California Cannabis Policy Paper
Tax Reform

Introduction and Summary

This report seeks to provide an overview of CalGrowers Tax Platform.

CalGrowers continues to maintain a moderate position on taxes, acknowledging that taxation is a part of the balance that has enabled recent policy reforms. Accordingly, we focus on reform rather than repeal.

Our strategy has been generally consistent since the introduction of SB 987 and AB 1548 in late 2015.

Background

Regulate and Tax. With cannabis, the two go together like peas in a pod. At both the state and local level conversations about regulation almost always include a discussion of taxation.

Over the last several years California has had a robust conversation deliberating cannabis policy, including several specific pieces of legislation related to the establishment of taxes.

The current cultivation tax is a fixed rate tax of $9.25 per ounce as first proposed by AB 2243 (as introduced) and enacted with the passage of Prop. 64. The current excise tax is 15 percent as first proposed in SB 987 (as introduced) and enacted with the passage of Prop. 64. Both were amended by SB 94.

Prop. 64 was filed prior to the 2016 legislative year. It contained language nearly identical to AB 2243 and SB 987 (as introduced). However, AB 2243and SB 987 were amended several times throughout 2016. Unfortunately, Prop. 64 could not be amended and the initiative as passed imposes an inferior tax.

The tax was reformed in SB 94 to address inconsistencies about the point of tax collection and clarified that the tax would be due when the product "enters the commercial market."

The two highest priority reforms are based on the amendments to these two bills.

- Reducing the excise tax rate are based on SB 987 (as amended).
- Establishing a tiered cultivation tax rate—is based on AB 2243 (as amended).

Published on March 1, 2018;
Updated to include support for AB 3157 on March 19, 2018

Reducing the excise tax rate will ensure that retailers in the regulated market are better able to compete with the unregulated market.

Analysis of this legislation by the Senate Appropriations Committee found that the establishment of the tiered tax rate would generate additional revenue, with estimates ranging from around $75 to 285 million per year.

In addition to increased revenue and helping licensed businesses compete against the unregulated market, the tiered tax structure also helps to level the playing field by shifting the tax burden to those larger scale producers most capable of absorbing the cost. This concept is similar to federal alcohol taxes that have stimulated the development of thousands of micro-brews and artisan wineries. A final component of the tiered tax rate is a benefit to the consumer reflected in reduced prices reflecting reductions in wholesale prices.

Why a fixed rate? A fixed rate provides tax incentive to produce higher value products or add value to products.

Growers may reduce their effective tax rate by differentiating products or adding value. Consider the following chart illustrating the effective tax rate with the current fixed rate of $9.25 per ounce:

Grade	Tax Per pound	Effective Rate
Low	$148.00	37%
Medium	$148.00	16%
High	$148.00	12%

As growers look for strategies to successfully manage the new financial realities of regulation many will be seeking to increase revenue to cover the cost of compliance.

An obvious strategy is to scale up and distribute those costs over more volume of transactions. However, oversupply is a problem in California so increasing volume is not desirable.

The fixed rate tax structure leads to desirable outcomes by creating a tax incentive to producing higher value products as an alternative to producing more products.

It can be thought of this way: if a producer adds value, either through artisanship, packaging, or marketing, they are not taxed on that additional value. The fixed tax rate provides an incentive to produce value added products thereby reducing the pressure to increase supply.

Reduce and Reform

There are two key elements to the CalGrowers Cannabis Tax Platform:

- CalGrowers supports a reduction of the excise tax rate.
- CalGrowers supports comprehensive reform of the cultivation tax, with an intial three-year sunrise period.

CalGrowers strongly supports AB 3157 as a critical first step toward correcting the cannabis tax in California. In addition to this important legislation we support the following tax reforms:

- **Tiered tax rate** – establish a tiered tax rate to correlate to tiered licensing fees.
- **Streamlined tax collection** – tax is due when product enters the commercial marketplace. Whoever owns the product when it is certified is liable for the tax. Distributor remits the tax.
- **Exemptions for cottage growers** – establish an exemption from the cultivation tax for cottage growers.
- **Exemptions for medical use** - establish an exemption from the excise tax for medical use
- **Exemptions for compassionate use** – establish an exemption from all taxes for donated medical cannabis
- **Repeal the leaf tax** –the cultivation tax should only apply to flower (and other non manufactured cannabis products)
- **Develop a production tax** – cannabis used in manufacturing process should be taxed based on potency at its most concentrated form.

Tiered tax rate

Tiers shall be determined by the license type a cultivator holds. Cultivators holding multiple licenses shall be in the tier that is equivalent to the cumulative square footage of all the licenses they hold.

The rates for the tiers would be as follows:

	Gram	Ounce	Pound
Tier 1	$0.27	$4.25	$68.00
Tier 2	$0.39	$6.25	$100.00
Tier 3	$0.58	$9.25	$148.00
Tier 5	$0.83	$13.25	$212.00

Exemption for cottage growers

Cottage growers – those growing less than 2500 square foot outdoor or mixed light or up to 500 square feet indoor—shall be exempt from the cultivation tax.

Exemption for medical use

Medical cannabis shall be exempt from the excise tax.

Exemptions for Compassionate use

Within one week of being certified to enter the commercial market the product may be donated to a compassionate use program. These donations shall not be subject to the cultivation tax or the production tax.

Repeal the leaf tax The leaf tax is extremely problematic and should be repealed and replaced. The current leaf tax is $2.25 an ounce. While this may sound low the effective rate of this tax is often 100 percent or more. This tax effectively double the cost of input material for concentrate makers which leads to significant increases on the retail price of these products, as well as for the input costs of manufacturers who make products using these concentrates as an ingredient. The leaf tax was a bad idea that was amended out of AB 2243 and should not have been included in Prop. 64.

Develop a potency tax. Manufacturers shall be responsible for paying a production tax based on the potency of their products. This tax should be assessed when the cannabis is in its most concentrated form. All further manufacturing (infusion) would not be subject to a production tax.

Benefits

These reforms would provide several important benefits:

- Reduce price of regulated cannabis.
- Shift the cost of the tax to the least price conscious consumers.
- Increase consumer choice and product diversity.
- Generate increased revenue.

Reduce price

The proposed tax rate would reduce the wholesale price of flower and generate consumer savings estimated to range from 6 to 15 percent. An additional savings would be realized based on any reduction to the excise tax.

Shift the cost

The estimated savings to the consumer would be highest for the lower priced products. Those consumers who are making choices based primarily on cost will see the most significant reductions. By shifting the tax burden to higher priced products these reforms would ensure price conscientious consumers receive the most significant savings.

Increase choice

By reducing the tax burden for smaller scale producers and providing exemptions, this policy will lead to increased consumer choice by ensuring a diversity of producers are able to compete in the marketplace.

Increase revenue

Based on analyses of similar legislation in 2016, the tiered tax rate is likely to increase revenue to the state. This increased revenue can be used to address unmet costs like increased enforcement, environmental cleanup, and can also be used to offset lost revenue attributable to the exemptions.

COALITION
FOR RESPONSIBLE
PERMITTING