



Ad hoc Rule?

Department of Taxation Using METRC Rather than Actual Sales Records to Assess WMT Tax in Audits

BY PAUL E. LARSEN, ESQ.

In an audit conducted of a taxpayer subject to the Nevada Wholesale Marijuana Tax (WMT), an auditor for the Nevada Department of Taxation (DoT) chose to disregard the taxpayer's actual sales records (invoices and manifests of wholesale transaction between the taxpayer and a wholesale buyer) for the audit period, and instead focused on the classification of products in those sales as set forth in the taxpayer's Marijuana Enforcement Tracking Reporting Compliance (METRC) inventory tracking system.

This is a curious new audit practice, as it essentially disregards the *actual records* of the sale, seemingly for the sole purpose of finding a higher taxable value for the wholesale transaction. No notice was or has been given to taxpayers of this new audit practice, despite confirmation from both the DoT (and the Cannabis Compliance Board [CCB]) that the audit practice is now routine.

As a preface, one must recall that the main question in a WMT audit is whether the taxpayer properly paid the 15 percent WMT due upon the “sales price” for wholesale cannabis transactions. Nevada Revised Statute (NRS) 306.300(1)(a) dictates that this inquiry starts with the “facts contained in the [tax] return.” “Sales price” is simply defined in NRS 378A.247

as the “total amount for which tangible property is sold” as documented by sales records. See also NRS 372A.270 and NRS 378A.285. NRS 306.300(1)(a) clearly designates the taxpayer's actual sales records—which list the product classes, weights, and sales price—and the tax return itself as the primary source records for any tax determination.

Nevada statutes only list four product classifications for reporting the WMT. However, the DoT's tax forms list up to eight product classifications, despite the DoT never having proposed or adopted regulations regarding these extra product classifications.¹

Using METRC to determine the product classification in lieu of the taxpayer's *actual* sales records of product classification and “sales price” (such as invoices, receipts, and manifests) can lead to erroneous results due to the limitations of METRC. Consider the following for a single classification, that of “Small/Popcorn Buds:”

1. The DoT's WMT forms for July 2017, January to June 2019 through December 2019 show “Small/Popcorn Buds” listed as a category (these forms are updated every six months by the DoT). The DoT forms also calculated a “Fair Market Value” or FMV for this product category and required the taxpayer to remit 15 percent of that FMV.
2. “Small/Popcorn Buds” were not listed in METRC as a classification choice until October 2019 for medical cultivation and November 2019 for retail (recreational) cultivation.
3. A FAQ from the CCB about METRC in August 2021 addressed the process of breaking up packages in a single classification into other product type

classifications as would need to be done when packaging and selling “Small/Popcorn Buds” from a larger lot classified as “Flower.” No taxpayer guidance from DoT has ever been published on this process; no DoT regulation has ever been proposed or adopted.

4. METRC Chief Executive Officer Michael Johnson has informally confirmed to this author that METRC classifications are not designed to replace the taxpayers’ actual sales records for WMT tax purposes.

The points above demonstrate that the DoT has historically depended on taxpayers to use self-reporting based on their actual sales records to determine which category to use for WMT taxation, as the Small/Popcorn Buds category existed for several years on the Department’s WMT form but not in METRC. Compliant and smart taxpayers thus developed procedures that depended on using the actual sales invoices as the definitive record for product type classification (since not all product categories on the DoT’s WMT form even exist in METRC). Despite the fact that the Nevada statutes and regulations only list four product classes, the DoT’s tax forms list approximately eight, for which several (such as the historic form classification of “pre-roll”) existed neither in statute nor regulation until recently.

After the new “Small/Popcorn Buds” category was created in METRC in late 2019, neither the CCB nor the DoT (and not even METRC) announced that it existed, how it was to be used, or that licensees would be out of compliance if they did not change their WMT reporting procedures, until almost two years later. That FAQ announcement was not a DoT instruction or requirement on how to report, only a “FAQ” of information on the CCB website (not the DoT’s) about METRC. Obviously, no DoT or CCB regulation or industry advisory has ever formally addressed the issue to date.

Various categories and features have evolved in METRC over time, and the DoT has historically not provided taxpayers with guidance on any requirement of reporting compliance for any of these METRC category additions, modifications, or changes. It is unclear how the DoT audit manual addresses the evolving nature of METRC over the years, given the dearth of guidance to taxpayers on the issue. One might even question whether the DoT audit manual even supports an auditors’ failure to give credence to the taxpayer’s primary records—the tax returns and specific documentation of the actual sales—over METRC as required by NRS 306.300(1)(a). NRS 306.300(1)(a) clearly designates *the taxpayer’s records, not METRC*, as the primary source of any tax determination.

Nevertheless, the DoT audit practice of using METRC over actual records is now with us, despite the DoT never having properly adopted regulations for the practice, and despite that fact that the practice seemingly overrules the applicable statutes on the issue. This practice needs to be addressed through public notice and rulemaking, not ad hoc audit practices that are not announced to the public. The Administrative Procedure Act demands no less.

ENDNOTE:

1. One must also note that prior to the adoption of AB 430 (2023), taxpayers were required by DoT to pay 15 percent of the Fair Market Value (FMV) for a class of product as calculated by the DoT on its WMT forms, rather than 15 percent of the actual sales price for that product class negotiated between the buyer and seller. This pre-AB 430 tax practice is outside the scope of this article, but one should note that the pre-AB 430 DoT tax forms for WMT used a fictitious FMV for each product class, despite the DoT having never adopted regulations for the practice, and despite statutes indicating that the WMT is to be assessed on the actual sales price of the four statutorily listed products classes. See pre-AB 430 versions of NRS 372A.270 and NRS 378A.285. Arguably, this use of the FMV calculation to tax actual sales was also improper *ad hoc* rulemaking proscribed by the Administrative Procedure Act. See NRS 233B.0617. See also NRS 233B.060, NRS 233B.0608, and NRS 233B.0665.



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