May 17, 2022

The Honorable Gavin Newsom
Governor of California
1021 O Street, Suite 9000
Sacramento, CA 95814

RE: Cannabis Tax Reform Trailer Bill Language - CONCERNS

Dear Governor Newsom:

On behalf of the California Cannabis Industry Association, I write to express our concerns regarding the proposed trailer bill language, released on May 13, to enact comprehensive tax reform for California's legal cannabis industry.

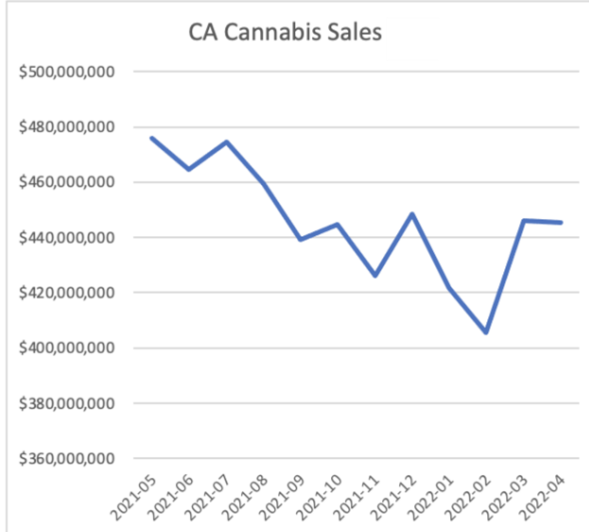
As proposed, the trailer bill language zeros out the cultivation tax indefinitely, beginning July 1, 2022; shifts the collection and remittance of the excise tax from distribution to retail beginning January 1, 2023; establishes a baseline of $670 million to ensure that the beneficiaries of existing cannabis tax allocations are kept whole for the three fiscal years following enactment; and increases the cannabis excise tax from 15 percent to 19 percent, beginning January 1, 2024, to offset any permanent reductions associated with the loss of cultivation tax revenue.

Suspending the cultivation tax and streamlining and simplifying the manner in which cannabis taxes are collected and remitted are critical priorities for CCIA and our over 400 members. As such, we are very appreciative to see these proposed changes, as they will help stabilize the cannabis supply chain and eliminate significant dysfunction that has persisted under the current tax collection framework. We also share your commitment to funding programs that restore and repair the environment, educate, prevent, and treat youth substance use disorders, and invest in community and public safety-related activities.

At the same time, we have significant concerns with the language that would trigger an automatic increase in the excise from 15 percent to 19 percent and find these provisions inconsistent with your objectives to "create a safe, sustainable, and equitable legal cannabis market" [i] and to "temporarily reduce the tax rate to support shifting consumers to the legal market." [ii]

Suppose that the cannabis market further constricts as it did this past year[iii] because customers are increasingly price-sensitive and transitioning back to the illicit market. The tax baseline means that lawful consumers (who buy in the regulated market) could see tax increases, beginning

January 1, 2024, potentially incentivizing more consumers to exit the regulated market, leading to a reduction in cannabis tax revenues.



While there are mechanisms in the proposed language that allow the California Department of Tax and Fee Administration (CDTFA) in consultation with the Department of Finance to lower the excise tax rate, the CDTFA is not required to do so in the language, as proposed. Nor are they authorized to reduce the excise tax below 15 percent of gross receipts if the pre-established baseline is surpassed and the 15 percent excise tax is proving to be a significant obstacle to transitioning consumers from the illicit to the legal market.

Below is a comparison of state cannabis tax collections[iv] in the current tax framework versus what they would be after January 1, 2024 if the current proposal is enacted.

Taxable Sales	Cultivation Tax		Excise Tax	Sales Tax	Total Taxes
$5,204,942,138	$163,188,392	**CURRENT**	$668,503,216	$462,941,191	$1,294,632,799
For comparison, assume no change in market size.	Reduced to zero in the new proposal.		Raised to 19% / based on actual sale price.	~7.88% of taxable sales + excise.	Under the proposed scenario, taxes increase by 14%.
$5,204,942,138	$0	**PROPOSED**	$988,939,006	$488,197,734	$1,477,136,740

As written, the current cannabis tax reform proposal would, after a short reprieve, *increase* the overall cannabis tax burden for consumers. Otherwise put: If the proposed 2024 tax structure had been in effect last year, consumers would have paid *$182 million more* in state taxes than they did under the current framework.

Increasing the tax burden on cannabis consumers by any amount, let alone an exorbitant 14 percent, will only strengthen the already robust illicit market. That would be disastrous not just for people who are part of the cannabis economy but for all Californians, the majority of whom voted in favor of legalizing cannabis for adult use. Our concerns are further outlined below.

1. **<u>The illicit market is robbing the state of billions in tax revenue</u>.** In 2021, California collected $1.29 billion in taxes from cannabis sales. [v] For every dollar spent in the regulated cannabis market, two dollars are spent in the illegal market. Illicit cannabis businesses have deprived Californian taxpayers of about $2.6 billion in cannabis tax revenue. Recent research by the Reason Foundation found that states with the lowest per-pound tax have been the most successful in migrating consumers to the licit market.[vi] The study further found that *lowering* the cannabis taxes to combat the illicit market and encourage consumers and businesses to enter into the legal, regulated cannabis market, may actually increase the state's cannabis tax revenues -- a point noted and affirmed in the trailer bill's findings and declarations.[vii]

2. **<u>The products produced in the illicit market are dangerous and burden the state's healthcare system</u>.** In the fall of 2019, about 50 people died and 2,800 or so were hospitalized due to EVALI (e-cigarette or vaping use-associated lung injury). The Centers for Disease Control investigators subsequently identified direct exposure to chemicals present in illegal cannabis vaping products as responsible for the outbreak.[viii] A study by CannaSafe (a California cannabis testing lab) confirmed the dangerousness of these products after finding "a toxic stew of dangerous chemicals — including formaldehyde and hydrogen cyanide — in the vapor produced by some illicit THC vaping cartridges."[ix] These products endanger public health at a time when our healthcare system is already overburdened.

3. **<u>The illicit market puts the community, particularly children, at risk</u>.** Regulated cannabis companies are prohibited from selling (BPC §26140) or marketing (BPC §26152) cannabis to minors. We are required to provide regulators with open access to our facilities and records (BPC §26160), to provide appropriate safety training and protocols (CCR §17211.1.), and to enter into and abide by the terms of a Labor Peace Agreement (BPC §26051.5). Should licensed businesses violate these provisions, we risk punishing fines, business disruptions, and the loss of our license to operate. Illicit businesses regularly sell to minors, exploit workers, and put neighbors at risk.

When cannabis is eventually legalized at a federal level, California should be the nation's largest exporter. California cannabis, like our wine, technology, and entertainment, should be a source of wealth and pride both inside and outside our state borders. It should also be a source of stable, well-paying jobs and careers. That can't and won't happen if we fail to wrest control of the market from the illicit industry through sensible tax reform.

Our state's wine industry provides a stark point of contrast. It's been nurtured to success in part by supportive tax policies: the state excise tax for wine is twenty cents per gallon[x] or four cents per bottle compared to an excise tax of $4.50 for an eighth ounce of cannabis. We believe there is a similar opportunity for our cannabis industry and that the path to increased tax revenue is through policies that encourage expansion of the legal market.

While most of the proposed trailer bill language represents genuine, thoughtful reform, <u>we implore you to remove the automatic and substantial increase of the excise tax to 19 percent in 2024. This</u>

provision is incompatible with our shared goal of building a thriving industry that benefits all Californians and will only serve to further strengthen an already formidable illicit industry. In place of the mandatory increase to 19% (and 15% floor), we ask that you consider establishing a trigger that allows the excise tax to fluctuate up or down to meet the state's dual goals of funding programs and migrating consumers to the legal market.

Thank you for your time and attention to our concerns. Should you have any questions or require further information, please contact CCIA's legislative advocate, Amy O'Gorman Jenkins, at 707-291-3270 or amy@precisionadvocacy.co.

Respectfully,

LINDSAY ROBINSON
Executive Director

Cc: Toni Atkins, Senate President pro Tempore
Anthony Rendon, Speaker of the Assembly
Nancy Skinner, Chair, Senate Budget and Fiscal Review Committee
Phil Ting, Chair, Assembly Budget Committee
Sydney Kamlager, Chair, Senate Budget Subcommittee No. 4
Wendy Carrillo, Chair Assembly Budget Subcommittee No. 4
Nicole Elliott, Director, Department of Cannabis Control
Nick Maduros, Director, California Department of Tax and Fee Administration
Seth Kerstein, Economist, Legislative Analyst's Office

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[i] Email from the Department of Cannabis Control, "Good news for cannabis in Governor's Budget," May 13, 2022.
[ii] Budget Summary of the May Revise, retrieved from https://www.ebudget.ca.gov/FullBudgetSummary.pdf on May 14, 2022.
[iii] Cannabis sales in California (Headset), retrieved from https://insights.headset.io/app/insights/report/market-overview on May 14, 2022. Sales in the regulated market are down 6.24% compared to this time last year.
[iv] Cannabis Tax Revenue, CDTFA. Retrieved from https://www.cdtfa.ca.gov/dataportal/charts.htm?url=CannabisTaxRevenues on May 14, 2022.
[v] Cannabis Tax Revenue, CDTFA. Retrieved from https://www.cdtfa.ca.gov/dataportal/charts.htm?url=CannabisTaxRevenues on May 14, 2022.
[vi] The Impact of California Cannabis Taxes on Participation Within The Legal Market. Retrieved from https://reason.org/wp-content/uploads/impact-of-california-cannabis-taxes-on-legal-market.pdf on May 14, 2022.
[vii] Draft Trailer Bill, Cannabis Tax Reform, retrieved from https://esd.dof.ca.gov/trailer-bill/public/trailerBill/pdf/708 on May 14, 2022.
[viii] Outbreak of Lung Injury Associated with the Use of E-Cigarette, or Vaping Products. Retrieved from https://www.cdc.gov/tobacco/basic_information/e-cigarettes/severe-lung-disease.html on May 12, 2022.
[ix] Vapes: What Are You Actually Inhaling? Retrieved from https://www.documentcloud.org/documents/6548832-CannaSafe-Vapes-Report.html on May 14. 2022.
[x] State Excise Tax Rates on Wine. Retrieved from https://wineinstitute.compliancerules.org/state-wine-excise-tax/ on May 14, 2022.