

*Senate Budget and Fiscal Review—Nancy Skinner, Chair*

**SUBCOMMITTEE NO. 4**

**Agenda**

**Senator Sydney Kamlager, Chair**

**Senator Anna Caballero**

**Senator Jim Nielsen**

**Senator Richard D. Roth**



**Wednesday, February 23, 2022**

**1:30 p.m.**

**State Capitol – Room 2040**

Consultant: Yong Salas

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**Public Comment**

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling (916) 651-1505. Requests should be made one week in advance whenever possible.

**1115 DEPARTMENT OF CANNABIS CONTROL**

The Department of Cannabis Control (DCC) was consolidated from three cannabis licensing entities into one department pursuant to Assembly Bill 141 (Committee on Budget), Chapter 70, Statutes of 2021. DCC licenses and regulates cannabis businesses, including cannabis-related cultivation, manufacturing, and sales.

**Budget Overview:** The Governor's budget proposes \$181.1 million and 626 positions in the budget year, as shown in the figure below. This is an increase of two positions but a decrease of approximately \$110 million from 2021-22, mostly due to significant one-time funding provided in the 2021-22 budget.

	Positions			Expenditures		
	2020-21	2021-22	2022-23	2020-21*	2021-22*	2022-23*
1460 Department of Cannabis Control	-	624.0	626.0	\$-	\$293,584	\$181,117
<b>TOTALS, POSITIONS AND EXPENDITURES (All Programs)</b>	<b>-</b>	<b>624.0</b>	<b>626.0</b>	<b>\$-</b>	<b>\$293,584</b>	<b>\$181,117</b>
<b>FUNDING</b>				<b>2020-21*</b>	<b>2021-22*</b>	<b>2022-23*</b>
0001 General Fund				\$-	\$125,733	\$1,429
0995 Reimbursements				-	185	737
3288 Cannabis Control Fund				-	157,666	155,277
3335 Cannabis Tax Fund - Cannabis Control				-	-	13,674
3346 Cannabis Tax Fund - Department of Cannabis Control - Allocation 2				-	10,000	10,000
<b>TOTALS, EXPENDITURES, ALL FUNDS</b>				<b>\$-</b>	<b>\$293,584</b>	<b>\$181,117</b>

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**Issue 1: Cannabis Tax Reform**

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**Panel**

- Seth Kerstein, Legislative Analyst’s Office
- Greg Minor, City of Oakland
- Amber Senter, Supernova Women
- Virgil Grant, Los Angeles Equity Operator
- Kristin Heidelbach, Teamsters
- Jassy Grewal, United Food and Commercial Workers Union
- Terry Brennand, SEIU
- Beverly Yu, United Domestic Workers/AFSCME Local 3930
- Caren Woodson, Kiva Convections
- Adrien Keys, Small Homestead Cannabis Farmer from Trinity County
- Nick Maduros, California Department of Tax and Fee Administration
- Nicole Elliott, Department of Cannabis Control

**Background**

Since the passage of Proposition 64—the Control, Regulation and Tax Adult Use of Marijuana Act, which authorized adults aged 21 years or older to legally grow, possess, and use marijuana for non-medical purposes—in 2016, the Legislature passed two pieces of legislation that further implemented the Act. First, in 2017, the Legislature passed Senate Bill 94 (Committee on Budget and Fiscal Review), Chapter 27, Statutes of 2017, the Medicinal and Adult-Use Cannabis Regulation and Safety Act, that created a single-comprehensive system to control and regulate the cultivation, distribution, transport, storage, manufacturing, processing and sale of both medicinal and adult-use cannabis. Then, in 2019, Assembly Bill 97 (Committee on Budget), Chapter 40, Statutes of 2019, strengthened enforcement tools and licensing requirements, and extended the time for local governments to undergo the California Environmental Quality Act to July 1, 2021, related to cannabis activities, among other provisions. Most recently, Assembly Bill 141 (Committee on Budget), Chapter 70, Statutes of 2021, consolidated the three licensing entities into one department, the Department of Cannabis Control, and extended the state’s provisional licensing program.

Prior to the passage of Proposition 64, the Legislature and the voters created a layered network of cannabis-related policies. These include:

- In 1996, California voters approved Proposition 215, known as the Compassionate Use Act, which statutorily authorized the use of medical cannabis, and provided protections for physicians who made medical cannabis recommendations.
- In 2003, Senate Bill 420 (Vasconcellos), Chapter 875, Statutes of 2003, established the voluntary Medical Marijuana Program under the California Department of Public Health, which provided access to medical cannabis for qualified patients and primary caregivers and created a medical marijuana identification card and registry database.

- In 2015, Governor Jerry Brown signed the Medical Marijuana Regulation and Safety Act, comprised of Assembly Bill 243 (Wood), Chapter 688, Statutes of 2015; Assembly Bill 266 (Bonta), Chapter 689, Statutes of 2015; and Senate Bill 643 (McGuire), Chapter 719, Statutes of 2015. Together, these bills established the oversight and regulatory framework for the cultivation, manufacture, transportation, storage, and distribution of medical cannabis in California.

As a result of varied and layered policies, the pathway for cannabis licensure has been burdensome and costly. Existing law and regulations require operators to be dually-licensed at both the local and state levels. In the 482 cities in California, approximately 41 percent allow for legal commercial cannabis business activity within their jurisdiction, while approximately 55 percent of counties allow for this activity.<sup>1</sup>

### **Cannabis Taxes**

Proposition 64 established two state excise taxes on cannabis: 1) 15 percent excise tax on retail gross receipts, and 2) a cultivation tax on harvested plants that is based on weight. The California Department of Tax and Fee Administration (CDTFA), which administers these cannabis taxes, is statutorily required to adjust the cultivation tax rates annually for inflation. Beginning on January 1, 2022, existing law required the cultivation tax to be adjusted to \$10.08 per ounce of dried flowers (an increase from the previous rate of \$9.65 per ounce of dried flowers), \$3.00 per ounce of dried leaves (an increase from the previous rate of \$2.87 per ounce of dried leaves), and \$1.41 per ounce of fresh plants (an increase from the previous rate \$1.35 per ounce of fresh plants). Proposition 64 eliminated the standard sales tax on medical marijuana patients with a state ID card; but recreational cannabis is subject to existing state and local sales tax. Lastly, locals have discretion on setting additional taxes on cannabis activity. In some jurisdictions, local taxes on cannabis products can be as high as ten percent.

The retail excise tax and the cultivation tax are both collected by distributors. At the end of 2019, CDTFA raised the mark-up<sup>2</sup> on wholesale cannabis from 60 percent to 80 percent, and it has remained at 80 percent since. The following chart from the Legislative Analyst's Office (LAO) outlines the cannabis tax structure.

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<sup>1</sup> <https://cannabis.ca.gov/wp-content/uploads/sites/2/2021/12/CAC-Annual-Report-2021.pdf>

<sup>2</sup> In an arm's length transaction, meaning the consideration received reflects the fair market value between two parties under no requirement to participate in the transaction, the distributor calculates the cannabis excise tax based on the "average market price," which is computed by applying the CDTFA's predetermined mark-up rate.

<b>California's Cannabis Taxes</b>		
<b>Tax</b>	<b>Type</b>	<b>Rate on January 1, 2020</b>
State retail excise tax	Ad valorem tax primarily on wholesale sales	Nominally 15 percent of retail price. In practice: <ul style="list-style-type: none"> <li>• For most sales, administratively determined percentage of wholesale price (currently 27 percent)</li> <li>• For some sales, 15 percent of retail price</li> </ul>
State cultivation tax	Weight-based tax on harvested cannabis	<ul style="list-style-type: none"> <li>• \$9.65 per ounce of dried cannabis flowers</li> <li>• \$2.87 per ounce of dried cannabis leaves</li> <li>• \$1.35 per ounce of fresh cannabis plant</li> </ul>
Local taxes	Varies; most commonly ad valorem or based on square footage	Varies—on average, roughly equivalent to a 14 percent tax on retail sales <sup>a</sup>

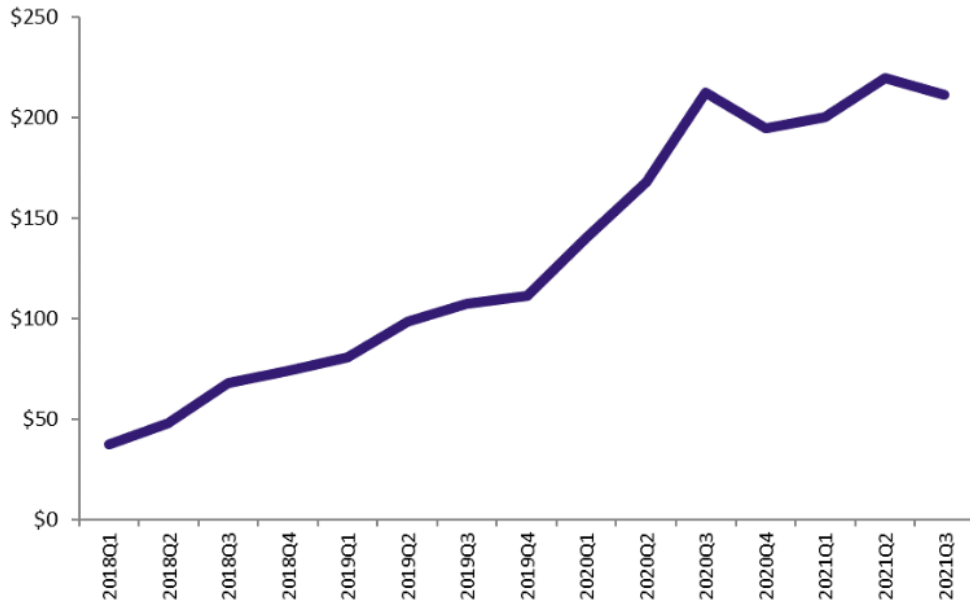
<sup>a</sup> LAO estimate of the average cumulative tax rate, including taxes on cultivation, manufacturing, distribution, testing, and retail.

**Governor’s Budget Proposal**

The cannabis excise tax and the cultivation tax are deposited into the Cannabis Tax Fund, which is then distributed for various purposes as required by Proposition 64. The Cannabis Tax Fund revenue is distributed in three Allocations. Revenue collected in a given fiscal year is first distributed to Allocations 1 and 2 (both described in more detail below). After the distributions to Allocations 1 and 2, the remaining revenue is carried over to the next fiscal year and distributed to Allocation 3 (described in more detail below). Pursuant to the Governor’s budget estimates, for the 2021-22 fiscal year, after distributions to Allocations 1 and 2, the balance is approximately \$595 million, which is carried into the 2022-23 fiscal year for Allocation 3 disbursements. The balance from 2020-21 that was carried over to provide the Allocation 3 disbursements for the 2021-22 fiscal year was approximately \$670 million. This represents an estimated \$75 million less available for Allocation 3 programs in 2022-23 as compared to 2021-22.

The Administration estimates that cannabis tax revenues will be \$786.8 million in 2022-23, an increase of \$78.9 million from 2021-22. The below chart shows the quarterly revenue trends for the Cannabis Tax Fund, provided by the LAO.

**Quarterly Cannabis Tax Revenues**  
In Millions



The estimated revenues and expenditure allocations for the Cannabis Tax Fund provided by the Department of Finance are on the next page.

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**California Cannabis Tax Fund (3314) Estimated Revenues & Expenditure Allocations**

	2020-21*	2021-22*	2022-23*
<b>REVENUES:</b>			
Beginning Balance	\$337,762	\$669,610	\$594,868
Cannabis Tax	770,380	710,915	786,836
<b>Total Revenues</b>	<b>\$1,108,142</b>	<b>\$1,380,525</b>	<b>\$1,381,704</b>
<b>Allocation 1: Regulatory and Administrative</b>			
Bureau of Cannabis Control (Equity Program)	15,517	-	-
Governor's Office of Business and Economic Development (Equity Program)	-	15,573	15,574
Department of Cannabis Control	-	-	13,674
Department of Fish and Wildlife	7,783	9,084	10,431
Department of Pesticide Regulation	3,418	2,726	2,729
State Water Resources Control Board	10,097	10,728	10,723
Employment Development Department	3,633	3,630	3,630
Department of Tax and Fee Administration	12,425	9,347	9,750
State Controller's Office	-	-	502
Department of Finance	-	440	-
Statewide General Administration	2,897	9,519	14,419
<b>Total Allocation 1</b>	<b>\$55,770</b>	<b>\$61,047</b>	<b>\$81,432</b>
<b>Allocation 2: Specified Allocations for Research and Other Programs</b>			
Public University/Universities in California	10,000	10,000	10,000
California Highway Patrol	3,000	3,000	3,000
Governor's Office of Business and Economic Development	30,000	40,000	50,000
University of San Diego Center for Medicinal Cannabis Research	2,000	2,000	2,000
<b>Total Allocation 2</b>	<b>\$45,000</b>	<b>\$55,000</b>	<b>\$65,000</b>
<b>Allocation 3: Percentage of Remaining Revenue Collection</b>			
Youth Education Prevention, Early Intervention and Treatment Account	202,657	401,766	356,921
Environmental Restoration and Protection Account	67,552	133,922	118,974
State and Local Government Law Enforcement Account	67,552	133,922	118,974
<b>Total Allocation 3</b>	<b>\$337,762</b>	<b>\$669,610</b>	<b>\$594,868</b>
Based on prior year actual tax collection			
<b>Total Expenditures</b>	<b>\$438,532</b>	<b>\$785,657</b>	<b>\$741,300</b>
<b>Balance of Tax Receipts</b>	<b>\$669,610</b>	<b>\$594,868</b>	<b>\$640,404</b>

In the above chart, "Allocation 1" refers to regulatory costs as allowed by Proposition 64, for the following agencies:

- CDTFA for administering and collecting taxes, not to exceed 4 percent of the tax revenues received.
- DCC for implementing, administering, and enforcing cannabis laws, to the extent these costs are not reimbursed by the Cannabis Control Fund, which receives licensing fees, until the end of the 2022-23 fiscal year.
- Department of Fish and Wildlife, the State Water Resources Control Board, and the Department of Pesticide for cannabis-related activities as required by law, to the extent that these costs are not reimbursed.
- Governor's Office of Business and Economic Development to implement the Cannabis Equity Act.
- The State Controller's Office, for cannabis-related activities, including audits.
- The Division of Labor Standards Enforcement and the Division of Occupational Safety and Health within the Department of Industrial Relations and the Employee Development Department for the costs of applying and enforcing state labor laws to cannabis licensees.

For the 2022-23 Budget, the Administration proposes new spending under Allocation 1:

- *Department of Cannabis Control.* One-time \$13.7 million Cannabis Tax Fund an information technology assessment of a unified cannabis licensing system, consumer awareness campaign, and data collection and sharing efforts.
- *Department of Tax and Fee Administration.* \$882,000 Cannabis Tax Fund in 2022-23 and \$815,000 beginning in 2023-24 and ongoing for to provide audit support for the Cannabis Taxes Program.
- *Department of Fish and Wildlife.* \$1.3 million in 2022-23, \$1.2 million in 2023-24, and \$1.2 million in 2024-25 from the Cannabis Tax Fund for costs related to the provisional licensing program.
- *State Controller's Office.* \$502,000 in 2022-23 and \$489,000 ongoing from the California Cannabis Tax Fund to support 3.0 permanent positions for audits of the California Cannabis Tax Fund.
- *California Highway Patrol.* Authority for 9 positions to provide oversight for the Cannabis Tax Fund grant program (\$40 million under Allocation 3).

“Allocation 2” refers to set allocations for research and other programs, as required by law, and includes for 2022-23:

- \$2 million annually to the University of California San Diego Center for Medicinal Cannabis Research.
- \$50 million annually for the Governor’s Office of Business and Economic Development for the Community Reinvestment grants program.
- \$3 million to the California Highway Patrol until 2022-23 to establish and adopt protocols related to impaired driving.
- \$10 million for the Department of Cannabis Control to award funds to public universities to conduct cannabis-related research until 2028-29.

“Allocation 3” distributes the remaining revenues from the prior year after the expenditures in Allocations 1 and 2, so that 60 percent of the remaining revenues are deposited into the Youth Education, Prevention, Early Intervention and Treatment Account, 20 percent are deposited in the Environmental Restoration and Protection Account, and the final 20 percent going to the State and Local Government Law Enforcement Account.

The chart below describes in further detail how the Allocation 3 funds will be distributed at Governor’s Budget:



Cannabis Taxes - Allocation 3	2021-22 at 2021 Budget Act	2021-22 at 2022-23 Governor's Budget	2021-22 Difference Compared to Budget Act	2022-23 at 2022-23 Governor's Budget
<b>Youth Education Prevention, Early Intervention &amp; Treatment Account</b>	<b>\$377,457,000</b>	<b>\$401,766,000</b>	<b>\$24,309,000</b>	<b>\$356,921,000</b>
CDPH for surveillance and education activities	\$12,000,000	\$12,000,000	\$0	\$12,000,000
DSS for access to subsidized child care (remaining 75%)	\$274,093,000	\$292,325,000	\$18,232,000	\$258,691,000
DHCS for competitive grants (remaining 20%)	\$73,091,000	\$77,953,000	\$4,862,000	\$68,984,000
Natural Resources Agency for Community Access (remaining 5%)	\$18,273,000	\$19,488,000	\$1,215,000	\$17,246,000
<b>Environmental Restoration and Protection Account</b>	<b>\$125,819,000</b>	<b>\$133,922,000</b>	<b>\$8,103,000</b>	<b>\$118,974,000</b>
Fish and Wildlife	\$75,491,000	\$80,353,000	\$4,862,000	\$71,384,000
Parks and Recreation	\$50,328,000	\$53,569,000	\$3,241,000	\$47,590,000
<b>State and Local Government Law Enforcement Account</b>	<b>\$125,819,000</b>	<b>\$133,922,000</b>	<b>\$8,103,000</b>	<b>\$118,974,000</b>
CHP for impaired driving activities and IT/admin staff	\$2,614,000	\$2,614,000	\$0	\$10,000,000
CHP for impaired driving/traffic safety grant program (includes related admin)	\$36,962,000	\$39,392,000	\$2,430,000	\$40,000,000
BSCC's public safety services grant program	\$86,243,000	\$91,916,000	\$5,673,000	\$68,974,000
<b>Total</b>	<b>\$629,095,000</b>	<b>\$669,610,000</b>	<b>\$40,515,000</b>	<b>\$594,869,000</b>

Source: Department of Finance

### **Suggested Questions**

- LAO/DOF: If the cannabis tax revenues decline, how would programs, particularly in Allocation 3, be impacted? Would any potential tax reform this year change the Allocation 3 funding levels in 2022-23?
- DCC: Are provisional licensees on track to transition to annual licenses? If the licensees are unable to successfully transition provisional licenses to annual licensure, what impacts would this have on cannabis tax revenues?
- General: In addition to tax relief, are there other things that the state can do to help alleviate regulatory burdens?

**Staff Recommendation.** This is an informational item only.