

November 24, 2015

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative related to the cultivation, use, possession, and sale of marijuana (A.G. File No. 15-0075, Amendment No. 1).

Background

State Law and Proposition 215. Under current state law, the possession, cultivation, or distribution of marijuana generally is illegal in California. Penalties for marijuana-related activities vary depending on the offense. For example, possession of less than one ounce of marijuana is an infraction punishable by a fine, while selling marijuana is a felony and may result in a jail or prison sentence.

In November 1996, voters approved Proposition 215, which made it legal under state law for individuals of any age to cultivate and possess marijuana in California for medical purposes only, specifically with a recommendation from a licensed physician. In 2003, the Legislature authorized the formation of medical marijuana cooperatives, which are nonprofit organizations of medical marijuana users that cultivate and distribute marijuana to their members through outlets known as dispensaries. State law also gives cities and counties the discretion to regulate the location and operation of such facilities. State and local governments currently collect sales tax on medical marijuana. A small number of cities also impose additional taxes on medical marijuana sales. We estimate that the total amount of state and local revenue collected statewide from the above taxes likely is in the high tens of millions of dollars annually.

Federal Law. Federal laws classify marijuana as an illegal substance and provide criminal penalties for various activities relating to its use. These laws are enforced by federal agencies that may act independently or in cooperation with state and local law enforcement agencies. The U.S. Supreme Court ruled in 2005 that federal authorities could continue under federal law to prosecute California patients and providers engaged in the cultivation and use of marijuana for medical purposes. Despite having this authority, the current policy of the U.S. Department of Justice (DOJ) is not to prosecute marijuana users and businesses that act in compliance with state

and local marijuana laws so long as those laws are written and enforced in a manner that upholds federal priorities. These priorities include ensuring that marijuana is not distributed to minors or diverted from states that have legalized marijuana to other states.

Proposal

This measure changes state law to legalize the possession, cultivation, and sale of marijuana. Despite these changes to state law, activities related to the use of marijuana would continue to be prohibited under federal law.

State Legalization of Marijuana-Related Activities. Under the measure, individuals age 21 or over could legally possess, sell, transport, process, and cultivate marijuana under state law. Specifically, individuals could, for personal use, (1) possess in public, share, or transport one ounce or less of marijuana; (2) possess at their personal residence 16 ounces or less of marijuana; and (3) cultivate a marijuana garden of not more than 100 square feet. Individuals could possess greater amounts of marijuana for personal use if (1) the marijuana is a product of their personal garden and (2) it is possessed on, or is being transported to, the grounds of their personal residence. While the measure would generally legalize marijuana, certain marijuana-related activities would remain unlawful including (1) operating a motor vehicle while under the impairment of marijuana, (2) diverting marijuana to another state, and (3) providing marijuana to individuals under the age of 21. Individuals over the age of 21 could also engage in commercial marijuana-related activities (such as cultivation and distribution) provided they adhere to the regulations described below.

Regulation of Commercial Marijuana Activities. This measure establishes the Office of Cannabis Regulation (OCR) to regulate the commercial cultivation, processing, testing, distribution, and sales of marijuana, as well as the California Cannabis Commission to oversee the office. Individuals or organizations engaging in commercial marijuana-related activities would be required to pay a fee and obtain a license from OCR. The measure requires the office to develop procedures for the application, issuance, renewal, modification, suspension, and revocation of licenses, including a process for individuals to appeal licensing decisions or administrative penalties imposed by the office (such as by seeking relief in superior courts). The measure states that, to the extent possible, marijuana sales shall be regulated consistent with alcohol sales.

Cannabis Safety Fund. As discussed below, in addition to the above license fee, the measure also establishes various state taxes, monetary penalties, and other fees. Under the measure, revenues from these taxes, penalties, and fees would be deposited into a new state fund—the Cannabis Safety Fund. In addition, under certain circumstances, some of these revenues would be deposited in the Environmental Restoration and Protection Account, a subaccount of the Cannabis Safety Fund. The measure requires the California Cannabis Commission, in consultation with the state Department of Finance (DOF), to allocate necessary funds to state agencies involved in the implementation, enforcement, and administration of the measure. It also requires the commission to use a portion of the funding to support research that furthers the purposes of the measure.

The measure requires that any remaining funds be annually allocated by the commission, in consultation with the DOF, with a portion allocated to community-based nonprofit organizations. Specifically, the measure states that of the remaining revenues:

- Not less than 50 percent and no more than 60 percent shall be allocated for various purposes, including child care programs for low-income families and youth education, counseling, and health care services.
- Not less than 2 percent and no more than 20 percent shall be allocated for each of the following (1) research on the health and medicinal effects of marijuana by the University of California's Center for Medicinal Cannabis Research; (2) initiatives intended to reduce the public safety, health, and environmental effects of marijuana use and cultivation; (3) substance abuse, mental health, and medical services and programs; and (4) projects related to the use and conservation of water.

Under the measure, revenues deposited in the Environmental Restoration and Protection Account would be allocated for: (1) cleanup and restoration of environmental damage caused by marijuana cultivation; (2) natural resource protection, including acquisition of lands, to offset the adverse environmental impacts of marijuana cultivation; and (3) operations and maintenance of state parks and wildlife habitats.

Taxation of Commercial Marijuana Sales. The measure establishes three types of taxes on the commercial production and sale of marijuana:

- ***Cultivation Tax.*** The measure imposes a cultivation tax of \$2 per square foot of plant canopy on marijuana grown for medical or recreational use. The measure requires the tax to be annually adjusted by the rate of inflation. Half of the revenue from this tax would be allocated to the city or county (if the cultivation occurs in an unincorporated area) where the marijuana is grown. The remaining half would be deposited into the Environmental Restoration and Protection Account.
- ***Wholesale Tax.*** The measure also imposes on producers of marijuana for medical or recreational use excise taxes on the wholesale price. Specifically, dried marijuana flowers would be initially taxed at a rate of \$5 per ounce on the first 500 pounds sold annually and \$15 per ounce thereafter. Other parts of the marijuana plant (such as the leaves) would initially be taxed at a rate of \$1 per ounce on the first 500 pounds sold annually and \$3 per ounce thereafter. However, the measure authorizes OCR to annually adjust the tax rate to reflect changes in relative market prices of different parts of the marijuana plant. The measure also requires the tax to be annually adjusted for inflation. The revenue generated by the wholesale excise tax would be allocated as follows: (1) 70 percent to the Cannabis Safety Fund, (2) 20 percent to the Environmental Restoration and Protection Account, and (3) 10 percent to the city or county (if the cultivation occurs in an unincorporated area) where the marijuana is grown.
- ***Retail Tax.*** The measure imposes state and local excise taxes on the retail sale of marijuana products. First, the measure imposes a state excise tax of 10 percent on edible marijuana products and concentrated extracts (such as hash) and 5 percent on

all other marijuana products. Marijuana sold for medical purposes would be exempt from the state excise retail taxes. Revenue from the state retail excise tax would be deposited into the Cannabis Safety Fund. Second, the measure imposes a 5 percent local retail excise tax on all marijuana products. However, marijuana sold for medical purposes to individuals who are eligible for Medi-Cal (a state administered health program for low-income residents) would be exempt from this local tax, as well as the state sales tax. The measure states that no other retail taxes shall be imposed by cities and counties on marijuana sales. Revenues from the local retail excise tax would be allocated to the city or county (if the sale occurs in an unincorporated area) where the marijuana is sold.

Local Restrictions for Marijuana Businesses. Under the measure, cities and counties could adopt laws that (1) regulate the location and hours of licensed marijuana retail stores; (2) restrict commercial cultivation, manufacturing, or distribution of marijuana; or (3) restrict or prohibit the use of marijuana in public areas. However, restrictions on medical marijuana would have to be approved by a majority vote of the electorate. In addition, local governments could not prohibit the cultivation or possession of marijuana for personal use or the delivery of marijuana for medical use.

Authorization of Civil and Criminal Penalties. While the measure eliminates existing marijuana-related crimes, it also creates new criminal penalties for certain marijuana-related activities. For example, under the measure, it would be an infraction punishable by a fine of up to \$100 for a person under the age of 21 to possess up to one ounce of marijuana. The measure also allows OCR to impose monetary penalties for administrative violations. For example, OCR can impose a penalty for administrative violations related to the cultivation of marijuana of \$50 per ounce of marijuana and up to \$10 per square foot of marijuana canopy cultivated. The measure requires that the revenues from such cultivation-related penalties be deposited in the Environmental Restoration and Protection Account.

Other Provisions. The measure states that schools, employers, and landlords may not discriminate against or penalize a person solely for their status as a medical marijuana patient or caretaker to a medical marijuana patient, unless failing to do so would put the school, employer, or landlord in violation of federal law or in jeopardy of losing a federal contract or funding. The measure also states that the only basis for determining whether a person is driving under the influence of marijuana shall be whether that person is so physically or mentally impaired that he or she is unable to drive using the caution of a sober person under similar circumstances. The measure requires the destruction of arrest and conviction records for individuals previously convicted of certain marijuana-related offenses. In addition, the measure allows individuals currently on probation for marijuana-related offenses to petition the court to grant early termination of probation.

Fiscal Effects

The provisions of this measure would affect both costs and revenues for state and local governments. The magnitude of these effects would depend upon (1) how, and to what extent, state and local governments choose to regulate the commercial production and sale of

marijuana; (2) future consumption by marijuana users; and (3) the extent to which the U.S. DOJ exercises its discretion to enforce federal prohibitions on marijuana activities otherwise permitted by this measure. Thus, the potential revenue and expenditure impacts of this measure described below are subject to considerable uncertainty.

Reduction in Various Criminal Justice Costs. The measure would result in reduced costs to the state and local governments by reducing the number of marijuana offenders incarcerated in state prison and county jail, as well as the number placed under community supervision (such as county probation). In addition, the measure would result in a reduction in state and local costs for the enforcement of marijuana-related offenses and the handling of related criminal cases in the state court system. In total, we estimate that the net reduction in state and local criminal justice costs from the above changes could range from the tens of millions of dollars to potentially exceeding \$100 million annually. In many cases, however, these resources would likely be redirected to other law enforcement and court activities.

Other Fiscal Effects on State and Local Programs. The measure could also have fiscal effects on various other state and local programs. For example, the measure could result in an increase in the consumption of marijuana, potentially resulting in an unknown increase in the number of individuals seeking publicly funded substance use treatment. However, any additional costs could be partially or entirely offset by additional funding that would be available for substance use treatment under the measure. This measure could also reduce both the costs and offsetting revenues of the state's Medical Marijuana Program, a patient registry that identifies those individuals eligible under state law to legally purchase and consume marijuana for medical purposes. This is because individuals could legally possess marijuana under the measure without participating in the Medical Marijuana Program. In addition, the measure would result in costs for the state to regulate the commercial production and sale of marijuana. These costs would vary depending on how, and to what extent, the state chooses to regulate marijuana but would be unlikely to exceed several tens of millions of dollars annually. Eventually these costs would be entirely offset by monies in the new Cannabis Safety Fund.

In the short term, the measure would result in a temporary increase in costs to state trial courts and state and local law enforcement agencies to (1) destroy records of arrest and conviction for certain marijuana-related crimes and (2) review petitions for early termination of probation for individuals serving sentences for marijuana-related crimes. We estimate these costs could range from the millions to the low tens of millions of dollars over the first couple of years following the implementation of the measure. In addition, the measure could result in minor ongoing costs in the long term to state trial courts to hear appeals from marijuana businesses appealing the OCR's decisions.

Effects on State and Local Revenues. State and local governments would receive additional revenues, such as sales and excise taxes from recreational marijuana sales permitted under this measure. This is largely because many individuals who are currently purchasing marijuana illegally would begin purchasing it legally under state law at businesses that collect such taxes. As noted earlier, the state revenues derived from excise taxes imposed by the measure would be deposited in the Cannabis Safety Fund to benefit various programs including education, environmental protection, marijuana-related research, and substance use treatment.

In addition, the measure could result in an increase in taxable economic activity in the state, as businesses and individuals currently producing and selling marijuana illegally could begin doing so legally under state law and pay personal income and corporation taxes. Moreover, the measure would increase economic activity in the state to the extent that out-of-state consumers (such as tourists) redirect spending into the state. In total, our best estimate is that the state and local governments would eventually collect additional revenues that could range from the high hundreds of millions of dollars to over \$1 billion annually.

Effects on Fine and Asset Forfeiture Revenues. The measure could reduce state and local revenues from the collection of the fines established in current law for marijuana offenses and the assets that are forfeited in some criminal marijuana cases. We estimate that these revenues could amount to millions or low tens of millions of dollars annually. This could be somewhat offset, however, by additional fine revenue generated from the new penalties created by the measure (such as for the possession of marijuana by persons under 21).

Summary of Fiscal Effects. We estimate that this measure would have the following major fiscal effects, which could vary considerably depending on (1) how, and to what extent, state and local governments choose to regulate the commercial production and sale of marijuana; (2) future consumption by marijuana users; and (3) the extent to which the U.S. DOJ exercises its discretion to enforce federal prohibitions on marijuana activities otherwise permitted by this measure.

- Net reduced costs ranging from tens of millions of dollars to potentially exceeding \$100 million annually to state and local governments related to enforcing certain marijuana-related offenses, handling the related criminal cases in the court system, and incarcerating and supervising certain marijuana offenders.
- Additional state and local tax revenues potentially ranging from the high hundreds of millions of dollars to over \$1 billion annually related to the production and sale of marijuana, most of which would be required to be spent for specific purposes such as education, environmental protection, marijuana-related research, and substance use treatment.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance