

Date of Hearing: May 5, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

Mike Gipson, Chair

AB 564 (Haney) – As Introduced February 12, 2025

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Cannabis: excise tax: rate increase repeal

SUMMARY: Repeals the rate increase under the Cannabis Tax Law scheduled for July 1, 2025, and the biennial rate adjustment thereafter.

EXISTING LAW:

- 1) Enacts the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA) to implement and consolidate Proposition (Prop.) 64, the Control, Regulate, and Tax Adult Use of Marijuana Act, which authorized the licensure and regulation of commercial adult-use cannabis, and the Medical Marijuana Regulation and Safety Act (MMRSA), which established a regulatory framework for the cultivation, manufacture, distribution, sale, and product safety of medicinal-use cannabis. (Business and Professions Code (B&PC) Section 26000 *et seq.*)
- 2) Enacts the Cannabis Tax Law, which imposes a cannabis excise tax on purchaser of cannabis or cannabis products at a rate of 15% on the "gross receipts" of any retail sale by a cannabis retailer, who is responsible for collecting and remitting that tax. The California Department of Tax and Fee Administration (CDTFA) must raise the cannabis excise tax rate by the percentage necessary to offset the revenue loss attributed to the suspension of the cannabis cultivation tax on July 1, 2025, and biennially thereafter. (R&TC Section 34010 *et seq.*)

FISCAL EFFECT: The CDTFA estimates an annual revenue loss of \$179.5 million, if this bill becomes operative on or before July 1, 2025. The 2025-26 fiscal year (FY) revenue loss would decrease to \$134.6 million if this bill became operative on October 1, 2025.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

In 2024, active cannabis licenses decreased by 18% and retail sales value decreased by 4.4%, all while the illicit market retained its stronghold over consumers seeking more economic options. California's cannabis industry is in dire economic straits, with sales revenues declining since 2021 and many licensees shutting their doors or on the verge of closure[.] Only 40% of cannabis consumed in California comes from the legally licensed marketplace according to the [Department of Cannabis Control] (DCC). Consumer demand for cannabis is highly elastic depending on price. California has just half the cannabis sales per capita of other states with lower taxes (Oregon, Michigan, Missouri). If California were on par in per capita sales with states like Michigan, it would be

generating \$13 billion in annual sales, and the state would be collecting substantially more tax revenue. Preventing a tax increase will keep the legal market from becoming even less competitive with illegal legacy marketers and prevent further closures and bankruptcies in the legal industry.

2) The California Cannabis Industry Association, writing in support of this bill, states, in part:

Since legalization, California's cannabis industry has created hundreds of thousands of jobs, from farming to retail sales, and is a major industry for entire regions of the state. But the cannabis industry in California has been deeply impacted by a history of high taxation, leaving room for the illegal market to thrive while small business owners and operators struggle to stay alive. At the same time, states like Michigan have seen significant growth in their industries due to lower taxes and friendlier policies.

Just last year, Michigan surpassed the once-dominant California cannabis market, outperforming California's sales by 7 million units and over \$200 more in per capita sales. If California were on par in per capita sales with Michigan, it would be generating \$13 billion in annual sales, and the state would be collecting substantially more tax revenue. Instead, the taxable sales for cannabis in 2024 was just \$4.6 billion – far short of its potential.

Taxes as high as 45% in some areas of California have suffocated California's infant legal cannabis industry before it had a chance to develop into a strong, sustainable economy and culture. The legal cannabis industry needs a lifeline to ensure that the industry is able to survive and support hundreds of thousands of workers. Allowing the legal cannabis industry to regain its foothold is a simple way to bring more revenue to our economy and combat the illegal market.

3) Writing in opposition to this bill, a coalition of childcare, health, environmental, and tribal advocates state, in part:

When voters approved Proposition 64, they were explicitly promised that hundreds of millions of dollars annually of Cannabis Excise Tax and Cultivation Tax revenues would be permanently dedicated for the Tier 3 programs, to protect children, youth and the environment. This revenue is a significant funding source for childcare for low-income families, youth substance use prevention programs, environmental remediation including restoration of watersheds damaged by cannabis cultivation, and law enforcement programs.

Many of our organizations refrained from opposing the 2022 cultivation tax only because an agreement was reached, and it was clearly required in law under AB 195, that a compensatory adjustment of the excise tax of up to 19% to maintain revenue neutrality would be implemented this year. Even with that adjustment it is unclear if it will fully compensate the loss of the cultivation tax [...] If the Legislature fails to uphold the promise made in AB 195, in our estimate, between \$145 to 182 million dollars annually for Tier 3 childcare, youth, environmental, and law enforcement program or other needed investments would be lost.

4) Committee Staff Comments:

- a) *Federal cannabis treatment:* Federally, cannabis is classified as a Schedule I drug under the Controlled Substances Act (CSA). The CSA distinguishes between different types of drugs and classifies them according to their medical use, potential for abuse, and safety or dependence liability. The schedules range from 1 to 5 in decreasing severity, with Schedule 1 drugs defined as having no currently accepted medical use and a high potential for abuse. Cannabis, termed marijuana in federal statute, is classified as a Schedule 1 drug under the CSA.
- b) *State cannabis regulation:* In 2015, the Legislature enacted the MMRSA, commencing the regulation of cannabis at the state level. The MMRSA was composed of numerous proposals that regulated the cultivation, manufacturing, transportation, distribution, sale, and product safety of medicinal-use cannabis, and subsequently renamed to the Medical Cannabis Regulation and Safety Act.

In November 2016, California voters approved Prop. 64, which legalized adult-use cannabis for people 21 years of age or older. Prop. 64 provided for the licensure and regulation of commercial adult-use cannabis and medicinal-use cannabis by various state agencies and permitted local jurisdictions to apply additional taxes and regulate cannabis businesses through local zoning, land-use requirements, and business license requirements. The initiative provided a mechanism for the Legislature to amend certain provisions by a 2/3 vote, but only so long as the amendments further the purposes and intents of the proposition. The initiative listed a series of various intents, but, in the aggregate, Prop. 64 had three overarching goals:

- i) Remove nonmedical cannabis from the illicit market;
- ii) Create a comprehensive regulatory structure that prevents access by minors; and,
- iii) Protect public safety, public health, and the environment.

To implement Prop. 64, the Legislature enacted the MAUCRSA in June 2017. MAUCRSA integrated the licensing and regulation of adult-use and medicinal-use cannabis activities. Enacted by SB 94 (Committee on Budget and Fiscal Review), Chapter 27, Statutes of 2017, MAUCRSA replaced references to "marijuana" with "cannabis" in existing law. Subsequently, in 2021, the Legislature consolidated the various state agencies responsible for administering the licensure and regulation of cannabis into the DCC by authorizing AB 141 (Committee on Budget), Chapter 70, Statutes of 2021.

- c) *Modifications to cannabis taxes:* When Prop. 64 was enacted, it imposed two taxes on cannabis businesses. The first was the cultivation tax, which was a flat tax on the weight of cannabis with rates based on the form of cannabis. Thus, each pound of cannabis was charged a flat dollar amount of tax regardless of wholesale cannabis prices. This led to

cultivators experiencing pressures from a cost and revenue perspective. Cultivators had to pay the flat amount of tax regardless of the price movement of cannabis¹.

The second was the cannabis excise tax, which imposed a 15% excise tax on the gross receipts from the sale of cannabis or cannabis products. Subsequently, the Legislature modified the imposition of these taxes in 2022, by suspending the cannabis cultivation tax and requiring a rate increase of the cannabis excise tax beginning July 1, 2025. The percentage increase in the cannabis excise tax rate was to be calculated based on the amount of forgone revenue resulting from the suspension of the cannabis cultivation tax, but capped at 19%.

- d) *Funding priorities:* Revenues derived from cannabis taxation are deposited into the Cannabis Tax Fund and allocated according to a stipulated schedule in Prop. 64. This schedule prioritizes reimbursement of costs incurred by implementing state agencies, including the CDTFA and the DCC. After these disbursements, Prop. 64 requires that revenues be allocated as follows, and in descending order of priority:
- i) \$10 million to public universities for research activities;
 - ii) \$3 million to the California Highway Patrol for establishing protocols to determine cannabis impairment while operating a vehicle;
 - iii) \$50 million to the Governor's Office of Business and Economic Development to establish a Community Reinvestments program; and,
 - iv) \$2 million to the University of California San Diego Center for Medicinal Cannabis Research to enhance the pharmacological applications and impact of cannabis.

After these allocations, the remaining revenues are allocated such that 60% are deposited into the Youth Education, Prevention, Early Intervention and Treatment Account, 20% into the Environmental Restoration and Protection Account, and 20% into the State and Local Government Enforcement Account. These final three categories are also referred to as "Tier 3 entities". The Governor has discretion regarding the percentage allocation of revenues within each account. Under Prop. 64, the Legislature, beginning on July 1, 2028, has the authority to allocate funds for purposes other than those stipulated in the measure by a majority vote, but only if the changes further the purpose of the measure and the amount of funds to each account are not reduced from their 2027-28 FY levels.

- e) *Cannabis market outlook report:* In January of this year, ERA Economics, an agricultural and resources economics consultancy, prepared a report for the DCC, the *California Cannabis Market Outlook 2024 Report* (CCMO Report). The CCMO Report evaluated the overall state of the cannabis market in California, examining the supply and demand of cannabis, cannabis business licenses, and the illicit market.

¹ For example, if the flat amount of cultivation tax was \$1.00 per pound of dried flower and that pound is selling for \$10, then the effective cultivation tax rate is 10%. If that price per pound fell to \$8, a cannabis cultivator would still owe \$1 in cultivation tax on that pound, which is an effective rate of 12.5%. Conversely, tax liabilities resulting from a flat percentage tax on the gross receipts from the retail sale of cannabis mirrors movements in cannabis prices.

The CCMO report describes the fluctuation in demand, supply, and price of cannabis. Cannabis prices peaked in the third quarter of 2021 and have been declining since. "This downward trend is driven entirely by prices – quantity sold, in terms of flower weight, and units of edibles and vape cartridges, has continued to increase."²

Contrary to arguments made by the cannabis industry, the legal market is not failing. The report states:

The total value of retail sales in the licensed market is down, leading some to conclude that the licensed market is failing or shrinking. The total volume of retail sales for nearly all product categories is up. That is, the decrease in the total dollar amount of retail sales is driven by lower prices, not less production to a contraction in the licensed market. The licensed market is continuing to grow³.

Wholesale cannabis flower prices "dropped dramatically from the peak in 2020" resulting in "financial stress on cultivation and other cannabis businesses."⁴

The above noted stress to cannabis businesses has resulted in some decrease to license holders. As the author notes, active cannabis business licenses has decreased. This averaged decrease does not provide sufficient context. The CCMO Report evaluated market entries and exits, along with active business holders. The report notes that active business licenses is an insufficient indicator in and of itself as some licensees may hold multiple types of licenses. This is particularly true for cultivators, which had some of the largest decrease in active license holders. The CCMO Report notes, however, that conversions represent a significant portion of the decrease in cultivation licenses⁵.

The report does state that active business licenses are a better representation for other types of license holders, such as retailers or manufacturers. Yet, when examining the decrease in active business licenses here, the decrease may be less than claimed. Through the start of 2024, retail licenses had been steadily increasing, but saw a small decrease in 2024. This decrease was mainly driven by non-storefront retailers, which dropped by 25% from a peak of about 300; storefront retailer licenses decreased by only 1%, from a peak of more than 1,200, over the same period⁶.

- f) *Contextual factors and wholesale prices:* The CCMO Report did not examine the cause of wholesale price decreases. Rather, the report simply noted the trend and underscored that the legal market is expanding in the aggregate. Given this, one might reasonably ask what factors led to drastic decreases in prices that undercut potential revenue gains from the increase in legal product sold. While a full examination of factors is beyond the scope of this analysis, two critical factors likely impacted cannabis prices. The first was the COVID-19 pandemic. Amidst ongoing stay-at-home orders and work from home accommodations, many Californians lacked the ability to engage in recreational activities

² ERA Economics, "CCMO, 2024 Report," published January, 2025, page 45.

³ *Id.*, page 10.

⁴ *Id.*, page 10.

⁵ *Id.*, page 52.

⁶ *Id.*, Page 55.

beyond their home. An article published in the National Library of Medicine finds that "qualitative data revealed that increases in cannabis and alcohol use were largely attributed to changes in employment and staying at home resulting in fewer impediments and boredom."

The second was the modification to cannabis taxes. The cultivation tax, as a flat amount tax, put downward pressures on cannabis production. Cultivators would have to pay the tax on the amount of cannabis grown no matter the sale price of the cannabis. When the state suspended the cultivation tax, the state removed this disincentive to grow.

In combination, the increased demand due to pandemic conditions and the suspension of the cultivation tax incentivized cultivators to produce greater amounts of cannabis. The data presented in the CCMO Report regarding the decline in the wholesale price of cannabis coincides with the tapering off of COVID-19 restrictions, though the report does not make a determination one way or the other to this effect. One might reasonably conclude that the decrease in wholesale cannabis prices is a correction to the lower, but still increasing, mean growth of the legal market.

- g) *Complicating factors in success of the legal cannabis industry:* Turning to the text of Prop. 64 itself, more complicating factors regarding the success of the legal cannabis industry arise. Prop. 64 gave wide leeway to local jurisdictions regarding cannabis legalization and taxation. This has led to a patchwork implementation of the cannabis regulatory system throughout California. Thus, those jurisdictions that choose to legalize and tax cannabis receive tax revenues that may then go toward combating the illicit market. These enforcement actions increase costs for illegal market participants. One might reasonably question whether reducing taxes would have any significant impact on the illicit market given whole swathes of the state do not engage in the legal cannabis system, a problem that this bill does not address.

Moreover, the wide authority of local jurisdictions to enact taxes on cannabis has resulted in compounding taxes. A compounding tax is one in which the underlying taxable amount includes amounts of taxes levied elsewhere in the supply chain. In other words, Prop. 64 allowed locals to apply a tax on a tax, a principle that generally counters sound tax policy. This, however, was authorized by Prop. 64 and was ostensibly a factor in garnering approval of the initiative in areas of the state that generally opposed legalization of cannabis. Thus, lowering the tax rate at the state level still does not alleviate the fundamental issue of the compounding taxation authorized in Prop. 64.

Finally, cannabis remains illegal at the federal level. As the CCMO Report notes, "as long as interstate trade remains federally illegal, licensed market participants are at a competitive disadvantage relative to illicit market participants who distribute across state borders."⁷ Lowering the cannabis excise tax rate would likely not impact this phenomenon, as exemplified by the CCMO Report's finding that cannabis prices amongst various states that have legalized the good generally trend together even after California provided a tax cut by suspending the cultivation tax.

⁷ *Id.*, page 70.

- h) *Constitutionality concerns:* Writing in a legal memo submitted to this Committee, the counsel for proponents of Prop. 64 during its circulation and consideration question the constitutionality of the change proposed by this bill. The memo, presented by Olson, Remcho, LLP, notes that this bill likely would be an amendment to Prop. 64, thus requiring this bill to further the intent and purposes of the initiative to remain constitutional. As noted previously, the initiative balances its purposes among three somewhat conflicting objectives; namely, comprehensively regulating nonmedical cannabis, reducing the illicit market, and providing sufficient funding for certain activities. Thus, while this bill may promote certain intents and purposes, it also arguably undermines others.

Additionally, when the Legislature does have the authority to modify Tier 3 entity allocations, the Legislature must ensure that revenues do not fall below certain thresholds. When the Legislature suspended the cultivation tax, it scheduled a rate increase to the cannabis excise tax acknowledging this fundamental requirement and backfilled the reduced revenues with other funds.

Repealing the scheduled rate increase to the cannabis excise tax, as this bill proposes, could be subject to legal challenge.

- i) *Bearing the burden:* Prop. 64 prescribed two types of taxes be imposed on cannabis as opponents note. When the Legislature modified the imposition of cannabis taxes, it effectively cut the taxes of the cannabis industry and backfilled these losses with other revenues. While the upcoming percentage rate increase to the cannabis excise tax must be sufficient to cover the lost revenue from the suspension of the cultivation tax, the increase is limited to 19%. Absent this restriction, the rate would increase to approximately 19.6% to fully compensate for lost cultivation tax revenues. Losses resulting from reductions in cannabis taxes generally cause reductions in funding to Tier 3 entities; these entities likely bear the majority, if not the entirety, of the loss.
- j) *What is a "tax expenditure"?* Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote. This bill repeals the cannabis excise tax rate adjustment scheduled for July 1, 2025, thereby qualifying as a tax expenditure.

k) *Committee's tax expenditure policy:* SB 1335 (Leno), Chapter 845, Statutes of 2014, added R&TC Section 41, which recognized that the Legislature should apply the same level of review used for government spending programs to tax credits introduced on or after January 1, 2015. AB 263 (Burke), Chapter 743, Statutes of 2019, extended the requirements in R&TC Section 41 to all tax expenditure measures under the Personal Income Tax Law, the Corporation Tax Law, and the Sales and Use Tax Law introduced on or after January 1, 2020. While existing statute does not apply to tax expenditures under the Cannabis Tax Law, this Committee's policy requires application of R&TC Section 41 to all tax expenditures. A tax expenditure proposal must outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. Sunsets are required because eliminating a tax expenditure generally requires a 2/3 vote. These requirements must be satisfied before a bill can receive a vote in this Committee. This bill does not comply with this Committee's policy on tax expenditures.

l) *Related legislation:*

- i) AB 8 (Aguiar-Curry) would integrate concentrated cannabinoids derived from industrial hemp into the existing cannabis regulatory system, and would lower the cannabis excise tax rate to 15% beginning on January 1, 2028. AB 8 is pending a hearing by the Assembly Committee on Appropriations.
- ii) AB 1397 (Flora) would amend the Sherman Food, Drug, and Cosmetic Law to allow hemp manufacturers to produce and sell low-dose hemp drinks, as restricted, and impose an excise tax on the gross receipts of any retail sale of those drinks. AB 1397 is pending a hearing by the Committee on Business and Professions.

m) *Previous legislation:*

- i) AB 195 (Committee on Budget), Chapter 56, Statutes of 2022, among other provisions, suspended the cultivation tax; required the CDTFA to estimate the forgone revenues resulting from the suspension of the cultivation tax; and required, on July 1, 2025, the cannabis excise tax rate to increase by the percentage necessary to offset the forgone cultivation tax revenues
- ii) SB 94 (Committee on Budget and Fiscal Review), Chapter 27, Statutes of 2017, reconciled the regulation, licensing, and enforcement of legal medical and recreational cannabis, thereby enacting MAUCRSA.

REGISTERED SUPPORT / OPPOSITION:

Support

Americans for Safe Access
Big Sur Farmers Association

California Cannabis Industry Association
California Cannabis Operators Association
California Minority Alliance
California NORML
Coachella Valley Cannabis Alliance Network
Embarc
Emerald Sky
Good Farmers, Great Neighbors
Hessel Farmers Grange
Highlands Dispensary
Humboldt County Growers Alliance
Humboldt, County of
KIVA Confections
Long Beach Collective Association
Mendocino Cannabis Alliance
Monarch Technologies, Inc.
Nevada, City of
Nevada, County of
Norcal Phoenix, Inc.
Origins Council
Pax Labs, Inc.
Proof Operations, Inc.
San Diego Regional Chamber of Commerce
San Francisco Cannabis Alliance
San Francisco Cannabis Retailers Alliance
Social Equity Los Angeles
Sonoma County Cannabis Alliance
Sparc
Strong Agronomy Management, Inc.
Three Trees
Tri County Chamber Alliance
Trinity County Agricultural Alliance
United Cannabis Business Association

Opposition

Alliance for Boys and Men of Color
Arts for Healing and Justice Network
Asian Refugees United
Back to the Start
Big Valley Band of Pomo Indians
Breakthrough Sacramento
CactusToCloud Institute
Cal Alliance of Child Family Services
Calexico Wellness Center
California Alliance for Youth and Community Justice
California Health Collaborative
California Native Plant Society
California School-Based Health Alliance

California State Parks Foundation
California Trout
CalPride
Cambodian Family, The
Center for Empowering Refugees and Immigrants
Centro Del Pueblo Movimiento Indigena Migrante
Child Action, Inc.
City Ministry Network
Club Stride, Inc.
Communities United for Restorative Youth Justice
Connected to Lead
Core 6
East Bay Asian Youth Center
El Sol Neighborhood Education Center
Endangered Habitats League
Environmental Protection Information Center
ExpandLA
Freedom 4 Youth
Fresh Lifelines for Youth
Friends of Harbors, Beaches, and Parks
Friends of the Eel River
Friends of the Inyo
Future Leaders of America
Gateway Mountain Center
Getting It Right from the Start
Girls Club of Los Angeles
Grace Institute, End Child Poverty in California
Healthy California
Healthy Vallejo Community Support Services, Inc.
Helpline Youth Counseling
Hermosa Coalition for Drug-Free Kids
Hills for Everyone
Hmong Innovating Politics
Indigenous Justice
Institute for Public Strategies
Klamath Forest Alliance
Kno'Qoti native Wellness Inc.
Latino Health Access
Legacy LA
LGBTQ Center OC
Lily of the Valley Emmanuel Church of Jesus Christ
Los Angeles Neighborhood Land Trust
Los Angeles Trust for Children's Health, The
Marin Residents for Public Health Cannabis Policies
Mental Health California
Merced Lao Family Community, Inc.
Mid-City CAN
Mojave Desert Land Trust
National Council on Alcoholism and Drug Dependence of east San Gabriel and Pomona Valleys

Native Dads Network
Native Sisters Circle
Pacific Forest Trust
Parent Voices California
Planning and Conservation League
Prevention Institute
Project Optimism
PRO Youth Families
Raizes Collective
Resilience Orange County
Resources Legacy Fund
River Partners
RYSE Youth Center
Sacramento Area Congregations Together
Sacramento LGBT Community Center
Sacramento Youth Center
Safe Passages
Safe Place for Youth
SAY San Diego
Showing Up for Racial Justice Santa Cruz County
Somos Mayfair
Sonoma Land Trust
Source LGBT+ Center, The
Tahoe Youth and Family Services
Tarzana Treatment Center, Inc.
Thriving Families California
Trout Unlimited
Underground GRIT
Urban Peace Movement
Urban Strategies Council
Wall Las Memorias, The
Watershed Research and Training Center
Waymakers
Youth Alliance
Youth Forward
Youth Leadership Institute
Youth Transforming Justice
Youth Will
4th Second

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