



AB 286 (Bonta) – Reducing the Illicit Cannabis Market through Temporary Tax Reduction (As Introduced January 28, 2019)

SUMMARY

AB 286 encourages cannabis operators and consumers to enter the legal market and reduces the black market by temporarily decreasing the cannabis excise tax from 15% to 11% and suspending the cultivation tax for three years.

BACKGROUND

In November 2016, 57 percent of California voters approved Proposition 64: The Control, Regulate and Tax Adult Use of Marijuana Act (AUMA/“Prop. 64”), which legalized the adult-use of cannabis. Its intent was to eliminate the illicit market while generating revenue for state and local governments through taxes on cannabis and cannabis products. For over 20 years, California had legal medical cannabis, but lacked a statewide regulatory structure. This created a “gray” market where it was difficult to distinguish between legal and illicit operators.

A sales tracking company called GreenEdge reported that legal cannabis sales have dropped since the legalization of adult-use. In 2018, about \$2.5 billion of legal cannabis was sold in California, which is half a billion dollars less than in 2017 when only medical cannabis was legal. California’s June 2018 budget had assumed that the 2017-2018 tax revenue would be \$185 million. The Legislative Analyst’s Office (LAO) reported that the first six months of 2018 were \$101 million below those projections.

According to a study produced by the California Department of Food and Agriculture (CDFA), the state was already overproducing cannabis prior to the passage of Prop 64, generating 13.5 million pounds in 2016, while only consuming 2.5 million pounds. Much of this excess production is likely distributed illicitly out of state.

California’s current taxes on cannabis imposed by Prop 64 are significant. They include a state excise tax of 15%, state cultivation tax of \$9.25 per ounce of cannabis flower (\$2.75 per ounce of cannabis leaf; \$1.29 per ounce of fresh cannabis plant), traditional sales taxes ranging from 7.25% to 9.25%), and local cannabis taxes which vary.

THE NEED FOR THE BILL

The majority of California consumers are not buying from the legal market. To reduce the illicit market, California must encourage cannabis operators to come into the legal and regulated system. One way to entice them to is by temporarily lowering the state’s tax on cannabis so their prices are more comparable to black market prices.

Fitch Ratings estimates that California’s cumulative tax rate can be as high as 45%. Given the large black market that still exists, high tax rates on cannabis presents a challenge to California’s efforts to establish a legal and regulated market. Compliant businesses are at a significant disadvantage due to their inability to compete with illicit actors who do not pay similar taxes, which is counter to the intent of Prop 64.

According to an analysis of Oregon’s cannabis market by Whitney Economics, consumer demand for cannabis is extremely elastic – demand decreases as price increases. The analysis found that a 5% change in price will decrease demand by 11.2 – 12%. However, the 11.2% - 12% decrease in demand will shift away from the legal market and instead back towards the illicit market. If California’s high tax rate continues, many consumers will likely continue to purchase from the black market sources.

In 2015, Washington overhauled its cannabis tax policy by switching from a three-pronged approach that assessed a 25% tax each level of commerce (cultivation, manufacturing, and retail), to a simpler model of a straight 37% excise tax at the point of retail sale. Since then, Washington has seen an exponential growth in cannabis tax revenue, increasing from \$13.4 million in June of 2015, which was the final month of initial high tax, to \$33.1 million in April of 2017 (see figure below).

SUPPORT

California State Treasurer, Fiona Ma (sponsor)

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SOLUTION

AB 286 will temporarily lower California’s total tax on cannabis by decreasing the cannabis excise tax from 15% to 11% and suspending the cultivation tax until June 2022.

This short-term tax reduction will encourage cannabis operators and consumers to enter the legal market and will reduce the market share of the black market.

Similar to Washington’s experience when it simplified its tax structure and reduced rates, California will likely see increases in tax revenue as the legal system gains market share relative to the black market. This allows for more cannabis purchases to be captured by taxing authorities.

After California has had time to fully implement Prop 64 and consumer behavior changes, the tax rates will return to their current rates.

Reported Marijuana tax Income - Washington

