



May 15, 2023

To: Cannabis Clients and Interested Stakeholders

From: Amy O’Gorman Jenkins, Legislative Advocate

**RE: Summary of the Governor’s May Revision of the 2023-24 Budget Proposal:
Cannabis**

Today Governor Gavin Newsom released the May Revision (Revise) of his 2023-24 State Budget proposal – a \$306.5 billion spending plan, which preserves ongoing investments in public education and higher education, homelessness, housing, mental health, public safety, climate and water resiliency, and jobs and economic development.

As anticipated, the May Revise assumes an additional budget shortfall, which is projected to be \$9.3 billion, for a total shortfall of \$31.5 billion. In his press conference, the governor highlighted various uncertainties that are contributing to a decline in revenues, including the federal and state tax filing deadline delays. The delay was imposed at the federal level because of severe winter storms across the state, which California also adopted. Other uncertainties he noted include the federal debt ceiling impasse, ongoing interest rate hikes and financial uncertainties associated with the latest bank failures. The governor also indicated that, while he does not anticipate a major recession, the State is modeling for a “moderate recession” and stressed the need to maintain fiscal prudence.

The governor’s revised budget opens what is expected to be an intense month of negotiations with the Legislature, as lawmakers seek to address the budget shortfall before the start of the new fiscal year on July 1.

With respect to cannabis, the May Revise projects an alarming decline in cannabis tax revenues, threatening funding guarantees enacted with the passage of [AB 195](#) (Budget Committee, 2022), which made substantial reforms to the cannabis tax structure. Specifically, the May Revise projects an estimated shortfall of \$102.6 million, but does not propose a solution to address that shortfall, which suggests that the administration is leaving it up to the Legislature to resolve. I have described this issue in further detail below. However, it’s important to note that this could threaten the integrity of AB 195 and tax cuts the legal industry fought so hard to achieve last year, which means your support and engagement on this matter is more important than ever.

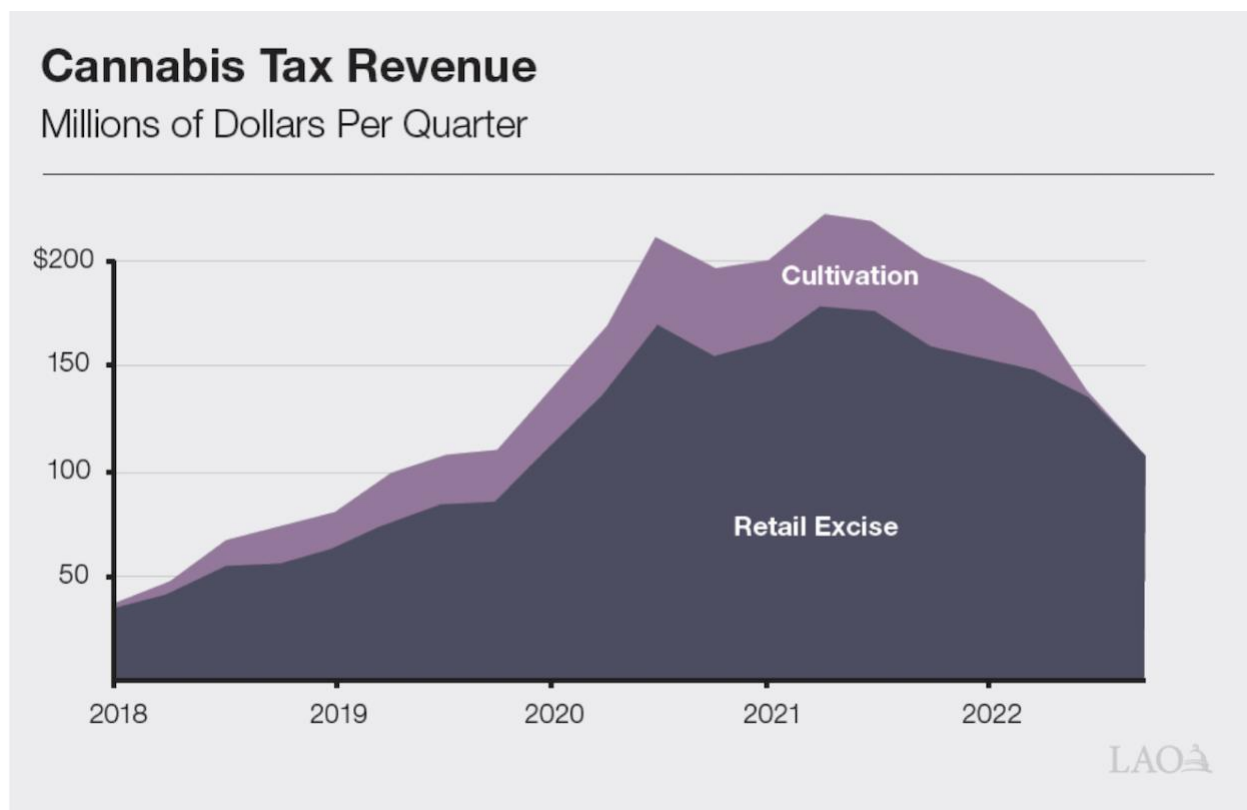
I will be updating this memo as new information is available. In the meantime, please don’t hesitate to contact me with any questions you may have.

Cannabis Tax Revenue Assumptions and Allocations

AB 195 (Budget Committee, 2022), which was enacted last year, substantially modified the cannabis tax structure. Prior to its enactment on July 1, 2022, the State applied two types of taxes on licensed cannabis businesses, pursuant to Proposition 64. The first was a 15% excise tax, which was collected and remitted by cannabis distributors, and a weight-based cultivation tax on harvested plants, which was annually adjusted by the California Department of Tax and Fee Administration (CDTFA) for inflation.

AB 195 zeroed out the cultivation tax indefinitely, beginning July 1, 2023, and shifted excise tax collection and remittance from distributors to the point of sale, beginning January 1, 2023. Additional tax reforms included a tax credit for high road retailers and the creation of two Cannabis Equity Tax Programs, including a vendor compensation program for cannabis retailers who have received an equity fee waiver from the Department of Cannabis Control and an Equity Tax Credit.

The governor's January Budget proposal assumed just \$108 million in the second quarter of 2022-23 (October-December), representing a decline for six consecutive quarters, as reflected in the chart, prepared by the [Legislative Analyst's Office](#) below.



Cannabis Tax Revenue Allocations

Proposition 64 specified the allocation of the State cannabis taxes, which are continuously appropriated into three buckets, as further described below. The governor's budget proposal maintains the current structure of these allocations, as required in Prop 64, as follows:

Allocation 1: Prioritizes the regulatory and administrative workload necessary to implement, administer and enforce the Cannabis Act (\$180.4 million)¹.

Allocation 2: Funds research and activities related to the legalization of cannabis and the past effects of its criminalization (\$25 million):

- \$10 million to public universities to evaluate the implementation and effect of Proposition 64.
- \$3 million to the California Highway Patrol to adopt metrics and best practices to evaluate DUI impairment associated with cannabis use.
- \$10 million to the Governor's Office of Business & Economic Development.
- \$2 million to the University of California, San Diego Center of Medicinal Cannabis Research.

Allocation 3: Once Allocation 1 and Allocation 2 priorities have been met, remaining funds are allocated as part of Allocation 3.

AB 195 requires that these Allocation 3 programs are funded at a baseline of \$670 million each year for three years (Fiscal Years 2022-23, 2023-24 and 2024-25), which would be satisfied with cannabis tax revenues, or a General Fund backfill, if needed. AB 195 further set aside \$150 million General Fund to backfill any revenue required to help meet the \$670 million baseline.

With cannabis tax revenue down for the last six consecutive quarters, the governor's May Revise estimates that only \$567.4 million will be available to fund Allocation 3 programs. This estimate includes both cannabis tax revenue, as well as the entire \$150 million set aside, reflecting an overall estimated shortfall of approximately \$102 million.

Projected allocations in the May Revise are provide below and reflect reductions from the governor's January Budget proposal:

- \$340.4 million (-\$16.5 million) for youth education, prevention, early intervention and treatment (60%);
- \$113.5 million (-\$5.5 million) for clean-up, remediation and enforcement of environmental impacts created by illegal cannabis (20%); and
- \$113.5 million (-\$5.5 million) for public safety-related activities (20%).

Conclusion and Next Steps

The passage of AB 195 in 2022 was the culmination of many years of work to advance meaningful tax review for the legal cannabis industry. Zeroing out the cultivation tax indefinitely and shifting excise tax collection from distribution to retail were key objectives for the legal industry.

AB 195 also included meaningful tax relief for at least three years, following an unsuccessful attempt to include an automatic tax increase, which would have taken effect in 2024. In other words, AB 195

¹ This amount reflects data provided in the governor's January Budget Proposal. It does not reflect allocations from the Cannabis Tax Fund to other state agencies tasked with carrying out duties as prescribed in the Medicinal and Adult Use Cannabis Regulations and Safety Act (MAUCRSA).

ensured that no increase in the excise tax would occur in the first three years following its enactment. However, the legislation did provide that an increase, up to 19 percent, may occur beginning July 1, 2025.

At the time AB 195 was approved, the state was enjoying a massive budget surplus. What wasn't anticipated was a substantial drop in tax revenue in the preceding twelve months, which has led to a projected \$31.5 billion project deficit.

To ensure that existing beneficiaries of cannabis tax funds do not experience any revenue losses within that period, AB 195 set a funding baseline guarantee of \$670 million in fiscal years 2022-23, 2023-24 and 2024-25 and set aside \$150 million in General Fund to backfill any revenue required to meet the baseline due to the cultivation tax cut.

With the governor's May Revise currently estimating a \$102.6 million shortfall to meet the \$670 million Allocation 3 baseline, the integrity of AB 195 is now in question. Not only does it require a budget solution to address the shortfall, it also leaves no General Fund balance to cover the 2024-25 fiscal year should cannabis tax revenues continue to come in lower than anticipated.

With the state's revenue outlook uncertain, it is imperative that we preserve the 2022 agreement struck between the industry, the administration and legislature to freeze any cannabis tax increases and consider additional tax relief for the legal cannabis industry.