

February 26, 2014

Hon. Kamala D. Harris  
Attorney General  
1300 I Street, 17<sup>th</sup> 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. 14-0002 Amdt. #1-S).

## 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 or be under the influence of marijuana while operating a motor vehicle, (2) export marijuana from California to states where it is illegal, (3) use marijuana in certain public places, including streets and parks, or (4) provide marijuana to individuals under the age of 21.

***Regulation of Commercial Marijuana Businesses.*** This measure designates the Department of Alcohol Beverage Control (ABC) as the primary state agency responsible for regulating the marijuana industry. The measure also requires additional regulatory oversight from several other state agencies. Specifically, the Department of Public Health is required to regulate the distribution and sale of marijuana for medical purposes, the Department of Food and Agriculture and the Environmental Protection Agency are jointly required to regulate the cultivation of marijuana, and the Board of Equalization is required to work with ABC to develop a fee and taxation system for marijuana businesses.

Under the measure, possession of up to three pounds of marijuana for personal use would be exempt from regulation. In addition, individuals could cultivate marijuana gardens for personal use in a private residence without regulation, so long as the marijuana is not visible from a public place and the gardens meet certain size limitations. Outdoor marijuana gardens would be limited to no more than 100 square feet and indoor gardens would be limited to using lighting with no more than 2,600 watts of power. Marijuana grown for personal medical use would be exempt from size limitations.

Individuals or organizations cultivating greater amounts of marijuana, or engaging in commercial cultivation, processing, transportation, distribution, or sale of marijuana, or conducting marijuana-related research would be subject to regulation. For example, the measure requires the state to establish rules and regulations pertaining to: (1) marijuana business licenses, (2) marijuana product labelling, (3) environmental protection requirements for marijuana cultivation, and (4) the prevention of the sale of or diversion of marijuana to persons under age 21. The measure creates a new Cannabis Appeals Board (CAB) to hear appeals from any individuals who are aggrieved by the regulatory decisions made by ABC. In addition, the measure allows individuals to appeal decisions by CAB directly to either the state Supreme Court or the state Courts of Appeal.

***Taxation of Commercial Marijuana Sales.*** For purposes of taxation, the measure states that marijuana businesses shall be classified as belonging to one or more of three industry sectors: (1) cultivation and manicuring, (2) wholesale, or (3) retail. The measure states that other industry sectors may be added in the future, but does not specify how additional sectors would be authorized. Under the measure, businesses in each industry sector would be subject to a tax of 6 percent of their gross receipts from sales of marijuana products for recreational use. Businesses involved in two or more industry sectors would be taxed on the estimated value of marijuana transferred from one industry sector to another. In addition, businesses that specialize in testing marijuana (such as to determine potency) would be subject to a 1 percent tax on the gross receipts they receive for such testing services. All revenue from the above gross receipts taxes would be deposited in a new special fund, the Cannabis Tax Fund to be allocated as follows:

- 40 percent to the county government in which the funds were collected. If the taxes were collected in a city, the revenue would be split evenly between the city and the county.
- 30 percent to the state General Fund.
- 20 percent for education divided evenly for student instruction in each of the following areas: (1) preschool, (2) primary school, (3) secondary school, and (4) community college.
- 5 percent to research various marijuana-related issues including (1) the safety and efficacy of marijuana for medical and social use; (2) methods for addressing drug abuse, driving, and employment safety concerns; and (3) the impact of the implementation of this measure.
- 5 percent for drug education and drug abuse prevention and treatment programs.

In addition to the gross receipts taxes, the measure authorizes counties to impose a supplemental sales tax of up to 5 percent on marijuana sold for nonmedical purposes. Under the measure, if the taxes were imposed by a county and collected in a city, the revenues would be split evenly between the county and city. In the event a county elects not to impose a supplemental sales tax on marijuana, cities within that county would be authorized to impose such a tax and would receive all of the revenue generated. Under the measure, sales of marijuana to patients requiring marijuana for treatment of serious debilitating illnesses would be exempt from any taxes, including existing state and local sales taxes that currently apply to medical marijuana. The measure would limit the ability of state and local government to levy marijuana-specific taxes to those specified in the measure.

***Zoning Restrictions for Marijuana Businesses.*** Under the measure, local governments could restrict marijuana gardens if the gardens are visible from public property. In addition, the measure generally authorizes local governments to prohibit or restrict commercial cultivation, processing, or sales of marijuana in their jurisdiction but requires such regulations to be passed by a vote of the electorate. However, local governments could not restrict commercial cultivation of marijuana in agricultural districts, nor could they ban access to medical marijuana in their jurisdiction.

***Authorization of Criminal Penalties.*** Under the measure, it would be an infraction to consume marijuana while (1) operating a vehicle, boat, or aircraft; (2) on a school or public bus; (3) on school grounds (other than at a college or university); or (4) on a children's playground. It would also be an infraction for individuals under age 21 to possess marijuana up to the amounts allowed for personal use or for an individual over the age of 21 to provide marijuana to an individual between the ages of 18 and 21. Under the measure, it would be either a misdemeanor crime or an infraction to possess, transport, cultivate, or sell marijuana in a manner that violates regulations established pursuant to the measure. The measure states that it would be a misdemeanor for individuals over the age of 21 to sell marijuana to individuals between the ages of 16 and 18.

In addition, the measure states that the following activities are crimes punishable as either a misdemeanor or felony: (1) the diversion of marijuana to states where it is illegal; (2) the sale of marijuana to children under age 16; (3) the use of violence, coercion, or duress in the unlawful cultivation or distribution of marijuana; (4) gross pollution or environmental destruction caused by unlawful cultivation of marijuana; and (5) cultivation of marijuana on public land or on private property where prohibited by the owner.

## **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 tax and 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, the state chooses to implement such regulations, these costs could potentially be in the several tens of millions of dollars annually. However, these costs would be largely offset by license fees required by the measure to be levied on marijuana businesses. In addition, the measure would result in costs to hear appeals from individuals aggrieved by marijuana regulatory decisions. This would include costs to create and operate the CAB as well as state court costs. The magnitude of these costs are unknown as they would depend on the number of appeals filed in response to the ABC's and CAB's decisions.

***Effects on State and Local Revenues.*** State and local governments could receive additional revenues from sales tax and the gross receipts tax on recreational marijuana businesses within the industry sectors specified under this measure. In addition, the cities and counties could also realize additional revenues from the supplemental sales tax on marijuana products authorized by the measure. However, since the measure prohibits taxation on medical marijuana sold to individuals for treatment of serious debilitating illnesses, these revenues would be partially offset by the loss of state and local sales and use taxes currently applied to such sales. As noted earlier, all revenues collected from the gross receipts tax on marijuana products would be deposited in the Cannabis 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 of 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 the state).

***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 tax and 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 of potentially several hundred million dollars annually related to the production and sale of marijuana, a portion of which is required to be spent on specified purposes including education, marijuana-related research, and drug treatment and education programs.

Sincerely,

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Mac Taylor  
Legislative Analyst

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Michael Cohen  
Director of Finance