

California craving more tax revenue from recreational cannabis sales

Phil Matier Feb. 3, 2019 Updated: Feb. 3, 2019 4 a.m.



Recreational marijuana sales in California aren't producing the tax revenue the state was hoping for.

Photo: Robyn Beck / AFP / Getty Images

California's high cash expectations from recreational marijuana are going up in smoke as most people are opting to buy their weed on the cheaper, more available and tax-free black market.

"We projected bringing in \$185 million in taxes in (fiscal) 2018," state Treasurer **Fiona Ma** said. "We got less than half of that."

To give the legal market a boost, Ma is joining other lawmakers in supporting AB286 by Democratic Assemblyman **Rob Bonta** of Oakland to cut the current 15 percent excise tax on pot down to 11 percent. The bill would also suspend the tax of \$143 per pound paid by growers for three years.

"Lowering a tax rate to bring in more money might sound counterintuitive, but as they found in Washington state, if you drop the tax, more people will buy more legally so revenue will go up," Bonta said.

The Fitch credit rating agency estimated that when local taxes are included, the cumulative tax rate can be as high as 45 percent, so a \$100 purchase winds up costing \$145.

The fact sheet accompanying the tax cut cites a report by sales-tracking company GreenEdge that found California sales of legal marijuana have dropped by \$500 million since 2017, when only medical — not recreational — cannabis was legal.

The fact sheet also states that the majority of California cannabis consumers are buying their buds and edibles on the cheaper untaxed market.

John Oram, whose company, NUG, handles cannabis from seed to sale, said high taxes are just part of the problem. Difficult local permitting processes have also shut out many legal retailers, he said.

"You don't see it so much in the Bay Area, but it is a real problem in Southern California," Oram said.

Taxing cannabis and ending the black market were big selling points in the campaign to pass Proposition 64, which made recreational cannabis legal beginning last year. The question is: Will high taxes wind up strangling the golden goose that voters were promised?

One year of legal pot sales and California doesn't have the bustling industry it expected. Here's why

By PATRICK MCGREEVY

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| SACRAMENTO



Leonardo Catalan smells different options of cannabis before making a decision to purchase at Delta-9 THC in Wilmington. (Marcus Yam / Los Angeles Times)

When Californians voted in 2016 to allow the sale of recreational marijuana, advocates of the move envisioned thousands of pot shops and cannabis farms obtaining state licenses, making the drug easily available to all adults within a short drive.

But as the first year of licensed sales comes to a close, California's legal market hasn't performed as state officials and the cannabis industry had hoped. Retailers and growers say they've been stunted by complex regulations, high taxes and decisions by most cities to ban cannabis shops. At the same time, many residents are going to city halls and courts to fight pot businesses they see as nuisances, and police chiefs are raising concerns about crime triggered by the marijuana trade.

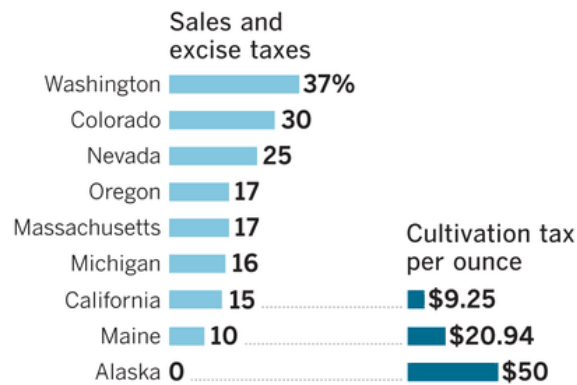
Gov.-elect Gavin Newsom, who played a large role in the legalization of cannabis, will inherit the numerous challenges when he takes office in January as legislators hope to send him a raft of bills next year to provide banking for the pot industry, ease the tax burden on retailers and crack down on sales to minors.

"The cannabis industry is being choked by California's penchant for over-regulation," said Dale Gieringer, director of California NORML, a pro-legalization group. "It's impossible to solve all of the problems without a drastic rewrite of the law, which is not in the cards for the foreseeable future."

After voters legalized marijuana two years ago under Proposition 64, state officials estimated there would be as many as 6,000 cannabis shops licensed in the first few

years. But the state Bureau of Cannabis Control has issued just 547 temporary and annual licenses to marijuana retail stores and dispensaries. Some 1,790 stores and dispensaries were paying taxes on medicinal pot sales before licenses were required starting Jan. 1.

Recreational marijuana taxes



Sales and excise taxes paid by retailers and customers, except in Nevada, where 15% of the excise tax is paid on sales by growers. Local taxes are not shown. Cultivation taxes are paid by growers.

Source: Times reporting

@latimesgraphics

State officials also predicted that legal cannabis would eventually bring in up to \$1 billion in revenue a year. But with many cities banning pot sales, tax revenue is falling far short of estimates. Based on taxes collected since Jan. 1, the state is expected to bring in \$471 million in revenue this fiscal year — much less than the \$630 million projected in Gov. Jerry Brown's budget.

"I think we all wish we could license more businesses, but our system is based on dual licensing and local control," said Alex Traverso, a spokesman for the state Bureau of Cannabis Control, referring to the requirement that cannabis businesses get permission from the state and the city in which they want to operate.

Less than 20% of cities in California — 89 of 482 — allow retail shops to sell cannabis for recreational use, according to the California Cannabis Industry Assn. Cities that allow cannabis sales include Los Angeles, Oakland, San Francisco and San Diego.

Eighty-two of Los Angeles County's 88 cities prohibit retail sales of recreational marijuana, according to Alexa Halloran, an attorney specializing in cannabis law for the firm Solomon, Saltsman & Jamieson. Pot shops are not allowed in cities including Burbank, Manhattan Beach, Alhambra, Beverly Hills, Inglewood, Compton, Redondo Beach, El Monte, Rancho Palos Verdes and Calabasas.

"While some cities have jumped in headfirst, we've taken a deliberate approach," said Manhattan Beach Mayor Steve Napolitano, "to see how things shake out elsewhere before further consideration. I think that's proven to be the smart approach."



Can you carry marijuana in LAX? Yes, but it's more complicated than that

SEP 28, 2018 | 6:40 AM

Voters have also been reluctant to allow cannabis stores in their communities. Of the 64 California cities and counties that voted on cannabis ballot measures in the November midterm election, eight banned the sale of cannabis or turned down taxation measures, seven allowed sales and 49 approved taxes on pot businesses, said Hilary Bricken, an attorney who represents the industry. Among them, voters in Malibu approved pot shops while Simi Valley residents voted for an advisory measure against allowing retail sales.

Javier Montes, owner of Wilmington pot store Delta-9 THC, says he is struggling to compete with a large illicit market unburdened by the taxes he pays as a licensed business.

“Because we are up against high taxes and the proliferation of illegal shops, it is difficult right now,” Montes said. “We expected lines out of our doors, but unfortunately the underground market was already conducting commercial cannabis activity and are continuing to do so.”

Montes, who received his city and state licenses in January, says his business faces a 15% state excise tax, a 10% recreational marijuana tax by the city of Los Angeles and 9.5% in sales tax by the county and state — a markup of more than 34%.

He says there isn't enough enforcement against illegal operators, and the hard times have caused him to cut the number of employees at his shop in half this year from 24 to 12.

“It's very hard whenever I have to lay people off, because they are like a family to me,” said Montes, who is vice president of the United Cannabis Business Assn., which represents firms including the about 170 cannabis retailers licensed by the city of Los Angeles.



DELTA-9 faces a 15% state excise tax, a 10% recreational cannabis tax by the city of Los Angeles and 9.5% in sales tax by the county and state, the shop owner says. (Marcus Yam / Los Angeles Times)

Sky Siegel, who operates a cannabis business in Studio City, said he recently gave up trying to open another store in Santa Monica because of its restrictions on such businesses.

“It turns into this ‘Hunger Games’ to try to get a license,” said Siegel, who is general manager of Perennial Holistic Wellness Center, which has a dozen employees in Studio City and also operates a delivery service.

He says his firm is up against thousands of unlicensed delivery services going into cities where storefronts are banned.

“To me, it doesn’t make sense” that many cities have prohibited shops, he said. “Banning does nothing. It’s already there. Why not turn this into a legitimized business, which is what the people want.”

California has also issued fewer cultivation licenses than expected in the first year of legalization, with about 2,160 growers registered with the state; an estimated 50,000 commercial cannabis cultivation operations existed before Proposition 64, according to the California Growers Assn. Some have given up growing pot, but many others are continuing to operate illegally.

The trade group hoped to see at least 5,000 commercial growers licensed in the first year, said Hezekiah Allen, the group’s former executive director who is now chairman of Emerald Grown, a cooperative of 130 licensed cultivators.

“We are lagging far behind,” Allen said. “It’s woefully inadequate. Most of the people in California who are buying cannabis are still buying it from the unregulated market. There just isn’t a reason for most growers to make the transition.”



Hemp is about to be legal under the 2018 farm bill. You can't get high from it — but you can wear it

DEC 19, 2018 | 3:20 PM

Assemblyman Jim Wood (D-Healdsburg), who has crafted cannabis regulations, said the licensing system had not yet lived up to its promise.

“The state licensing process this past year has been a painful one,” said Wood, adding that the complex rules are particularly difficult for small businesses. “I recognize that this has been a significant undertaking for the state, and you combine that with the cannabis industry learning how to navigate the process — it’s been difficult for them both.”

The legalization of recreational pot has also created tension in areas of the state where cannabis growers are operating close to residents.

Jesse Jones said he moved his family to Petaluma from Marin County six months ago so his three children could enjoy more open space, but he is now fighting a proposal for a cannabis farm to operate a few hundred feet from his home, in part because of safety issues.

“You are going to have what is still a [Schedule 1] narcotic being produced in line of sight of my kids’ trampoline, on a shared road that was never intended for this type of commercial operation,” said Jones, an energy industry executive.

Sanjay Bagai, a former investment banker who lives with his family next door to a new cannabis farm in Sonoma County, is a leader of a residents group called Save Our Sonoma Neighborhoods, which has obtained a preliminary court ruling against one cannabis-growing operation.

Bagai said his group was “not anti-cannabis” but added that pot cultivation “is not something that fits into our neighborhood here.”

“The smell is horrific,” he said of the marijuana plants. “It’s like rotting flesh. And the traffic is insane.”

Quality-of-life complaints have also surfaced in neighborhoods where cannabis sellers have set up shop.

Van Nuys Neighborhood Council President George Thomas said he had received about a dozen complaints in the last year from residents living near pot stores who were concerned about loitering, the smell of marijuana smoke and other issues. Thomas, who is the publisher of the Van Nuys News Press and is an LAPD volunteer, passes complaints on to police officers.

“If they are not in compliance,” Thomas said, “if they are within a thousand feet of a school or church, we are totally against them and we are happy to work with the neighborhood prosecutor in the city attorney’s office to shut them down.”



Screened at the border, Canadians who are honest about using marijuana could be banned from the U.S.

OCT 15, 2018 | 3:00 AM

At the same time, he said, the neighborhood council has worked with licensed cannabis stores to get them involved in improving the community and has asked the Los Angeles City Council to devote some of the tax revenue from Van Nuys shops to solving local problems, including homelessness and crime.

Meanwhile, despite concerns from law enforcement, the state is finalizing a proposal to allow deliveries throughout California — including in cities that ban retail stores. The new rule by Lori Ajax, chief of the state Bureau of Cannabis Control, is expected to be implemented in January.

Ajax says she believes that as the system is refined and is shown to operate successfully in some cities, other local governments will allow retail pot sales. But opponents of pot legalization, including Kevin Sabet, president of Smart Approaches to Marijuana, are happy that most cities are saying “no” to selling the drug.

“The residents of Compton and these other cities have seen the ills that come with allowing marijuana in the door,” Sabet said, “including skyrocketing drugged driving; the promise, then failure of social justice; and the targeting of children through the use of colorful and deceptive candies, gummies and sodas.”

Even in cities that allow cannabis sales, businesses face big hurdles.

The various taxes and fees could drive up the cost of legal cannabis in parts of California by 45%, according to the global credit ratings firm Fitch Ratings.

There is less of a tax burden in Oregon, where voters legalized recreational pot in 2014, and state and local taxes are capped at 20%. With nearly a tenth of the population of California, that state has more licensed cannabis shops — 601. On a per capita basis,

Alaska has also approved more pot shop licenses than California, — 94 so far. The state imposes a tax on cultivation, but there is no retail excise tax on pot.

Assemblyman Rob Bonta (D-Alameda) tried and failed this year to push for a temporary reduction in California's pot taxes to help the industry get on its feet.

"It's a work in progress," Bonta said of the current regulatory system. "We knew we weren't going to get it exactly right on Day 1, and so we're always looking for ways to achieve the original intentions and goal."

Bonta said he may revisit the taxation issue in 2019 and is exploring the idea of having the state do more to get cities to approve businesses, possibly by providing advisory guidelines for local legalization that address cities' concerns.

California cannabis businesses, like their counterparts in Colorado and Oregon, also face costs to test marijuana for harmful chemicals.

"The testing costs are excessive — \$500 to \$1,000 per batch, and most crops involve multiple batches," said Gieringer, the director of California NORML. "No other agricultural product is required to undergo such costly or sensitive tests."

Another problem hampering the legal market is a lack of banking for cannabis businesses. Federally regulated banks are reluctant to handle cash from pot, which remains an illegal drug under federal law.

"Banking continues to be an issue in terms of creating a real public safety problem with significant amounts of cash being moved for transactions," said Bonta, who co-wrote a bill this year that would have created a state-sanctioned bank to handle money from pot sellers. It failed to pass after legislative analysts said the proposal faced "significant obstacles," including no protection from federal law enforcement.

Industry leaders and activists said they knew it would be a slow process to establish a strong legal market, noting other states with legal pot, including Colorado, Washington and Oregon, also faced growing pains and problems along the way.

But Ajax, the state pot czar, says her agency has had a productive first year, issuing initial licenses, refining the rules and stepping up action against unlicensed operations, including partnering with the Los Angeles Police Department to seize \$2 million worth of marijuana products from an unlicensed shop in Sylmar in October.

"I am optimistic about the coming year, where our focus will be primarily on getting more businesses licensed and increasing enforcement efforts on the illegal market," Ajax said.

California lawmakers are considering a tax cut — for cannabis

BY ANDREW SHEELER

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It soon could get a little cheaper to grow and buy legal marijuana in California.

California lawmakers announced a bill that would temporarily reduce or eliminate two cannabis taxes in an effort to help fertilize a newly legal industry that they say is having trouble competing with black market operators.

The bill would reduce the state's [15 percent cannabis excise tax](#) to 11 percent and eliminate a cultivation tax that growers pay for three years.

“Those good businesses, those good actors, are not able to compete with the black market product if they cannot be competitive on price and cost,” said Assemblyman Rob Bonta, D-Alameda, one of the sponsors of Assembly Bill 286.

People who buy cannabis from licensed stores in California sometimes face taxes that are equivalent to 45 percent of the cost of their purchase, [according to a report from Fitch Ratings](#). Aside from the excise and cultivation tax, local governments sometimes have their own taxes on marijuana.

Assemblyman Tom Lackey, R-Palmdale, also supports the bill. He noted that state revenue from cannabis taxes came in about \$100 million below what Gov. Jerry Brown's office projected last year. The state collected \$84 million in revenue for fiscal year 2017-18, and projects to receive \$355 million in 2018-19 and \$514 million in 2019-20.

An example of how the excise can dramatically increase the sales price of a cannabis product: When a lawful retailer sells an ounce of high-quality cannabis for \$256.63 — the average price in California according to the user-data-generated website [Price of Weed](#) — they must add more than \$38 to the final bill to cover the tax. Despite legalization, the black market still thrives in California. The CHP seized [nearly eight tons](#) of cannabis between January and November of 2018. That's nearly double the amount seized in 2017, and the most seized in a calendar year since 2014.

“Right now, the illicit market is dominating the cannabis industry. These are bad actors. These are people who are evading taxes and making our communities less safe,” Lackey said.

Bonta was part of a group of lawmakers to introduce a similar bill in the last legislative session; that bill died in the Assembly Appropriations Committee.

State Treasurer Fiona Ma, another bill co-sponsor, said that her office has heard from members of the cannabis industry that a 15 percent excise tax is too high.

“We don't tax start-up businesses (in other industries) when they start,” Ma said. “We need to do better. This is anywhere from a \$6 billion to \$20 billion industry here in California.”