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DEPARTMENT OF CANNABIS CONTROL: REPORT ON THE CONDITION AND HEALTH OF THE CANNABIS INDUSTRY

**Joint Informational Hearing
Assembly Committee on Business and Professions and
Senate Committee on Business, Professions, and Economic Development
Tuesday, March 11, 2025**

BACKGROUND PAPER

Overview

The Department of Cannabis Control (DCC) is the state agency responsible for licensing and regulating cannabis businesses in California. When the voters approved Proposition 64 in 2016, they did so with an understanding that revenue generated from state and local taxation “could eventually range from the high hundreds of millions of dollars to over \$1 billion annually,” which would be used to fund youth programs, environmental protection efforts, and local law enforcement.¹ Over the years following passage of the initiative, however, it has been widely reported that the legal cannabis industry has not consistently grown to meet the expectations of California voters. These challenges have been attributed to a number of factors, including regulatory burdens at the state and local levels and competition from the illicit market.

Over the course of numerous policy discussions as to how to address the state’s floundering cannabis marketplace, many stakeholders have consistently argued that state taxes imposed on the sale of licensed cannabis and cannabis products can discourage consumers and weaken revenue for operators. After several unsuccessful legislative efforts to reduce the tax rate on cannabis cultivation and sales, Assembly Bill 195 (Committee on Budget) was enacted in 2022 as part of the 2022-23 Budget Act, which simplified and streamlined the cannabis tax structure. Among other provisions, the trailer bill suspended the state’s cultivation tax and moved collection of the state’s excise tax from the distributor to the point-of-sale. The trailer bill additionally required the California Department of Tax and Fee Administration (CDTFA) to subsequently adjust the excise tax rate every two years, beginning July 1, 2025, to a rate of up to 19 percent in order to replace revenue lost due to suspension of the cultivation tax. In the meantime, the 2022-23 Budget Act set aside \$150 million in General Fund to backfill the estimated lost tax revenue that would have funded entities operating youth programs, environmental programs, and law enforcement.

¹ Legislative Analyst’s Office, “Proposition 64: Marijuana Legalization. Initiative Statute,” July 20, 2016, <https://www.lao.ca.gov/ballot/2016/prop64-110816.pdf>.

In anticipation of the potential for a state excise tax increase in 2025—which could perceivably run contrary to the original goals of stakeholders seeking tax relief for cannabis businesses—the 2022-23 Budget Act also included a requirement that the DCC provide the Legislature with specified information relating to the economic realities of the licensed cannabis market so that legislators could holistically evaluate the effect of tax reform and consider additional reforms to strengthen the industry and encourage participation in the marketplace. Specifically, Section 34020.1 of the Revenue and Taxation Code required the DCC, in consultation with the Department of Finance (DOF) and the CDTFA, to “submit a report to the Legislature on the condition and health of the cannabis industry in the state” no later than March 2025. This report was recently submitted by the DCC and is the primary topic of discussion for the informational hearing being held jointly by the Assembly Committee on Business and Professions and the Senate Committee on Business, Professions, and Economic Development.

It can be cogently argued that there is no one major cause to blame for the struggles of the state’s legal cannabis industry, and correspondingly there is likely no single identifiable solution. The role that state taxation has played in the licensed marketplace’s inability to thrive is difficult to confidently assess given the myriad other contributing factors and the shifting economic landscape since Proposition 64 was implemented. Nevertheless, it can be assumed that the issue of state taxation on cannabis sales will continue to be debated as policymakers pursue strategies for promoting the licensed cannabis industry as a preferred alternative to the illicit market, and the DCC’s report to the Legislature serves as a useful tool for informing that discussion within a broader context.

Background

Early History of Cannabis Regulation in California. California was the first state to make the consumption of cannabis lawful when voters approved Proposition 215, or the Compassionate Use Act, in 1996. Proposition 215 protected qualified patients and caregivers from prosecution relating to the possession and cultivation of cannabis for medicinal purposes, if recommended by a physician. The initiative prohibited physicians from being punished or denied any right or privilege for making a medicinal cannabis recommendation to a patient. Proposition 215 additionally included findings and declarations encouraging the federal and state governments to implement a plan to provide for the safe and affordable distribution of cannabis to patients with medical needs.

The regulatory scheme for medicinal cannabis was further refined when the Legislature passed Senate Bill 420 (Vasconcellos) in 2003, which established the state’s Medical Marijuana Program (MMP.) Under the MMP, qualified patients were eligible to obtain a voluntary medical marijuana patient card, which could be used to verify that the patient or a caregiver had authorization to cultivate, possess, transport, or use medicinal cannabis. The MMP’s identification cards were intended to help law enforcement officers identify and verify that cardholders were allowed to cultivate, possess, or transport limited amounts of cannabis without being subject to arrest. The MMP also created protections for qualified patients and primary caregivers from prosecution for the formation of collectives and cooperatives for medicinal cannabis cultivation.

Without the adoption of a formal framework to provide for state licensure and regulation of medicinal cannabis, a proliferation of informally regulated cannabis collectives and cooperatives were largely left to the enforcement of local governments. As a result, a patchwork of local regulations was created with little statewide involvement. More restrictive laws and ordinances by cities and counties were ultimately upheld by the California Supreme Court in its 2013 decision in *City of Riverside v. Inland Empire Patients*, which held that state law did not expressly or implicitly limit the inherent authority of a local jurisdiction, by its own ordinances, to regulate the use of its land, including the authority to provide that facilities for the distribution of medicinal cannabis be prohibited from operating within its borders.

Even after several years of lawful cannabis cultivation and consumption under state law, a lack of a uniform regulatory framework led to persistent problems across the state. Cannabis's continued illegality under the federal Controlled Substances Act, which classifies cannabis as a Schedule I drug ineligible for prescription, generated periodic enforcement activities by the United States Department of Justice. The constant threat of action by the federal government created apprehension among California's cannabis community.

A document issued by the United States Attorney General in 2013 known as the "Cole Memorandum" indicated that the existence of a strong and effective state regulatory system, and a cannabis operation's compliance with such a system, could allay the threat of federal enforcement interests. Federal prosecutors were urged under the memo to review cannabis cases on a case-by-case basis and consider whether a cannabis operation was in compliance with a strong and effective state regulatory system prior to prosecution. The memo was followed by Congress's passage of the Rohrabacher-Farr amendment, which prohibits the United States Department of Justice from interceding in state efforts to implement medicinal cannabis.

Medical Cannabis Regulation and Safety Act. After several attempts to improve the state's regulation of cannabis, the Legislature passed the Medical Marijuana Regulation and Safety Act—subsequently retitled the Medical Cannabis Regulation and Safety Act (MCRSA)—in 2015. MCRSA consisted of a package of legislation: Assembly Bill 243 (Wood); Assembly Bill 266 (Bonta, Cooley, Jones-Sawyer, Lackey, and Wood); and Senate Bill 643 (McGuire). MCRSA established, for the first time, a comprehensive statewide licensing and regulatory framework for the cultivation, manufacture, transportation, testing, distribution, and sale of medicinal cannabis to be administered by a newly established Bureau of Cannabis Control (BCC) within the Department of Consumer Affairs; the California Department of Public Health (CDPH); and the California Department of Food and Agriculture (CDFA), with implementation relying on each agency's area of expertise.

MCRSA vested authority for:

- The BCC to license and regulate dispensaries, distributors, transporters, and (subsequently) testing laboratories, and to provide oversight for the state's regulatory framework;
- The CDPH to license and regulate manufacturers; and
- The CDFA to license and regulate cultivators.

While entrusting state agencies to promulgate extensive regulations governing the implementation of the state’s cannabis laws, MCRSA fully preserved local control. Under MCRSA, local governments may establish their own ordinances to regulate medicinal cannabis activity. Local jurisdictions could also choose to ban cannabis establishments altogether.

Proposition 64. Not long after the Legislature enacted MCRSA, California voters passed Proposition 64, the Adult Use of Marijuana Act (AUMA). The passage of the AUMA legalized cannabis for non-medicinal adult use in a private home or licensed business; allowed adults 21 and over to possess and give away up to approximately one ounce of cannabis and up to eight grams of concentrate; and permitted the personal cultivation of up to six plants. The law retained prohibitions against smoking in or operating a vehicle while under the effects of cannabis, possessing cannabis at a school or other child oriented facility while minors are present, growing in an unlocked or public place, and providing cannabis to minors.

The proponents of the AUMA sought to utilize much of the regulatory framework and authorities set out by MCRSA, while making several notable changes to the structure still being implemented. In addition, the AUMA approved by the voters adopted the January 1, 2018 deadline for state implementation of non-medicinal cannabis in addition to the regulations required in MCRSA that were scheduled to take effect on the same date. The same agencies given authority under MCRSA remained responsible for implementing regulations for adult use.

Under the AUMA, the BCC within the Department of Consumer Affairs continued to serve as the lead regulatory agency for all cannabis, both medicinal and non-medicinal. The AUMA included 19 different license types compared to the original 17 in MCRSA, and provided the Department of Consumer Affairs (and the BCC) with exclusive authority to license and regulate the transportation of cannabis. The AUMA also authorized vertical integration models which allowed for the holding of multiple license types, as previously prohibited under MCRSA. Additionally, while MCRSA required both a state and local license to operate, the AUMA only required a state license; however, the state was also directed not to issue a license to an applicant if it would “violate the provisions of any local ordinance or regulation.”

The language of the AUMA allows for legislative modifications that “implement” or “give practical effect” to the law by a majority vote. However, what constitutes “implementing” has been interpreted to be limited. Consequently, proposed changes to the voters’ intent in the AUMA often require a two-thirds vote and of those, some may be deemed to require voter approval.

Reconciliation of Laws. In the spring of 2017, Senate Bill 94 (Committee on Budget and Fiscal Review) was introduced to reconcile the distinct systems for the regulation, licensing, and enforcement of legal cannabis that had been established under the respective authorities of MCRSA and the AUMA. The single consolidated system established by the bill—known as the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA)—created a unified series of cannabis laws and deleted redundant code sections no longer necessary due to the combination of the two systems. MAUCRSA also clarified a number of components, including but not limited to licensing, local control, taxation, testing, and edibles.

Implementing Regulations. On January 16, 2019, the state’s three cannabis licensing authorities—the BCC, the CDPH, and the CDFA—officially announced that the Office of Administrative Law had approved final cannabis regulations promulgated by the three agencies respectively to implement MAUCRSA. These final regulations replaced emergency regulations that had previously been in place, and made various changes to numerous requirements following the public rulemaking process. The adoption of final rules provided some sense of finality to the state’s long history in providing for the regulation of lawful cannabis sale and use.

Consolidation of Regulatory Entities. In early 2021, the DOF released trailer bill language to create a new Department of Cannabis Control (DCC) with centralized authority for cannabis licensing and enforcement activities. This new department was created through a consolidation of the three prior licensing authorities’ cannabis programs. As of July 1, 2021, the DCC is the sole entity responsible for administering and enforcing the majority of MAUCRSA.

In September of 2021, the DCC underwent emergency rulemaking to effectuate the reorganization. The emergency regulations consolidated rules previously promulgated by the three prior licensing entities and made changes intended to clarify and make consistent licensing and enforcement requirements for all cannabis businesses. These regulations were subsequently readopted in March of 2022, allowing the rules to remain in place as the DCC continued to go through the regular rulemaking process to establish new permanent regulations.

The DCC formally issued its notice of proposed rulemaking for permanent regulations on March 4, 2022. The proposed regulation text included the language contained in the emergency regulations implementing the departmental reorganization. The DCC has characterized this rulemaking package as a “comprehensive regulatory proposal to make changes to streamline and simplify the cannabis regulations, enhance consumer protections and make permanent changes that are currently in effect as emergency regulations.” The new permanent regulations went into effect on January 1, 2023 to effectuate the organizational consolidation and make other changes to cannabis regulation.

Implementation Challenges with State Licensure. Language included in MAUCRSA authorized the state’s cannabis licensing authorities to issue four month “temporary licenses” to applicants, which could be extended in 90-day increments. These temporary licenses allowed businesses to engage in commercial cannabis activity under state approval while local governments commenced with establishing their own local authorization processes and reviewing applications for local approval. Temporary licenses were issued without any fees and temporary licensees did not have access to the state’s track and trace system.

While the intent of MAUCRSA was to transition businesses to full annual licensure no later than December 31, 2018—at which time temporary license authority was scheduled to expire—many local jurisdictions struggled to launch their approval programs. For example, by August of 2018, Humboldt County regulators had received 2,376 permit applications and only approved 240. Some jurisdictions issued temporary or provisional local permits, but had not completed the full process for local permitting.

One of the driving issues behind the delay with local authorization was the requirement that a “complete” application include evidence of compliance with the California Environmental Quality Act (CEQA). Signed into law by Governor Ronald Reagan in 1970, CEQA requires public agencies to consider the environmental impact when approving discretionary projects. While the scope of this process can vary based on the nature of the project, CEQA review can frequently be protracted and complex.

To transition away from temporary licensure while local authorization issues remained unresolved, the Legislature passed Senate Bill 1459 (Cannella) in 2018, which instead established a new “provisional license” scheme. Unlike temporary licenses, provisional license holders must pay a fee, comply with track and trace requirements, and meet additional responsibilities under MAUCRSA. However, provisional licensure does not require proof of compliance with the requirements of CEQA. According to information provided by the DCC in 2022, approximately 70 percent of licenses in California remained provisional.

The authority to issue and renew provisional licenses was originally scheduled to sunset on January 1, 2020; this was subsequently extended to January 1, 2022. The 2021-22 Budget Act further extended this expiration date, prohibiting the DCC from renewing a provisional license after January 1, 2025 and sunseting the provisional licensing program on January 1, 2026. Specific expiration dates and deadlines were applied to provisional licensees and applicants based on the size and nature of the business, and new requirements for certain applicants to submit documentation regarding lake or streambed alteration agreement were enacted. Beginning January 1, 2025, the DCC is no longer authorized to renew provisional licenses with the exception of locally verified equity retail licenses.

Cannabis Taxation under Proposition 64. The AUMA, and subsequently MAUCRSA, imposed a 15 percent excise tax on sales of cannabis and imposed a tax on cannabis cultivation at a rate of \$9.25 per dry-weight ounce of cannabis flowers and \$2.75 per dry-weight ounce of cannabis leaves that are harvested and brought to market. These taxes are distinct from state sales and use taxes, which apply to recreational cannabis but not medicinal cannabis. Local governments are also empowered to impose their own taxes on commercial cannabis activity.

State excise tax and cultivation tax revenues are deposited into a special fund referred to as the California Cannabis Tax Fund (Tax Fund) and are then allocated for a variety of purposes in order of priority. First, expenditures incurred by state agencies responsible for implementing cannabis laws are to be paid for through the Tax Fund. This includes reasonable costs incurred by the CDTFA for administering and collecting the taxes, not to exceed 4 percent of revenue; reasonable costs incurred by the DCC for licensing and enforcement programs; reasonable costs incurred by the Department of Fish and Wildlife, the State Water Resources Control Board, and the Department of Pesticide Regulation for carrying out their environmental protection duties under the state’s cannabis laws; and other state agencies. Allocations to reimburse these state entities shall only be made to the extent the entities are not otherwise reimbursed for their costs.

After reimbursement, Tax Fund revenue is next allocated to fund a series of specific programs originally designated under Proposition 64. Each of these programs are provided with precise allocations of funding totaling \$25 million, appropriated annually until the 2028-29 fiscal year.

This includes \$10 million to a public university to research and evaluate the implementation and effect of legal cannabis and make recommendations to the Legislature and Governor regarding possible changes to the law; \$3 million to the California Highway Patrol (CHP) to establish and adopt protocols to determine whether a driver is operating a vehicle while impaired; \$10 million to the Governor's Office of Business and Economic Development (GO-Biz), which subsequently increases by an additional \$10 million each fiscal year until reaching a total disbursement of \$50 million annually beginning in the 2022-23 fiscal year, to administer a community reinvestments grants program; and \$2 million to the University of California San Diego Center for Medicinal Cannabis Research to further the objectives of the center, including the enhanced understanding of the efficacy and adverse effects of cannabis as a pharmacological agent.

After each of the above allocations have been made in sequential order, totaling \$25 million, any remaining revenue in the Tax Fund is divided into sub-trust accounts according to a percentage outlined by Proposition 64. The division is as follows:

- 1) 60 percent of the remaining revenue is deposited in the Youth Education, Prevention, Early Intervention and Treatment Account, and disbursed by the Controller to the DHCS for programs for youth that are designed to educate about and to prevent substance use disorders and to prevent harm from substance use.
- 2) 20 percent of the remaining revenue is deposited in the Environmental Restoration and Protection Account, and disbursed by the Controller as follows:
 - a. To the Department of Fish and Wildlife and the Department of Parks and Recreation for the cleanup, remediation, and restoration of environmental damage in watersheds affected by cannabis cultivation and related activities including, but not limited to, damage that occurred prior to enactment of Proposition 64, and to support local partnerships for this purpose. The Department of Fish and Wildlife and the Department of Parks and Recreation may distribute a portion of the funds they receive through grants.
 - b. To the Department of Fish and Wildlife and the Department of Parks and Recreation for the stewardship and operation of state-owned wildlife habitat areas and state park units in a manner that discourages and prevents the illegal cultivation, production, sale, and use of cannabis and cannabis products on public lands, and to facilitate the investigation, enforcement, and prosecution of illegal cultivation, production, sale, and use of cannabis or cannabis products on public lands.
 - c. To the Department of Fish and Wildlife to assist in funding the watershed enforcement program and multiagency taskforce to facilitate the investigation, enforcement, and prosecution of these offenses and to ensure the reduction of adverse impacts of cannabis cultivation, production, sale, and use on fish and wildlife habitats throughout the state.
- 3) 20 percent of the remaining revenue is deposited in the State and Local Government Law Enforcement Account and disbursed by the Controller as follows:

- a. To the CHP for conducting training programs for detecting, testing and enforcing laws against driving under the influence of alcohol and other drugs, including driving under the influence of cannabis.
- b. To the CHP to fund internal programs and grants to qualified nonprofit organizations and local governments for education, prevention, and enforcement of laws related to driving under the influence of alcohol and other drugs, including cannabis; programs that help enforce traffic laws, educate the public in traffic safety, provide varied and effective means of reducing fatalities, injuries, and economic losses from collisions; and for the purchase of equipment related to enforcement of laws related to driving under the influence of alcohol and other drugs, including cannabis.
- c. To the Board of State and Community Corrections (BSCC) for making grants to local governments to assist with law enforcement, fire protection, or other local programs addressing public health and safety associated with the implementation of Proposition 64; the BSCC is prohibited from making grants to local governments which have banned the cultivation or retail sale of cannabis.
- d. The DOF shall determine the allocation of revenues between the agencies; provided, however, beginning in the 2022–23 fiscal year the amount allocated to CHP for training programs shall not be less than \$10 million annually and the amount allocated to the CHP for grants shall not be less than \$40 million.

Initial Efforts to Reform State Cannabis Taxation. Early tax revenues collected following the implementation of the AUMA signaled that Proposition 64’s promise of substantial tax revenue was not to be immediately fulfilled. The Governor’s Budget Summary for the 2018-19 fiscal year stated that “cannabis excise taxes are expected to generate \$175 million in 2017-18 and \$643 million in 2018-19.” The January 10, 2019 release of the Governor’s Proposed Budget predicted that approximately \$355 million in excise tax revenue would be collected by the end of the fiscal year—nearly half of what was originally anticipated.

This situation was not unique to California. For example, Massachusetts officials projected \$63 million in tax revenue for the first year of that state’s cannabis legalization, but as of March 1, the state had collected only \$5.9 million. Advocates for California’s legal cannabis industry attributed the lackluster tax revenues on larger struggles for licensed operators to thrive under the requirements of MAUCRSA. Many specifically pointed out that the rate of taxation itself was part of the problem, as products sold on the illicit market were able to be priced much lower than products in the legal market.

Given that fewer businesses initially entered the newly licensed cannabis industry than anticipated and many jurisdictions still banned cannabis locally, the illicit market posed a significant challenge to the success of MAUCRSA. Multiple bills were subsequently introduced to lower the state’s excise tax and suspend the cultivation tax, including bills championed by the original authors of MCRSA. Supporters of these bills argued that because the high tax rate on cannabis businesses is a leading cause for this slow industry growth, a tax levy would ultimately lead to a larger scale of taxable activity and thus greater revenue.

Supporters of tax reform pointed to how when the State of Washington first legalized cannabis, it initially had higher tax rates; when that state lowered their rate and simplified their system, the state eventually began generating greater revenue. New Frontier Data provided estimates for an earlier iteration of this bill that “a 4 percent reduction in the state excise tax would expect to see an increase in legal participation by 119,000 consumers, generating an estimated additional \$278 million in retail revenue.” However, it was pointed out that the State of Washington was not a perfect allegory for California—originally, Initiative 502 in that state levied a 25 percent tax on cannabis at three separate points in the supply chain: a 25 percent tax on producer sales to processors, another 25 percent tax on processor sales to retailers, and a third 25 percent tax on retailer sales to customers. The change made in Washington was to replace this three-tiered system of taxation with a single 37 percent tax on final sales of cannabis. Not only was this a much more significant reform to the state’s legal scheme for cannabis, but both the resulting excise tax rate of 37 percent remained much higher than California’s 15 percent rate.

It was also noted that state-level taxes on the cultivation and sale of cannabis in California represent only a portion of the overall effective tax rate for any given cannabis operation. Under Proposition 64 and MAUCRSA, local governments are permitted to levy their own taxes on a cannabis business, and many jurisdictions have imposed additional taxes that greatly exceed the assessments adjusted by this bill. For example, the County of Monterey imposed its own cultivation tax of \$15 per square foot. The City of Berkeley cut its local excise tax on cannabis sales from 10 percent to 5 percent. In 2017, the City of Campbell approved a measure to impose an initial tax of 7 percent on cannabis businesses that could be raised through local ordinance to a tax rate as high as 15 percent.

Between 2018 and 2022, multiple pieces of legislation attempted to reform the state’s taxation of cannabis, but none were successful, with the majority of bills failing to pass either the Assembly Committee on Revenue and Taxation or the Assembly Committee on Appropriations. Concerns were raised about the potential short-term impact on cannabis tax revenue that would be caused by a tax cut; the State of California had transferred \$135 million in General Fund loans to the Cannabis Control Fund, which needed to be paid back. Additionally, the 2019 Governor’s proposed budget summary stated that “the Administration is deferring allocations for Proposition 64 programs until the May Revision, when more updated revenue data will be available.”

In December 2019, the Legislative Analyst’s Office (LAO) released a report to the Legislature titled: *How High? Adjusting California’s Cannabis Taxes*. This report, required as part of Proposition 64, was aimed at making recommendations for adjustments to the state’s cannabis tax rate to achieve three goals: (1) undercutting illicit market prices, (2) ensuring sufficient revenues are generated to fund the types of programs designated by the measure, and (3) discouraging youth use. The report went over several different types of taxation, ultimately recommending that the state adopt a potency-based tax or tiered ad valorem cannabis tax. The LAO acknowledged that the Legislature was unlikely to enact the scale of reform recommended in the report, and stated: “If the Legislature decides not to adopt a potency-based or tiered ad valorem cannabis tax, we nevertheless recommend that the Legislature eliminate the cultivation tax. In this case, we recommend that the Legislature set the retail excise tax rate somewhere in the range of 15 percent to 20 percent depending on its policy preferences.”

As efforts persisted to reform the cannabis tax structure, questions have been raised as to what types of reforms would be deemed legally permissible. Proposition 64 expressly prohibited the Legislature from changing how money in the Cannabis Tax Fund is allocated until July 1, 2028. Beginning on that date, the Legislature will be authorized to change those allocations by majority vote to further the purposes of Proposition 64. However, Proposition 64 prohibits any changes to the allocations from resulting in a reduction of funds to GO-Biz or the sub-accounts from the amount allocated to each account in the 2027-28 fiscal year. These provisions of Proposition 64 have been interpreted by some stakeholders as legally prohibiting any reduction of the excise tax that would result in a reduction of tax revenue for purposes of the programs funded through that revenue under MAUCRSA.

Enacted Cannabis Tax Reforms. On January 10, 2022, Governor Gavin Newsom published a summary of his proposed 2022-23 Budget, which provided an update on Tax Fund allocations and the continued funding of programs under the DCC. The Budget summary then stated that “the Administration supports cannabis tax reform and plans to work with the Legislature to make modifications to California’s cannabis tax policy to help stabilize the market; better support California’s small licensed operators; and strengthen compliance with state law.” This announcement was made as several legislators had introduced their own cannabis tax reform bills.

While there appeared to be early consensus around the need to suspend (or zero out) the state’s cultivation tax, there was significant disagreement among stakeholders regarding what reforms should be enacted to the imposition of the state’s excise tax. One frequently cited issue was that MAUCRSA required taxes to be collected at the point of distribution, not sale, requiring the tax to be imposed against the “average market price of any retail sale.” The CDTFA was then required to “mark up” the average price of cannabis at retail, resulting in uncertainty and volatility in the effective impact of taxation. There were numerous discussions about whether to shift tax collection to the point of sale, with some representatives of labor opposing that change.

Another point of contention was about the impact that a reduction of state cannabis taxes would have on programs funded through revenues from those taxes. Advocates for programs focused on child care and for youth prevention, as well as advocates for environmental clean-up programs, formally opposed proposals to reduce the taxes that funded those programs. Other stakeholders weighed in with strong legal opinions that changes to cannabis taxes specified in the AUMA would violate Proposition 64, which gave the Legislature only limited authority to amend provisions of the initiative relating to taxation that would result in a reduction of Tax Fund allocations.

Over the next several months, the Governor’s office convened several meetings with numerous stakeholders. Language was then drafted as part of the budget process to effectuate the agreement reached between the Administration and the Legislature. The resulting trailer bill, enacted as part of the 2022-23 Budget Act, ultimately made a series of changes to the imposition and collection of cannabis taxes. Specifically, Assembly Bill 195 (Committee on Budget) suspended the state’s cultivation tax, effective July 1, 2022. The trailer bill maintained the 15 percent cannabis excise tax, as required by Proposition 64, until June 30, 2025; however, the trailer bill moved collection of that tax from the distributor to the point-of-sale, thus eliminating the need for CDTFA to assess an estimated “mark up” for purposes of excise tax collection.

The trailer bill required the CDTFA to adjust the excise tax every two years by a rate that would generate an amount of revenue equivalent to what would have been collected from the cultivation tax. Finally, the trailer bill also set a baseline of new cannabis tax revenue for Allocation 3 entities (those entities that use cannabis revenues to operate youth programs, environmental programs, and law enforcement) at \$670 million in 2022-23, 2023-24, and 2024-25, which may be satisfied with tax revenues, or General Fund backfill if needed. The 2022-23 Budget Act set aside \$150 million General Fund to backfill any lost revenue.

Report on the Condition and Health of the Industry. In addition to effectuating statutory changes to streamline and simplify the state’s cannabis tax structure, the 2022-23 Budget Act required the DCC, in consultation with the DOF and the CDTFA, to submit a report to the Legislature on the condition and health of the cannabis industry in the state. The statute created within the Revenue and Taxation Code specifically required the report to include all of the following information:

- (1) How many local jurisdictions have permitted commercial cannabis activity.
- (2) How many local jurisdictions have not permitted commercial cannabis activity.
- (3) Information or analysis concerning the potential expansion or contraction of the cannabis market in the state, which may include information concerning any increase in retail cannabis sales and activity in the illicit market.
- (4) How many equity licensees have been approved by the DCC.
- (5) In what counties the state equity licensees located.
- (6) The health of the Tax Fund, and any future projections of Tax Fund revenues.
- (7) Information on the viability of cannabis businesses in the state, and the ability to continue to operate cannabis businesses in the state, from a general and equity licensee standpoint.
- (8) The impacts of the suspension of the cultivation tax ... including whether that suspension resulted in a decrease in retail cannabis prices or increased participation in the legal cannabis market.

In addition to requiring the submission of factual information, the statute further provides that the report “may include recommendations to strengthen the state’s legal cannabis market.” The DCC was authorized to contract with a public university or universities in California to prepare the report, and those universities were themselves authorized to contract with other organizations in connection with the report, subject to the DCC’s approval. The statute additionally allowed for the DCC to consolidate the report with any other reports it was required to submit.

The DCC formally submitted its report to the Legislature on March 3, 2025. In its transmittal letter, the DCC argues that “California has made significant progress since launching licensed cannabis sales in 2018” while conceding that “the legal industry continues to face persistent challenges.” The letter concludes with the following paragraph:

California’s cannabis market is undergoing a profound transformation—one that will span years and demands relentless vigilance. The Department of Cannabis Control is pleased to submit this report and reiterate its commitment to support and collaborate with policymakers to ensure the state delivers on its fundamental promise: to promote public safety, protect consumers, and facilitate the transition of cannabis to a fully regulated legal market.

The full report submitted by the DCC includes a lengthy analysis and executive summary prepared by ERA Economics, a firm that provides economic consulting services, as part of its report titled *California Cannabis Market Outlook*. This analysis is accompanied by a supplemental report prepared by the DCC to meet the specific requirements of statute. Both the DCC’s *Condition and Health of the Cannabis Industry in California* report and the ERA report include a number of key findings.

For example, the DCC’s report indicates that 46 percent of cities and counties in California allow at least one type of commercial cannabis activity. The report further finds that the rate of cannabis use in California has steadily been increasing, with approximately 40 percent of cannabis obtained from the licensed marketplace. The DCC reports that “2024 saw the most licensed cannabis produced and a steady increase of the volume of licensed cannabis sold since the introduction of the cannabis regulatory framework in January 2018” despite competition from the illicit market.

According to the DCC’s report, cannabis tax revenues have largely subsided back to their pre-pandemic levels following the surge in sales in 2021-22. The Governor’s Budget projects revenues of about \$762 million in Fiscal Year 2025-26, about six percent lower than 2021-22. The DCC’s report also provides information about ongoing efforts to support equity operators, with approximately 2,103 locally identified equity licensees in California at the time of the report.

In addition to the economic data provided in the ERA’s *California Cannabis Market Outlook* are a handful of specific policy recommendations. The ERA report lists each of the following recommendations, some of which were contained in prior reports, with greater detail provided for each item in the full report:

- 1) Continue to help the licensed market compete with the illicit market.
- 2) Improve cultivator data.
- 3) Improve market intermediary data.
- 4) Create a standardized database of unlicensed cannabis eradication statistics.
- 5) Encourage local municipalities to lower restrictions, taxes, and fees for cannabis businesses.
- 6) Continue to identify other ways to reduce compliance costs.

Finally, the ERA report acknowledges that the uncertain possibility of federal legalization of cannabis would help the licensed market in California. The ERA analysis opines that “federal legalization of cannabis and facilitation of trade between different states with licensed markets would dissuade illicit trade of cannabis and could lead to more stable prices in California and other states.” ERA further notes that ongoing efforts to limit the availability of intoxicating hemp cannabinoids “will push some consumers to the licensed cannabis market.”