

January 30, 2014

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. 13-0061).

Background

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.

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 legalized under state law the cultivation and possession of marijuana in California for medical purposes. State law also authorizes cities and counties to regulate the establishment of medical marijuana dispensaries in their jurisdictions. The U.S. Supreme Court ruled in 2005, however, 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 those that have not. State and local governments currently collect sales tax on medicinal marijuana sales.

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. As discussed below, the production and sales of specified amounts of marijuana for recreational purposes would be subject to regulation by the state and local governments.

Although the measure would generally legalize marijuana, it would remain unlawful for individuals to (1) use marijuana in a motor vehicle, (2) operate a motor vehicle while under the impairment of marijuana, (3) import or export marijuana to or from California, (4) use marijuana in a public place, or (5) provide marijuana to individuals under the age of 21. In addition, the measure states that it does not restrict the ability of employers to enact policies prohibiting or restricting activities otherwise permitted by the measure (such as using or possessing marijuana) in the workplace or by employees.

Regulation of Commercial Marijuana Businesses. This measure requires the Department of Alcohol Beverage Control (ABC) to regulate the cultivation, distribution, and sale of marijuana. Under the measure, possession of up to one ounce of marijuana for personal use would be exempt from regulation. In addition, individuals could grow and possess up to six marijuana plants (including any marijuana produced by such plants) in a private residence without regulation, so long as the marijuana is not visible from a public place. Moreover, medical marijuana dispensaries or individuals cultivating or possessing marijuana for medical purposes, as allowed by current law, would also be exempt from any new regulations established by the measure. Industrial hemp cultivation is currently prohibited under state and federal law. The measure states that if industrial hemp cultivation becomes legal in the future, the cultivation and use of industrial hemp would also be exempt from any regulations or taxes included in the measure.

Individuals or organizations cultivating greater amounts of marijuana, or engaging in commercial cultivation, processing, transportation, distribution, or sale of marijuana for non-medical purposes would be subject to regulation. For example, the measure requires ABC to establish rules and regulations pertaining to: (1) marijuana business licenses, including application and renewal fees; (2) marijuana advertising, marketing, labelling, and packaging; (3) health, safety, and environmental protection requirements; (4) limits on the total amount of marijuana that may be produced in California; and (5) the prevention of the sale of or diversion of marijuana to persons under age 21.

The measure requires ABC to work with state and local law enforcement to enforce its rules and regulations and to create penalties (such as suspending or revoking a marijuana business license or imposing fines) for violations. In addition, the measure requires ABC to establish a process by which persons affected by the department's decisions can protest and appeal those decisions, including the right to seek judicial review of any final decision by the department. The measure also requires state and local law enforcement agencies to immediately notify ABC of

any arrests that involve a marijuana business license holder or any actions that are under the department's jurisdiction.

Taxation of Commercial Marijuana Sales. The measure states that existing state and local sales and use taxes shall be applied to marijuana sold for recreational use. In addition, the measure initially levies a supplemental 25 percent sales tax on marijuana products sold by businesses required to be licensed under the measure. The measure states that the Legislature could not change the 25 percent supplemental sales tax rate or authorize any additional taxes on marijuana until 2022. All revenue from the supplemental sales tax would be deposited in a new special fund, the Marijuana Tax Fund. The measure states that the revenues in this fund shall be annually appropriated as follows: (1) \$3 million to a public university to research and evaluate the implementation of the measure, (2) funding to reimburse the ABC for their costs associated with implementing the measure, and (3) funding to reimburse the Board of Equalization for the costs of administering and collecting the supplemental sales tax on marijuana products.

Under the measure, any remaining funds in the Marijuana Tax Fund would be allocated annually as follows:

- 55 percent for K-12 after school programs.
- 30 percent for substance abuse treatment services and the evaluation of such services.
- 10 percent for local government programs (such as law enforcement) that address public health and safety issues that may be associated with the measure.
- 5 percent for restoration of clean air, water, and soil and the mitigation of environmental harms in cases where there is no financially responsible party.

The measure also authorizes a \$30 million loan from the General Fund to cover initial costs of regulation, tax collection and administration, and public education and outreach related to the measure, which would be repaid by 2020 from the Marijuana Tax Fund.

Zoning Restrictions for Marijuana Businesses. The measure generally allows cities and counties to ban or regulate the establishment of marijuana businesses within their jurisdiction. In addition, the measure authorizes ABC to deny a license to a marijuana business located within 1,000 feet of any K-12 school. The measure also requires ABC to deny a business license if granting the license would result in or add to an "undue concentration" of licenses within a particular community. Moreover, the measure prohibits advertisements for marijuana products within 1,000 feet of any K-12 school.

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) the extent to which the U.S. DOJ exercises its discretion to enforce federal prohibitions on marijuana activities otherwise permitted by this measure and (2) how state and local governments choose to regulate the commercial production and sale of marijuana. 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 prisons and county jails, 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, these reduced costs could potentially exceed \$100 million annually.

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 abuse treatment and other medical services. This measure could also potentially 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. In addition, the measure could result in costs for the state to regulate the commercial production and sale of marijuana. Depending on how, and to what extent, ABC chooses to implement such regulations, these costs could potentially be up to the low tens of millions of dollars annually. However, these costs would be entirely offset by license fees required by the measure to be levied on marijuana businesses, as well as revenues from the supplemental marijuana sales tax.

In addition, the measure could result in costs to state trial courts from hearing appeals from marijuana businesses aggrieved by ABC's decisions. The magnitude of these costs are unknown as they would depend on the number of appeals filed in response to the department's decisions. The measure could also result in costs to local law enforcement agencies, such as from having to notify ABC of arrests involving licensed marijuana businesses or persons engaging in actions under the department's jurisdiction.

Effects on State and Local Revenues. State and local governments could receive additional sales tax revenues from recreational marijuana sales permitted under this measure. In addition, the state could also realize additional revenues from the supplemental sales tax on marijuana products and any future taxes imposed after 2022. As noted earlier, all revenues collected from the supplemental sales tax on marijuana products would be deposited in the Marijuana Tax Fund and allocated for various purposes specified in the measure.

The measure could also result in an increase in taxable economic activity in the state, as businesses and individuals producing and selling marijuana would pay personal income and corporation taxes. Moreover, the measure would increase economic activity in the state to the extent that out-of-state consumers redirected spending into the state. The magnitude of the net increase in economic activity is unknown and would depend considerably on the extent to which the federal government enforces marijuana laws in California. In total, our best estimate is that the state and local governments could eventually collect net additional revenues potentially exceeding several hundred million dollars annually.

Reduction of Existing 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 the 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 violating regulations established by ABC).

Summary of Fiscal Effects. We estimate that this measure would have the following major fiscal effects, which could vary considerably depending on (1) future actions by the federal government to enforce federal marijuana laws and (2) how state and local governments choose to regulate the commercial production and sale of marijuana.

- Reduced costs 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.
- Net additional tax revenues potentially exceeding several hundred million dollars annually related to the production and sale of marijuana, a portion of which is required to be spent on after-school programs, public safety, substance abuse treatment, environmental restoration, and the regulation of commercial marijuana activities.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance