costly requirements. In fact, just with all of the costs I am incurring in getting my farm and property into proper legal and environmental compliance in preparation for a cultivation license, I predict that I will not be making a profit for some time. In order to keep afloat I'll need to be producing crops that I can then sell straight off the farm, dried and with stems and water leaves removed, to other entities that will perform thier own processing or add their own brands to that crop. I have heard this approach referred to as selling 'white label'.

My objections are:

To be taxed a Flower tax rate for the leaves that are, as yet, untrimmed off the flower, but that *will* be, is not only unfair, it is detrimental to my ability to survive as a small farmer whose only option is to grow and sell whole flower in a 'white label' capacity.

To say, as it does in the attached CDTFA document, that untrimmed flower "*may* contain a minimal amount of leaves" is incorrect. Untrimmed flower **does** contain extra leaf.

My main comment is:

Leaf matter, whether still attached to the flower or not, should still be taxed at a lesser rate to reflect the lower monetary value it garners.

My recommendation is as follows:

Create a separate tax rate for untrimmed flower that is derived from the reasonably determined ratio of percentage of flower to percentage leaf contained in the whole amount of untrimmed flower, using data gained directly from the industry.

Apply the current tax rates at the value of those percentages by category of flower and leaf for a combined lower tax rate that is more fair and just (see example below).

For example, let's assume that, by using input from operators within the industry, a ratio of untrimmed leaf to flower has been determined to be on average **85%** flower to **15%** leaf, the rates by flower/leaf category would be calculated thusly:

- **85%** of the **Flower** tax rate comes to **$7.8625 per oz**
- **15%** of the **Leaf** tax rate comes to **$0.4125**
- Added together, that would total an

To avoid misuse of the lower tax rate, form a rule that this lower tax rate can only be used by cultivators when selling dried, untrimmed flower directly off the farm in such a manner as the cultivator releases all ownership of the flower in the conditions of that sale.

In addition, require that the next holder in the supply chain furnish evidence of how the untrimmed flower was processed so as to validate that the flower was, in fact, sold in untrimmed state by the cultivator.

Examples from the industry:

I understand that it is difficult to quantify the ratio of leaf to flower in advance of removing the extra leaf. Every strain and every crop is different to some degree. The best approach is to use data gained directly from the industry to establish a reasonable average of the ratio of actual leaf to actual flower contained in untrimmed flower (that has had extra stems and water leaves removed).

Towards this end, I consulted with a manufacturer, a grower and a manager for

a company that manicures flower. Their input, based on their own experience, is as follows:

The **manufacturer** trims their flower (that has had extra stem and water leaves removed) and then uses the trimmed off leaf for extraction. They said they end up with, on average, 0.25 lbs of leaf for every one pound of trimmed flower. This ratio expressed in percentages of the whole untrimmed amount is **20%** leaf and 80% trimmed flower (1 lb flower and .25 lb leaf equals total of 1.25 lbs untrimmed flower, 0.25 divided by 1.25 equals 0.20).

The **grower** who is just now beginning to work out the quantifying of trimmed flower to trimmed leaves offered their beginning averaged results of 0.20 lbs of leaf for every one pound of trimmed flower. This ratio expressed in percentages of the whole untrimmed amount is **17%** leaf and 83% trimmed flower (1 lb trimmed flower and 0.2 lb leaf equals total of 1.2 lbs untrimmed flower, 0.2 divided by 1.2 equals 0.167).

The **manager of a company that trims flower professionally** has set their own standard that is based on the starting weight of the untrimmed flower (that has had extra stem and water leaves removed). The standard states that the finished ratio of trimmed flower to leaf should not exceed 70% flower to 30% leaf respectively of the whole of the starting weight (1 pound starting weight of untrimmed flower resulting in 0.7 lb trimmed flower and 0.3 lb leaf).

While their standard is set at 30%, they said that the actual percentage range of leaf they end up with is usually between 10% and 20% of the whole starting weight. They suggested that **15%** of the whole untrimmed weight is a fair estimate as to the ratio of trimmed flower to leaf that results.

Additional comments:

As stated, I've attached the document wherein I found this email address to send comments to. In addition, I have copied and pasted the text below from that document with highlights of text that I strongly maintain is incorrectly worded, the consequences of such allows for the imposition of an unfair burden of overtaxation on those who can least afford it.

By this I mean the small grower, such as myself and any one else facing similar difficulties around being able to process thier own crop onsite and whose only option is to sell 'white label' flower, untrimmed and unprocessed, directly from the farm to such agents as will perform thier own further sales, processing or brands to that crop.

My suggestion towards correcting that wording is to replace the use of '***may***' and '***minimal amounts of leaves***' with wording that more accurately reflects the fact that untrimmed flower **does** contain leaf, the quantities of which should be determined from data taken directly from industry.

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, 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).)

In closing, thank you for the opportunity to comment. My success as a cultivator, along with all the cultivators who stand to benefit from a more fair application of the cultiavation tax, will count towards the success of the CDTFA.

Please let me know if my comments have been received.

Thank You,

Ruth Bergman
Deep Roots Farm

From: Moe Abdelwahed <msacpatax@gmail.com>
Date: August 16, 2018 at 12:34:34 PM PDT
To: trista.gonzalez@cdtfa.ca.gov
Subject: RE: Comments on Proposed Amendments to Regulations 3700, 3701, and 3702

Good evening,

I'm a tax practitioner with clients in the industry and I attended the *Meeting of Interested Parties* on August 2, 2018 in Sacramento. I appreciate the CDTFA conducting this meeting for public comments and being proactive and issue guidance on these regulations that make sense for the industry. This was a very beneficial meeting with quality discussion and input.

After careful review and based on the knowledge of my clients' businesses, I have the following comments in regards to the proposed amendments:

Regulation 3700(a)(2) - Definitions of Cannabis Flower: Due to the high tax associated with cannabis flowers at $9.25/oz, this definition should NOT include untrimmed flower. Untrimmed flower has its own market altogether and it does not sell at the same price as trimmed cannabis flower. For that reason alone, there should be a separate category for untrimmed cannabis flower with a cultivation tax closer to that of cannabis leaves. I'm sure that amount can be determined by the CDTFA based on market analysis.
Regulation 3700(g) - Cannabis or Cannabis Products sold with Cannabis Accessories: I don't believe that need to separate based on accessories but more along the lines of when cartridge comes packaged with an active cannabis ingredient, then it should be subject to excise tax. Vape cartridges usually include cannabis ingredients packed in to them and manufacturers and distributors will not want to list out each item separately on invoices due to excise tax. It may be proprietary information in regards to costs of materials. This encourages manufacturers and distributors to package accessories separately in order to not pay excise tax on items that do not have active cannabis ingredients. I believe this will complicate things even more.
Regulation 3700(i) - Penalty for Unpaid Taxes: This is more of a general

comment on the penalty as a whole. I know the consensus in the room at the meeting is this is an unfair penalty for an industry that has not even been given proper guidance on how to adhere to all the taxes they are subjected to. How can we address this and change this 50% penalty? I know some of the CDTFA representatives agreed it is excessive. I understand that there is a waiver that can be filed but that is burdensome to keep up with for a new industry with businesses establishing their footing and attempting to survive. I would appreciate information on hearings in which I can represent my clients on this matter.

I appreciate your time and consideration on this matter. If you have any questions at all about my comments, please feel free to reach me at this email or the phone number listed below.

--
Sincerely,

M.Abdelwahed, CPA
P: 949.701.9524
P.O. Box 11645 I Beverly Hills, CA 90212

10/30/2018
Trista Gonzalez, Chief
CDTFA Tax Policy Bureau
3321 Power Inn Road, Suite 210
Sacramento, CA 95826

Jonathan Gee, Sr. Accountant
Cura CA LLC
5852 88th St Ste 400
Sacramento, CA 95828

Public Comment

To whom it may concern,

We thank the CDTFA for this opportunity for us to provide constructive feedback regarding CDTFA's proposed changes to Regulation 3700. Cura Cannabis Solutions' comments and recommendations are as follow.

With regard to Section A Subsection 7; we would like for CDTFA to please clarify whether there are any additional reporting requirements related to the harvesting of fresh cannabis plant. Here is an example: let us say that Cura decides to purchase fresh cannabis plant from a vendor and this vendor weighs the plant within two hours of harvest and manifests this total weight to Cura. Is there any requirement that this fresh cannabis plant leaves the place of harvest immediately? If the cultivator were to dry/process the fresh cannabis plant before it leaves the premises, does this have any effect on the taxable rate of the cannabis?

With regard to Section A Subsection 11; we strongly agree with the CDTFA's proposed changes to the regulation. Cura offers differing pricing structures for different customers based on many factors. Attempting to define a "wholesale cost" is therefore challenging for Cura; this causes complications when we are also forced to then quantify the "wholesale cost" and take the pricing variability as the "discount". Legal Cannabis is a brand new industry in California and therefore costs and prices are not well established as in other industries.

With regard to Section D Subsection 3 and Section E; we request that CDTFA clarify the language that cannabis business should use when indicating whether or not tax has been paid on cannabis material. We have found that each of our vendors utilize different methods to report whether or not cultivation

tax has been paid on cannabis material. The lack of standardization in reporting cultivation tax causes confusion and increases the amount of time it takes us to process and report our material purchases.

Thank you very much for your time. Sincerely,

Jonathan Gee
Sr. Accountant
Jgee@curacan.com
(209) 559 - 2021

www.mypbg.com
2366 San Pablo Avenue
Berkeley, California 94702
Tel: 510.540.6013
Fax: 510.540.1928

August 16, 2018

Ms. Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
405 N Street
Sacramento, CA 95814 VIA EMAIL: TRISTA.GONZALEZ@CDTFA.CA.GOV

RE: CANNABIS TAXES PROPOSED RULEMAKING DISCUSSION PAPER

Dear Chief Gonzalez,

Thank you for the opportunity to provide feedback on the CDTFA's latest proposed rulemaking discussion paper. The comments provided below include policy recommendations regarding the separation of cannabis and cannabis products from accessories, packaging and additional ingredients for the purposes of calculating the excise tax and pursuant to Section 11018.2 of the Health and Safety Code.

Your discussion paper also indicates an interest in readdressing the definition of wholesale cost found in Regulation 3700(a)(9). We have included some proposed amendments that would clarify how these costs should be calculated. More specifically, to determine the wholesale cost in an arms-length transaction, cannabis and cannabis products should be documented and calculated without consideration of the cost of packaging, hardware, and additional ingredients.

The opportunity to provide feedback is greatly appreciated. Thank you for your time and consideration.

Best regards,
Sabrina Fendrick

Sabrina Fendrick
Director of Government Affairs
Berkeley Patients Group

www.mypbg.com 2366 San Pablo Avenue Tel: 510.540.6013
Berkeley, California 94702 Fax: 510.540.1928

REGULATION 3700(g)(1)(2). CANNABIS EXCISE AND CULTIVATION TAXES.

CDTFA Proposed Amendments [re: cannabis sold with accessories]

(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.

POSITION

Support [with proposed amendment]

COMMENT

For purposes of applying or calculating the proper amount of cannabis excise tax, we support mandating that cannabis accessories[i] and cannabis or cannabis product be separately stated on the invoice from the non retail seller or distributor of the cannabis or cannabis products to the retailer. The industry needs one clear standard and process for determining the excise tax based upon the wholesale price of cannabis or a cannabis product. As stated in the CDTFA's proposed changes, "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."

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Berkeley, California 94702 Fax: 510.540.1928

Any opportunity to further clarify and reduce the tax burden would benefit operators. What's more, analyses demonstrate that proposed trade tariffs from China would drive up cannabis accessory production prices, particularly for vape pens, by 15-20%. These costs would drive up consumer prices and further hinder the ability for the legal market to economically compete with illicit operators, further dis incentivizing consumers to support the legal market. Licensees are already required to track the weight of cannabis or cannabis product as it moves through the supply chain. It is therefore possible for providers to easily separate the cost of the hardware and packaging from the wholesale value of the cannabis or cannabis product.

Pursuant to MAUCRSA, CDTFA derives its authority to impose this tax on "cannabis or cannabis products" from Section 34011(a) of the Revenue and Taxation Code. The excise tax authorization is very specific. Therefore, CDTFA does not have authority to impose this specific tax upon non cannabis items and should also expressly clarify that the tax calculation does not include the cost of packaging, or, "the weight of any other ingredient combined with cannabis to prepare topical or oral administrations, food, drink, or other product."[ii]

Furthermore, the use of the word, "seller" in the proposed text, may generate ambiguity with regard to which party is responsible for creating and maintaining documentation that would establish costs and justify the allocation of costs. There is clearly a need to create and maintain auditable records of the allocation of costs. However, as the manufacturer is traditionally the party with that information, may keep aspects of that information confidential as part of its business, and the term is well defined in applicable law, the use of "manufacturer or distributor" should replace the use of "seller or distributor" in any related publication, ISOR, or regulatory text.

Ultimately, there should be <u>a single standard for calculating the excise tax separate from accessories and product hardware</u>. Allowing two separate options for how distributors will calculate the excise tax creates ambiguity and leaves too much room for interpretation, especially as this agency work to gather accurate data for determining wholesale costs and retail prices.

PROPOSED TEXT
<u>(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</u>

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15 percent of the average market price of any retail sale by a cannabis retailer. ~~Unless as otherwise provided below, t~~The cannabis excise tax does not apply to the cost of cannabis accessories, additional ingredients or packaging materials.

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

(2) The manufacturer or distributor of the cannabis or cannabis products shall maintain documentation that would establish the individual cost of the cannabis or cannabis products separately from the cannabis accessories, additional ingredients or packaging materials in accordance with the provisions of Regulation 1698 of the Sales and Use Tax Regulations as may be amended.

~~(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.~~

REGULATION 3700(A)(9). WHOLESALE COST.

CURRENT DEFINITION OF WHOLESALE COST

3700(a)(9) *"Wholesale cost" means the amount paid by the retailer for the cannabis or cannabis product, including transportation charges. Discounts and trade allowances must be added back when determining wholesale cost*.

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COMMENT

The same argument provided above for the proposed amendments to section 3700(g)(1)(2) can also be applied to the definition of wholesale price, especially with regard to the calculation of an "arms-length transaction." Section 34010(b)(1)[iii] of the Revenue and Taxation Code requires that the average retail price be "determined by the wholesale cost of the cannabis[iv] or cannabis products[v] sold…". Health and Safety Code section 11018(b) expressly excludes the weight of any other ingredient combined with cannabis and Health and Safety Code section 11018.1 includes the term "packaging" as part of the definition of "cannabis accessory." The only component of a product to be calculated for excise tax, or to fall within the definition of wholesale cost, should be the value of the weight of the actual cannabis or cannabis product, regardless of the hardware, packaging or other ingredients that get calculated into the total purchase price.

PROPOSED DEFINITION OF WHOLESALE COST

3700(a)(9) "Wholesale cost" means the amount paid by the retailer for the cannabis or cannabis product pursuant to subsection (A), including transportation charges. Discounts and trade allowances must be added back when determining wholesale cost.

(A) The amount paid by the retailer for the cannabis or cannabis products shall be determined by the value of the associated weight of the cannabis or cannabis products as documented on a sales invoice or manifest, and entered into track and trace when applicable, prior to entering the commercial market.

(1) A sales price segregation shall be documented and maintained by the manufacturer or distributor to establish the individual cost of the cannabis or cannabis products as separate from the cannabis accessories and any other ingredients combined with cannabis.

(2) The cost of any cannabis accessories or other ingredients as described in Sections 11018.2 and 11018(b) of the Health and Safety Code shall be excluded from the definition and calculation of the wholesale cost of cannabis or cannabis products.

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2366 San Pablo Avenue
Berkeley, California 94702
Tel: 510.540.6013
Fax: 510.540.1928

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[i]Health and Safety Code 11018.2. “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**.

[ii] Health and Safety Code. 11018(b). “Cannabis” does not include; “The weight of any other ingredient combined with cannabis to prepare topical or oral administrations, food, drink, or other product.

[iii] Revenue and Taxation Code. 34010(b)(1). In an arms length transaction, the average market price means the average retail price determined by the wholesale cost of the cannabis or cannabis products sold or transferred to a cannabis retailer, plus a mark-up, as determined by the department on a biannual basis in six-month intervals.

[iv] Business and Professions Code. 26001(f). “Cannabis” means all parts of the plant Cannabis sativa Linnaeus, Cannabis indica, or Cannabis ruderalis, whether growing or not; the seeds thereof; the resin, whether crude or purified, extracted from any part of the plant; and every compound, manufacture, salt, derivative, mixture, or preparation of the plant, its seeds, or resin. “Cannabis” also means the separated resin, whether crude or purified, obtained from cannabis. “Cannabis” does not include the mature stalks of the plant, fiber produced from the stalks, oil or cake made from the seeds of the plant, any other compound, manufacture, salt, derivative, mixture, or preparation of the mature stalks (except the resin extracted therefrom), fiber, oil, or cake, or the sterilized seed of the plant which is incapable of germination. For the purpose of this division, “cannabis” does not mean “industrial hemp” as defined by Section 11018.5 of the Health and Safety Code.

[v]Health and Safety Code. 11018.1. “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.

JAVIER A. BASTIDAS
jbastidas@lpslaw.com

August 17, 2018

Via Electronic Mail

ATTN: Trista Gonzalez
Tax Policy Bureau Chief
Business Tax and Fee Division
450 N Street
Sacramento, CA 94279
E-mail: trista.gonzalez@cdtfa.ca.gov

Re: Comments on Proposed Rules with Respect to Cannabis Taxes

Dear Ms. Gonzalez:

Our office hereby submits the following comments to the proposed *Amended Regulations with Respect to Cannabis Taxes* proposed by the California Department of Tax and Fee Administration's ("CDTFA"):

Regulation 3700. Cannabis Excise and Cultivation Taxes.

The proposed amendment to Regulation 3700(g) reads as follows:

(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.

Concern: The measure is unconstitutional. Pursuant to the Medicinal and Adult-Use Cannabis Regulation and Safety Act ("MAUCRSA"), the CDTFA derives its authority to impose this tax on "cannabis or cannabis products" from Section 34011(a) of the Revenue and Taxation Code ("Tax Code"). The excise tax authorization is very specific. Therefore, CDTFA does not have the authority to impose this specific tax upon non-cannabis items.

Furthermore, the measure would complicate an already confusing and burdensome taxing scheme for the cannabis industry. The industry needs one clear standard and a process for determining the excise tax based upon the wholesale price of cannabis or a cannabis product, period. There must be a system in place that ensures the creation and maintenance of auditable records concerning the allocation of costs. The use of the word "seller" in the proposed text may generate ambiguity with regard to who exactly is responsible for creating and maintaining such records. The manufacturer is in a better position to be responsible for this task. With the track and trace system monitoring cannabis product from cultivation down the supply chain, it will not be difficult to document the cost of the cannabis or cannabis product separately from the accessories. Allowing two separate options for how distributors will calculate the excise tax creates ambiguity and leaves too much room for interpretation. Overburdening the industry will only drive more operators into the illicit marketplace, which is in complete odds with one of the main purposes of MAUCRSA.

Moreover, we believe these records should be maintained for a period of seven (7) years, to be more consistent with other provisions within MAUCRSA (see Section 5037(a)(1) of the Bureau of Cannabis Control's proposed Regular Regulations).

I further note that Health and Safety Code §11018.2 defines "Cannabis Accessories 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 containing cannabis, or for ingesting, inhaling, or otherwise introducing cannabis or cannabis products into the human body." It is therefore clear that with this section, when taken in hand with Section 34011(a) of the Tax Code (see above), the Legislature intended to keep the excise tax limited to cannabis and cannabis product only and identifying costs for accessories is a simple accounting task given the extremely specific detail

within §11018.2. There should be no reason to allow a secondary option for distributors to calculate the excise tax.

For purposes of applying or calculating the *proper* amount of cannabis excise tax, we therefore support mandating that cannabis accessories and cannabis or cannabis product be separately stated on the invoice from the manufacturer or distributor of the cannabis or cannabis products to the retailer.

Finally, I note that our sitting President has recently threatened to raise trade tariffs for China as high as **25%**. Given how the proposed tariffs will drive up production costs and in turn consumer prices, especially in the realm of vape pens (incidentally, we applaud the inclusion of "vape cartridges" within the amended language), we must strive to reduce the potential tax burden to benefit operators. Otherwise, the State will further hinder the ability for the legal market to economically compete with illicit operators, further dis-incentivizing consumers to support the legal market.

In sum, not only is the measure unconstitutional, it's simply bad policy. Allowing two separate options for how distributors will calculate the excise tax creates ambiguity and leaves too much room for interpretation. This fledgling industry is already overtaxed. If we want MAUCRSA to succeed in its goals, we must do as much as we can to simplify the tax regime and not overburden the businesses within this sector.

Proposed Solution: Use the following language instead:

> (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 or packaging materials.
>
> (1) When cannabis or cannabis products are sold with cannabis accessories (e.g., vape cartridges, rolling paper), a sales price segregation must be documented to establish the individual cost of the cannabis or cannabis products separate 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) The manufacturer or distributor of the cannabis or cannabis products shall maintain documentation that would establish the individual cost of the cannabis or cannabis products and the cannabis accessories for a period of no less than seven (7) years.

Regulation 3700(a)(10) – Defintion of Wholesale Cost.

The new proposed language for the definition of "wholesale cost" reads as follows:

(10) "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.

Concern: The same argument provided above for the proposed amendments to §3700(g) can be applied to the definition for "wholesale price. "Section 34010(b)(1)[i] of the Tax Code requires that the average retail price be "determined by the wholesale cost of the ***cannabis*** or ***cannabis products*** sold…" (emphasis added). Health and Safety Code §11018(b) expressly excludes the weight of any other ingredient combined with cannabis, and Health and Safety Code §11018.1 includes the term "packaging" as part of the definition of "cannabis accessory." The only components of a product to be calculated for excise tax, or to fall within the definition of wholesale cost, should therefore only be the weight or volume of the actual cannabis or cannabis product, regardless of the hardware, packaging or other ingredients that get calculated into the total purchase price. Furthermore, the wholesale cost should exclude any local tax markup added by a licensee higher up on the supply chain.

Proposed Solution: Amend the definition as follows:

3700(a)(10) "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.

(A) The amount paid by the retailer for the cannabis or cannabis products shall be determined by the value of the associated weight of the cannabis or cannabis products as documented on a sales invoice or manifest, and entered into track and trace when applicable, prior to entering the commercial market.

(1) A sales price segregation shall be documented and maintained by the manufacturer or distributor to establish the individual cost of the cannabis or cannabis products as separate from the cannabis accessories and any other ingredients combined with cannabis.

(2) The cost of any cannabis accessories or other ingredients as described in Sections 11018.2 and 11018(b) of the Health and Safety Code shall be excluded from the definition of wholesale cost.

Very truly yours,

Javier A. Bastidas
LELAND, PARACHINI, STEINBERG,
MATZGER & MELNICK, LLP

MCCLELLAN DAVIS®, LLC
SALES AND USE TAX SPECIALISTS

508 GIBSON DRIVE, SUITE 120
ROSEVILLE, CA 95678
(855) 995-6789 | (916) 788-0999
FAX (916) 788-0989 | WWW.SALESTAXHELP.COM
TAXHELP@SALESTAXHELP.COM

August 24, 2018

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

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you for providing us with the opportunity to make this submission on behalf of the California Cannabis Industry Association (CCIA). This submission is being made in response to the Discussion Paper issued on July 20, 2018, and the interested parties meeting which was held on August 2, 2018.

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

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

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

I. Definition of Wholesale Cost (Reg. 3700, subd. (a)(10).)

The regulation currently defines wholesale cost as:

> ""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."

Staff indicated that the definition of wholesale cost was adopted from the Cigarette and Tobacco Products Tax Law (CTPL). There is no mention of discounts or trade allowances in the Cannabis Tax Law and we believe there is no valid basis to use the definition from the CTPL to establish the definition of wholesale cost for cannabis. The industries are completely distinct in virtually every relevant aspect and the taxing schemes are also distinct. Because the Cannabis Tax Law does not define wholesale cost, we believe the plain meaning of the term should be used to establish the definition used in the regulation. As such, we recommend the following definition:

> "Wholesale cost means the amount paid by the retailer for the cannabis or cannabis product, including transportation charges."

II. Requirement for retailers to only state that tax is included in the selling price, without an option to separately state the amount. (Reg. 3700, subd. (f).)

Revenue and Taxation Code (RTC) section 34011, subdivision (a)(2), states that a cannabis retailer shall provide a purchaser with an invoice, receipt, or other document that includes a statement that reads: "The cannabis excise taxes are included in the total amount of this invoice." RTC section 34011, subdivision (a)(3), however, provides the CDTFA with authority to prescribe other means to display the cannabis excise tax on an invoice, receipt or

other document given to the purchaser. Thus, the law provides the CDTFA with some flexibility in this regard.

We previously sought to maintain the option to include a statement indicating that tax is included in the selling price, without requiring a separately stated tax amount. The goal was to avoid disclosing (by computation) the markup applied to the wholesale cost. Staff explained that requiring a statement as opposed to separately stating the amount, would also mitigate potential issues with excess tax reimbursement. The Regulation was amended to require a statement indicating that tax is included in the selling price, consistent with the statute, but it precludes a retailer from separately stating the tax amount. We are in agreement with other parties at the meeting that a retailer should have an option to separately state the tax amount or include a statement, in the same way that option exists for sales and use tax under Regulation 1700. We believe either method, a statement, or a separately stated amount, will satisfy the requirements under the law and relieve the purchaser of its liability.

III. Average Market Price computation. Arm's length transactions and nonarm's length transactions

The average market price is the measure of the retail cannabis excise tax under an arm's length transaction, but the regulations do not provide any guidelines in this regard. RTC section 34010, subdivision (b), defines average market price. Regulatory guidelines should be established that clearly explain how the "Average Market Price" is computed. The applicable regulation should explain how the computation is carried out, including a description of what costs the markup should be applied to, and how the tax is computed therefrom. We believe it would be significantly beneficial to provide *at least one* example of how the average market price is computed, and how it flows into the tax computation.

There should also be a description of a nonarm's length transaction, the applicable measure of tax and an example of how to compute the tax. There is a lot of confusion in the industry on these aspects of the law and clear guidelines are needed to enable greater compliance. Individuals should be provided with a clear understanding of the measure of tax within the regulations, without having to look to the statutes or other publications in order to synthesize the authority.

VI. Cannabis or Cannabis Products sold with accessories. (Reg. 3700, subd. (g).)

In summary, the related revisions to the Regulation require the price of cannabis and cannabis products to be separately stated when sold with accessories, or the accessories will be included in the wholesale cost of the cannabis, thereby making them subject to the cannabis retail excise tax. We strongly support these provisions, but we want to make certain that a seller or distributor will be provided with an opportunity to produce documentation that will establish the

relevant costs at a later time to avoid a potentially significant (unintended) liability, in the event that it mistakenly fails to separately state the related prices on its invoice. It appears subdivision (g)(2) provides that opportunity, but it is unclear. We recommend the following language for subdivision (g)(2):

> "When the seller or distributor does not separately state the price of the cannabis or cannabis products from the cannabis accessories, the cost of the cannabis accessories shall be included in the wholesale cost for determining the average market price to which the cannabis excise tax applies, unless the seller or distributor is able to provide documentation that will separately establish the cost of the cannabis or cannabis products and the cannabis accessories."

VII. Penalty established under RTC section 34013, subdivision (e).

In our submission made on August 24, 2017, we disputed the conclusion that the penalty provided is mandatory and that the penalty is applicable for merely making an untimely payment. Since AB 133 established relief for the penalty under Collections and Procedures Law section 55044, our greatest concern now is that staff continues to treat the penalty as if it was designed to apply to untimely payments. We believe the penalty should only apply when a person fails to pay the tax, not when there is a failure to pay *timely* and/or an unintentional error in reporting.

RTC section 34013, subdivision, (e) provides:

> "Any person who fails to pay the taxes imposed under this part shall, in addition to owing the taxes not paid, **be subject to** a penalty of at least one-half the amount of the taxes not paid, and shall **be subject to** having its license revoked pursuant to Section 26031 of the Business and Professions Code or pursuant to Chapter 3.5 (commencing with Section 19300) of Division 8 of the Business and Professions Code." (Emphasis added)

CDTFA's July 20, 2018, rulemaking discussion paper provides revised regulatory language for the penalty as follows:

> "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."

Revised Regulation 3700 changed the title of subdivision (i)(1) from "Late Payments" to "Penalty for Unpaid Taxes," and it also removed "Late Payment" and "timely" from subdivision (i)(2). But, at the interested parties meeting, staff explained that it still intends to assess the penalty for late payments.

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

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

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

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

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

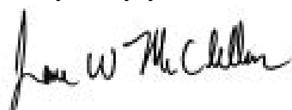
We believe the other penalties provided for under the Fee Collection Procedures Law should also be clearly described in a regulation, rather than merely referenced, since most people will have difficulty cross-referencing and understanding different sections of the law. Sales and Use Tax Regulation 1703,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

VII. Other issues raised in our prior submission

Unless the issues raised in our prior submission dated August 24, 2017, were addressed in the proposed regulations, we hereby incorporate them by reference as if they were fully set forth within this document.

On behalf of CCIA, we again thank you for your efforts to establish comprehensive and clear regulatory guidelines that will help enable industry participants to comply with the law. Please do not hesitate to contact me with any questions or comments.

Very truly yours,



Jesse W. McClellan, Esq.
McClellan Davis
On behalf of CCIA

Cc: CCIA
Mr. Robert Wilke, CDTFA Tax Policy Division
Mr. Robert Prasad, CDTFA Tax Policy Division

FLOW KANA

February 20, 2019

ATTN: Trista Gonzalez
Tax Policy Bureau Chief
Business Tax and Fee Division
450 N Street
Sacramento, CA 95814
E-mail: trista.gonzalez@cdtfa.ca.gov

Re: Proposed Cannabis Tax Regulation 3700

Dear Chief Gonzalez,

Flow Kana appreciates the diligence and effort you and your staff have put into the proposed revisions to the cannabis tax regulations, circulated January 25, 2019. First, we would like to acknowledge the many positive developments contained within the revised regulations. Of these revisions, three provisions stand out that we fully support:

New definition of "wholesale cost"
We support this new definition of wholesale cost. Simplifying "average market rate" to the price paid by retailers will make collection and remittance of excise tax much easier.

Cultivation Tax Invoicing Requirements.
The added clarity of this section will help the industry understand how to properly pass through the supply chain from licensee to licensee.

Receipts for Excise Tax Paid to Cannabis Retailers.
We support this addition of a retailer's ability to specify the amount of excise tax collected from a retail customer. This, in conjunction with the revised definition of average market rate, should make the collection and remittance of excise tax easier and more accurate.

In addition to these priorities within the proposed revisions to the final regulations, Flow Kana has made the following 2 recommendations below:

FLOW KANA

1) Cannabis or Cannabis Products Sold with Cannabis Accessories.

Recommendation:
We support this new section, and propose an addition to ensure alignment with BCC's definition of a cannabis accessory, which is "*Cannabis accessories" has the same meaning as in Health and Safety Code section 11018.2.*" according to BCC regulations section § 5000 Definitions.

Discussion:
To help this new addition be as effective as possible, we recommend including BCC's reference to Health and Safety Code section 11018.2, whose definition of a cannabis accessory is:

> "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.

2) Cultivation Tax Rates

Recommendation:
We propose revising the cultivation tax rate to an **8% of gross receipts** tax rate for all plant material (trimmed flower, untrimmed flower, stems, and leaves) that enter the commercial market.

Discussion:
There are 3 major benefits to converting to a percentage based cultivation tax rate:

1. Moving to a percentage based tax rate across all types of plant material will eliminate the confusion around whether material is classified as flower (trimmed or untrimmed), leaves, or stems.
    a. This will prevent cases of fraud where businesses misclassify their product under the leaves & stems category when it may be a predominately flower product.

2. It will bridge the gap of tax inconsistency between different pricing levels of cannabis flower.
    a. Because of the variance in pricing of different products, the flat dollar amount of $148 per pound ($9.25/oz * 16oz/lb= $148/lb) tax rate ends up unfairly charging a higher tax % rate for farmers of lower priced flower vs higher priced flower.

FLOW KANA

i. Lower quality flower sold by a cultivator for $750 / lb. is paying 20% ($148/ $750/lb) in cultivation tax.
ii. Above average flower sold by a cultivator for $1200 is paying 12% ($148/ $1200) in cultivation tax.
iii. Higher priced flower is being taxed as low as 8% ($148/$1800) when priced at upwards of $1800/lb.
    1. This is the reason for proposing the 8% number in our proposal, so that the larger businesses are not the only ones benefiting from the lower tax rate.

b. The flat dollar amount cultivation tax structure creates a high barrier to entry for emerging businesses, since established brands charging higher prices will pay less taxes percentage wise compared to new businesses.
    i. This will impact equity partners that may not have as much marketing budget to help drive up their product prices.

3. A % based structure will account for market fluctuation of product pricing.
    a. Flat dollar amount taxes means that rates will go up if the value of product goes down.
        i. In Oregon, one study showed that flower that originally sold for $2500/lb in 2017 lowered in value to $800/lb by the end of 2018.
        ii. If taxed at the current CA flat rate of $148 per pound, that same farmer would be experiencing an increase in tax rate from 6% ($148/2500) to 18.5% ($148/$800).
        iii. If this flat dollar amount still exists in a future where prices have dropped significantly, current operators will struggle to survive if they have to pay the same amount of taxes then if & when their product value goes down.
    b. A % of gross receipts will give cultivators some reprieve in case their products do get devalued.

Thank you for thorough review and careful consideration of our comments. If you have any additional questions please don't hesitate to contact me directly:

Mark Rapanut | Manager of Compliance | 408-598-7124 | mark@flowkana.com

February 19, 2019

Mr. Nicolas Maduros
Director, California Department of Tax & Fee Administration
P.O. Box 942897
Sacramento, CA 94279-4530

Ms. Lori Ajax
Director, Bureau of Cannabis Control
P.O. Box 138200
Sacramento, CA 95813-8200

Re: Comments on Regulation 3700, *Cannabis Excise and Cultivation Taxes*

Dear Mr. Maduros & Ms. Ajax:

The Cannabis Distribution Association (CDA) is pleased to provide comments regarding proposed amendments to the CDTFA regulations, as proposed in Exhibit 1 of the Second Discussion Paper on Cannabis Tax Regulation 3700. The CDA is a statewide trade association representing licensed distributors who remit taxes on a vast majority of regulated cannabis products throughout California.

1. **Identifying the Distributor responsible for collecting and remitting Cultivation Tax**

   New proposed language in subsection (e) of Regulation 3700 Cannabis Excise and Cultivation Taxes, reads:

   > (e) Remittance of Cultivation Tax. A distributor who conducts the final quality assurance review before the cannabis or cannabis products can be sold or transferred to a cannabis retailer pursuant to section 26110 of the Business and Professions Code is responsible for the remittance of the cultivation tax based on the weight and category of the cannabis that entered the commercial market.

   This language a) contradicts previous and current CDTFA guidance in a written response letter and on its website, b) conflicts with the intent of statute as outlined in Revenue and Tax Code 34010 (m) regarding what constitutes *entering the commercial market*, and c) if it were to go into effect, would further complicate an already complex tax collection process, elongating the timeframe for tax remittance and making auditing more difficult for the Department.

   a) Previous CDTFA guidance in the attached letter from the department to the Cannabis Distribution Association dated December 18, 2017 reads as follows: "**The distributor who arranges the testing for the cannabis or cannabis product and performs the quality assurance review is responsible for collection and remittance of the cultivation tax.** The distributor who transfers or sells the cannabis or cannabis product to the retailer is responsible for the collection and remittance of the excise tax." Additionally, the CDTFA website states, "If the cannabis or cannabis product is sold or transferred to one or more manufacturer(s) prior to being sold or transferred to the distributor who arranges for testing and performs the quality assurance review, the cultivation tax must be collected

based on the category and weight of the cannabis used to make cannabis product and passed to the next manufacturer who takes possession of the cannabis or cannabis product until the tax is remitted to the distributor who is responsible for remitting the tax to the CDTFA. **The distributor who performs the quality assurance review after the cannabis or cannabis product passes the required testing is the distributor who is responsible for remitting the cultivation tax to the CDTFA.**"

b) Revenue and Tax Code 34010 (m) defines "Enters the commercial market" to mean cannabis or cannabis product, except for immature cannabis plants and seeds, that complete and comply with a quality assurance review and testing, as described in Section 26110 of the Business and Professions Code. Given that the distributor who facilitates the required lab test is also responsible for conducting the initial quality assurance review before further distribution, both components of Revenue and Tax Code 34010 (m) would have been met by that distributor and thus the product would have been considered to have entered the commercial market at that time. Pursuant to Revenue and Tax Code Section 34012 (a) Effective January 1, 2018, there is hereby imposed a cultivation tax on all harvested cannabis that enters the commercial market upon all cultivators. The tax shall be due after the cannabis is harvested and enters the commercial market. **Thereby the required lab test and initial quality assurance review is the trigger for the tax becoming due in the quarter in which these requirements are met, and thus the distributor facilitating the test and initial quality assurance review would be responsible for remitting the cultivation tax for all product passing the required lab test and initial quality assurance review.**

c) In distributor-to-distributor transfers after the point of testing, as authorized by SB 311, the proposed change would require the tax monies (which are most often cash) be transferred from the distributor who facilitates the test and initial quality assurance review to yet another party further down in the supply chain after the product has already entered the commercial market. If, for example, Distributor A who facilitates the test and initial quality assurance review decides to then sell or transfer the product from that batch to multiple other regional Distributors who will sell their portion of the batch to retailers in their region, Distributor A would have to pass the tax monies to each other distributor, proportionate to the percentage of the batch distributed to each distributor, rather than simply remitting the entire tax from that batch directly to the CDTFA. Each receiving distributor would then be responsible for remitting that tax once they have completed their final quality assurance review on the product, which is not required to occur at any specific time so long as it occurs prior to distribution to retail. The CDTFA, in this scenario, would be receiving the cultivation tax for a single test batch from multiple distributors instead of one, and at varying times. Whereas, if the language stays as it is, there would be a defined date for when the batch is considered to have entered the commercial market (the date on the Certificate of Analysis from the testing lab). This date is the trigger for the tax, and the Distributor who facilitated that test, is the sole responsible party for remitting the tax for that batch. The date, amount, and responsible party for remittance are all clearly defined by the issuance of that Certificate of Analysis which lists these three critical

data points. This becomes the audit document for the CDTFA to ensure the cultivation tax is submitted in timely fashion and in full.

We suggest the following changes to more accurately reflect statute, to clarify the system for ease of compliance by operators, and to help the CDTFA auditors accurately track tax revenue.

(e) Remittance of Cultivation Tax. A distributor who conducts compliance testing and the ~~final~~ initial quality assurance review before the cannabis or cannabis products can be sold or transferred to a cannabis retailer, or other distributor, pursuant to section 26110 of the Business and Professions Code is responsible for the remittance of the cultivation tax based on the weight and category of the cannabis that entered the commercial market.

2. **Addressing Discounts and Trade Allowances in relation to Wholesale Cost**

New proposed language in subsection (a)(11) of Regulation 3700 Cannabis Excise and Cultivation Taxes, reads:

“Wholesale cost” means:

(A) Prior to January 1, 2020, the amount paid by the cannabis retailer for the cannabis or cannabis products, 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) On and after January 1, 2020, the amount paid by the cannabis retailer for the cannabis or cannabis products, including transportation charges.

The excise tax calculation for *arm’s length transactions* is based on the Wholesale Cost. Discounts and trade allowances, which reduce this Wholesale Cost, are a form of payment from Distributors to Retailers to pay for slotting fees and other common incentives. This reduction in Wholesale Cost is directly correlated to a reduction in Excise Tax for arm’s length transactions, which is calculated as a percentage of the Wholesale Cost multiplied by the average mark-up rate. **To the extent that these discounts and trade allowances reduce the average Wholesale Cost below Fair Market Price (FMP), these such transactions should be considered *non-arm’s length transactions*, which are defined as sales that do not reflect the fair market price in the open market. We believe that the determination for a non-arm’s length transaction needs to be more clearly**

defined as well as enforceable. For example, starting with defining how Fair Market Price is determined, and how it will be applied to a single transaction or series of transactions.

3. **Support for changes to address Cultivation and Excise Tax Liability**

We welcome the addition of Subsections (d) and (g), which serve to clarify each parties liability for payment of the relevant taxes, and have no suggested changes to the proposed language. Our members have encountered many situations where cultivators or retailers are unable to pay their relevant tax burden at the time that it is due, which can result in significant out-of-pocket expenses. The clarification that each parties' liability is not extinguished until a receipt is issued will ease business transactions and simplify our collection and remittance efforts.

Thank you for your consideration of these comments. We are available to answer any questions or discuss further.

Sincerely,

Lauren Fraser
Executive Director
Cannabis Distribution Association
lauren@distributeca.org | 916.304.4714

To: Robert Wilke
Trista Gonzalez
CDTFA
450 N St.
Sacramento, CA 95814
Via email: Robert.Wilke@cdtfa.ca.gov

From: Gavin Bates, president
Pigeon Racer Farm
5050 Dry Creek Rd.
Sacramento, CA 95838
916-671-0799
pigeonracermanagement@gmail.com

Dated: August 17, 2018

Re: Cannabis Tax Regulations - cultivation tax rates – small bud

Robert and Trista:

Our company will be a cultivator in the City of Sacramento; we recently have submitted and are awaiting approval of our temporary license from CalCannabis, CDFA.

I am writing to ask CDTFA to consider a new category of cannabis, small bud, that I think would be appropriate for a separate category of taxation. The size of a small bud ranges from the size of a pencil eraser to the size of a piece of popcorn.

Small buds of cannabis are sold separately from flower to cannabis retailers and dispensaries, which in turn would sell the small bud at a lesser price than cannabis flower. Small bud is not sold mixed with flower as a retailer would pay less for flower with noticeable small bud than it would for only flower. Small bud is not sold to manufacturers as it would be more expensive than cannabis trim, and there would be no reason for a manufacturer to pay more for small bud than for a cannabis product that will be a part of the manufacturing process. (Of course a very small amount of small bud may inadvertently be mixed in with either flower or trim, but that mixing would not be purposeful because it would lower the price of flower sold to a retailer or dispensary to have noticeable small bud, and it would not make business sense to mix small bud with the lower-price trim sold to manufacturers, who would not pay more for the small bud/trim mixture.)

I have seen small bud purchased, at least here in the Sacramento area, for a price that is approximately 30% to 50% of the price of flower. I do not know what its price would be in other areas of California, but it would appear to be the case that all purchasers of cannabis product from a retailer would value and therefor pay less for cannabis bud than cannabis flower, thus driving the wholesale price of cannabis bud lower than that of flower.

I note that the state of Nevada, under a different taxing scheme, through authorization given to the Nevada Department of Taxation, does include a category of “Small/Popcorn Bud” on its Wholesale Marijuana Tax Return – Cultivation Facility, that is taxed at a rate different than flower, trim, and other categories. (NRS 453D.500, Regulation R092-17)

I would appreciate CDTFA’s consideration of small bud (sometimes called popcorn bud) as a separate category of taxation.

February 20, 2019

Ms. Trista Gonzalez
Chief of the Tax policy Bureau
California Department of Tax and Fee Administration
450 N. Street Sacramento CA 94279

Re: Comments on the Proposed Rulemaking – Comments due February 20, 2019
Relating to: CTR 3700, CTR 3701, CTR 3702

Dear Ms. Gonzalez:

Below please find our comments relating to the proposed permanent regulations. Please note that this document contains comments on the proposed regulations, as well as some other items we would like the Department of Tax and Fee Administration (the Department) to consider.

Definitions – Average Market Price Definition for Determining Excise Tax - Section-34010
Problem: The current formula for determining the average market price does not reflect recent market conditions and should be adjusted down to account for the discounting which is epidemic in the Cannabis Industry.

Discussion: Both medical patients and consumers are in full flight from licensed businesses, which must pass on both regulatory costs and taxes.

One licensed retailer in Los Angeles created a list of all of the un-regulated operators around his shop. He found ten within three miles of his location, one located right across the street. This is an epidemic of epic proportions, exists all around the state and should be acknowledged and result in adjusted rates from all taxing agencies.

In Los Angeles, consumers pay a combined tax rate of 34% which has driven patrons away from licensed entities and towards rogue, unlicensed businesses which, because they have no regulatory or tax obligations, can sell cannabis at a steeply discounted rate.

This has caused retailers to discount their products as much as they can, and still remain in business. These discounts are not reflected in the excise tax calculation which is paid at the time the product is acquired, discounting occurs after the taxing event.

Additionally, cannabis and cannabis products are fungible and must move off the retailer's shelves in an expeditious manner or lose their appeal to consumers.

The current formula, which adds a 60% mark-up to the wholesale price, is a punishment to an industry being driven towards bankruptcy by rogue operators who are a state-wide risk to the regulated market.

The Department needs to revise down the current mark-up rate to reflect the deep discounting which licensed operators are being driven towards, both to more accurately reflect the current market and bring some relief to licensed retail operators who currently pay an unrealistic amount of excise tax, in relation to what the product ends up selling for.

Excise tax is determined prior to the retail sale. Retailers forced to sell at a deep discount are currently punished twice: they pay an inflated excise tax when they acquire a product then receive no excise tax relief when they must sell at a deep discount.

In July of 2018, retail operators were forced to dispose of millions of dollars in inventory all of which they'd already paid excise taxes on. This was not due to lack of consumer interest, but because of an artificial deadline set by the state and never revised. Retailers should be able to reflect this loss on future returns and obtain a one-time deduction for this loss.

Solution: Until such time as the state is able to rid itself of unlicensed, unregulated retailers the current mark-up rate related to the excise tax must be drastically reduced to reflect the current crisis or the state will collect no taxes at all. Taxpayers will have been driven into bankruptcy by relentless and unreasonable taxation and the refusal of the state to engage in any meaningful enforcement against illegal actors.

Some mechanism must be put in place to allow those forced to sell at a deep discount some relief from the exaggerated excise tax they were forced to pay prior to determining the actual price at which the product could be sold to consumers.

Retailers forced to dispose of inventory in July of 2018 because of an artificial deadline set by the state should be offered a one-time deduction to off-set this loss.

Currently, proposed Regulation 3700 (a) (11) requires discounts and trade allowances or deductions of any kind, to be added back when determining the wholesale cost, so the only way a retailer might find some relief, is that if the final retail price reflecting a deep discount necessary to move the product is allowed to serve as the basis for a future deduction.

<u>Regulation 3702 Reporting of wholesale and retail sales.</u>
Problem: Reporting of wholesale and retail sales is expensive and problematic.

Discussion: It's estimated that about 30% of staffing costs will go towards maintaining the Track and Trace Systems at each business, an astonishing cost. To add a requirement that wholesale

and retail entities supply the Department with sales information is potentially a terrible financial burden that will needlessly increase the track and trace expenses for wholesale and retail businesses. It will burden the Department as well, which will have to maintain and analyze each transaction.

The Department sets the formula for the 15% excise tax, and must come up with a formula which is uniformly applied. Because it is applied before the taxed item is sold, the only relevant information would be reporting relating to situations where an entity had been forced to sell something at a discount, below the 60% currently used to calculate the mark-up. Because of the situations discussed above, rogue entities currently have a significant impact on what licensed operators can charge and still remain competitive.

Additionally, retailers seeking to transfer items into their compassion programs should have a mechanism for the rebate of the excise tax they initially paid. Pending Senate Bill No. 34 would allow suspension of taxes for compassion program cannabis and cannabis products but does not address this. Typically a retailer uses cannabis and cannabis products from the existing inventory and the Department should provide a mechanism for the rebate of excise taxes on these items.

Solution: Rather than simply endlessly collect sales information, information should only be sought when an entity seeks an adjustment, based on discounting an already taxed product. Entities which voluntarily submit this information should be rewarded, with some system of adjustment for the excise tax they paid in relation to what the true excise tax would have been on the discounted item.

While the Department cannot lower the 15% excise tax, it can come up with a formula which reflects the realities of the current marketplace and offers relief to licensed entities who are following the rules and paying taxes but are besieged by illegal entities in a position to sell cheaper goods because they pay no taxes and carry no regulatory costs.

Regulation 3700 (i) (1) Taxation of the Cannabis Accessory when no separate statement of the cannabis contained in the accessory exists.

Problem: Taxing the total weight of a vape pen or other cannabis accessory as if it were entirely composed of cannabis when only a small amount of cannabis is present.

Discussion: Staff proposes to tax accessories separately from the small amount of cannabis oil within them, unless the receipt given to the retailer by the wholesaler does not separate the two, then the weight of the entire accessory is taxed.

The cannabis excise tax is levied upon cannabis, not the plastic, glass and ceramics which might surround the cannabis oil when placed in an accessory such as a vape pen.

Whatever the composition of the pen itself, the amount of cannabis oil contained within the pen is always a known quantity and should be the only component of the accessory taxed as the excise tax is computed only on cannabis or cannabis products, it was never meant to include plastic, glass or ceramic materials which may surround the cannabis product.

Solution: The amount of the cannabis oil within accessories is easily determined, and is usually printed on the pen or the box the pen comes in. The excise tax should only be computed on the actual oil within the accessory, as both the distributor and the retailer can readily determine the amount of oil that needs to be taxed.

Regulation 3700 – Taxing rate for fresh cannabis is too high.
Problem: Current taxing rate for fresh cannabis is $1.29 per ounce.

Discussion: The tax rate for fresh cannabis, $1.29 per ounce is too high an amount for cannabis plants which are uncured as it does not take into consideration the high water content of the plant, which artificially increases the weight and has no value in the marketplace. Additionally, large numbers of unlicensed retail operators across the state have put so much pressure on licensed retailers, that taxes along the supply chain should be reduced as much as possible to facilitate the survival of the legitimate market place.

Solution: Reduce down the current taxing rate by subtracting the water weight at a fixed percentage tied to the size of the plant so that what is actually taxed has value in the marketplace.

Request That All Meetings Relating To Rulemaking Be Taped and Archived
Problem:
Public comments relating to the promulgation of tax rules are of great interest to all cannabis stakeholders. If the Department does not tape these meetings, or supply a transcript on-line, stakeholders have no way to determine what transpired at these meetings.

Discussion:
To ensure participation by all, and to safeguard the rights and remedies of taxpayers, we would like to suggest that all meetings relating to the promulgation of rules or changes relating to rules be taped (an audio recording is fine) and archived. If this is not possible our organization would like to request that a written transcript of all proceedings be prepared and posted on-line.

There are several reasons for this. Meetings may be held so far away from where stakeholders live and work, that attending a meeting in person would be impossible. If the Department does not care to publish comments, (whether written or verbal) then stakeholders are at a double disadvantage as they have no way to access the thoughts of other stakeholders or the comments of staff made during the hearings.

This can make for endless confusion. For instance, an issue that can only be corrected statutorily may engender endless requests for a rule change. Access to a transcript with commentary by staff stating that the issue required a statutory change would eliminate these multiple pleas, saving Department staff time and resources.

Access to audio of a meeting or a transcript also provides a level of transparency that is important. The Cannabis Industry pays multiple taxes (state, federal, local, payroll, corporate and excise taxes). Taxes can only be fairly imposed if there is a continual dialog between the stakeholders and the Department. Being able to access audio or transcripts in a timely manner will allow this dialog to move forward with clarity and transparency.

Solution: Audio of all meetings or a full written transcript should be provided on the Department's website within 72 hours of the meeting. To ensure this expense is covered it should be a permanent item in the Department's budget and the requirement for providing audio or a transcript should be enshrined in a regulation.

This completes our comments on the proposed permanent regulations. Should you have any questions or concerns our policy chair can be reached at (805) 279-8229 or policy@southerncaliforniacoalition.com

Founded four years ago, the Southern California Coalition is the Southland's largest trade organization for cannabis stakeholders. It is unique in that it has meaningful partnerships with organizations like Americans for Safe Access and organized labor. Our board includes participation by veterans, social equity candidates and women.

Sincerely,

Sarah Armstrong JD
Policy Chair
The Southern California Coalition

Trista Gonzalez,
Chief-Tax Policy Bureau, California Department of Tax and Fee Administration
450 N. Street
Sacramento, Ca. 95814

August 16, 2018

Dear Ms. Gonzalez:

River Distributing would like to thank you and your staff for your dedication and commitment to educating the cannabis industry on tax compliance. We would also like to thank you for addressing many issues we face regarding collecting and remitting cannabis cultivation and excise taxes. Below are River's comments to CDTFA's proposed amendments to cannabis tax regulations:

Distributor to Distributor Sales:

River Distributing strongly supports additional regulatory guidance to specify records necessary for distributor to distributor transactions. As CDTFA staff is aware, there has been much confusion on this issue.

River Distributing conducts many transactions with other licensed cannabis distributors, especially with microbusiness who purchase product from River under their distribution arm. Many of these companies are unaware of their responsibility to collect and remit the cannabis excise tax. River Distributing continues to advise these companies of their duty to collect and remit the cannabis excise tax. However, guidance from CDTFA is essential for distributors who perform these transactions to completely understand their responsibility for collecting and remitting the cannabis excise tax.

In addition, River Distributing respectfully asks CDTFA to provide regulatory guidance to specify records necessary for the collection of cultivation taxes. The last distributor who facilitates a state certified test and conducts a quality assurance review before product is sold to the retail market is responsible for remitting the cultivation tax to CDTFA. Business and Professions Code 26110 requires the last distributor to facilitate state certified testing and distribute product if that product has passed testing. It should be clear in distributor to distributor transactions that the last distributor is responsible for collecting and remitting the cultivation tax to CDTFA. Clearer documentation mandated by CDTFA in these types of transactions will eliminate

confusion of who is responsible for remitting the cultivation tax in a distributor to distributor transaction.

Documenting Transfer of Cannabis and Cannabis Products to Distributors and Manufacturers:

River Distributing strongly supports CDTFA proposal to require every invoice, receipt, manifest to include weight and category of the cannabis that is sold. This requirement will ensure that distributors responsible for collecting and remitting the cultivation tax can comply with cannabis tax law. In addition, this proposed regulation change will ensure that CDTFA will accurately collect cultivation taxes from the cannabis industry.

Cannabis or Cannabis Products Sold with Cannabis Accessories:

River Distributing respectfully opposes any amendment to CDTFA regulations to separately itemize on a receipt or invoice cannabis products bundled with cannabis accessories. This proposed requirement would lead to confusion of the actual value of cannabis accessories bundled with cannabis products. In addition, it would lead to increased operational costs due to extensive programing of computer systems to separate the wholesale value of cannabis accessories from cannabis products.

California tax law is clear that cannabis accessories are not subject to the cannabis excise tax. River Distributing separately lists cannabis accessories not bundled with cannabis on invoices, and does not charge the cannabis excise tax.

Thank you for your attention to the comments above. Please contact Tim Morland, River Distributing's Compliance and Policy Director for any comments or questions.

Tim Morland

Director of Compliance and Policy
River Distributing
Cell: (916) 833-1979; Email: tmorland@rvrdc.com

Cc:
Nicolas Maduros, Director of California Department of Tax and Fee Administration
Khaim Morton, Deputy Secretary of Legislation, Cal Gov Ops

McClellan Davis, LLC
Sales and Use Tax Specialists

508 Gibson Drive, Suite 120
Roseville, CA 95678
(855) 995-6789 | (916) 788-0999
Fax (916) 788-0989 | www.salestaxhelp.com
taxhelp@salestaxhelp.com

February 20, 2019

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

Re: Cannabis Tax Regulations

Dear Ms. Gonzalez,

Thank you, again, for providing us with the opportunity to make this submission on behalf of the California Cannabis Industry Association (CCIA). This submission is being made in response to the Discussion Paper issued on January 25, 2019, and the interested parties meeting held on February 5, 2019.

CCIA is the leading association for the California cannabis industry and remains committed to participating in the rulemaking process to help make certain that regulations are established that will enable the cannabis industry thrive. We greatly appreciate the CDTFA's willingness to work with the California cannabis industry. Many of our previous concerns with the proposed regulations have been addressed, but we continue to disagree with the proposed treatment of cannabis accessories and we also believe the discussion on who should be responsible for remitting the cultivation tax, should be explored further. Each issue is addressed separately below.

I. Cannabis or Cannabis Products Sold with Accessories. (Reg. 3700, subd. (i).)

There is no question that cannabis tax does not apply to accessories, e.g., pipes, bongs, vape devices, etc. Proposed Regulation 3700, subdivision (i)(2), however, provides that

cannabis excise tax will apply if the accessories are not separately stated from the selling price of cannabis or cannabis products on the invoice.

We understand the desire to segregate charges on the invoice, but because cannabis tax is not legally imposed upon accessories, we believe, at a minimum, that a rebuttable presumption should be established. In other words, if a distributor fails to separately state the selling price of accessories from cannabis or cannabis products, it will be rebuttably presumed that the entire price represents gross receipts from the sale of cannabis or cannabis products. The presumption will be rebuttable by evidence which establishes the individual selling prices. Such an approach will enable the CDTFA to maintain the requirement to segregate charges, but it will also provide distributors with an opportunity to avoid undue cannabis tax from applying to accessories in the event of a clerical oversight. We recommend the following or similar language:

> When cannabis or cannabis products are sold or transferred with cannabis accessories (e.g., vape cartridges) to a cannabis retailer, and a distributor does not separately state the sales price of the cannabis or cannabis products from the cannabis accessories, it shall be rebuttably presumed that the cannabis accessories are included in the average market price to which the cannabis excise tax applies. The distributor will overcome this presumption by presenting the separate value of the cannabis, cannabis products and cannabis accessories to the CDTFA.

II. Remittance of Cultivation Tax. (Reg. 3700, subd. (e).)

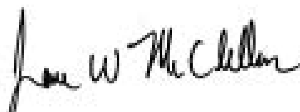
Regulation 3700, subdivision (e), provides that a distributor who conducts the final quality assurance review is responsible for the remittance of the cultivation tax. We agree the provision is consistent with Code sections 34012, subdivision (a), and 34010, subdivision (m). Code section 34012, subdivision (a), states that the cultivation "tax shall be due after the cannabis is harvested and enters the commercial market." Code section 34010, subdivision (m), in relevant part, states that cannabis "enters the commercial market," after it has completed and complies with all quality assurance, inspection and testing.

On the other hand, Code section 34012, subdivision (g)(2)(A), states that "[a]ll cultivation tax applicable to a unique identifier shall be paid upon the first sale or transfer of cannabis or cannabis product with an associated unique identifier." Further, Code section 34012, subdivision (i), states that "[a]ll cannabis removed from a cultivator's premises, except for plant waste, shall be presumed to be sold and thereby taxable under this section." The foregoing provisions establish that tax applies to cannabis and cannabis products when they leave the cultivator's premises. Because the tax is generally collected at that time in practice, it appears feasible for the first distributor to remit the tax.

In summary, there has been discussions about it being more efficient to have the first distributor remit the cultivation tax, so that the tax would not have to be passed through multiple distributors, with the last distributor making the remittance. In the event that products do not pass final testing, Code section 14012.5 will allow the distributor to obtain a refund via credit on its return, and similarly credit or refund the tax back to the cultivator. Because the law appears to provide the CDTFA with some flexibility in this regard, if the industry and the CDTFA agree that it is more efficient to have the first distributor remit the tax, then that should be the rule that is promulgated in the regulation.

On behalf of CCIA, we again thank you for your continued efforts to establish clear regulatory guidelines that will help enable the California cannabis industry to comply with the law. Please do not hesitate to contact me with any questions or comments.

Very truly yours,



Jesse W. McClellan, Esq.
McClellan Davis
On behalf of CCIA

Cc: CCIA
Mr. Robert Wilke, CDTFA Tax Policy Division
Mr. Robert Prasad, CDTFA Tax Policy Division

From: Sequoyah Hudson <sequoyah@cannassert.com>
Sent: Wednesday, February 20, 2019 3:14:13 PM
To: DCA, BCC@DCA; Gonzalez, Trista
Subject: Comments re: RTC 3700 and BCC Testing

Hello, I am having trouble with fully understanding the process on the ground of cannabis products flowing through the supply chain and when and how the harvest tax is applied and collected.
Since these matters intersect and are dependent on the other for purposes of implementation I am including both the BCC and CDTFA on this comment/inquiry.

It has become more commonplace that we are needing to perform a compliance test solely for the purposes of marketing and to determine what path a product might travel down the supply chain (i.e. packaged as flower, made into pre-rolls, sent to manufacture, etc). However the product would not be in its final form and not yet in final packaging ready for the final quality assurance review. This is a very complex system that has many variables so I appreciate your guidance and help in understanding and confirming so that I am implementing a system that best complies with the Bureau and CDTFA's expectations.

It is my understanding that a product *'enters the commercial marketplace'* upon completion of **BOTH** the compliance test **(CT)** and the quality assurance review **(QAR)**.
It is also my understanding that when a product '*enters the commercial marketplace'* the harvest tax is now calculated and due within 30 days of the end of the reporting period (i.e. quarter).

I would like to present the following examples for your consideration when answering the questions presented:

Examples:

This is a fairly simple and not so complex example:

a) Cannabis flower harvested and processed by cultivator flower is sent to *Distributer 1* as a bulk harvest batch. Compliance tested as **Batch A (however not in final form)**. Cultivator maintains title.

- **i.** Cultivator orders Distro 1 to package entire **Batch A** into appropriate consumer facing packaging as flower, passes through **QAR** , enters the commercial market and tax is assessed.

This is not too complex, but more so than previous example:

b) Cannabis flower harvested and processed by cultivator, is sent to *Distributor 1* – Wants to find a bulk buyer (and not package) but needs a **CT** in order for a buyer to consider purchasing.

- **i.** Compliance tested as **Batch A by distributor 1**- No QA review since not in final form/package, for purposes of finding a buyer (marketing)- Cultivator maintains title
  - **a.** **PROBLEM 1**- Product is not in final form – BCC **§ 5705(b) prohibits a compliance test to be performed.**
- **ii.** ***IF CT was able to be performed -*** *Distributor 2* agrees to purchase Batch A – packages into consumer facing packaging as flower, passes through QAR, enters commercial market and tax is assessed.
- **iii.** ***If a CT was able to be performed -*** *Manufacturer A* may also buy and choose to either make pre-rolls or extract.
  - **a.** **PROBLEM 2**- Upon manufacturing (Extraction), *Manufacturer A* will end up with a bulk product that is ready to sell however again, BCC **§ 5705(b) prohibits a compliance test to be performed when not in final form/package.**

    If a CT was able to be performed- *Manufacturer A* would sell to *Manufacturer B* who would then package, send to *Distributor 2* for final CT and QAR, product enters the commercial market and tax is assessed.

This is a fairly complex example:

c) Cannabis flower harvested, processed (Dry and Cure only) by cultivator and transferred (No change of title) to *Distributor 1* as whole plant, un trimmed, bulk harvest batch. Cultivator needs CT in order to find a buyer.

- **i.** **PROBLEM 1**- Product is not in final form – BCC **§ 5705(b) prohibits a compliance test to be performed.**
- **ii.** ***If a CT was able to be performed –*** *Manufacture A* may buy the product and either A) perform further processing themselves AND/OR B) send to a processor for further processing.
  1. *Manufacture A* may separate by flower (for retail), bbuds (for pre-rolls), trim (for extraction) and waste (to be disposed).
     - a. Problem 1-Is a manufacturer allowed to do processing (i.e. trim, sort and package?)
     - b. Problem 2-For product sorted for pre-rolls (Unbranded), again would need ability to perform CT for purposes of marketing and BCC § 5705(b) prohibits a compliance test to be performed.
       - i. IF a CT was able to be performed – Manufacture A could sell to *Distributor 2* who could then package and label for any licensee, product would pass QAR, enter commercial market and tax would be assessed.
  2. *Manufacture A* could sell trim to *Manufacture B* who would perform extraction and either have bulk product that would be subject to same situation presented in example b above (BCC **§ 5705(b)**) or package into consumer facing packages themselves, send to *distributor 2*, CT test would be performed, QAR would be done, product enters the commercial market and tax assessed.

While each of the above examples are only a few of the situations that have arisen, they are representative of how complex and difficult it is to be able to keep the supply chain flowing under regulations that honestly are just simply prohibitive against efficiencies and possibly are not fully aware of how product needs to actually flow throughout the supply chain.

So I present the following:

Question 1:

1) May a product have a **CT** performed early on in the supply chain (upon harvest), for purposes of marketing and determining next steps? Then have a final **CT** further down the supply chain once it has gone thru whatever processing/manufacturing takes place and packaged in its final form (now that it is in its final form and packaged ready for retail)?

    BCC § 5705(b) appears to prohibit this activity as bulk product is not in final packaging and would be transferred for further manufacturing and/or packaging. Upon this final packaging and QAR final compliance test AND the quality assurance review should be performed and tax assessed.

Question 2: Under the proposed Tax Regulation changes to RTC 3700 can you clarify if an activity being performed by a manufacturer or distributor, under direction from the cultivator (No change in title), qualifies as an exemption/rebuttal to the assumption that it has entered the commercial marketplace if title still remains with the cultivator? (i.e. cultivator pays distributor to make pre-rolls, package, label and test.)

Question 3: This added language appears to be discounting the fact that manufactureres and distributors also may be required to take a product through firther processing and should also be entiltled to the rebuttal for purposes of taxation. I would encourage you to reconsider adding language that excludes this rebuttal to other licensees.

I hope I have been able to present the above in a way that is understood. It is a very hard situation to articulate in writing. Should you have any further questions or wish to seek clarity please feel free to contact me.

Thank you for your time and consideration of my concerns, Sequoyah

Sequoyah Hudson

CannAssert, LLC
CFO/Chief Compliance Officer
8 Mile Family Farms
Owner
California Growers Association
Board Of Directors/Treasurer
Humboldt Heritage, LLC (TRUE HUMBOLDT)
Founding Member
Humboldt Sun Growers Guild
Founding Member

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August 17, 2018

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

RE: Proposed Rulemaking with Respect to Cannabis Taxes

Dear Ms. Gonzalez,

UCBA Trade Association (UCBA) applauds the California Department of Tax and Fee Administration ("CDTFA") for setting forth a set of potential amendments to permanently adopt a set of rules and regulations to implement the Cannabis Tax Law ("CTL") set forth in MAUCRSA. UCBA represents Los Angeles compliant and licensed cannabis businesses including retailers, distributors, cultivators and manufacturers in the City of Los Angeles that strive to provide the highest quality products to their patients and customers and to raise awareness about the cannabis industry and its benefits. Many of the members of UCBA are also engaged in commercial cannabis activity in other parts of the State of California.

UCBA respectfully submits the following comments and concerns on the proposed adoption of Cannabis Tax Regulation 3701, 3701 and 3702 as set forth by set forth by the CDTFA regulators. It should be emphasized that UCBA recognizes that CDTFA is obligated to set forth rules that have been statutorily created by MAUCRSA and that the fairness or extent of the excise taxes and cultivation taxes, as well as any penalties assessed regarding these taxes are above and beyond the control of CDTFA.

Regulation 3700. Cannabis Excise and Cultivation Taxes.

1. **Cannabis Accessories --3700 (g):** There needs to be clarification between cannabis accessories sold without cannabis and packaged and sold separately and cannabis accessories sold with cannabis and packaged with a cannabis product.
   a. **Vape cartridges:** A cartridge filled with cannabis oil must be sold as a cannabis product.
   b. **Vape batteries sold with vape cartridges in single package:** A manufacturer who packages as a set a vape cartridge filled with cannabis and a battery to operate the cartridge should be sold as a cannabis product.
   c. **Cannabis flower and pre-rolls with accessories:** Cultivators who package flower and pre-rolls with papers, wicks, matches and/or lighters that are sold as a single unit should be sold as a cannabis product.
   d. **Cannabis accessories sold without any cannabis product in the package:** These are not subject to excise taxes. They should have a separate skew or UID to differentiate them for the purpose of excise tax calculation.

2. **Cultivation Tax Invoicing Requirements 3700 (d):** There still is confusion regarding when the cultivation tax is due when a distributor purchases the cannabis and tests the product for quality assurance and then distributes the product to a manufacturer. Technically the product has passed

quality assurance and testing at the flower level. Is the cultivation tax due at this point? What if the product is then distributed to a manufacturer. There needs to be a clarification that if the cannabis is then distributed to a manufacturer who processes the flower and it does not pass testing at the next distribution point, and is not remediated, that the cultivation tax would need to be refunded. It would make more sense that until the cultivated product is in its final form for retail sale, the cultivation tax is not due to the state.

3. **Receipts for Excise Tax paid to Cannabis Retailers – 3700 (f) (3).**
   a. **Separately stating the Cannabis Excise Tax for the Purchaser.** While there is no requirement that the Excise Tax be separately stated, prohibiting the retailer from separately stating the charge is against good retail practices. Customers like to see the breakdown on their receipts of the price of the goods, the amount of excise taxes and the amount of sales taxes. To congregate the taxes into a bucket with other charges, base price, local taxes, etc. will lead to under and over statement of cannabis excise taxes. This should be at the option of the retailer and not a mandatory requirement of CDTFA. Also, for future audits, it will help the CDTFA to see what each retailer is charging for excise taxes.

4. **Distributor to Distributor Sales – 3700 (h) (3).** UCBA agrees with Section 3700 (h) (3). Each manifest from distributor to distributor should clearly state that excise tax was not paid by the prior distributor when passing from distributor to distributor.

Regulation 3702 California Cannabis Track-and-Trace (CCTT)

1. **Wholesale and Retail Price.** Section 34011 of the Revenue and Taxation Code clearly relieves the purchaser of the 15% excise tax when the 15% excise tax is paid to the state and the invoice or receipt states that the excise taxes are included in the total amount of the invoice. While UCBA believes that Section 34011 does not account for the fluidity of the retail market and that changes to the code must be accomplished through legislation, the entry of the wholesale and retail price into CCTT will provide valid information to justify future changes to the R&T Code.

Respectfully submitted,
UCBA Trade Association

By *Lisa Selan*
Lisa Selan, General Counsel

GROUNDWORKS
INDUSTRIES

August 16, 2018

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street, Sacramento, CA 95814
PO Box 942879, Sacramento, CA 94279-0092

Re: Cannabis Tax Regulation 3700, Cannabis Excise and Cultivation Taxes

Dear Chief Gonzalez:

On behalf of Groundworks Industries, one of the leading cannabis companies in the state of Oregon, I am submitting comments in response to the proposed tax regulation 3700 titled Cannabis Excise and Cultivation Taxes. As we work to bring the company to my home state, it is critical that we advocate for regulations that are fair to all stakeholders involved, including the public, industry, and regulatory authorities.

Our first concern is with section (f) of regulation 3700, which states that "a cannabis retailer may not make a separately stated charge for the cannabis excise tax [on the receipt] when the cannabis or cannabis products are sold to a purchaser," and further requires the receipt to state, "The cannabis excise taxes are included in the total amount of this invoice." This policy buries the cost of the underlying state taxes contributing to the higher total price of a product by the retailer, making it appear as if retailers are solely responsible for pushing the cost of goods upward. More importantly, this policy promotes the lack of transparency by our government. Consumers have a right to know where their hard-earned dollars are going. We understand that creating and implementing a new regulatory framework for a complex industry is both challenging and costly. We also understand that some retailers may be incorrectly computing the cannabis excise tax, which could result in an over or under collection of taxes. However, there is no reason to contribute to the confusion by the public, industry, and other stakeholders by hiding the true cost of the state taxes mandated under state law. Instead there should be further education of retailers on how to correctly calculate and itemize the taxes on receipts or invoices. We oppose these provisions and recommend that the regulations be amended as follows:

> *(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~~,~~ or receipt~~, or other document that includes a statement that reads: "The cannabis excise taxes are included in the total amount of this invoice.~~ upon request by the purchaser."*

> ~~*(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~~2) 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.*

With the amendments above, licensed cannabis retailers will be able to promote transparency regarding the costs of the items purchased by their customers. These amendments also provide the licensee with the flexibility to demonstrate evidence of inclusion of the state excise tax in the total cost of each product. We also suggest that, outside of these regulations, the California Department of Tax and Fee Administration should continue its good work of educating the industry by including additional materials that detail how to calculate the sales tax. While there are materials available on the website, this is an important subject that has caused confusion for many retailers and therefore should be further highlighted.

We are also concerned with a proposed provision under section (d) regarding the liability of the cultivator regarding payment of the cultivation tax. We understand that the provision clarifies state law, which asserts that a cultivator is liable for paying the state cannabis cultivation tax. However, there is no exception to that liability if a manufacturer or distributor provides incorrect or insufficient documentation to the cultivator. Under these circumstances, the cultivator should be allowed some leeway regarding payment of the state cannabis tax to provide them with sufficient time for the manufacturer or distributor to deliver the correct documentation. Further, the manufacturer or distributor should be required to provide the updated, correct documentation in a specific, reasonable amount of time.

Thank you for the hard work and effort by your team to establish regulations for this new industry. We are grateful for the opportunity to submit our thoughts and suggestions for improvement. Should you have any questions regarding these comments, contact An-Chi Tsou at (518) 527-0287 or An-Chi@TsouConsulting.com. We look forward to your response.

Sincerely,

Spencer Noecker
Chief Executive Officer and Owner
Groundworks Industries

August 16, 2018

Trista Gonzalez, Chief
Tax Policy Bureau
Business Tax and Fee Division
California Department of Tax and Fee Administration
450 N Street, Sacramento, CA 95814
PO Box 942879, Sacramento, CA 94279-0092

Subject: Cannabis Tax Regulation 3700, Cannabis Excise and Cultivation Taxes

Dear Chief Gonzalez:

On behalf of Green Beach Ventures, I submit the following comments in response to the proposed cannabis tax regulation 3700 titled Cannabis Excise and Cultivation Taxes.

1. **Regulation 3700, subdivision (d): Cultivation Tax Invoicing Requirements.**

   As currently written, this provision holds the cultivator liable for paying the cultivation tax until it is received by the state or until sufficient documentation is provided from the manufacturer or distributor to which the product is transferred or sold. The latter is problematic because there is the potential, in practice, for distributors or manufacturers to provide insufficient or incorrect documentation to the cultivator. These circumstances are clearly out of the control of the cultivator, and it would be unreasonable for the state to hold the cultivator liable in these cases. The regulation should be amended to allow a narrow exception to the liability clause for circumstances under which the distributor or manufacturer provides insufficient or incorrect documentation to the cultivator.

2. **Regulation 3700, subdivision (f): Receipts for Excise Tax Paid to Cannabis Retailers.**

   We are also greatly concerned with the new language under section (f) that states that a receipt must read, "The cannabis excise taxes are included in the total amount of this invoice," and expressly prohibits retailers from making a separately stated charge for the cannabis excise tax on the receipt. Throughout the regulatory process for California's

cannabis industry, the state has proclaimed its desire to be transparent with the public. However, this provision does not allow cannabis businesses to be transparent about where its customers' money is being spent. Many stakeholders have provided public comment expressing opposition to the current cannabis taxes, asserting they are too high. As currently written, many consumers will blame retailers for the high cost of products without realizing that the state excise tax is one of the primary contributors to the increased price. This in turn could hurt business owners, particularly those running smaller operations, as people turn to the black market to avoid the high cost of goods. If retailers are given the opportunity to be transparent about its costs, many consumers may be more willing to stay loyal, understanding that retailers are not arbitrarily raising their prices. Furthermore, considerations must be made for POS systems that allow customers to opt out of receipts; this is a standard practice with mainstream POS systems and the most environmentally-friendly option. To eliminate these concerns, we suggest that the CDTFA strike subdivisions (f)(1) and (f)(3) from the regulations.

We appreciate your work on these important regulations and thank you for the opportunity to submit comments to your agency on these matters. Should you have any questions regarding our comments, please do not hesitate to reach out to our consultant, An-Chi Tsou at (518) 527-0287 or An-Chi@TsouConsulting.com. We look forward to reading your responses to the comments and continuing to work with your agency in the future.

Sincerely,

Michael T Herron

Michael T. Herron
Chairman
Green Beach Ventures, LLC

8/17/2018
Trista Gonzalez
Chief, Tax Policy Bureau
California Department of Tax and Fee Administration
450 N Street
Sacramento, CA 94279

Jonathan Gee
Sr. Accountant
Cura CA LLC
5852 88th St, Ste 400
Sacramento, CA 95828

Written Comments

To Whom It May Concern:

As an interested party, Cura Cannabis Solutions (Cura) would like to submit the following comments and proposed changes to the language used by CDTFA in respect to the taxation of cannabis and cannabis products in the state of California. We thank the CDTFA for taking the time to read and respond to our concerns.

First and foremost, Cura would like to express its concern for the tracking of the Cultivation Tax. As a licensed manufacturer of oil vape cartridges, Cura purchases cannabis oil from other licensed manufacturers to use for our finished product. This is a common practice in the industry for secondary manufacturers, companies such as vape, edible, topical, and other manufacturers that use cannabis oil processed by other manufacturers in their product. Currently, these companies such as ours have no way to verify how much starting material was used by the first manufacturer in a single batch of finished cannabis oil. The manufacturer processing the cannabis oil could potentially deflate numbers representing the starting amounts of raw material, while the secondary manufacturer has no way to verify the actual starting material amounts. This is because the yield of finished cannabis oil per starting weight is highly variable, and even a small percentage difference may represent thousands of dollars in lost cultivation taxes. We ask that the CDTFA suspend the Cultivation Tax until it can be tracked and regulated fairly and effectively using METRC.

With regard to Regulation 3700, Section A, Subsection 2: we would like to recommend that the CDTFA create a new category in the tax code for “Whole Cannabis Plant”. The cultivation tax rate for “Flower” is greater than 100% of the raw material cost that Cura typically purchases. As such, it is a deterrent for

Cura to use flower-based cannabis oil in our products. Being unable to offer greater range of product limits Cura's selections and represents lost tax revenue for CDTFA. We recommend that CDTFA adopts language that allows for "Whole Cannabis Plant" taxed at a rate greater than, but similar to the $2.75 per ounce rate currently applied to cannabis "Leaves".

With regard to Regulation 3700, Section F, Subsection 3G: we would like to express our approval of this language. The excise tax statute is clearly intended to apply to "cannabis products" and to specifically exclude products which are not considered "cannabis products". The CDTFA website includes a section for retailers which specifies that "If you are a cannabis distributor who sells these preassembled units with cannabis, you should separately list the retailer's cost of the cannabis on your invoice to the retailer in order to properly apply the excise tax to the cannabis only". While retailers have compared the sale of a preassembled unit to a pre-rolled joint, this comparison ignores the massive price difference to the manufacturer between the cost of a premanufactured battery and cartridge assembly and the fractional cost of a rolling paper.

Thank you reviewing our comments and please contact us if you seek clarification on any of the above stated matters.

Sincerely,

Jonathan Gee
Accountant
Jgee@curacan.com
(925) 876 - 9979

SOUTHERN CALIFORNIA COALITION

August 13, 2018

Ms. Trista Gonzalez
Chief of the Tax Policy Bureau
California Department of Tax and Fee Administration
450 N. Street Sacramento CA 94279

Re: Comments on the Proposed Rulemaking – Comments due August 17, 2018
Relating to: CTR 3700, CTR 3701, CTR 3702

Dear Ms. Gonzalez:

Below please find our comments relating to the proposed permanent regulations. Please note that this document contains comments on the proposed regulations, as well as some other items we would like the Department of Tax and Fee Administration (the Department) to consider.

Definitions – Average Market Price Definition for Determining Excise Tax - Section-34010
Problem: The current formula for determining the average market price does not reflect recent market conditions. The mark-up of 60% should be adjusted down to account for the discounting which is widespread in the Cannabis Industry and necessary for the survival of licensed cannabis businesses.

Discussion: Both medical patients and consumers are in full flight from licensed businesses, which must pass on both regulatory costs and taxes.

One licensed retailer in Los Angeles created a list of all of the un-regulated operators around his shop. He found ten within three miles of his location, one located right across the street. This is an epidemic of epic proportions; it exists all over the state. It should be acknowledged and result in adjusted rates from all taxing agencies.

In Los Angeles, consumers pay a combined tax rate of 34% which has driven patrons away from licensed entities and towards rogue, unlicensed businesses which, because they have no regulatory or tax obligations, can sell cannabis at a steeply discounted rate.

This has caused retailers to discount their products as much as they can, and still remain in business. These discounts are not reflected in the excise tax calculation which is paid at the time the product is acquired, discounting occurs after the taxing event.

Additionally, cannabis and cannabis products are fungible and must move off the retailer's shelves in an expeditious manner or lose their appeal to consumers.

The current formula, which adds a 60% mark-up to the wholesale price, is a punishment to an industry being driven towards bankruptcy by rogue operators who are a state-wide risk to the regulated market.

The Department needs to revise down the current mark-up rate to reflect the deep discounting which licensed operators are being driven towards, both to more accurately reflect the current market and bring some relief to licensed retail operators who currently pay an unrealistic amount of excise tax, in relation to what the product ends up selling for.

SOUTHERN CALIFORNIA COALITION

The excise tax is determined prior to the retail sale. Retailers forced to sell at a deep discount are currently punished twice: they pay an inflated excise tax when they acquire a product; then receive no excise tax relief when they must sell at a deep discount.

In July of this year, retail operators were forced to dispose of millions of dollars in inventory all of which they'd already paid excise taxes on. This was not due to lack of consumer interest, but because of an artificial deadline set by the state and never revised. Retailers should be able to reflect this loss on future returns and obtain a one-time deduction for this loss.

Solution: Until such time as the state is able to rid itself of unlicensed, unregulated retailers the current mark-up rate related to the excise tax must be drastically reduced to reflect the current crisis or the state will collect no taxes at all. Taxpayers will have been driven into bankruptcy by relentless and unreasonable taxation and the refusal of the state to engage in any meaningful enforcement against illegal actors.

Some mechanism must be put in place to allow those forced to sell at a deep discount some relief from the exaggerated excise tax they were forced to pay prior to determining the actual price at which the product could be sold to consumers.

Retailers forced to dispose of inventory in July of 2018 because of an artificial deadline set by the state should be offered a one-time deduction to off-set this loss.

Currently, proposed Regulation 3700 (a) (9) (proposed to be 3700 (a) (10)) requires discounts and trade allowances or deductions of any kind, to be added back when determining the wholesale cost, so the only way a retailer might find some relief, is that if the final retail price reflecting a deep discount necessary to move the product is allowed to serve as the basis for a future deduction.

Regulation 3702 (a) (4) (b) Reporting of wholesale and retail sales.
Problem: Reporting of wholesale and retail sales is expensive and problematic.

Discussion: It's estimated that about 30% of staffing costs will go towards maintaining the Track and Trace Systems at each business, an astonishing cost. To add a requirement that wholesale and retail entities supply the Department with sales information is a terrible financial burden that will needlessly increase the track and trace expenses for wholesale and retail businesses and burden the Department as well, which will have to maintain and analyze each transaction.

The Department sets the formula for the 15% excise tax, and must come up with a formula which is uniformly applied. Because it is applied before the taxed item is sold, the only relevant information would be reporting relating to situations where an entity had been forced to sell something at a discount, below the 60% currently used to calculate the mark-up. Because of the situations discussed above, rogue entities currently have a significant impact on what licensed operators can charge and still remain competitive.

Additionally, retailers seeking to transfer items into their compassion programs should have a mechanism for the rebate of the excise tax they initially paid. Pending Senate Bill No. 829 would allow suspension of taxes for compassion program cannabis and cannabis products but does not address this. Typically a retailer uses cannabis and cannabis products from the existing inventory and the Department should provide a mechanism for the rebate of excise taxes on these items.

Southern California Coalition

Solution: Rather than simply endlessly collect sales information, information should only be sought when an entity seeks an adjustment, based on discounting an already taxed product. Entities which voluntarily submit this information should be rewarded, with some system of adjustment for the excise tax they paid in relation to what the true excise tax would have been on the discounted item.

While the Department cannot lower the 15% excise tax, it can come up with a formula which reflects the realities of the current marketplace and offers relief to licensed entities who are following the rules and paying taxes but are besieged by illegal entities in a position to sell cheaper goods because they pay no taxes and carry no regulatory costs.

Regulation 3700 (g) (2) Taxation of the Cannabis Accessory when no separate statement of the cannabis contained in the accessory exists.

Problem: Taxing the total weight of a vape pen or other cannabis accessory as if it were entirely composed of cannabis when only a small amount of cannabis is present.

Discussion: Staff proposes to tax accessories separately from the small amount of cannabis oil within them, unless the receipt given to the retailer by the wholesaler does not separate the two, then the weight of the entire accessory is taxed.

The cannabis excise tax is levied upon cannabis, not the plastic, glass and ceramics which might surround the cannabis oil when placed in an accessory such as a vape pen.

Whatever the composition of the pen itself, the amount of cannabis oil contained within the pen is always a known quantity and should be the only component of the accessory taxed as the excise tax is computed only on cannabis or cannabis products, it was never meant to include plastic, glass or ceramic materials which may surround the cannabis product.

Solution: The amount of the cannabis oil within accessories is easily determined, and is usually printed on the pen or the box the pen comes in. The excise tax should only be computed on the actual oil within the accessory, and both the distributor and the retailer can readily determine the amount of oil that needs to be taxed, which like all cannabis transfers, would be carried on the appropriate paperwork.

Regulation 3700 – Taxing rate for fresh cannabis is too high.
Problem: Current taxing rate for fresh cannabis is $1.29 per ounce.

Discussion: The tax rate for fresh cannabis, $1.29 per ounce is too high an amount for cannabis plants which are uncured as it does not take into consideration the high water content of the plant, which artificially increases the weight and has no value in the marketplace. Additionally, large numbers of unlicensed retail operators across the state have put so much pressure on licensed retailers, that taxes along the supply chain should be reduced as much as possible to facilitate the survival of the legitimate market place.

Solution: Reduce down the current taxing rate by subtracting the water weight at a fixed percentage tied to the size of the plant so that what is actually taxed has value in the marketplace.

SOUTHERN CALIFORNIA COALITION

Regulation No. 3700 (a) (2)(3) Cannabis Taxes on leaves, stalks and stems

Problem: The words "trimmed or untrimmed" in the context of the sentence "Cannabis flowers" means the flowers of the plant Cannabis sativa L that have been harvested, dried, trimmed or untrimmed and cured, prior to any processing..." is problematic. The definition of cannabis leaves, which would include stalks and stems because of the way the definition is written, is also problematic. Both definitions artificially enlarge taxation of the cannabis plant.

Discussion: When you include leaves in the definition of cannabis flower, which is the case with the word "untrimmed" you transmute leaves which were never intended to be taxed at the highest level into the highest level of taxation cultivators endure (i.e. $9.25 an ounce).

There is no component of a cannabis leaf which justifies transmutation into the highest level of taxation, and the leaf surrounding an untrimmed bud is often so small that they are of no use to anyone and should be simply considered trash, not taxed. What the section contemplates would be like taxing the shell of a walnut, when it's actually the nut inside which carries a taxable value.

Currently, Regulation No. 3700 (a) (2) when read in conjunction with the definition of leaves in Section 3700 (a) (3) not only forces what is typically trash into the most expensive level of taxation, it artificially enlarges taxation of leaves.

The definition in 3700 (a) (3) would expand the taxation of leaves to include the taxation of stalks and stems. Depending on the size of the plant, this could be a burden which would drastically increase the amount of the tax a cultivator pays even though stalks and stems have little value in the marketplace.

Enlarging definitions of plant components to include sections of the plant which have little value and thus should not be taxed is merely adding extraneous bulk in pursuit of collecting more robust taxes.

As the definition of a "fresh cannabis plant" in 3700 (a) 6) includes leaves, stalks, and stems. There is a mechanism for including all components of the plant, should there be a demand for fresh, uncured plants

Solution: To avoid the economic burden and confusion that will result when tiny leaves which have no value, are taxed at the very highest rate imposed on cultivators, the Department should establish a definition for leaves that specifies the measurement of a mature leaf, one large enough to have value in the marketplace, but allows all others to be discarded as trash. This definition should be arrived at after consultation with experienced cultivators.

Stalks and stems should not be included in the definition of leaves, both to facilitate fair taxation and avoid confusion, as stalks and stems add artificial bulk that increases the tax. It's akin to taxing the plant's roots as the stalks and stems are part of the same circulatory system as the roots, and like the roots, have no meaningful stand alone economic value.

Request That All Meetings Relating To Rulemaking Be Taped and Archived

Problem:

Public comments relating to the promulgation of tax rules are of great interest to all cannabis stakeholders. If the Department does not tape these meetings, or supply a transcript on-line, stakeholders have no way to determine what transpired at these meetings.

SOUTHERN CALIFORNIA COALITION

Discussion:
To ensure participation by all, and to safeguard the rights and remedies of taxpayers, we would like to suggest that all meetings relating to the promulgation of rules or changes relating to rules be taped (an audio recording is fine) and archived. If this is not possible our organization would like to request that a written transcript of all proceedings be prepared and posted on-line.

There are several reasons for this. Meetings may be held so far away from where stakeholders live and work, that attending a meeting in person would be impossible. If the Department does not care to publish comments, (whether written or verbal) then stakeholders are at a double disadvantage as they have no way to access the thoughts of other stakeholders or the comments of staff made during the hearings.

This can make for endless confusion. For instance, an issue that can only be corrected statutorily may engender endless requests for a rule change. Access to a transcript with commentary by staff stating that the issue required a statutory change would eliminate these multiple pleas, saving Department staff time and resources.

Access to audio of a meeting or a transcript also provides a level of transparency that is important. The Cannabis Industry pays multiple taxes (state, federal, local, payroll, corporate and excise taxes). Taxes can only be fairly imposed if there is a continual dialog between the stakeholders and the Department. Being able to access audio or transcripts in a timely manner will allow this dialog to move forward with clarity and transparency.

Solution: Audio of all meetings or a full written transcript should be provided on the Department's website within 72 hours of the meeting. To ensure this expense is covered it should be a permanent item in the Department's budget and the requirement for providing audio or a transcript should be enshrined in a regulation.

This completes our comments on the proposed permanent regulations. Should you have any questions or concerns our policy chair can be reached at (805) 279-8229 or policy@southerncaliforniacoalition.com We look forward to hearing your response to our concerns.

Founded three years ago, the Southern California Coalition is the Southland's largest trade organization for cannabis stakeholders. It is unique in that it has meaningful partnerships with organizations like Americans for Safe Access and organized labor. Our board includes participation by veterans, social equity candidates and women.

Sincerely,

Sarah Armstrong JD
Policy Chair
The Southern California Coalition

From: Bill De Zenzo [mailto:bill@taxnexus.net]
Sent: Tuesday, February 19, 2019 4:59 PM
To: Gonzalez, Trista; Founders
Subject: Interested Party's Comment re Proposed Amendments to Reg. 3700 (CDTFA)

Dear Ms. Gonzalez,

Taxnexus, Inc. submits this letter as an interested party following participation in the conference call held on February 5, 2019 regarding proposed amendments to Regulation 3700.

Taxnexus provides automated transactional tax compliance services to businesses along the cannabis product chain at state and local levels. We have studied the tax compliance issues plaguing the industry in depth and recognize numerous obstacles making it difficult for taxpayers to comply with cannabis regulations. Some of these problems were raised during the conference call by industry participants, which highlighted the real hardship for businesses to be tax compliant. Our studies reveal that many of the business expending resources in effort to be tax compliant are failing to do so.

Below are just a couple of specific examples of complexities that have compounded the tax regulation failure in the California cannabis industry. The big picture, when taking them all into account, calls for an automated specialty tax solution, which regularly exists in other specialty tax industries.

Regulation 3700, Subdivision (i) - Cannabis or Cannabis Products Sold with Cannabis Accessories.

The problem here deals with “blended products” -- those that include cannabis or cannabis products and accessories together. To the best of our knowledge, current point of sale systems do not provide a solution that offers different tax treatments for the different parts of an item, and based on the proposed amendments, if distributors do not separate the sales prices for the different parts, retailers would have to pay excise tax on accessories. This is an unintended obstacle that unnecessarily negatively impacts the taxpayer.

Distributor Collection/Remittance Accuracy

The current system leaves room for inaccuracies and discrepancies in the amount of cannabis taxes distributors collect and remit. This requires an improved method of accounting procedure to streamline and ensure accuracy and compliance by distributors. Given the continuing shortfall in tax revenue collected, it is important to encourage solutions that make it easier for taxpayers to be in compliance.

Financial System of Record

As Metrc is set up to handle the state’s cannabis product compliance via track and trace, similarly there is a need for a system of record to handle tax compliance duties. Through working together with appropriate officials at CDTFA, Taxnexus can enable the cannabis industry into tax compliance, which will in turn benefit state regulators by receiving the accurate amount of tax remittances based on true sales and tax calculations.

Thank you for the opportunity to provide our feedback and offer solutions to aid the success of the industry through tax compliance.

Kind regards,

Bill De Zenzo
Co-Founder & VP of Business Development

2625 Alcatraz Ave, Suite 295, Berkeley, CA 94705
(510) 679-1900 (office), (510) 338-2264 (mobile)
taxnexus.net, bill@taxnexus.net

August 27, 2018

Via Email to bcc.comments@dca.ca.gov
Lori Ajax, Chief
Bureau of Cannabis Control
2920 Kilgore Road
Rancho Cordova, CA 95670

Via Email to regulations@cdph.ca.gov
California Department of Public Health
Manufactured Cannabis Safety Branch
1415 L Street, Suite 500
Sacramento CA 95814

Via Email to calcannabisregs@cdfa.ca.gov
California Department of Food and Agriculture
CalCannabis Cultivation Licensing Division
Proposed Cannabis Cultivation Regulations
P.O. Box 942871
Sacramento, CA 94271

Via Email to Richard.Bennion@cdtfa.ca.gov
California Department of Tax and Fee Administration
P.O. Box 942879
Sacramento, CA 94279

RE: CDA COMMENT LETTER ON PROPOSED PERMANENT RULEMAKING ACTION

Dear Regulators:

The Cannabis Distribution Association represents several dozen licensed cannabis distributors who have contributed to our collective comments enclosed. On behalf of our members, we appreciate your commitment to the successful implementation of cannabis licensing and regulation and to your consideration of our recommendations to overcome supply chain constraints and improve broad understanding and adoption of commercial cannabis regulatory policies.

Enclosed please find a summary of our feedback categorized into sections - Quality Assurance and Testing, Packaging and Labeling, Tax Collection and Remittance, Security, Administrative and Other - and more detailed discussion on each comment in the pages to follow.

Thank you for your consideration. Please feel free to contact us with any questions.

Respectfully,

Lauren Fraser
Executive Director
Cannabis Distribution Association
lauren@distributeca.org, policy@distributeca.org
916.304.4714

Quality Assurance and Testing

1. **Support and recommendations for distributor-to-distributor transfers post-testing. (§ 5307)**
2. **Require testing labs to clearly display the reason for lab test failure and to clearly display whether the test is an official certified test vs a non-certified test. (§ 5726)**
3. **Need for composite testing. (§ 5305)**
4. **Allow appeal process for initial test results; ability to request a secondary test. (§ 5306)**
5. **Increase cannabinoid variance from 10% to 20%, especially for cannabis flower and non-infused prerolls. (§ 5724)**
6. **Upon a product recall, each receiving party must notify the party from whom they received the cannabis goods. (§ 5053)**

Packaging and Labeling

7. **Support and recommendation for adjustments to labeling requirements. (§ 5724)**
8. **Remove the requirement for potency to be listed on the interior container for multilevel packaging. (BPC § 40403(1)).**
9. **Allow distributors to relabel manufactured products. (§ 5303(b))**
10. **Allow distributors to assemble non-infused prerolls from tested harvest batches. (§ 5303)**
11. **Support for weight variance for dried flower, recommend increased variance. (§ 5303.1)**
12. **Support for CR exit packaging *or* individual child-resistant packaging (CRP). (§ 5413)**
13. **Clarify that goods in compliance at the time of packaging will satisfy requirements, despite new labeling compliance changes. (BPC § 26120)**

Tax Collection and Remittance

14. **Need for regulatory recourse for distributors upon failure to collect cultivation or excise taxes from producers or retailers, respectively. (CDTFA)**
15. **Clarify excise tax requirements for microbusinesses. (CDTFA)**

Security

16. **Exempt transport-only distributors from premises-based security requirements and allow a transport-only premises to be shared with another licensed premises. (§ 5315)**

17. **Support for revised holding period for security recordings from 180 to 90 days. (§ 5305(c))**

18. **Increase security requirement for non-storefront retail delivery vehicles. (§5417)**

19. **Clarify and consider amendment to certain motor carrier permit requirements. (§ 5311)**

Administrative and Other

20. **Allow retailers to reject partial shipments of cannabis goods. (§ 5052.1)**

21. **Allow distributor access to licensee database for verification of licensed addresses.**

22. **Streamline administration for Licensed Distributors with multiple premises. (§ 5023, 5025)**

23. **Need for more detailed regulations for distribution supporting licensed events. (§ 5601)**

24. **Need for enforcement against businesses that facilitate non-licensed activity, particularly to the extent that the activities directly impedes upon the regulated marketplace.**

25. **Clarify regulations regarding products containing hemp-derived CBD.**

26. **Clarify the definition of “cannabis products” in each agency’s regulation text. (§5000)**

27. **Allow expired cannabis goods to be disposed at any storefront retail location. (§5410(a))**

28. **Grant regulators discretion to allow normal commercial cannabis activity in the event of an extended track and trace system outage. (§5050(d))**

To expand on the summary points listed above, the following pages provide detailed discussion on each.

Quality Assurance and Testing

1. **Support and recommendations for distributor-to-distributor transfers post-testing. (§ 5307)**

   CDA supports the clarification provided in § 5307 allowing a certificate of analysis to transfer from one distributor to another, to facilitate post-testing transfers between distributors.

   Recommend the following clarification to Bureau Regulations § 5307:

   When a licensed distributor receives a certificate of analysis from the licensed testing laboratory or upon transfer from another licensed distributor stating that the sample meets specifications required by law, the distributor shall ensure the following before transporting the cannabis goods, packaged as they will be sold at final sale, to one or more licensed distributors, licensed retailers or licensed microbusinesses...

   Recommend the following new clarifications be provided in CDTFA Regulations:

   The distributor who arranges the testing for the cannabis or cannabis product batch and who performs the quality assurance review is responsible for collection and remittance of the cultivation tax. The distributor who transfers or sells the cannabis or cannabis product to the retailer is responsible for the collection and remittance of the excise tax.

   Should the agency determine that a reasonable cap be placed on the number of times a single tested cannabis good may be transferred, we would ask the agency to consider the following:

   Packaged, tested cannabis goods from a single test batch may be distributed to multiple licensed distribution premises, in which case each receiving distributor shall be responsible for conducting a Quality Assurance Review in accordance with section 5307. After the certified test is conducted, the same cannabis good may only be transferred to up to X [three to five] licensed distribution premises, except for transfers between licensed distribution premises that are owned by the same licensee which may be transferred an unlimited number of times between premises with the exact same ownership structure.

   [For example, a 50-pound batch of cannabis may be tested, packaged, and distributed to many different distributors (for example, 10 pounds in final packaged form to each of 5 distributors). Each receiving distributor may transfer the cannabis goods to other licensed distribution premises it owns an unlimited number of times. However to distribution premises that are not owned by the receiving distributor, each tested cannabis good may be relocated between *X [three to five]* or fewer distribution licensees without triggering the need for a new certified test. Note the distinction between the number of entities not number of transfers, and distinction that the chain of custody is on the individual good / item, not the batch as a whole which may be widely distributed.]

   Prior to certified testing, cannabis goods may be transferred without limitation to the number of transfers between licensees. Once a cannabis good is packaged in its final, packaged form it may not be transferred backwards in the supply chain, except for remediation provided in § *5306(d).*

2. **Require testing labs to clearly display the reason for lab test failure and to clearly display whether the test is an official certified test vs a non-certified test. (§ 5726)**

   There is great inconsistency with how lab testing results are displayed on the Certificate of Analysis. Into August, there are still multiple labs that are not reporting cannabinoid label results, as mandated in section 5724(b). To ease confusion and ensure all parties are working off the same information, we suggest requiring consistent language and uniform formatting for official COA results, and encouraging labs to report R&D results with a statement similar to "This test is for research and development purposes only, and does not meet the requirements for certified commercial cannabis under Business and Professions Code 26100(a)".

   Currently, the distributor is required to verify that the weight is correct, the packaging and labeling requirements are met, and the COA corresponds with the batch. However, in lieu of accurate reporting by some labs, distributors are often additionally required to act as second validator of results. For example, when the testing lab does not follow proper reporting standards on the COA it places the responsibility on distributors to determine if the pesticide or residual solvent action levels are considered passing or failing. The lab should be required to provide clear guidance that the batch passes or fails and for which compounds. Whatever information is to be provided to the Bureau should also be provided to the distributor and producer, with notifications to all parties within a 24-hour window of one another or at the same time.

   Regarding incorrect reporting by the lab or testing for the incorrect phase:

   - If product moves to retail sale due to an error on COA, the fault should lie with the lab, but it currently falls on the producer or manufacturer, with civil action as their only recourse. The impact can be detrimental or near fatal for the producer's business; labs with repeat offences should be fined, with possible revocation or suspension of their licenses, and we suggest the Bureau actively communicate issues like this. Currently the industry is left to rumour and piecing news accounts together of what really went wrong, which is not an effective method of making business decisions.
   - When a distributor requests a Phase 1, 2, or 3 testing panel, and the lab tests for a phase higher than what is required, a retest should be available at the expense of the lab and the initial test should be able to be disregarded due to the mistake by the lab.

3. **Need for composite testing. (§ 5305)**

   In light of escalating testing costs and bottlenecks, regulations that allow for compositing are a high priority. Compositing is a set of testing rules that allow multiple strains to be tested together for pesticides and other contaminants, so long as they were harvested at the same premises at the same time, and the consolidated batch falls under the total maximum batch size of fifty pounds. These rules have already been adopted in Oregon and are explained in detail on pages 2-4 of the Oregona Liquor Control Commission "Sampling and Testing Metrc Guide." (https://www.oregon.gov/olcc/marijuana/Documents/CTS/SamplingandTestingGuide.pdf)

   Under the current system, a cultivator growing three strains – each of which produce fifteen pounds – must pass three independent tests for pesticides, solvents, microbial impurities, foreign material, mycotoxins, and heavy metals, even if all three strains were harvested from the same premises at the same time.

Adopting compositing rules would have major and positive impacts for both businesses and consumers. In addition to reducing costs for cultivators, compositing would reverse artificial incentives towards monoculture, encouraging the production of diverse cannabis strains and allowing for more medically-targeted strains and greater consumer choice in the regulated market. It would also decrease the overall burden on testing labs, alleviating the bottlenecks which affect everyone.

The Bureau has broad authority to implement regulations that manage testing costs. Sections 26100(b) and 26104(b)(2) of the Business and Professions Code direct the Bureau to "develop criteria to determine which batches shall be tested" and "specify how often licensees shall test cannabis and cannabis products," respectively. As the industry as a whole struggles under limited testing capacity and increasingly demanding Phase 2 testing requirements, we believe compositing is a commonsense way for the BCC to manage testing costs without compromising consumer safety.

4. **Allow appeal process for initial test results; ability to request a secondary test. (§ 5306)**

   In the event of a failed test result, producer should have the right to appeal the result and request a retest at the cost of the producer. Until the rate of false-positives by testing laboratories is proven to be negligible, producers should not be punished by having to remediate or potentially destroy an entire batch. The retest would be required to be completed at the same lab. Should the lab come back with a different (passing) result the second time, the retest and the COA will be reflected with the new information. This is the only instance allowing the COA to be amended. The testing lab must provide a report as to the reasons for the false positive on the initial test. Furthermore, the agencies should work to develop an audit and evaluation process for the labs to test for false positive scenarios.

5. **Increase cannabinoid variance from 10% to 20%, especially for cannabis flower and non-infused prerolls. (§ 5724)**

   As our members have gone through multiple rounds of harvests and testing, we've seen significant variance in potency results, even when sampling is randomized, and tests are conducted by the same lab. The 10% variance is regularly achievable for a manufactured product, where cannabinoids are distilled and carefully measured, but flower has significant variance in potency within parts of the plant. Additionally, as most methods of consumption are self-titrating, in practice, expanding the variance allowed versus labeled content does not present a significant health and safety risk.

   Additionally, the action levels should be reconsidered for various pesticides and residual solvents. The wide variety of cannabis products on the market should be reflected in the action levels, and the different action levels should reflect actual harm to health and safety. In particular, we would like to see a distinction for action levels between consumable and topical goods. Many products designed for external use only contain ingredients that would be harmful if consumed, and providing relaxed standards for topical goods that accurately reflect the risk to the consumer would give an avenue for cannabis that is unsafe for inhalation or consumption to be sold rather than destroyed. We recommend aligning topical standards with those of the cosmetic industry.

6. **Upon a product recall, each receiving party must notify the party from whom they received the cannabis goods. (§ 5053)**

   In the event of a recall initiated by the Bureau or other licensing authority, all licensees at one time in the chain of custody of the cannabis goods from the recalled batch should be notified of the recall. For example, if a licensed retailer has a product pulled off of the shelf for a compliance reason, the retailer should be responsible for notifying the distributor from whom it received the product, and the distributor should be responsible for notifying the producer from who it received the goods as well as all retailers to whom the goods were provided. Required notification will ensure that all parties have an opportunity to become aware of the issue and to reduce the likelihood of these issues reoccuring.

Packaging and Labeling

7. **Support and recommendation for adjustments to labeling requirements. (§ 5724)**

   CDA supports the clarification provided in § 5724 (d) to reduce lab test failures for cannabinoid potencies under 5%. The following additional clarification is necessary:

   > *The sample shall be deemed to have passed the cannabinoid testing if the concentration of any one cannabinoid, claimed to be present at 5% or greater ~~of the total cannabinoid profile,~~ does not exceed the labeled content of the cannabinoid."*

   CDA supports the clarification provided in § 5724 (d)(1-3) to increase the allowable variances for low-dose edible products.

   Recommend the following clarification to § 5724 (c):

   If the labeled content of any one cannabinoid is expressed as a total concentration of the cannabinoid, the laboratory shall calculate the total cannabinoid concentration as follows:
   (1) For concentration expressed in weight:
   - *(a) For cannabis flower: Total cannabinoid concentration (percentage) = (cannabinoid acid form concentration (percentage) x 0.877) + cannabinoid concentration (percentage)*
   - *(b) For cannabis products: Total cannabinoid concentration (mg/g) = (cannabinoid acid form concentration (mg/g) x 0.877) + cannabinoid concentration (mg/g)*

   Recommend the following clarification to § 5724 (e):

   If the sample fails cannabinoid testing, the batch from which the sample was collected fails cannabinoid testing and shall not be released for retail sale until the goods within that batch are re-labeled with the cannabinoid content matching the COA.

   Recommend adding the following new language in sub-section § 5724 (f):

   Failed lab results whereby the failure is strictly due to the cannabinoid testing portion of the COA may be remediated by the distributor re-labeling the batch with the appropriate cannabinoid content, after which the batch would not require additional review by the agency or testing

laboratory. The COA should specify "Cannabinoid Claim Failure - Remediation Method: Relabel." The distributor responsible for remediation shall sign off on the COA, taking responsibility for having completed the necessary remediation action.

This should expedite the turn around time from failed COA to completed remediation, by not needing to wait for agency approval of the remediation plan (often 3-17 business days) as well as indicate to the retailer that the failure is not for a contaminant, and encourage the retailer to look for the adjusted label to confidently accept the cannabis goods. (Currently retailers are rejecting products that have already been remediated, because they take one look at the "Failed" COA and determine the product is not fit for sale.)

8. Remove the requirement for potency to be listed on the interior container for multilevel packaging. (BPC § 40403(1)).

Recommend to strike the requirement in § 40403(1) that requires potency to be on the interior container for multi level packaging. With the significant variance in testing results, distributors are forced to relabel a very large proportion of products, and requiring the potency on the interior presents an onerous burden on the distributor.

Additionally, this requirement is in direct conflict with BCC § 5303(b), which prohibits re-packaging manufactured products by a distributor (which we recommend changing below). Many manufactured products have the tamper evident seal on the exterior of the packaging, or exterior packaging that is single-use, in which case relabeling the interior tube or jar would require violating the integrity of that seal, and in many cases, destroy the usability of the exterior packaging. We support the intent of ensuring consumers have accurate information about dosing and potency, but the current variability in testing results and product integrity requirements do not allow for an efficient or cost-effective method of relabeling potency on the interior packaging.

9. Allow distributors to relabel manufactured products. (§ 5303(b))

Recommend to amend § 5303(b) to allow distributors to relabel manufactured products, in order to conduct clerical label corrections for manufactured products to ensure the they meet all compliance requirements. Often, products arrive with minor labeling errors (ex: missing a required datapoint, weight listed in the wrong denomination, requiring an additional warning, etc). Distributors must be able to make these relabeling adjustments, at the discretion of the producer, in order to ease supply chain bottlenecks and so as not to send product backwards once transferred to the distributor.

10. Allow distributors to assemble non-infused prerolls from tested harvest batches. (§5303)

CDA supports the new definition for "preroll" in § 5000 (o) and the clarification provided in §5303(a) authorizing a licensed distributor to package, re-package, label, and re-label cannabis, including prerolls, for retail sale. Additionally, it is essential for distributors to be able to assemble prerolls from an unpackaged harvest batch after testing, just as they would assemble flower grams, eighths, or other sized flower product for the following reasons. We seek revision to the proposed regulations that would clarify that Distributors are allowed to roll (non-infused) prerolls. Please consider the following rationale, based on statute and current regulatory definitions, and

supply chain and public policy considerations:

- A preroll is by definition a non-manufactured product. Indeed a non-infused preroll is no more than ground or collected dried cannabis flowers enclosed and rolled in paper. No other treatment, processing, alteration, or manipulation of the dried flower is involved in creating a preroll.

- “Rolling” is no different than “Packaging,” and there is no public safety or other reason to create a distinction. There is physically, practically and functionally no difference between the act of “rolling” a preroll [rolling dried cannabis in paper] and “packaging” [placing cannabis goods into “any container or wrapper that may be used for enclosing or containing any cannabis goods for final retail sale].”

- Packaging of Cannabis (but not Manufactured Cannabis) by Distributors is Allowed: The Bureau has allowed, since the first inception of the Emergency Regulations and continuing through to the Proposed Permanent Regulations, distributors to “package, re-package, label, and re-label cannabis, including prerolls,” but not manufactured cannabis products. In fact, most readers of the proposed permanent regulations believe there is no distinction and that this already has been addressed by the Bureau’s ISOR that states “Subsection (o) defines “preroll” as any combination of the following in paper: flower, shake, leaf, or kief that is obtained from accumulation in containers or sifted from loose, dry cannabis flower or leaf with a mesh screen or sieve. Licensed distributors have the ability to package, re-package, label, and re-label cannabis, including prerolls; this definition is necessary because it provides added clarity regarding what a preroll may be comprised of.”

- Allowing Distributors to Roll Prerolls Serves Supply Chain Efficiency and Cultivators’ Bottom Line: When Distributors weigh, portion, and package bulk flower, a substantial amount of loose dried cannabis collects in the process. As this product is not allowed to go back to Cultivators or Processors for additional packaging (as the Bureau notes as support for allowing distributors to package flower in the first place), 6 prohibiting Distributors from collecting this perfectly usable cannabis to use in prerolls is wasteful and costly. And Cultivators must bear the entire cost of this loss, which is only further exacerbated by a rule that does not allow distributors to roll prerolls. Anecdotally in discussions with clients and industry groups, Cultivators who send dried flower to be packaged can expect to see on average only 90-95% of that dried flower actually go to market. With the tight margins Cultivators are already operating on slim margins; this five to ten percent is significant. Allowing Distributors to make prerolls can mitigate this loss.

- Proposed section 5303 prohibits a distributor from packaging, re-packaging, labeling, or re- labeling cannabis products, with certain exceptions. Subsection (a) allows distributors to package and label cannabis, including prerolls, so that, after a batch has gone through laboratory testing, the cannabis need not return to the cultivator for packaging and labeling, as prohibited by the Department of Food and Agriculture regulations.

11. Support for weight variance for dried flower, recommend increased variance. (§ 5303.1)

We support the addition of section 5303.1 to allow for a weight variance for packaged dried flower. This definition should additionally extend to prerolls.

Given such small sized increments for packaged flower products (typically from 1 gram to 3.5 grams), a 2.5% variance is negligible and does not factor into account the potential variance as moisture leaves the plant over time. We recommend increasing the allowable variance to 5-10% for product in its final packaging (5% for increments of 3.5 grams or larger, 10% for increments below 3.5 grams), and does not apply to unpacked harvest batches. While this would be legally allowed to satisfy regulatory requirements, the market (consumer) may take issue to packages that are below the expected weight they expect to receive, and they may take this up with as a complaint to the business. Most licensees will intentionally over-pack the product, to account for moisture loss over-time, and should not be penalized for this.

12. Support for CR exit packaging *or* individual child-resistant packaging (CRP). (§ 5413)

We support the BCC and DPH's new standards regarding child-resistant packaging (CRP), which would remove requirements for CRP on cannabis goods, and instead require retailers to place all cannabis goods in child-resistant and resealable exit bags. Requiring CRP on each package produces large amounts of waste and is significantly more expensive than CR exit bags. Some producers have made large investments in developing and purchasing child-resistant packaging under current regulations and should have the flexibility to use this packaging rather than exit bags. Additionally, some producers may prefer to place CRP on the product itself, with which an exit package would be redundant and unnecessary.

Recommend the following amendment to § 5413:

Cannabis goods purchased by a customer shall not leave the licensed retailer's premises unless the goods are in individual child-resistant packaging or placed in a resealable child-resistant opaque exit package.

We have heard the arguments for requiring certain products, namely edibles, to be placed in resealable childproof packaging. Should the agencies determine it necessary to require certain products to be in resealable childproof packaging, we would recommend that this requirement not apply to cannabis goods that are non-decarboxylated (such as flower and concentrates) where the cannabis good cannot cause someone to become intoxicated from accidental ingestion, rather only if applied to heat and inhaled.

We would additionally like to recommend the following:

- By 2020 all exit bags should be required to be durable, intended for multiple uses, and made of compostable materials. While most current CR exit bags contain mylar and are not environmentally sustainable, it's essential that sustainable exit bags be developed and adopted universally as soon as possible. Standardizing design in exit bags - rather than in thousands of different packages for individual products - provides an opportunity for sustainable design at scale. If the market does not provide this solution, the state should require it.

- Customers may re-use their exit bags. Re-use, even more than recycling, is crucial to environmental sustainability. Single-use exit bags will produce enormous amounts of unnecessary waste.
- Retailers should be required to make exit bags available on request. Retailers may charge a fee for exit bags as part of a program to encourage reuse. Customers should have the opportunity to request exit bags if they prefer. Additionally, the ability for retailers to charge a fee for exit bags is important to encourage customers to re-use exit bags.

13. Clarify that goods in compliance at the time of packaging will satisfy requirements, despite new labeling compliance changes. (BPC § 26120)

The changes to labeling requirements do not specify what happens to goods that are currently in compliance, but will go out of compliance once the permanent regulations are in effect. As an example, BPC § 26120 does not require the universal symbol for cannabis flower, but the new MCSB regulations require it to be placed on the primary panel. Consider language that clarifies that all cannabis goods are subject to the labeling requirements in place at the time of packaging. This will allow items in various parts of the supply chain that are currently compliant to be sold and transferred without unnecessary relabeling or destruction as a result of new regulation. Additionally, agencies should seek to unify packaging and labeling requirements defined in each set of regulations, for example clarifying on which goods the the universal symbol is required.

Tax Collection and Remittance

14. Need for regulatory recourse for distributors upon failure to collect cultivation or excise taxes from producers or retailers, respectively. (CDTFA)

Without the authority to enforce penalties on producers or retailers for failure to pay harvest and excise taxes respectively, distributors are held liable for the tax obligations of others with whom they have no recourse for failure to pay. The complicated nature of the tax law makes it such that the logistics of receiving payment (typically in cash) would more easily occur prior to the tax actually becoming due, placing cash flow constraints on producers and retailers who thereby resist paying for as long as possible. Please consider the following amendments to ease the financial burden on distributors:

Licensed distributors are required to report any uncollectable harvest tax amounts due from licensed cultivators and manufacturers and any uncollectable excise tax amounts due from licensed retailers within 30 days of the calendar quarter end for the quarter in which the tax obligations become due. Upon notification by the agency, the past-due licensee shall have thirty days to reconcile the past-due amount or will otherwise be subject to an investigation by licensing authorities. The agency (CDTFA) may impose penalties on the past-due licensees, where upon failure to pay amounts past due could lead to penalty fees, suspension or possible failure to renew the annual license for the applicants.

Licensed distributors are responsible for remitting to the department all harvest and excise tax amounts collected during the period. Harvest and Excise taxes due but not collected by the distributor shall not be required to be remitted by the distributor until the collection is complete.

15. **Clarify excise tax requirements for microbusinesses. (CDTFA)**

    Recommend the following new clarifications be provided in CDTFA Regulations:

    When transferring or selling product to a microbusiness, the transferring distributor is responsible for collecting excise tax unless the transfer is designated on the manifest as being transferred to the distribution portion of the microbusiness, in which case the microbusiness assumes the liability to remit the excise tax and releases the transferring distributor of that liability.

Security

16. **Exempt transport-only distributors from premises-based security requirements and allow a transport-only premises to be shared with another licensed premises. (§ 5315)**

    We appreciate the addition of §5315(g) in the last round of emergency regulations, which exempts transport-only self-distributors from Article 5 security requirements, including video surveillance and alarm systems. However, we think it's clear that this exemption should be expanded to all transport-only distributors, as formally recommended by the Cannabis Advisory Committee at their March meeting, and consistent with the transport-only license's total lack of land use impact. To be clear, we support security requirements on vehicles themselves under §5311, and our requested change is limited to security requirements applied to the premises itself. The current security exemption for self-distribution is not sufficient for rural communities which may have dozens of licensed cultivation sites located hours from a major roadway. In these cases, centralizing transport in a single licensee will often be more efficient than each business obtaining its own self-distribution transport-only license.

    Additionally, since the transportation-only license has no land use impact and does not authorize cannabis storage, it should be clarified that the license does not have any state land use requirements other than the requirement to have a premises of some sort. Requiring the designation of a separate structure for a transport-only license imposes significant costs on businesses for no regulatory benefit, especially when considering high real estate costs in urban areas and building code issues in rural areas. The simplest solution for most licensees would be to allow a transport-only license to be issued at a premises already permitted for another activity by that licensee, and require records to be kept at this premises. This would follow established legal precedent in the original emergency regulations, which allowed multiple licenses to be issued at a single premises for adult-use and medicinal activity conducted by the same licensee.

17. **Support for revised holding period for security recordings from 180 to 90 days. (§ 5305(c))**

    We support the change from 180 days to 90 days for maintaining video recordings of the sampling procedure; 90 days is a reasonable amount of time to ensure sampling procedures were accurately followed.

18. Increase security requirement for non-storefront retail delivery vehicles. (§5417)

With the changes in non-storefront retail colloquially referred to the “ice cream truck” model, and the increase in allowable product from $3,000 to $10,000, we encourage the Bureau to re-examine the security requirements for non-storefront delivery vehicles. Proposed regulations allow fulfillment and packaging of orders while on the road, but also require goods to be stored in a locked box, container, or cage. In practice, this can result packing of order bags while on the side of the road, which is not a secure location, and presents significant safety concerns.

19. Clarify and consider amendment to certain motor carrier permit requirements. (§ 5311)

Three points below are addressed relative to motor carrier permits: A) who is required to obtain, B) how to obtain, and C) security concerns related to certain MCP requirements.

A. There is some confusion among industry operators as to which licensees are and are not required to obtain a motor carrier permit. §5311 references motor carriers for hire as those required to obtain the MCP.

- Recommend the following <u>clarification</u> to §5311 (c):

  All vehicles transporting cannabis goods for hire shall be required to have a motor carrier permit pursuant to Chapter 2 (commencing with Section 34620) of Division 14.85 of the Vehicle Code<u>, whereby “for hire” refers to the transporting of cannabis goods that are not owned or titled to the Distributor conducting the transportation service</u>.

B. In addition to clarifying which businesses are required to obtain the MCP, operators should understand that they are required to register their CA# with the DMV, as required by Vehicle Code § 34620. Operators have been confused about whether or not a U.S. DOT Number is additionally required, however this should not be required given these operators are strictly intra-state and not operating outside California borders. This informational would be useful to include on the cannabis portal site cannabis.ca.gov/motor-carrier-permits/.

C. Lastly, a major concern from industry is Vehicle Code § 27900 (a) which requires motor carriers to have displayed on both sides of each vehicle or on both sides of one of the vehicles in each combination of vehicles the name or trademark of the person under whose authority the vehicle or combination of vehicles is being operated. This requirement poses security risks to cannabis businesses, specifically at the point of retail delivery where targeted threats are commonplace and delivery drivers are often followed back to their vehicles, or followed all the way to the distribution facility. California Highway Patrol will ticket motor carriers without this name or trademark designation on the vehicle, with potential fines and/or revocation of the permit as penalty for non-compliance. However, currently several licensed cannabis distributors are concerned to place the name or trademark on the vehicles for the reasons mentioned above.

Administrative and Other

20. **Allow retailers to reject partial shipments of cannabis goods. (§ 5052.1)**

    While administratively easier to manage in some regards, distributors will incur tremendous costs for re-stocking and re-delivery and potential lost business if retailers are not allowed to reject partial shipments at the time of delivery. Often times, a retailer will be satisfied with the majority of the items they are receiving but may want to reject a portion of the shipment because the specific items were not exactly what they were expecting, or there are differing opinions regarding packaging and labeling compliance. Without the ability to receive the portion of the order that they do wish to receive, the retailer, distributor, and producer all suffer the loss of sending back the entire shipment.

    - Recommend to strike §5052.1 entirely or strike (b) and replace (a) with the following:

      (a) If a licensee receives a shipment containing cannabis goods that differ from those listed on the sales invoice or receipt, the licensee shall reject the portion of the shipment that is not accurately reflected on the sales invoice or receipt.

21. **Allow distributor access to licensee database for verification of licensed addresses.**

    On the BCC website bcc.ca.gov/clear/license_search.html, the previous database allowed for operators to sort by license type and export licensee information. The recent change to the site converted this easy-to-use tool into a PDF table of licensee information, excluding information such as the physical address of the licensee. While for safety reasons it is good that this information is no longer publicly available, the downside is that licensees such as distributors can no longer verify the licensed premise address for the operators they delivering to. Licensed facility addresses, for all license types, should be privately (but not publically) accessible to licensed distributors who are responsible for ensuring transfers are conducted only to/from licensed facility locations. Agency-provided information is the source of truth for verified, licensed premises.

    - Recommend to provide private access to distributors to a verified database (for licensees of all three licensing agencies) with physical addresses for each licensee, also including expiration dates for licenses

22. **Streamline administration for Licensed Distributors with multiple premises. (§ 5023, 5025)**

    There are several issues to unpack as it relates to a single distribution business with multiple distribution facilities throughout the state: 1) internal transfers between owned facilities, 2) streamlined application process and one annual application fee, 3) remitting consolidated tax payments, and 4) streamlining change of ownership and other administrative updates.

    The ideal scenario would be for a business entity or licensee to be assigned one single license number for it's distribution business, registering each locally authorized premise location under the one license number. When transferring cannabis goods between its own facilities, the manifest would recognize this as an internal transfer (same license number as shipper and receiver), a single application and renewal package would be submitted to the state with a single

application fee, all tax collections would be submitted by the business under one license number, all updates to the ownership or other licensee information would be submitted under one license instead of multiple.

Recommend the following adjustment to §5025 (a):

Each license shall have a designated licensed premises, with a distinct street address and suite number if applicable, for the licensee's commercial cannabis activity. Each licensed premises shall be subject to inspection by the Bureau. A licensee with multiple licensed premises of the same license type may consolidate the application process for the licensed premises under a single license number, so long as each premise is individually licensed by the Bureau and has obtained required local approval.

Alternatively, if this method of streamlining is not easily accommodated with the existing track-and-trace system infrastructure, the agency might consider developing a streamlined application process for distributors who have a primary licensed premise and seek to add additional licensed premises conducting the same use-type (Type 11 Distribution). This streamlined application process would allow for records submitted on the primary application to be referenced in the follow-on applications, and for a single application fee to be applied to the licensee or business entity. The Bureau would also inform CDTFA of the consolidated business license numbers for the purposes of collecting tax from a single business license. Any material changes to the business which must be submitted to the Bureau can be submitted once under the primary license number, and referencing the other license numbers associated.

Additionally, please note CDA is supportive of the clarification in § 5023 which allows for the business to continue to operate under the active license while the Bureau reviews the application for change of ownership if at least one owner is not transferring his or her ownership interest and will remain as an owner under the new license and ownership structure.

23. Need for more detailed regulations for distribution supporting licensed events. (§ 5602(g))

Regulation text in § 5602(g) reads: "The cannabis goods sold onsite at a temporary cannabis event shall be transported by a licensed distributor or licensed microbusiness in compliance with the Act and this division." It should be further clarified where the cannabis goods may originate from and where they must be returned to after the event.

Recommend the following clarifications:

Cannabis goods intended for sale at a temporary cannabis event may be transported either directly from a licensed distributor or directly from a licensed retail location of a retailer holding the temporary event permit. Any unsold inventory at the end of the temporary cannabis event may be transported back to the premise of the licensed retailer to whom the cannabis goods are titled, or to a licensed distributor for temporary storage until ultimately being transferred to the licensed retailer to whom the cannabis goods are titled.

Additionally, we suggest mandating hours of secured vehicle access into the licensed temporary event location. Event organizers of past events early this year have required distribution vehicles to park in remote parking lots and transport product by hand or push-cart, which presents a

significant safety concern. We are in full support fo the addition of 5602(h), which clarifies secure storage requirements during the event and suggest requiring secure vehicle loading zones.

24. Need for enforcement against businesses that facilitate non-licensed activity, particularly to the extent that the activities directly impede upon the regulated marketplace.

The regulations do not address enforcement action or penalties for persons who willingly and intentionally undermine the success and integrity of the regulated marketplace. The two most egregious examples of such impediments include: 1) online advertising platforms that promote unlicensed operators, thereby driving consumers to the unregulated market and placing significant hardship on licensed operators competing with higher prices and higher operational costs, and 2) licensed operators who knowingly buy or sell cannabis goods that have not originated from a licensed producer and have entered the supply chain (inversion) from unlicensed producers. These activities undermine the entire regulatory system, and should be penalized with severe consequences such as suspension and revocation of their license.

25. Clarify regulations regarding products containing hemp-derived CBD.

Given the uncertain nature of changing state and federal laws relative to CBD, hemp-derived CBD, and industrial hemp production, we recommend the following policies for hemp-derived CBD as it relates to products produced and sold within the licensed commercial cannabis market:

Treat hemp-derived CBD as an ingredient, whereby hemp CBD products may only be sold by licensed cannabis operators if the hemp-derived CBD entered into the supply chain at the production (manufacturing) level as an ingredient in a manufactured product. Furthermore, such hemp-derived CBD must have a chain of custody illustrating that it was legally produced and legally purchased, according to state and federal laws regarding industrial hemp production, importation, purchase, and sale.

Additionally, it would be helpful to clarify that any topical or consumable products sold by a licensed retailer must have been produced by a licensed cultivator or licensed manufacturer. Whereby, only accessories and other non-consumable products (§5407) may be sold by a licensed retailer, requiring all consumable and topical products to have been produced within the regulated supply chain.

26. Clarify the definition of “cannabis products” in each agency’s regulation text. (§5000)

While both state law and DPH regulation define “cannabis products” as manufactured products, BCC’s regulations do not include a clear definition of “cannabis products.” Without clarification, this is likely to cause confusion for non-attorneys and make regulatory compliance more difficult for businesses. Adding a definition of “cannabis products” consistent with state law will help to avoid confusion, differentiating “cannabis products” from “cannabis goods” in each agencies definitions.

27. Allow expired cannabis goods to be disposed at any storefront retail location. (§5410(a))

We encourage the Bureau to expand section 5410(a), regarding returns of customer goods, to require all retailers to accept returns of any cannabis products, and not limiting returns to solely

the retailer they were purchased from. In other circumstances, consumers can return beverage containers for recycling to any recycling center, and expired pharmaceuticals can be returned to any pharmacy. This “drug take-back” program would provide a compliant manner to dispose of expired, spoiled, or goods that are no longer needed by the consumer.

28. Grant regulators discretion to allow normal commercial cannabis activity in the event of an extended track and trace system outage. (§5050(d))

Regulation text §5050(d) currently forbids any commercial transport or transfer of cannabis if a licensee loses access to the track-and-trace system. While we understand the intent of the regulation, we think it should be amended considering the potential for an extended server-side outage, such as the one that impacted Maryland just last month. The current regulation is acceptable in most cases, but regulators should leave themselves discretion to allow normal commercial cannabis activity if necessary to prevent an extended market-wide shutdown, so long as licensees track their activity on paper.

From: Juli Crockett <juliocrockett@gmail.com>
Sent: Friday, August 17, 2018 5:23:25 PM
To: Gonzalez, Trista
Subject: Comments in response to CDTFA Discussion Paper on proposed rulemaking re: taxation of cannabis and cannabis products

Hello Trista. These are some brief comments in response to CDTFA proposed rule-making for cannabis products.

- 50% penalty for late payment is too severe.

- Cultivation tax should be remitted by cultivators.

- Excise tax should be collected from purchasers and remitted by retailers, just like Sales and Use taxes have been successfully collected for a very long time.

- Excise tax should not be applied to medical sales, as it was part of an adult use initiative. How these two got conflated is horrific.

- A medical recommendation should be sufficient for relief from Sales & Use tax. Sick people on fixed incomes should not have to pay additional fees for county card, which is not easy to get for homebound medical cannabis users.

- CDTFA should deliver clear guidance as to the taxation of samples and sample kits provided to retailers' buyers and staff for product review prior to purchasing. Some operators have received instruction from CDTFA that the excise tax does not apply in this scenario, whereas others have received guidance that they must be charging the excise tax. Therefore these taxes are being collected irregular. Operators need clear guidance on this topic, and ultimately the excise tax should not apply to samples sold to retail buyers for review. A taxation scheme for "not for resale" sample products should be clarified.

- There should also be a tax (i.e. no tax) for compassionate care programs wherein retailers providing cannabis products at low cost for compassionate care programs for sick and low income individuals may be relieved of the taxes for those deeply discounted/donated items.

- There should be no taxing of tax. Highway robbery.

Thank you.

Juli

Juli Crockett

Playwright - Director - Evangenital
323-251-9645 cell

Same Comments Submitted Separately by the following persons: John Crenshaw, Dennis Ballere, Julia Ross, Brennan Cameron, Damian Pugliese, Layla Ross, Derek Baer, Nikki Myers, dgmann

CDTFA
AVERAGE MARKET PRICE
The retailer should be able to determine their own retail value. They will know their customers. What is the point of having this very complicated formula. Most products have a turnkey markup, or just double the wholesale. Some products have more margins than others. Some companies are able to charge a little bit more or less depending on their area or demographic. This should be something left to the retailer and manufacturer to decide.

CANNABIS EXCISE TAX
The cultivation and excise taxes that are being imposed, are extremely high. If California makes cannabis too expensive for the end user, the cannabis industry will fail, and the illicit market will thrive again. Unless California lowers these tax rates, these things are practically guaranteed to happen. The state recently said that they expected to receive $175 million from taxes, and only collected $34 million, only 19.43% of what was anticipated. There was a study that showed if the state decreases the tax by 5% the sales would increase by 25%. Currently, if you buy an eight (3.4g) of cannabis flower for $50 in Oakland, between the 15% excise tax, 9.25% sales tax, and 10% Oakland Cannabis Tax, there is an additional $17.13 in taxes added onto the sale, which is 34.2% of what the actual retail cost of the flower is. Simply put, people will not be able to afford these high taxes. Not only will you have the consumer not being able to afford these prices, but the cultivators and manufacturers have to lower the cost in order to just make some sales to recoup something rather than nothing, they in turn will end up losing money and going out of business. This is something that the State should remedy asap, as this seems like a situation where only large corporations will be able to survive this situation with their deep pockets until something else gets sorted out. Please put something on the ballot to lower the taxes the next voter time, and help the consumers AND small businesses support this industry.

The cannabis excise tax is in addition to the sales and use tax imposed by the state and local governments.
Also, how is it legal or fair to tax on a tax? This is also adding to the high cost that people will not be able to afford. California is being greedy trying to tax on a tax. This is unjust.

COLLECTION AND REMITTANCE OF THE CANNABIS EXCISE TAX
Also, Distributors should not be responsible for collecting these taxes from cultivators, manufacturers, and retailers. This is not efficient, and poses a safety threat to the distributor when transporting this amount of cash between their facility and the tax office. Criminals will target the cars transporting the cash. Each company should be responsible for keeping track of and paying their own taxes to the state. It creates unnecessary additional hours for the distributors, retailers, manufacturers, and cultivators by having to pay taxes TO THE SAME ENTITY they are already paying sales and use tax to, but THROUGH a different entity. This also trickles down to having the CDTFA having more and longer meetings with many different companies. The overall effect creates more time and money spent for all parties involved. Without making it easier for companies to pay their taxes and the hours of the state tax officials collecting the money, also means that an portion of the tax revenue generated by the companies will go to the State's employees rather than going to fund the issues in which the voters voted for the measure for in the first place, but could be avoided.

Same Comments Submitted Separately by the following persons: John Crenshaw, Dennis Ballere, Julia Ross, Brennan Cameron, Damian Pugliese, Layla Ross, Derek Baer, Nikki Myers, dgmann

RECEIPTS FROM DISTRIBUTORS

This is not an efficient way for taxes to be paid to the CDTFA. This creates more paperwork for the CDTFA rather than just having the retailer pay the excise taxes directly along with their Sales and Use Tax. It creates unnecessary additional hours for the distributors, retailers, manufacturers, and cultivators by having to pay taxes TO THE SAME ENTITY they are already paying sales and use tax to, but THROUGH a different entity. It creates more room for error and confusion. This also trickles down to having the CDTFA having more and longer meetings with many different companies. The overall effect creates more time and money spent for all parties involved. Without making it easier for companies to pay their taxes and the hours of the state tax officials collecting the money, also means that a portion of the tax revenue generated by the companies will go to the State's employees rather than going to fund the issues in which the voters voted for the measure for in the first place, but could be avoided.

SALES AND USE TAX EXEMPTION

This should be extended to excise tax for medicinal patients as well, as this was an adult use ballot initiative.

CULTIVATOR'S LIABILITY FOR THE CULTIVATION TAX

The cultivator should be responsible to pay their own cultivation tax to CDTFA. To be required to rely on another entity to pay your taxes on your behalf seems ridiculous. It causes more paperwork, more risk for confusion and mistakes the more hands the receipts have to go through. This creates more money being spent for all parties involved where there doesn't need to be. If the CDTFA has to create more man hours than necessary, it is taking money away from going to other places in which the voters wanted to see the money allocated to.

COLLECTION AND REMITTANCE OF THE CULTIVATION TAX

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ALTERNATIVE METHODS FOR COLLECTIONS AND REMITTANCE

If the state would create a public bank, and a tax portal where the cultivators could go on and pay in the same fashion as the way sales and use taxes are paid, that would save a lot of people time and money. It would also lower the risk of people being targets to be robbed when they are on their way to pay CDTFA with large amounts of cash.

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RECEIPTS FROM DISTRIBUTOR OR MANUFACTURER
This is an unnecessary step if the cultivator just pays the taxes on their own behalf to the CDTFA.

DEBT TO THE STATE
This should be the direct responsibility of the cultivator or retailer. By eliminating having the cultivation and excise taxes go through so many parties prior to getting to the CDTFA, it is creating more room for error and for this to happen.

EXCESS TAX COLLECTED
By eliminating the tax collection going through a distributor, if a cultivator or retailer over pays the credit can go directly back to the cultivator or retailer. This eliminates man hours, confusion, and speeds up the process of getting the money directly back to the original party.

REFUND PROCESS FOR PRODUCT FAILURE
When the cultivator or manufacturer is creating their tax forms for the upcoming quarter, there should be a spot for them to claim a credit for said taxes.

INDICIA FOR CULTIVATION TAX PAID
Doesn't track and trace eliminate the need for this?

SECURITY DEPOSIT
Imposing yet another start up cost seems unnecessary. This seems like it could be especially troublesome for small businesses that are already having to come up with more and more money just to get started. This seems like it would be something that would be put into place for companies that have not paid their taxes on time previously in order to keep doing business. Is this something that is imposed upon in other industries? If not, why is the cannabis industry being singled out?

REPORTING
The reporting should be handled directly by the cultivator or retailer directly to CDTFA. This would eliminate a lot of man power, confusion, for all parties involved.

PENALTIES
The penalty of "at least one half of the amount of taxes due" seems egregious. How is this number determined? Shouldn't it be in line with perhaps other industries like alcohol or pharmaceuticals? Also, the fact that the taxes are required to go through so many other parties prior to getting to the CDTFA make this penalty seem like the CDTFA is hoping to impose obstacles on purpose so they can collect this outrageous fee on top of the already incredibly high taxes they are already collecting. This would also put some businesses out of business. This is not fair.

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INSPECTIONS
Is it normal in other industries for tax officers to be granted peace officer status? If not, why only cannabis industry?

What does cannabis being securely packaged have anything to do with paying taxes and why should a tax officer be able to make this determination? Will the tax officers be trained in the same manner as the peace officers?

TRACK AND TRACE
Would it not make more sense to wait until the temporary licenses are over, or until January 1, 2020, before bringing Track and Trace online? Currently other licenses will be coming online at different times. This could create a huge mess of confusion that may be hard to recover from for not only the companies, but the state as well.