

October 9, 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. 15-0049, Amendment #1).

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 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. 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 other states. State and local governments currently collect sales tax on medicinal marijuana sales. A small number of cities also impose a supplemental tax on medical marijuana retail 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. Although 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) providing marijuana to individuals under the age of 21, (3) consuming marijuana in public, or (4) smoking marijuana in any space where minors are present.

Marijuana Possession and Cultivation for Personal Use. Under the measure, the cultivation and possession of marijuana for personal use generally would be exempt from regulation. The measure specifies limits on the amount of marijuana that could be cultivated or possessed for personal use. For example, individuals could not (1) cultivate a marijuana garden that exceeds 25 square feet in size per “residence or, in the absence of any residence, the parcel” or (2) possess more than one ounce of marijuana, unless the marijuana is a product of the individual’s marijuana garden and is within the premises where grown. However, local governments could authorize cultivation or possession for personal use of greater amounts.

Regulation of Commercial Marijuana Activities. This measure allows local governments to establish laws that permit the commercial cultivation, processing, distribution, and sales of marijuana for recreational use. For example, under the measure local governments could issue licenses to businesses that cultivate, sell, or allow on-site consumption of marijuana. The measure also allows local governments to regulate marijuana businesses such as by restricting their location, hours of operation, and use of advertising. Under the measure, individuals or organizations engaging in commercial cultivation, processing, transportation, or sales of marijuana for recreational or medical purposes would be required to pay a fee and obtain a license from the State Board of Equalization. The board would be required to establish an information technology (IT) system to track marijuana products as they move through the production and distribution chain.

Taxation of Commercial Marijuana Sales. The measure establishes a statewide excise tax on marijuana products sold for recreational or medical purposes. Specifically, the measure imposes a tax of 10 percent of the price of marijuana when each of the following transactions occurs: (1) marijuana is sold by a producer to another producer or processor; (2) marijuana is sold by a processor to another processor, a wholesaler, or a retailer; and (3) marijuana is sold by a retailer.

Revenues collected from the statewide excise tax would be deposited in a new special fund—the Dedicated Cannabis Fund. The measure requires revenues deposited in the account to first be used to support the costs of implementing the IT system to track marijuana products. Remaining funds would be allocated for grants to public and nonprofit entities for specified purposes, including substance abuse education, prevention, research, and healthcare. The measure states that at least 50 percent of all revenue collected shall be distributed to nonprofit entities whose

principal objectives are to (1) ensure the political, educational, social and economic equality of minority citizens of the state; (2) eliminate racial prejudice and disparities; and (3) remove the impacts of racial discrimination, in order to improve the quality of life of the state's minorities.

In addition, the measure authorizes local governments to place additional taxes on medical or recreational marijuana sales if the taxes meet certain requirements. For example, local general purpose taxes on marijuana must be approved by two-thirds of the local governing body and a majority vote of the electorate. Local special purpose taxes on marijuana must be approved by a majority vote of the local governing body and two-thirds of the electorate.

Authorization of Criminal Penalties. The measure creates various new marijuana-related crimes. For example, under the measure it would be a misdemeanor crime punishable by a fine of up to \$3,000 and/or up to a year in county jail to (1) violate business license requirements set by the board (such as by failing to record marijuana sales transactions) or (2) make a false statement when applying for a marijuana business license.

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, local governments choose to permit, regulate, and tax 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 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, we estimate that the reduction in state and local criminal justice costs from the above changes could eventually range from the tens of millions of dollars to potentially exceeding \$100 million annually. (The magnitude of the savings would be reduced to the extent that local governments decline to permit the commercial production and sale of marijuana.) 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 may be made available by the measure for substance use treatment. 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. 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 and local governments to regulate the commercial production and sale of marijuana. These costs would vary depending on how, and to what extent, the state and local governments choose to adopt and enforce such regulations but could amount to several tens of millions of dollars annually, primarily borne by local governments. Eventually the costs to state government could be largely or entirely offset by license fees authorized by the measure to be levied on marijuana-related businesses, as well as revenues from an excise tax imposed on marijuana sales. Similarly, the costs to local governments could be offset to the extent such governments implement the general or special purposes taxes authorized by the measure.

Effects on State and Local Revenues. Assuming passage of the measure does not result in a significant change in the federal government's enforcement activities, the measure would result in increased governmental revenues. First, state and local governments would receive additional revenues, such as sales taxes, from marijuana sales permitted under this measure. This is because many individuals who are currently purchasing marijuana illegally could begin purchasing it legally under state law at businesses that collect such taxes. In addition, the state would also receive revenue from the new excise tax imposed on recreational and medical marijuana by the measure. As noted earlier, the revenues derived from this tax would be deposited in the Dedicated Cannabis Fund to support the costs of regulating the marijuana industry as well as various programs. Similarly, local governments would receive additional revenue to the extent that such governments implement the general or special purposes taxes authorized by the measure.

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. 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 additional revenues of up to several hundred million dollars annually.

Effect 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 violating licensing requirements established by the board).

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, local governments choose to permit, regulate, and tax 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.

- 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 of potentially up to several hundred million dollars annually from taxes on the production and sale of marijuana, a portion of which is required to be spent on substance abuse education, prevention, research, and healthcare, and regulation of commercial marijuana activities.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance