

## San Francisco Cannabis State Legalization Task Force Issue Brief #5 – Regulation and City Agency Framework

In November 2016, California voters will consider legalizing and regulating nonmedical use and possession of cannabis.<sup>i</sup> To prepare for possible legalization, the San Francisco Board of Supervisors created the Cannabis State Legalization Task Force via Ordinance in July of 2015. According to the Ordinance, “the purpose of the Task Force shall be to advise the Board of Supervisors, the Mayor, and other City departments on matters relating to the potential legalization of cannabis so that the City's policymakers are fully prepared to address the policy questions through legislation, administrative actions, and otherwise, following the adoption of a State law.”<sup>1</sup>

In order to fulfill this mandate, the Cannabis State Legalization Task Force will design a set of viable recommendations for consideration by San Francisco’s policymakers. As part of this process, the Task Force will discuss regulatory and city agency framework issues as they relate to adult use cannabis legalization. This issue brief therefore highlights licensing, regulatory oversight, taxation, and monitoring/evaluation considerations, and also identifies relevant provisions outlined in the Control, Regulate and Tax Adult Use of Marijuana Act (AUMA)<sup>ii</sup> to serve as a basis for Task Force recommendation development discussions.

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<sup>i</sup>Unless part of a quote or formal name of a statute, organization or regulatory body, the term “cannabis” will be used throughout this document.

<sup>ii</sup>There were many adult use initiatives submitted to the California Secretary of State for the November 2016 ballot, and, according to various news reports, the Control, Regulate and Tax Adult Use of Marijuana Act (AUMA) seems to have the most momentum and will be featured on the November 2016 ballot. As such and as mentioned in previous issue briefs, it forms the policy framework for the Task Force’s discussions.

## ADULT USE LICENSING

### Adult Use Licensing Considerations

**The licensing process can provide a framework for regulators to effectively monitor the adult use cannabis market and achieve broader legalization goals.**

#### *Legalization and Regulatory Goals*

The legalization of cannabis for adult use purposes would require a regulatory structure to monitor the process and its effects. According to a 2015 report by the Blue Ribbon Commission on Marijuana Policy,<sup>iii</sup> any legalization effort should outline legalization and regulatory goals, suggesting the following:<sup>2</sup>

- 1) **Promote the health, safety and well-being of California’s youth:** limit youth access, provide prevention, education, and treatment measures, and keep youth out of the criminal justice system.
- 2) **Public Safety:** ensure that our streets, schools, and communities are safe.
- 3) **Equity:** address racial and economic disparities and meet the needs of a diverse population.
- 4) **Public Health:** protect public health, strengthen treatment programs, and educate about public health issues associated with cannabis use.
- 5) **Environment:** protect land, habitats, and watersheds and reduce the environmental harms of production.
- 6) **Medicine:** ensure continued access to cannabis for medical purposes for patients.
- 7) **Consumer protection:** provide protections, such as testing and labeling of cannabis products, to help consumers make informed decisions.
- 8) **Workforce:** provide for legal employment and economic activity, and protect workers.
- 9) **Market Access:** ensure that responsible entities and small- and mid-sized businesses have access to the licensed market.

#### *State and Local Licensing and Fees*

The Blue Ribbon Commission recommends that legalization consist of a “coordinated regulatory scheme that is clearly defined, with a unified state system of licensing and oversight, as well as local regulation.”<sup>3</sup> Along these lines, the adult use licensing process can provide a framework for regulators to effectively monitor the cannabis market to achieve the aforementioned and/or other goals. The Commission suggests that business entities participating in any aspect of the cannabis industry be required to hold both state and local operating licenses, similar to other industries. This structure allows the State to set minimum uniform standards, while enabling local governments to adopt measures that are responsive to local needs.<sup>4</sup> Requiring businesses to maintain licenses can also be a tool for civil enforcement, allowing local governments to collect fees and taxes and revoke licenses if a business fails to comply with regulations.<sup>5</sup>

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<sup>iii</sup> In anticipation of nonmedical cannabis legalization, California Lieutenant Governor Gavin Newsom and other policy experts formed the California Blue Ribbon Commission on Marijuana Policy in 2013. The Commission has engaged in an effort to examine various cannabis policy options and its most recent report, “Policy Options for Regulating Marijuana in California,” provides a blueprint for the State and local jurisdictions to consider in preparation for possible legalization. More information available at <https://www.safeandsmartpolicy.org/>.

According to the Commission, license fees should be set at reasonable levels that cover administrative and regulatory costs, as high license fees may limit entry for those without the necessary capital and/or encourage actors to remain in the illicit market.<sup>6</sup> The licensing framework could also examine whether current actors with a history of responsible behavior should be considered for new licenses.<sup>7</sup>

### *Possible Workforce Licensing Requirements*

The Commission notes that the cannabis agricultural industry will be different than other agricultural industries in that it “must establish public trust in its operation, handle a high-value crop, and ensure that its harvest is not diverted to the illicit market.”<sup>8</sup> The retail cannabis industry will also be unique given the need to educate consumers about the health impacts of cannabis use and the priority of limiting youth cannabis access. Given these characteristics, the Commission suggests that policymakers consider licensing requirements for the cannabis industry’s workforce. This could include a training component, such as an educational or apprenticeship program.<sup>9</sup>

## Experiences from Other States

**Colorado and Washington operate dual state-local licensing processes.**

**In Denver, rapid cannabis industry growth in recent years led the locality to establish caps on the number of licenses available for retailers and cultivators.**

**In Seattle, an initial cap on retail licenses was later raised to respond to the needs of medical patients as the medical and adult use markets merged into a single regulatory scheme.**

## Cannabis Licensing in Colorado

Individuals who wish to open a medical or adult use cannabis business in Colorado must first obtain a license from the State’s Marijuana Enforcement Division within the Department of Revenue. For adult use cannabis, there are four available license types<sup>iv</sup> at the State and local levels: retail store, cultivation facility, infused products manufacturer, and testing facility.<sup>10</sup> Colorado also requires employees at licensed cannabis businesses to obtain individual occupational licenses, which include a background check.<sup>11</sup>

### *Local Licensing in Denver*

Upon approval of a license at the State level, license information is then sent to the City of Denver, where the City’s Department of Excise and Licenses administers and coordinates the local cannabis licensing process. Denver applicants pay a one-time application fee and an annual licensing fee. Application and license fees differ depending on whether the applicant is applying as a medical cannabis<sup>v</sup> or adult use cannabis business. For adult use cannabis businesses, the annual licensing fee is uniform regardless of license type. The initial application fee varies by license type and is also relatively lower for existing medical cannabis businesses adding an adult

<sup>iv</sup> In Colorado, all adult use licenses are referred to as “retail marijuana” licenses.

<sup>v</sup> For more specific information on the medical cannabis licensing process, see Denver’s Business Licensing Center – Medical Marijuana at <https://www.denvergov.org/content/denvergov/en/denver-business-licensing-center/marijuana-licenses/medical-marijuana.html>.

use license. Final license approval requires authorization by all city agencies involved in regulation, including the Building Inspections and Zoning Divisions within the Community Planning and Development Department, the Environmental Health Department, the Fire Department, and the Department of Excise and Licenses.<sup>12</sup>

In April 2016, the Denver City Council passed Bill 16-0291, which caps the total number of medical and adult use cannabis sales and cultivation locations depending on the number of approved and pending license applications, and creates a lottery system for future adult use license opportunities.<sup>13</sup> According to the bill, Denver experienced a rapid expansion in the number of licensed cannabis businesses since 2010 and had “the largest number of licensed marijuana businesses in comparison to any other local jurisdiction in the state.” The City Council proposed the cap in response to this rapid growth and in the interest of “public health, safety and the general welfare.”<sup>14</sup>

Bill 16-0291 also requires applicants for a new or renewal license of any type to complete a community engagement plan and requires that new cultivation locations be 1,000 feet from residential zone districts and schools.<sup>15,16</sup> According to news reports, the bill will constrain rapid cannabis industry expansion, provide new protections for saturated neighborhoods, and give the City additional time to plan for responsible industry growth.<sup>17,18</sup>

### **Cannabis Licensing in Washington**

In 2015, Washington State consolidated its medical and adult use regulatory structures via the adoption of Senate Bill 5052.<sup>19</sup> In this new regulatory scheme, certain adult use retail locations have an endorsement to serve medical cannabis patients. Individuals who wish to open an adult use cannabis business, with or without a medical endorsement, must first obtain two separate state licenses: a business license and a cannabis license. Washington State’s Department of Revenue (DOR) receives both license applications, processing the business license and transferring the cannabis license to the Washington State Liquor and Cannabis Board (WSLCB).<sup>20</sup> There are five available license types at the State and local levels: producer (3), processor (1), and retailer (1).<sup>21</sup>

Per Initiative 502 which legalized adult use cannabis in Washington in 2012, the WSLCB established initial county-based cannabis retail license caps, taking into consideration population distribution, security and safety, and adequate access to discourage illicit sales.<sup>22</sup> Senate Bill 5052 added the requirement that, in determining the cap, the WSLCB should also consider the number of retail outlets with medical cannabis endorsements that were necessary to meet medical needs of qualified patients and directed the Board to increase them.<sup>23</sup> As a result, in January 2016, the WSLCB raised the retail license cap and prioritized early applicants with an existing legally-compliant medical cannabis license in order to expand the number of medical cannabis-endorsed sites and ensure continued access for medical cannabis patients within the consolidated regulatory structure.<sup>24</sup> The WSLCB is not accepting retail license applications at this time, as the expanded license cap has since been met.

### ***Local Licensing in Seattle***

As the WSLCB processes the aforementioned state cannabis license, it gives localities, including Seattle, 20 days to respond to each application with a recommendation to approve or object.<sup>25</sup> Upon approval by the State, the license information is sent to the City of Seattle where the

Department of Finance and Administrative Services (FAS) oversees cannabis licensing. Any cannabis business located or doing business in Seattle must obtain a local Marijuana Business License and a Business License Tax Certificate.<sup>26</sup> Businesses must pay a license fee, which is higher for businesses physically located in Seattle than those not located in the City.<sup>27</sup>

Seattle's license application review process requires City agency coordination through FAS, with the City Attorney and Police Departments reviewing each application.<sup>28</sup> There are building and zoning requirements for cannabis businesses physically located within city limits, and the Department of Construction and Inspections monitors these requirements.<sup>29</sup> Producers and processors must also have an air quality permit managed by the Puget Sound Clean Air Agency and may need a permit from the Fire Department if performing hazardous extraction processes.<sup>30</sup>

### The AUMA Approach to Adult Use Licensing

**The AUMA provides a framework for state-level adult use licensing across the industry spectrum, from cultivation to sale.**

**The AUMA does not require a local permit to operate a cannabis business, but allows localities to develop business license and permitting requirements.**

The AUMA provides the framework for state-level licensing and provides additional guidance that could inform local practice. The AUMA outlines the following 19 license types based on business activity and size:<sup>31</sup>

- Type I = Cultivation; Specialty outdoor; Small.
- Type IA = Cultivation; Specialty indoor; Small.
- Type IB = Cultivation; Specialty mixed-light; Small.
- Type 2 = Cultivation; Outdoor; Small.
- Type 2A = Cultivation; Indoor; Small.
- Type 2B = Cultivation; Mixed-light; Small.
- Type 3 = Cultivation; Outdoor; Medium.
- Type 3A = Cultivation; Indoor; Medium.
- Type 4 = Cultivation; Nursery.
- Type 3B = Cultivation; Mixed-light; Medium.
- Type 5 = Cultivation; Outdoor; Large.
- Type 5A = Cultivation; Indoor; Large.
- Type 5B = Cultivation; Mixed-light; Large.
- Type 6 = Manufacturer 1.
- Type 7 = Manufacturer 2.
- Type 8 = Testing.
- Type 10 = Retailer.
- Type 11 = Distributor.
- Type 12 = Microbusiness [i.e. licensed to cultivate in area <10,000sqft and act as distributor, manufacturer and retailer]

### *General Licensing Provisions*

Licenses in the aforementioned categories would be valid for one year. The AUMA generally allows licensees to hold multiple licenses across the various licensing categories, with two exceptions. First, entities holding testing licenses may not hold any other license.<sup>32</sup> Second, large cultivation licenses (Types 5, 5A, and 5B) are delayed for the first five years that the AUMA is in effect. After such time, state regulators may issue those licenses, but only in accordance with a

vertical integration prohibition under which the large cultivator–distributor license combination is prohibited.<sup>33</sup> Adult use licensees may not hold tobacco or alcohol retail licenses.<sup>34</sup>

The AUMA also requires all license applicants to establish continuous California residency from or before January 1, 2015.<sup>vi</sup> It gives licensing priority to medical cannabis actors who are in compliance with the Compassionate Use Act prior to September 1, 2016, or currently operate per the Medical Cannabis Regulation and Safety Act.<sup>vii,35</sup>

### *Nonprofit Licenses*

The AUMA directs the Bureau of Marijuana Control (BMC), i.e. the State entity responsible for regulating cannabis in California under the AUMA, to investigate the feasibility of creating one or more license types for nonprofits. The BMC may consider whether such nonprofit licenses should be exempt from certain taxes, fees, and regulations, and how these businesses would interact with other licensees. Until the BMC makes a determination, local jurisdictions may issue temporary local licenses to nonprofit entities that are providing whole-plant cannabis and cannabis products to low income persons, so long as they do not generate annual gross revenues in excess of two million dollars. Participating nonprofits must be registered with the CA Attorney General’s Registry of Charitable Trusts and be in good standing. Local jurisdictions that issue such temporary licenses must license and regulate nonprofit businesses to protect public health and safety and notify the Bureau with details about local nonprofit licenses issued.<sup>36</sup>

### *Cannabis Delivery Services*

The AUMA defines “delivery” as the commercial transfer of cannabis or cannabis products to a customer and the use by a retailer of any technology platform that enables customers to arrange for that commercial transfer.<sup>37</sup> Under the Act, only licensed retailers, microbusinesses and nonprofits can make cannabis deliveries, and local jurisdictions may not prevent cannabis delivery on public roads by licensees acting in compliance with the AUMA and local law. Delivery customers are required to maintain a physical or electronic copy of the delivery request and make it available to license authorities and law enforcement if requested.<sup>38</sup> The Bureau of Marijuana Control is required to establish additional security and transportation safety requirements, including minimum qualifications for delivery personnel and vehicle type.<sup>39</sup>

### *State Licensing Agencies and Licensing Policy Considerations*

Three regulatory agencies would each administer certain types of licenses under the AUMA:

- Department of Consumer Affairs – retailers, distributors, and microbusiness licenses
- Department of Public Health – manufacturing and testing facility licenses
- Department of Food and Agriculture – cultivation licenses

The AUMA asserts that each regulatory authority would establish its own procedures for issuing the licenses under its purview. It further requires that license fees be scaled according to business size and that all application, licensing, and renewal fees not exceed reasonable regulatory costs.<sup>40</sup>

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<sup>vi</sup> This provision expires on 12/31/2019 unless reenacted by the State Legislature.

<sup>vii</sup> In October of 2015, California Governor Jerry Brown signed three bills into law that are collectively known as the Medical Cannabis Regulation and Safety Act (MCRSA). Taken together, MCRSA gives the State more regulatory control over the medical cannabis industry, from cultivation to sale.

In determining whether to grant, deny, or renew a State license, the AUMA provides policy guidance for licensing authorities, suggesting consideration of the following factors:<sup>41</sup>

- Restraints on competition or creation of unlawful monopoly powers
- Underage access and use
- Perpetuation of the illicit market
- Violation of environmental laws
- Excessive concentration of licenses in a given locality

### *Local Licensing Authority*

The AUMA does not establish a dual state-local licensing system. It does allow local jurisdictions to develop local business license and permitting requirements in addition to the required State license.<sup>42, viii</sup>

## AGENCY REGULATION AND OVERSIGHT

### Regulatory Framework Considerations for Adult Use Legalization

**The Blue Ribbon Commission recommends that a cannabis regulatory scheme be organized, consistent, and flexible, with input from a variety of stakeholders, including law enforcement, youth, parents, researchers and the public.**

**The Commission also suggests that the regulatory scheme also consider the relationship between the medical and adult use markets and the need to track products from cultivation to sale to ensure regulatory compliance.**

At the State level, the Blue Ribbon Commission highlights that an organized, consistent, and flexible regulatory structure can promote public health and safety by providing for successful and realistic implementation and compliance. To achieve this, the Commission provides some suggestions. First, that there be one central coordinating entity overseeing the activities of various agency partners in the regulatory process. This structure would ensure adequate oversight, harmonization, and accountability, while also leveraging the expertise of multiple contributing agencies. The regulatory scheme should also provide for ongoing flexibility and input from a variety of stakeholders, including law enforcement, youth, parents, researchers and the public. Additionally, the Commission notes that it will be important to consider the interaction of the medical and adult use industries and develop policy goals regarding their simultaneous regulation to achieve desired outcomes.<sup>43</sup>

The Commission also recommends a track and trace program to monitor cannabis as it travels through the supply chain, from cultivation to sale. Such a program would be an important tool to help minimize diversion to the illicit market, allow the testing of products for consumer safety purposes, and enable regulators to measure product amount, type, and potency.<sup>44</sup>

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<sup>viii</sup> Note that, in contrast, the Medical Cannabis Regulation and Safety Act (MCRSA) does establish a dual State and local cannabis licensing system, requiring that licenses obtain approval to operate at both the State and local levels.

## Experiences from Other States

**Colorado and Washington have similar structures that feature a primary regulatory oversight entity and multiple contributing agencies, as well as track and trace systems.**

### Cannabis Agency Oversight in Colorado

Colorado's Marijuana Enforcement Division (MED) within the Department of Revenue oversees cannabis regulation. Multiple agencies are collaboratively involved in the regulatory process, including the Governor's Office of Marijuana Coordination, and the Departments of Public Health and Environment, Transportation, Education, Human Services, and Agriculture.<sup>45</sup> The MED oversees both the medical and adult use regulatory systems, and the regulations, licensing procedures, fees, and tax rates vary between systems. Localities may choose whether to allow medical and/or adult use cannabis facilities within their jurisdictions.<sup>46</sup>

Colorado operates the Marijuana Inventory Tracking System, which is used by both state regulators and individual business participants for cannabis tracking purposes. Under this tracking system, each cannabis plant and/or product has an identification tag, allowing regulators to monitor it as it moves through the supply chain.<sup>47,ix</sup>

#### *Local Agency Structure in Denver*

In Denver, the overarching cannabis regulatory framework is similar to the State system. Denver's Office of Marijuana Policy (OMP) is responsible for administering and implementing policies, overseeing and coordinating multiple agencies' regulatory and enforcement efforts, and serving as the liaison between the City and other stakeholders. OMP oversees both medical and adult use cannabis, with different licensing procedures, fees, and taxes for the medical cannabis sector.<sup>48</sup> As referenced in the previous section, the agencies involved in the local licensing and regulatory process are the Building Inspections and Zoning Divisions within the Community Planning and Development Department, the Environmental Health Department, the Fire Department, and the Department of Excise and Licenses.<sup>49</sup>

### Cannabis Agency Oversight in Washington

The Liquor and Cannabis Board (WSLCB) is the primary regulatory authority for adult use and medical cannabis in Washington State. Other agencies closely involved in different aspects of the regulatory process include the Departments of Revenue, Public Health, Agriculture, Ecology, and regional clean air agencies.<sup>50</sup> As referenced earlier, the State merged the medical and adult use cannabis regulatory systems as of July 1, 2016 via the passage of Senate Bill 5052. According to the Bill, significantly higher regulatory safety standards for the adult use market as compared to that of medical put medical cannabis patients at risk of consuming products that could endanger their health, thereby necessitating regulatory standardization between the two markets.<sup>51</sup> According to news reports, the new framework may reduce medical cannabis access and result in increased taxes for medical patients.<sup>52,53</sup>

Washington monitors cannabis throughout the supply chain using a track and trace system. Licensees must submit specific information to the WSLCB through this system, which ensures

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<sup>ix</sup> Alaska and Oregon have a similar tracking system.

compliance with state regulations and assists with data analysis, auditing operations, and enforcement efforts.<sup>54</sup>

### *Local Agency Structure in Seattle*

In Seattle, the Department of Finance and Administrative Services' (FAS) Regulatory Compliance & Consumer Protection Division oversees cannabis regulation. FAS provides general cannabis information to the public and also administers local licenses, which, as noted previously, requires additional review from the City Attorney and the Seattle Police Department.<sup>55</sup> The Department of Construction and Inspections regulates permitting and zoning for physical locations, the Fire Department regulates hazardous extraction processes, and the Puget Sound Clean Air Agency regulates air quality for producers and processors.<sup>56,57</sup> The Seattle-King County Department of Public Health provides cannabis health education and tracks cannabis usage data.<sup>58</sup>

### **The AUMA Agency Oversight Approach**

**The AUMA provides a framework for State-level regulation that creates a primary regulatory agency, involves multiple other contributing agencies, and establishes a track and trace system.**

**Under the AUMA, the State establishes minimum regulatory standards in certain areas, and allows local jurisdictions to develop and enforce additional regulations and standards.**

The AUMA notes that one of its purposes is to “strictly control [the cannabis industry supply chain] through a system of state licensing, regulation, and enforcement.”<sup>59</sup> A newly formed Bureau of Marijuana Control (BMC), housed within the Department of Consumer Affairs (DCA), will oversee and coordinate medical and adult use cannabis regulation at the State level.<sup>60</sup> In addition to general administration, the Bureau will establish security and transportation safety requirements for cannabis distribution and delivery.<sup>61</sup> The Bureau will also work in conjunction with other agencies to develop various guidelines and standards, such as protocols to ensure compliance with state environmental laws, a process for certified organic designations, and appellation of origin standards.<sup>62</sup>

Adult use legalization implementation will involve multiple departments. For example, each State licensing authority will create, regulate, and enforce licensing provisions as necessary and described previously.<sup>63</sup> This State regulatory structure goes beyond licensing, with the Department of Food and Agriculture also overseeing cannabis cultivation processes in collaboration with other agencies such as the Departments of Pesticide Regulation, Fish and Wildlife and the State Water Resources Control Board to monitor pesticide and water use as well as environmental impacts.<sup>64</sup> The Department of Public Health, along with its manufacturing and testing licensing responsibilities, may also regulate cannabis and cannabis product warning labels.<sup>65</sup> The AUMA establishes a Marijuana Control Appeals Panel to manage licensing decision appeal requests.<sup>66</sup> The adult use regulatory structure also includes the State Board of Equalization to collect taxes and the Controller to manage revenue allocation processes.<sup>67</sup>

### *Local Regulation under the AUMA*

Under the AUMA, local jurisdictions may adopt and enforce local cannabis-related ordinances, including business license requirements, as well as requirements that would reduce secondhand smoke exposure or prohibit the operation of a type of cannabis business within that locality.<sup>68</sup> The State would establish minimum standards with respect to health and safety, environmental protection, testing, security, food safety, and worker protections, and allows local jurisdictions to establish additional standards and requirements in these areas.<sup>69</sup>

### *Track and Trace System*

The AUMA also requires a “seed to sale” track and trace system to monitor cannabis and cannabis products at every step in the cannabis supply chain. The Medical Cannabis Regulation and Safety Act of 2015 (MCRSA) created this track and trace system for medical cannabis, and the AUMA would authorize the Department of Food and Agriculture, the Bureau of Marijuana Control and the Board of Equalization to expand the program to include adult use cannabis. Under the track and trace system, each cannabis plant would possess a unique identifier to enable regulatory agencies to monitor its movement within the supply chain.<sup>70</sup>

## **TAXATION AND REVENUE**

### **Cannabis Taxation and Adult Use Legalization Policy Goals**

**Cannabis taxation will have an effect on the overarching policy and regulatory goals of adult use legalization, and an effective taxation structure will reflect these goals in its design.**

Taxation is a tool that can be used to generate revenue for a particular purpose and encourage broader policy goals.<sup>71</sup> With respect to cannabis, there are taxation considerations that would have an impact on the policy goals of legalization. For example, over-taxation of the cannabis industry could discourage legal compliance and may maintain or bolster the illicit market.<sup>72</sup> According to California’s Blue Ribbon Commission on Marijuana Policy, revenue should not be the main goal of cannabis legalization. Rather, the Commission advises the protection of youth and the promotion of public safety and health goals as guiding principles. It further states that an effective taxation scheme should be one that can be both enforced and administered by the appropriate parties. The Commission suggests an approach that continuously monitors the effects of taxation and allows for the flexibility to make adjustments that can adequately respond to the evolving legalization environment.<sup>73</sup>

With these guiding principles in mind, the main cannabis taxation questions are when, how, and how much to tax cannabis. Consideration should be given to how state and local taxation structures and revenue streams may overlap or complement one another. Taxation methods have different

advantages and disadvantages,<sup>x</sup> and identifying the purpose or goals of taxation will allow local policymakers to make decisions about the appropriate method and level of taxation for cannabis.

### *Cannabis Taxation Revenue*

Cannabis taxes and fees at the state and local levels will generate streams of revenue that can be used to cover administrative and regulatory costs and also support targeted policies and programs. The Commission suggests that the use of revenue should be aligned with the priorities of voters and policymakers. Policymakers should consider whether these funds would be earmarked for a specific purpose or support the general fund and flow towards evolving priorities such as youth education, prevention, and treatment, public health campaigns and programs, public safety, regulatory enforcement, workforce and entrepreneur training and development, environmental protection and restoration, and/or research and data collection.<sup>74</sup>

### **Experiences from Other States**

**Colorado and Washington have used a combination of cannabis sales, excise, and gross receipts taxes at the state and local levels.**

**In both Denver and Seattle, cannabis tax revenues support the general fund and can be used to support evolving cannabis policy priority areas.**

Although taxation structures vary by state and locality, experiences from states that have legalized cannabis for adult use may provide information for consideration. Colorado, Washington, and Oregon have reduced initial cannabis taxation rates for the adult use market as a way of competing with the illicit market more effectively. These three states also tax medical cannabis at lower rates than adult use cannabis.<sup>75</sup>

### *Colorado's Taxation Scheme*

In addition to the standard 2.9 percent sales tax, Colorado established a 10 percent sales tax on retail sales of cannabis for adult use. There is a 15 percent state excise tax on adult use cannabis cultivation, depending on the average market rate of wholesale cannabis.<sup>76</sup> Effective July 2017 and via Colorado General Assembly House Bill 15-1367, the 10 percent sales tax rate will be reduced to 8 percent amidst stakeholder concerns that the tax rate was too high to effectively compete with the illicit market.<sup>77,78</sup>

In Denver, there is a special sales tax of 3.5 percent for all retail cannabis and cannabis products, in addition to the standard sales tax and special district taxes.<sup>79</sup> Denver's cannabis-related tax revenue flows to the city's general fund, and the city then allocates these funds across the 13 city departments and agencies collaborating on cannabis issues in the priority areas of regulation, enforcement, education, and public health.<sup>80,xi</sup>

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<sup>x</sup> Documents from Blue Ribbon Commission on Marijuana Policy, the Institute on Taxation and Economic Policy and other sources have in-depth information on the advantages and disadvantages of various taxation structures.

<sup>xi</sup> See the Denver 2016 Annual Report for details on revenue allocation, specific programs, and metrics. Available at [https://www.denvergov.org/content/dam/denvergov/Portals/782/documents/Annual%20Report\\_Reader.pdf](https://www.denvergov.org/content/dam/denvergov/Portals/782/documents/Annual%20Report_Reader.pdf)

### *Washington's Taxation Scheme*

In addition to the business and occupation tax on gross receipts applied to all businesses and a retail sales tax of 6.5 percent, Washington established a 37 percent excise tax on cannabis at the retail level, altering the previous structure that taxed cannabis at various levels.<sup>81</sup> As of July 1, 2016, and via House Bill 2136, medical cannabis is exempt from the sales tax. A proposed 2016 bill that would have reduced the excise tax to 25 percent did not move through the legislative process successfully.<sup>82</sup> Media reports that, according to the bill's proponents, the bill would have lowered the retail price of cannabis, reduced the appeal of cheaper illicit market cannabis products, and made Washington more competitive with Oregon's cannabis markets, where taxes are lower.<sup>83</sup>

In Seattle, a local business and occupation tax on gross receipts is applied to all businesses, including cannabis businesses. This tax rate varies by business type and does not apply to businesses with under \$100,000 in annual taxable gross revenue.<sup>84</sup> Seattle also has a 3.1 percent sales tax in addition to the State sales tax.<sup>xii,85</sup> In Seattle, revenue generated from business and occupation and sales taxes (including those applied to cannabis businesses) flows to the general fund and the city can allocate these funds to priority areas as needed.<sup>86</sup>

### **The AUMA Taxation Approach**

**The AUMA institutes State cannabis taxes at the cultivation and retail levels, while also allowing for local taxation schemes.**

Among other purposes noted within the AUMA, the initiative seeks to “tax the growth and sale of marijuana in a way that drives out the illicit market for marijuana and discourages use by minors, and abuse by adults.”<sup>87</sup> To achieve these goals, the AUMA requires the Bureau of Marijuana Control, i.e. the agency with primary responsibility for regulating the adult use system at the State level, to establish an advisory group that ensures that the regulatory environment does not lead to an enhanced illicit market.<sup>88</sup> It also requires the California Legislative Analyst's Office to submit a report to the Legislature with recommendations for cannabis tax rate adjustments that undermine the illicit market.<sup>89</sup>

At the State level, the AUMA institutes a weight-based cultivation tax—\$9.25 per dry weight ounce of flower and \$2.75 per dry weight ounce of leaves. Cultivators would pay this tax based on the amount harvested. The AUMA also establishes a 15 percent retail excise tax, which would apply to both medical and adult use cannabis.<sup>90</sup> The California Legislature may adjust these taxation rates by a two-thirds majority vote, and any such adjustments must align with the Initiative's original intent.<sup>91</sup>

### *Local Taxation and Revenue Allocation Authority under the AUMA*

The Initiative allows localities to establish their own taxation and fee structures,<sup>92</sup> and local jurisdictions would have control over the use of revenue generated from these sources. In considering possible local taxation schemes for San Francisco, the impacts of adult use and medical cannabis taxation options on the overarching policy goals of legalization will be important

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<sup>xii</sup> The 3.1 percent sales tax includes a 2.7 percent tax which goes to the City of Seattle and 0.4 percent tax which goes to the Regional Transit Authority.

to consider. For example, an adult use taxation structure that is perceived to make cannabis too expensive may push some to the medical cannabis market inappropriately, and it would be essential to monitor such effects.

### *AUMA Tax Revenue Allocations*

The AUMA also directs the distribution of State tax revenue. It establishes the California Marijuana Tax Fund in the State Treasury where State revenues will be deposited. Funds will be allocated for:<sup>93</sup>

- AUMA administration and implementation
- Developing and implementing public health and safety measures
- Research and evaluation
- Community Reinvestment Grants
- Youth drug prevention, education, and treatment
- Environmental restoration and protection
- State and local law enforcement

### *Recent Developments*

Two recent state bills, SB 987 and AB 2243, which would have applied a sales and excise tax, respectively, to medical cannabis did not move through the legislative process successfully.<sup>94,95</sup> News reports suggest that the medical cannabis tax discussion may have been premature, given that there is a cannabis-related initiative on the November 2016 ballot whose taxation structure would also apply to medical cannabis.<sup>96</sup>

## **Taxation Process in San Francisco**

**Existing local gross receipts and sales taxes would apply to adult use cannabis.**

**In considering local taxation options for cannabis, local governments may not establish, extend, or increase any general tax unless approved by majority ballot initiative vote, and earmarked taxes require two-thirds majority vote.**

As a result of a 2012 ballot initiative, San Francisco is currently transitioning from a payroll expense tax to a gross receipts tax on business activities conducted in San Francisco. Under the new structure, tax rates vary depending on the type of business activity (retail, manufacturing, etc.) and rates increase as gross receipts increase. Businesses with annual gross receipts of \$1,000,000 or less are exempt from the gross receipts tax. All businesses, regardless of size, pay an annual business registration fee.<sup>97</sup> This tax structure already applies to medical cannabis businesses, and would apply to adult use cannabis businesses.

San Francisco has an 8.75 percent retail sales tax, which includes the statewide retail sales tax of 7.5 percent and a local sales tax of 1.25 percent.<sup>98</sup> According to State law, local sales taxes may not generally exceed 2 percent.<sup>99</sup> Sales tax is collected by the State Board of Equalization and managed locally by the San Francisco Controller's Office. Sales tax revenue is divided between the general fund and earmarked funds for specific programs.<sup>100</sup> Sales taxes do currently apply to

medical cannabis businesses, and would apply to adult use cannabis businesses. Under the AUMA, medical cannabis would be exempt from State sales tax.<sup>101</sup>

### *State Law Taxation Rules for Localities*

Per State law, local governments may not establish, extend, or increase any tax for general governmental purposes unless approved by majority vote via ballot initiative, and earmarked tax approval requires a two-thirds majority vote.<sup>102</sup> A ballot initiative can be put forth by a member of the public obtaining the necessary number of signatures, or by receiving support from four Members of the Board of Supervisors.<sup>103</sup> Any local cannabis taxation scheme for San Francisco would need to follow this process.

## DATA COLLECTION AND MONITORING

### Data Monitoring for Regulatory Success

**Collecting data on different aspects of the cannabis industry and legalization outcomes will be necessary to evaluate the impact of cannabis policies and regulations. A variety of research tools could be used to collect the necessary information, and funding could be set aside specifically for this purpose.**

As the Blue Ribbon Commission highlights, collecting data on different aspects of the cannabis industry and the outcomes of legalization will be necessary to evaluate the impact of policies and regulations. This information can be used to guide both state and local policymakers as they adjust and amend future regulations to ensure that policy goals are achieved. The Commission suggests that a variety of research tools be used to collect data, and that funding be set aside specifically for this purpose.<sup>104</sup>

The Commission recommends collecting data on variety of topics including: demographic characteristics, cannabis usage, amount and types of products produced, workforce characteristics, licensing, health and safety outcomes, enforcement, legalization's impact on the illicit market, and fiscal outcomes.<sup>105</sup> The Commission also calls specifically for data collection on types of criminal justice sanctions used and the racial disparity in those sanctions.<sup>106</sup>

### Experiences from Other States

**Though state and local data collection processes differ, common data indicators include number, types, and locations of licensees, crime statistics, usage rates, especially among youth, sales information, and tax revenue.**

### *Data Collection in Denver*

The Denver Marijuana Information Center, operated by the Office of Marijuana Policy, is a resource for cannabis-related data and statistics.<sup>107</sup> The Information Center issues an annual report and publishes data in the areas of revenue and sales, crime, licensing and locations, and public health. Some statistics compare adult use cannabis to medical cannabis and other drugs and alcohol. The State of Colorado collects similar data, and, according to a 2016 Colorado Department of Public Safety Report, data challenges include: limited or no data on some topics, limited or

short-term trend data, lack of data sharing among different regulatory agencies, and an inability to separate cannabis data from data on other drugs.<sup>108</sup>

### *Data Collection in Seattle*

Seattle does not appear to have a centralized resource for cannabis-related data reporting. For example, the Police Department monitors fines for smoking in public, specifically to ensure equitable enforcement, and in the past has tracked cannabis-related crime incidents.<sup>109</sup> The Public Health Department of Seattle/King County reports cannabis usage rates and Seattle Public Schools monitors student cannabis violations and disciplinary actions.<sup>110</sup> At the State level, the Washington State Liquor and Cannabis Board tracks number and location of licensees, production levels, sales, tax revenue, and license violations, which it shares weekly via an online report.<sup>111</sup>

### **The AUMA Approach to Data Collection**

**The AUMA allocates revenue for research and evaluation on the impacts of adult use legalization, including data collection in the areas suggested by the Blue Ribbon Commission.**

The AUMA, in its revenue allocation provision, provides funding to public universities to research, evaluate and publish reports on the Initiative's impact. Data will be collected on a variety of topics, such as: impacts on public health and health care costs, drug usage and treatment, effectiveness of public safety measures, and revenues/costs.<sup>112</sup> The AUMA also requires the State Legislative Analyst's Office to specifically monitor and provide recommendations on future tax rate adjustments.<sup>113</sup>

## **CONCLUSION**

Within the regulatory and city agency framework for adult use cannabis, processes such as licensing, agency oversight, taxation, and data monitoring have important, and, at times, overlapping impacts that will feature in Task Force discussions. It will therefore be essential for the Task Force to design recommendations that both highlight and reflect these considerations.

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