

Goodmans^{LLP} Update

(Not?) Taxes – Cost to Participate in Canada’s Pending Recreational Cannabis Market Just Went up!

On July 12, 2018, Health Canada released its *Consultation Document – Proposed Approach to Cost Recovery for the Regulation of Cannabis* (the “**Cost Proposal**”). According to the Cost Proposal, the proposed fees are intended to enable the federal government to recoup the estimated \$553 million it will spend to implement, administer and enforce the legalized cannabis framework over five years (from its fiscal 2017 year).¹ However described and whatever their purpose, the proposed fees would increase costs. Those costs may ultimately be passed on to the end-users in the form of higher retail prices, thwarting one of the stated objectives of the *Cannabis Act* to combat the illegal cannabis market.

The Cost Proposal contemplates four types of fees, (1) the Application Screening Fee, (2) the Import/Export Permit Fee, (3) the Security Screening Fee and (4) the Annual Regulatory Fee. These proposed fees would apply to each type of licence contemplated by the *Cannabis Act*. However, the Cost Proposal includes certain discounts and exemptions for some of the fees to accommodate the different scale of operations and the stated policy objective to support small businesses and a diverse cannabis industry that includes smaller entities and specialist licensees. In addition, the proposed fees would not apply to licensed participants for industrial hemp, research, analytical testing or health and natural health products containing cannabis.

Application Screening Fee

The Application Screening Fee is intended to recover the costs associated with screening new licence applications for all categories of licences under the *Cannabis Act*. However, the fee would not apply to renewals or amendments to existing licences. The proposed fee is \$3,277 per application, with a lesser fee of \$1,638 for micro-cultivation, nursery and micro-processing licences. In either case, the fee is non-refundable for incomplete or rejected applications.²

Import/Export Permit Fee

The Import/Export Permit Fee is intended to recover the costs associated with screening, processing and issuing or refusing an import or export permit (which is currently only permissible for medical or scientific purposes). The proposed fee, also non-refundable, is \$610 per permit request, with no discount for different types of licence holders.

Security Screening Fee

The Security Screening Fee would recover the costs associated with screening, processing and issuing or denying security clearances for applicants and licence holders. Licence holders must obtain security clearances for key individuals under the conditions set out in the *Cannabis Act* and its regulations (see [Goodmans Update of July 3, 2018](#)). The proposed non-refundable fee is \$1,654 per security screening request, applicable equally to all categories of licenced holders. Notably, as security clearances could be granted for up to five years only, this fee would be a recurring one for all licenced holders.

Annual Regulatory Fee

Likely the most substantial fee for licence holders, the Annual Regulatory Fee would recover the costs of the cannabis regulatory regime not covered by the Application Screening Fee, Import/Export Permit Fee, or Security Screening Fee. This proposed fee would be payable when a licence is granted and then annually for as long as the licence is held or renewed. With the stated objective to support a diverse cannabis industry that includes smaller entities, the Cost Proposal contemplates a materially lower fee for micro-cultivators, micro-processors and nursery licence holders with less than \$1 million in gross revenue. This proposed fee for all categories of licenced holders is the greater of \$23,000 and 2.3% of gross revenue, except that for micro-cultivators, micro-processors and nursery licence holders (only) with less than \$1 million in gross revenue, the fee is the greater of \$2,500 and 1.0% of gross revenue.

Gross Revenue

Gross revenue is generally calculated on (a) the amount sold plus (b) the amount transferred to another licence holder less (c) the amount purchased or transferred-in from another licence holder. For both micro- and standard-processing licence holders, gross revenue also adds the amount transferred to the provincial or territorial wholesaler. Interestingly, while licence holders who sell exclusively for medical purposes (i.e., to authorized persons or authorized patients) will be exempt from the proposed Annual Regulatory Fee, licence holders who sell to the non-medical market through provincial/territorial wholesalers and also do direct sales under a federal medical sales licence, will not benefit from any exemption or discount from the Annual Regulatory Fee as the calculation of gross revenue does not make any distinction for sales for medical purposes for those licence holders.

The Cost Proposal does not currently set, and feedback is being sought on, the periods that will be taken into account in calculating gross revenue; forecast revenue for the upcoming year, the actual revenue of the prior year or a combination of both are being considered.

Additional Thoughts

In the Cost Proposal, Health Canada states “cost recovery is based on the principle that the public should not bear the costs of government activities in cases where private parties derive the primary benefit.” However, despite discounting certain fees for certain micro-classes of licenced holders, the proposed fees may be too onerous on licence holders, drive up costs and potentially threaten a main objective of supplanting the illegal cannabis marketplace.³ In addition, the Cost Proposal makes clear that it covers only the costs of the federal government, which suggests that little, if any, of the collected fees will be shared with the provincial/territorial or municipal governments, who have long complained about shouldering the heavier costs burden of the recreational cannabis regime. It remains to be seen if, emboldened by the federal government’s proposal, other levels of government are tempted to follow suit, further driving up industry costs.

The Cost Proposal is open for public comments until August 9, 2018. In Annex 1 to the Cost Proposal, specific questions are listed where feedback is sought, including questions about fairness of the proposal to licenced holders and the government and the potential effect of the proposed fees on a licence holder’s ability to compete.

Goodmans Cannabis Group

Goodmans LLP has a leading cannabis practice in the corporate/commercial field, having been actively involved in the industry from the beginning. Our corporate cannabis lawyers have extensive knowledge of the various players in the industry and have provided strategic business advice on governance, financing, licensing, regulation, capital markets, mergers and acquisitions and real estate matters. Our clients include start-ups, importers and exporters, and financial institutions related to the cannabis industry.

In addition, Goodmans is uniquely positioned with its extensive regulatory, health and intellectual property practices to advise new and existing market entrants. In particular, given our extensive work with respect to “traditional” pharmaceuticals regulated under the Food and Drugs Act and its associated Regulations (legislation used, in part, as the model for the upcoming Cannabis Act Regulations), we uniquely understand the industry, are equipped to address regulatory concerns that may arise, and know how to best protect and enforce our clients’ intellectual property. This includes matters such as licensing and regulation in the industry’s preliminary stages and future issues that may arise with regulators and competitors, including with respect to labelling and packaging, patent and trademark applications and prosecutions and the protection of trade secrets and confidential information.

For more information on any of the above information, please contact any member of our [Cannabis Group](#).

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¹ See <https://www.budget.gc.ca/fes-eea/2017/docs/statement-enonce/fes-eea-2017-eng.pdf> (see p.66), where \$59 million, \$98 million, \$118 million, \$128 million and \$143 million were allocated to Health Canada, the RCMP, the Canada Border Services Agency and Public Safety Canada for the 2017 to 2021 fiscal years. To this, the Cost Proposal added another \$6 million of 'additional identified' expenditures.

² The Cost Proposal also introduces certain administrative (i.e., non-binding) service standards for both the Application Screening and the Import/Export Permit applications. The proposed timeline to complete its review is 30 business days from receipt of payment (and, presumably, a duly completed application).

³ In the Cost Proposal, at gross revenues of \$500,000 (micro), \$10,000,000 (medium) and \$50,000,000 (large), and assuming five security clearances for a licensed holder (including renewals), the proposed total costs for a micro-class license holder is \$9,100 in initial fees and \$6,000 in ongoing annual fees; over \$67,000 initial and almost \$240,000 ongoing annual for a medium-sized license holder and over \$90,000 and over \$1.15 million ongoing annual for a large size license holder.