



CONSENT CALENDAR
January 25, 2022

To: Honorable Members of the City Council

From: Mayor Jesse Arreguín (Author), Councilmember Ben Bartlett (Co-Sponsor), Councilmember Rashi Kesarwani (Co-Sponsor)

Subject: Resolution Requesting State Cannabis Cultivation Tax Reform

RECOMMENDATION

Adopt a Resolution requesting State cannabis cultivation tax reform.

BACKGROUND

California voters in 2016 passed Proposition 64, which legalized cannabis for non-medical adult use, and created a framework for regulating the cannabis industry. Within this regulatory framework, Proposition 64 establishes two commercial cannabis taxes: an excise tax upon the retail sale of cannabis and cannabis products, and a cultivation tax on all harvested cannabis. The current regulatory structure is overly complex and imposes notably high taxation rates. As a result, local cannabis businesses within the City of Berkeley and elsewhere have struggled.

This resolution seeks to address these challenges by urging the Governor and State Legislature to eliminate the cultivation tax and adjust state regulations to ensure the success of legal commercial cannabis activities.

Despite the City of Berkeley embracing legalization and permitting the operation of commercial cannabis businesses within the City, the industry continues to be burdened by high taxation rates imposed at the state level. Starting January 1, 2022, California's cultivation tax rate will be \$10.08 for flower per dry-weight, \$3.00 for leaves/trim per dry-weight ounce, and \$1.41 for fresh cannabis plant per ounce. These rates, compounded with the already high 15% excise tax, are placing undue barriers on legal cannabis businesses and perpetuating the illicit cannabis market.

The Legislature in both 2018 and 2019 considered bills to temporarily eliminate the cultivation tax, citing severe under-collection of expected tax revenue and an ever-present illicit market as grounds for reevaluating the current tax structure. However, both measures failed to pass during the legislative process.

Given the enduring and increased challenges legal cannabis operators face from overly-complex and high taxation rates, this resolution urges Governor Newsom and the California Legislature to eliminate the cultivation tax and to establish a regulated environment for commercial cannabis activities, including reasonable taxation, that does not impose such barriers as to perpetuate the illicit market for cannabis

ENVIRONMENTAL SUSTAINABILITY AND CLIMATE IMPACTS

The environmental impact of allowing illegal cannabis to proliferate is widely known. It involves illegal logging of national and state forest and park land, poisoning creeks, streams and entire riparian ecosystems. Locally, it can involve harmful chemicals being illegally dumped, utility theft, and unpermitted work leading to faulty wiring, residential and structure fires, and explosions.

FINANCIAL IMPLICATIONS

None.

CONTACT PERSON

Jesse Arreguín, Mayor, (510) 981-7100

RESOLUTION NO. ##,###-N.S.

REQUESTING STATE CANNABIS CULTIVATION TAX REFORM

WHEREAS, California voters passed Proposition 64 in 2016, establishing two commercial cannabis taxes that, effective January 1, 2018, imposed an excise tax upon the retail sale of cannabis or cannabis products at a rate of fifteen percent (15%), and a cultivation tax on all harvested cannabis that enters the commercial market at a rate of nine dollars and twenty-five cents (\$9.25) for dry-weight flower per ounce, and two dollars and seventy-five cents (\$2.75) per dry-weight leaves/trim per ounce; and

WHEREAS, the City of Berkeley embraced legalization and established a regulatory framework to permit commercial cannabis businesses, including cultivation, has been burdened by the onerous nature of State regulations, rapidly expanding illicit cultivation, and the economic instability of the legal market has impacted the jurisdiction's ability to provide other core mandated services; and

WHEREAS, Proposition 64 required that the Bureau of Cannabis Control convene a committee to advise the licensing authorities on the development of standards and regulations, including best practices and guidelines that protect public health and safety while ensuring commercial cannabis regulations do not impose barriers that perpetuate, rather than reduce and eliminate, the illicit market for cannabis. This committee came to be known as the Cannabis Advisory Committee (CAC); and

WHEREAS, in 2018, and again in 2019, the California Legislature considered, but did not approve, bills to temporarily eliminate the cultivation tax. California State Treasurer Fiona Ma, sponsor of Assembly Bill 286 (Bonta, 2019) argued that "given that we now have seen a year of severe under-collection of expected tax revenue and that the black market still exists, it is understood that excessive taxation is an obstacle to establishing a fully viable legal market. Compliant businesses are at a significant disadvantage, and this high tax rate incentivizes businesses to stay underground." Treasurer Ma characterized the bill as "imperative to temporarily lessen California's total tax on cannabis, and give these businesses and the State enough time to fully implement Prop 64."; and

WHEREAS, in 2019, Harinder Kapur, Senior Assistant Attorney General, testified to the California Legislature stating that upwards of 80 percent of California's cannabis businesses remained in the illicit market; and

WHEREAS, in November 2019, the California Department of Tax and Fee Administration announced that effective January 1, 2020, per statutory mandate, the cultivation tax would increase to account for inflation, leading the CAC to express concern in its 2019 Annual Report that the increase in taxation, "...come[s] at a time when the complex regulatory framework, coupled with high taxation, pose[s] significant challenges to the licensed cannabis market," noting a report published by Arcview Market Research, that these two factors could disadvantage the licensed market by as much as 77 percent on pricing compared to well- established illicit market operations; and

WHEREAS, in 2020, the Legislature again considered a bill to eliminate the cultivation tax, but, due to emergency orders and economic uncertainty caused by the COVID-19 pandemic, held the bill in Committee, and instead approved Assembly Bill 1872 (Committee on Budget, Chapter 93, Statutes of 2020) which suspended for one year the California Department of Tax and Fee Administration's authority to adjust the cannabis cultivation tax for inflation; and

WHEREAS, on November 17, 2021, the California Department of Tax and Fee Administration announced that effective January 1, 2022, the cultivation tax would increase from nine dollars and sixty-five cents (\$9.65) to ten dollars and eight cents (\$10.08) for flower per dry-weight ounce; from two dollars and eighty-seven cents (\$2.87) to three dollars (\$3.00) for leaves/trim per dry-weight ounce; and, from one dollar and thirty-five cents (\$1.35) to one dollar and forty-one cents (\$1.41) for fresh cannabis plant per ounce; and

WHEREAS, a November 2021 sales report from BDS Analytics shows that legal sales in California fell by more than eleven percent (11.4%) to \$293.1 million when compared to last year and are down nearly eight percent (7.7%) from August 2021, additionally showing that cannabis flower sales fell twenty-three percent (23%), while concentrates, the second-largest product category, declined eight percent (8%); and

WHEREAS, the licensed cannabis market is currently experiencing a price collapse and that the average wholesale price for dried cannabis flower has fallen to approximately five hundred dollars (\$500) a pound, and that the average wholesale price for dry leaves and trim has fallen to thirty dollars (\$30) a pound making the current tax rate for dry flower equivalent to fifty-one percent (51%) of gross receipts and the current tax rate for dry leaves and trim equivalent to one hundred fifty-three percent (153%) of gross receipts; and

WHEREAS, the ongoing consequences of high state taxes combined with over-regulation has continued to economically challenge legal cannabis businesses and disincentivize the permitting and licensing of new cannabis businesses by local jurisdictions, including the City of Berkeley; and

WHEREAS, local jurisdictions, including the City of Berkeley, have experienced increased challenges collecting cultivation taxes, regulating commercial cannabis cultivators, and addressing illicit cultivation; and

WHEREAS, in November 2016, Proposition 64 was enacted to, "...accomplish [...] taxation on the growth and sale of cannabis in a way that drives out the illicit market for marijuana and discourages use by minors, and abuse by adults."

NOW THEREFORE, BE IT RESOLVED, by the Council of the City of Berkeley that it strongly urges Governor Newsom and the California Legislature to immediately eliminate the State cultivation tax and to establish a regulated environment for commercial cannabis activities, including reasonable taxation, that do not impose such barriers as to perpetuate, rather than reduce and eliminate, the illicit market for cannabis.

