May 19, 2022

The Honorable Gavin Newsom
Governor
State of California
State Capitol, First Floor
Sacramento, CA 95814

The Honorable Anthony Rendon
Speaker of the Assembly
State of California
1021 O Street, Suite 8330
Sacramento, CA 95814

The Honorable Toni Atkins
Senate President Pro Tempore
State of California
1021 O Street, Suite 8518
Sacramento, CA 95814

Dear Governor Newsom, Pro Tempore Atkins and Speaker Rendon:

On behalf of California's leading cannabis trade organizations representing cultivators, manufacturers, processors, distributors, laboratories and retailers across California's regulated cannabis supply chain, we write in response to the "Cannabis Tax Reform" trailer bill proposal outlined in the Governor's May Revise Budget Proposal.

1. We support setting the cultivation tax rate at zero beginning July 1, 2022 and appreciate this first step towards simplifying the existing tax framework.
2. We do not object to shifting the point of collection and remittance for excise tax from distribution to retail on January 1, 2023. However, by applying the excise tax to the retail price rather than the wholesale price plus a mark-up rate, this results in an effective tax increase when compared to the existing tax framework.
3. Tax revenue goals for Allocation 3 funding should be inextricably linked to the overall health of the regulated industry, establishing a trigger that allows the excise tax to fluctuate up or down to balance the state's dual goals of funding programs and migrating consumers to the legal market.
4. A significant concern with the proposal is the automatic excise tax rate increase from 15% to 19% by July 1, 2025, which is an effective tax increase when compared to the existing tax framework. We object to tax increases.

As a stand-alone policy, setting the cultivation tax at zero reduces overall tax revenues by 3.14%[1] of total retail sales. In contrast, by shifting the point of collection from distribution to retail, this results in an immediate increase in tax revenues by 2.16%[2] of total retail sales. The net impact is a 0.98% reduction in taxes as a percentage of retail sales, assuming the excise tax rate remains at 15%. This is not meaningful reform. In fact, it's a tax increase proposal once the excise tax rate spikes to 19% within three years.

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[1] 3.14% = 2021 Cultivation Taxes of $163M less 2021 Taxable Sales of $5.2B

[2] 2.16% = 15% less 12.84% (12.84% = 2021 Excise Taxes of $668M divided by 2021 Taxable Sales of $5.2B)

Establishment of an excise tax rate to anything above 16% would be an effective tax increase above the existing cannabis tax structure. This proposal as it currently stands would, within three years, increase the effective tax rate far above the status quo, driving up prices to the end consumer, further destabilizing a fragile legal market and further empowering a formidable illicit market.

Within three years, or sooner based on the proposed triggers, this proposal would automatically increase the excise tax from 15% to 19%, which is a 12% increase in tax revenues above the existing tax framework, as illustrated in the table below using 2021 Baseline Revenue data as reported from the California Department of Tax and Fee Administration (dollar amounts in millions).

	Taxable Sales	**Cultivation Tax**	**Excise Tax**	**Sales Tax**	**Total Taxes**	**Delta 2021**
Baseline (2021)	$5,204	$163	$668	$462	$1,294	0%
Scenario 1 (15%)	$5,204	$0	$780	$462	$1,243	-4%
Scenario 2 (16%)	$5,204	$0	$832	$462	$1,295	0%
Scenario 3 (19%)	$5,204	$0	$988	$462	$1,451	12%

Our organizations cannot accept a proposal that significantly increases the consumer tax burden on cannabis products. For the legal market to have any chance of long-term stability – and for the state to transition consumers to the regulated market in meaningful numbers – we must have competitive pricing with the illicit market. Currently, illegal products are less than half the cost of legal products. As written, after a brief reprieve, the “Cannabis Tax Reform” proposal will amplify the disparity.

While we are in favor of zeroing-out the convoluted, weight-based cultivation tax, we do not view this as a tax reduction effort when combined with shifting the point of tax collection from distribution to retail and the automatic increase up to 19%. Shifting the point of collection from distributors to retailers, rationalizes the supply chain and reduces abrasions, but increases the effective excise tax rate immediately. Accounts receivable for product payments across the supply chain may also be further exacerbated, as distributors would not be in the same position to demand payment on invoices as they are today as tax collectors.

The proposal streamlines the administrative burden of collecting, auditing, and reconciling taxes, but automatically increases the effective tax rate to levels above the existing tax framework, the impact of which would be devastating to the legal cannabis industry.

Currently, the illicit market is robbing Californians of billions of tax dollars per year. The Allocation 3 recipients of cannabis funds – including youth education / intervention / treatment, environmental restoration, and state and local law enforcement programs – should be gravely concerned with combating California’s illicit cannabis market.

Tax increases will reduce regulated transactions, eliminate thousands of jobs, drive consumers to seek out alternative, illicit products, and is counter to California's stated goal of fostering a safe and sustainable cannabis industry. Within one year of Washington State's adult use program coming online, cannabis products were cheaper in state sanctioned stores than the pre-existing unregulated medical stores. The unregulated stores couldn't compete and the regulated system prevailed. According to Global Go Analytics, Washington has an 88% compound annual growth rate, versus Colorado at 58%, Oregon at 57%, and California at 21%.

Capturing a larger tax base by converting existing cannabis users who are currently buying from the illicit market should be the focus. Increasing legal points of access at the local level in conjunction with lowering taxes are the most effective ways to achieve this goal. The former issue of local control is perhaps the most substantive barrier to the success of the legal market. In essence, when local jurisdictions ban cannabis retail, "local control" means "no control." All cannabis commerce in these areas is illicit and untaxed.

Tax relief is the only way for the state to effectively combat the illicit market. The recent Reason Foundation report illustrates how a reduction to the excise tax rate would yield faster growth of the legal market thereby increasing overall tax revenue. By way of example, in 2019 the City of Long Beach lowered local taxes to 1% and within 2 years the overall tax revenue doubled and jobs increased from 500 to 1,100. This case study is an example of what can be achieved on a larger scale with a statewide temporary tax reduction initiative.

Comprehensive tax reform, inclusive of streamlining tax collection along with true tax relief will reduce the gap in price between regulated and illicit products, increasing affordable access to regulated cannabis versus the dangerous alternatives: less expensive, untested products which are more readily available to youth and diversion markets, fueling criminal activity. Addressing unlicensed and illegal operators should be our highest priority, and in doing so would significantly bolster participation in the legal market and increase tax revenues to the state.

We urge policymakers to look at the wealth of available data that supports the economic as well as public safety arguments for implementing comprehensive tax reform that both streamlines the process for collecting taxes and provides for tax relief to the legal industry and consumers. As written, we are opposed to the 19% automatic increase which drives the effective tax rate above current levels on the already egregiously over-taxed cannabis 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 balance the state's dual goals of funding programs and migrating consumers to the legal market.

Jerred Kiloh	Kenny Morrison	Lauren Coté	Lindsay Robinson
President	President	Board Co-Chair	Executive Director
UCBA	CCMA	CDA	CCIA