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December 7, 2015

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

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INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

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. 15-0085, Amendment #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.

In 2015, the Legislature passed and the Governor signed legislation to regulate the commercial medical marijuana industry, creating the Bureau of Medical Marijuana Regulation within the Department of Consumer Affairs as the lead enforcement agency. Under the legislation (effective January 2016), medical marijuana cooperatives will be phased out within a few years and replaced by state-licensed businesses that cultivate and distribute medical

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marijuana. Local governments will continue to have the authority to regulate the location and operation of such businesses. The legislation also requires the state to set standards for labeling, testing, and packaging medical marijuana products and to develop a system to track such products throughout the supply chain.

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. However, certain marijuana-related activities would remain illegal. For example, it would remain unlawful for individuals to (1) operate a motor vehicle while under the impairment of marijuana, (2) divert marijuana to another state, or (3) provide marijuana to individuals under the age of 21. The measure also provides various protections for individuals that lawfully use marijuana. For example, the measure states that no individual can be denied employment or a license or permit (such as a professional license) for engaging in lawful marijuana-related activities, with the exception of individuals in certain occupations, such as those in safety-sensitive occupations (including airplane pilots and train conductors).

Regulation of Commercial Marijuana Activities. This measure establishes the Cannabis Control Commission to regulate the commercial cultivation, processing, distribution, and sales of marijuana. The measure states that (1) it shall supersede all existing laws or regulatory schemes related to commercial marijuana activities and (2) neither the Legislature nor local governments shall further regulate the use or distribution of marijuana beyond the regulations established in the measure or by the commission. However, the measure states that local governments shall not be prevented from enforcing local zoning and nuisance laws on marijuana businesses so long as they do not conflict with the measure. Individuals or organizations engaging in commercial cultivation, processing, transportation, distribution, or sales of marijuana would be required to

pay various fees and obtain a certificate from the commission. For example, marijuana cultivators with annual net sales of \$500,000 or more would be required to pay a \$10,000 flat fee and an additional \$150 per 100 square feet of marijuana cultivated.

Under the measure, until regulations are implemented by the commission, existing medical marijuana dispensaries that are at least 600 feet from K-12 schools (current state requirement) would be exempt from any enforcement actions with respect to local zoning ordinances. In addition, all existing and future medical marijuana dispensaries would not be required to obtain a certificate from the commission in order to operate.

The measure also authorizes the commission to monitor compliance with its regulations; investigate suspected violations; and restrict, suspend, or revoke business certificates of violators. In addition, the measure requires the commission to establish and maintain a repository of all reasonably available genetic strains of the marijuana plant. The measure allows any person who is denied a marijuana business certificate to appeal to a state trial court for judicial review. In addition, any business whose certificate is limited, suspended, or revoked could appeal directly to the Sacramento County Superior Court for judicial review. The measure also gives the commission the authority to require state and local law enforcement agencies to provide it with any materials related to an investigation or prosecution of an individual for a violation of any law related to marijuana.

Taxation of Commercial Marijuana Sales. The measure states that existing state and local sales taxes shall be applied to marijuana sold for recreational use. In addition, the measure states that the Legislature could place excise taxes on the retail sale of recreational marijuana products. Under the measure, any excise tax on retail sales, or any combination of such taxes, would be initially limited to 10 percent of the retail price of marijuana products. After three years, the measure states that the Legislature could increase the tax up to 1 percent annually to a maximum of 15 percent. In addition, the Legislature could place an excise tax on the bulk storage of marijuana products of up to 10 percent of the wholesale price provided that the tax is only applied to amounts exceeding 100 pounds of dry weight or 10 gallons of liquid. The measure states that no taxes other than those specified by the measure shall be imposed on marijuana sold for recreational use. Moreover, the measure states that marijuana sold for medical or dietary purposes shall be exempt from any sales, use, and excise tax.

Revenues collected from any marijuana excise taxes, as well as certain fines or fees imposed by the commission, would be deposited in a new special fund, the Cannabis Public Benefit Fund. According to the measure, monies deposited in the fund would first be used to reimburse administrative costs to collect the excise tax. The measure also states that 10 percent of the revenues deposited in the fund would be allocated annually for each of the following: (1) state colleges and universities; (2) public K-12 schools; (3) water conservation and environmental restoration; (4) drug abuse research, education, and treatment, including marijuana impairment studies; (5) fire, police, and sheriffs services; (6) cities and counties that do not ban storefront

cannabis retailers; (7) marijuana research and support of a marijuana genetic repository; and (8) nonprofit entities dedicated to promoting racial equality for minority citizens. The measure also allocates \$7.5 million annually (adjusted biennially for inflation) to support the operations of the commission. The measure requires that at least 67 percent of the total amount allocated as described above (excluding expenditures to administer the tax) be appropriated to counties, cities, or special districts. Any funds not allocated for the above purposes would be spent on public education including preschool, K-12, and community college. The measure authorizes the Legislature and Governor to determine the specific recipients within the categories described above.

Zoning Restrictions for Marijuana Businesses. The measure prohibits (1) the establishment of storefront marijuana businesses within 600 feet of any K-12 school; (2) outdoor commercial marijuana cultivation on land zoned exclusively for residential use, unless approved by a local government; and (3) indoor commercial marijuana cultivation on land not zoned for industrial, agricultural, or commercial use. The measure allows governments in small cities and counties (fewer than 10,000 residents) to permanently ban storefront marijuana businesses. Governments in medium-sized cities and counties (between 10,000 and 25,000 residents) could permanently limit the number of storefront marijuana businesses to one. Governments in large cities and counties (more than 25,000 residents) could permanently limit the number of storefront marijuana businesses to two per 25,000 residents. However, medium-sized and large cities and counties could further restrict, or completely ban, such storefront businesses, as well as any other marijuana businesses, with voter approval.

Marijuana Cultivation for Personal Use. Under the measure, the cultivation of marijuana for personal use would only be allowed in a locked area on private property. The measure authorizes the commission or local neighborhoods to limit the amount that could be cultivated.

Authorization of Civil and Criminal Penalties. Under the measure, an individual who violates any provision of the measure or any regulation established by the commission would be subject to certain fines and penalties. For example, violators would be subject to a civil fine of up to \$10,000 per violation. Violators could also be charged with a misdemeanor crime if they are found to have knowingly and willfully committed a violation. Similarly, the measure states that the following activities are crimes punishable either with a fine, or as a misdemeanor, felony, or by a requirement to attend a marijuana education program that each county would be required to establish: (1) the diversion of marijuana to other states; (2) marijuana-related activity used as a cover for the trafficking of illegal drugs or other illegal activity; (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) unlawfully providing non-medicinal marijuana to an individual under the age of 21.

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 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 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. These reductions would be slightly offset by an increase in costs to state and local governments to provide training, as required by the measure, to all state law enforcement agents on marijuana legalization. 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 if the state levied an excise tax on marijuana sales. 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 to regulate the commercial production and sale of marijuana and to establish and maintain a marijuana genetic repository. These costs would vary depending on how, and to what extent, the state chooses to implement the above regulations but would be unlikely to exceed several tens of millions of dollars annually. Eventually these costs could be partially or entirely offset by revenues deposited in the Cannabis Public Benefit Fund.

In addition, the measure could result in costs to state trial courts from hearing appeals from marijuana businesses aggrieved by the commission's decisions. The magnitude of these costs are unknown as they would depend on the number of appeals filed in response to the commission

decisions. The measure could also result in costs to state and local law enforcement agencies related to providing the commission with materials related to marijuana investigations or prosecutions, depending on the amount and type of information the commission requests from law enforcement. Moreover, the measure would result in costs to counties to create and administer marijuana education programs. However, these costs would be largely offset by fees charged to program participants.

Effects on State and Local Revenues. State and local governments would receive additional revenues, such as sales taxes from recreational marijuana sales permitted under this measure. This is largely because many individuals who are currently purchasing marijuana illegally could begin purchasing it legally under state law at businesses that collect sales taxes. In addition, state and local governments could also receive revenue from excise taxes, if such taxes were enacted by the Legislature. As noted earlier, the revenues derived from any excise tax imposed by the Legislature would be deposited in the Cannabis Public Benefit Fund to benefit various programs including education, public safety, and drug abuse education and treatment. However, since the measure prohibits sales and use taxes on medical and dietary marijuana products, these revenues would be partially offset by the loss of sales tax currently collected on medical and dietary marijuana sales.

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 could eventually collect net additional revenues of potentially up to several hundred million dollars annually, which assumes the enactment of an excise tax. The potential revenues could be substantially less if a significant portion of consumers purchase marijuana for medical rather than recreational use since the measure exempts medical marijuana from excise and sales and use taxes.

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 violating regulations established by the commission).

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 and tax the commercial production and sale of marijuana, (2) future consumption by marijuana users, and (3) the extent to which the U.S. Department of

Justice 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.
- Net additional state and local tax revenues of potentially up to several hundred million dollars annually related to the production and sale of marijuana, most of which would be required to be spent for specific purposes such as education, public safety, and drug abuse education and treatment.

Sincerely,

for Anthony M. Lio
Mac Taylor
Legislative Analyst

for Ken Kroger
Michael Cohen
Director of Finance