

HUMBOLDT COUNTY GROWERS ALLIANCE

Federal Cannabis Policy and Humboldt County: Initial Comments on the MORE Act

Date: January 11, 2021

Humboldt County Growers Alliance (HCGA) appreciates the opportunity to offer initial comments and feedback on the MORE Act, as approved by the House of Representatives on December 4.

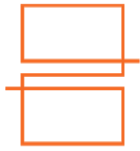
HCGA is a trade association representing over 250 licensed cannabis businesses located in Humboldt County, California. While most of our members are small and independent farms, we represent businesses across the cannabis supply chain in segments including manufacturing, distribution, testing, and retail.

Our perspective on the MORE Act, and federal legalization more broadly, stems from the unique position that Humboldt holds within the state, national, and global cannabis industry. To our knowledge, Humboldt County contains more licensed and regulated cannabis agriculture within its boundaries than in any other region in the world, with 838 licensed farms and over 150 licensed manufacturers, distributors, testing labs, and retailers located within the county.

In both number and character, Humboldt cannabis businesses differ sharply from businesses located in other states and regions. In many states, scarce licenses to operate legal cannabis businesses are held by a small number of large and vertically integrated businesses. Even within California – where there is no limit on the number of state licenses available – many regions are dominated by small numbers of large farms, and many portions of the supply chain have become increasingly consolidated and corporatized.

By contrast, Humboldt cannabis businesses are small and independent: the average size of a licensed Humboldt cannabis farm is half an acre, and 51% of Humboldt farms are under a quarter-acre in size. Farms are commonly owner and family-operated, often by families who live on-farm on homesteads. Many Humboldt cannabis businesses are operated by individuals who have been directly impacted by prohibition-era cannabis enforcement, including multi-generational cannabis farmers who were impacted by law enforcement activities over the course of decades.

The historical and present realities of cannabis production in Humboldt County ground our advocacy on local, state, and federal cannabis policy issues in a core set of values, including reducing barriers to entry for small and independent businesses, providing opportunities for legacy cannabis businesses impacted by the War on Drugs, and establishing strong baselines and incentives for environmentally and socially sustainable business practices. These values are the foundation on the initial comments on the MORE Act which follow.



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1. The end of federal cannabis prohibition is long overdue.

From a criminal and community justice perspective, the MORE Act's provisions for decriminalization, expungement, community reinvestment, access to federal benefits, and protection under immigration laws are groundbreaking steps forward in addressing the harms of prohibition and planting the seeds for a more just future.

From a business perspective, the MORE Act would provide access to banking, repeal IRS Section 280E, and establish access to SBA programs. These steps would go a long way towards normalizing cannabis businesses, providing access to basic services like banking which other businesses take for granted. Normalization would come as a major relief to Humboldt cannabis businesses, which continue to be treated inequitably by a range of service providers despite their state-legal and regulated status, whether due to prohibitionist stigma or the material consequences of federal criminalization.

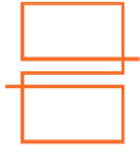
2. The MORE Act's stated focus on equity is essential, and all aspects of the legislation should be scrutinized through an equity lens.

The increasing consensus in favor of cannabis legalization cannot obscure the importance of *how* cannabis is legalized, and for whose benefit. Cannabis legalization which excludes individuals who were impacted by the War on Drugs, or which provides an on-ramp to corporate consolidation, risks replicating the injustices of the drug war in a new form.

Throughout its "findings" section, the MORE Act recognizes the importance of building an equitable cannabis industry, as well as the barriers to entry and inequities that have already been built into many state-level cannabis frameworks. This commitment is expressed in many places throughout the MORE Act, including the decision to reinvest 100% of cannabis tax revenue into individuals and communities harmed by the War on Drugs.

In its findings and intent, we view the MORE Act as model legislation that embeds equity deeply into the foundation of a legal cannabis framework. In certain important details, however, we believe the MORE Act can be – and must be – substantially improved.

Once a federal cannabis framework is built, it will be extremely difficult to undo or substantially revise. In the worst case, a federal cannabis framework that lacks a substantive focus on racial and economic justice risks unwittingly turning over a \$50 billion dollar industry over to a small number of large corporate actors, squandering a generational opportunity to support communities and establish livelihoods among those targeted by the drug war. We strongly encourage federal policymakers to take seriously the project of building a just and equitable framework on day one, rather than rushing to implement a flawed framework that fails to achieve the MORE Act's stated goals.



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3. The last-minute addition of felony exclusion language to the MORE Act is deeply concerning, undermines the purpose of the legislation, and would set the groundwork for a corporatized, exclusive, and inequitable cannabis industry.

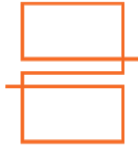
In House Rules Committee in the week before the final vote on the MORE Act, Section 5922(a)(2)(A) was added to the Act. This language would give the Secretary of the Treasury the authority to deny a federal cannabis permit to a business based on *“their business experience, financial standing, or trade connections or by reason of previous or current legal proceedings involving a felony violation of any other provision of Federal or State criminal law relating to cannabis.”*

The potential felony exclusion contained in this section is extremely concerning and contradicts the stated findings of the MORE Act, which emphasize discrimination in cannabis enforcement and sentencing under prohibition. The felony exclusion also contradicts multiple guidelines for the administration of the Opportunity Trust Fund, such as Section 3054(b)(2)(B), which directs federal funding to local governments that allow individuals with previous convictions to obtain cannabis licenses.

Similarly concerning is vague language surrounding “business experience, financial standing, or trade connections.” Such language appears to give free reign to the Treasury Department to deny a cannabis permit to any person who they consider “suspect,” without setting any guidelines for who would fall under this designation. Many existing Humboldt County cannabis operators who are fully compliant with state and local law risk exclusion under this provision, either due to prior cannabis convictions or as a result of vague exclusions based on “trade connections.”

We also seek additional clarification regarding Section 5922(a)(1), which allows the Secretary of the Treasury to deny a federal cannabis tax permit based on a finding that *“the premises on which it is proposed to conduct the cannabis enterprise are not adequate to protect the revenue.”* In some jurisdictions (though not in current state and local regulations pertaining to Humboldt cannabis farms), policymakers have determined that “adequate” security requirements for cannabis businesses must involve fully indoor operation, and/or total coverage of the premises by high-resolution security cameras. Requirements along these lines, if adopted at a federal level (whether explicitly or at the discretion of the Secretary of Treasury), would be incompatible with outdoor cannabis agriculture in Humboldt and elsewhere.

4. Multiple aspects of the proposed tax structure deserve scrutiny through a lens of equity, administrability, and workability.



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HCGA's policy committee has not yet voted on our position on federal tax policy, and we do not have a formal position on the MORE Act's tax structure at this time. Additionally, the specific proposal embedded in the MORE Act is new to us, and we are interested in better understanding the rationale for many of its details before taking a formal position.

With that in mind, we have several significant concerns based on an initial review of the proposed tax structure. Due to the novelty and complexity of the proposed tax structure – spanning 35 pages and comprising the bulk of the bill's text – there are several issues that we think deserve significant consideration.

- **Excessive federal tax will boost the illicit market and undermine environmental, public health, and equity goals** – cannabis is already heavily taxed at the state and local level. In California, in addition to the state cultivation and excise tax, most local jurisdictions levy separate taxes on each independent step of the supply chain, including cultivation, manufacturing, distribution, testing, and retail. Fitch Ratings has found that the cumulative burden of state and local taxes in California can be as high as 45%.¹

In California, the illicit market continues to be a major force, estimated at 75% of the total in-state cannabis market.² High taxes encourage businesses and consumers alike to remain in the illicit and unregulated market, exacerbating negative effects on the environment and public health that cannabis legalization was designed to solve, and complicating a successful transition into the legal market for individuals impacted by cannabis prohibition.

Consequently, while cannabis taxes are often framed through a public health lens as a tax on excessive consumption, they can alternatively be framed as a tax on businesses that choose to enter the regulated market and consumers who choose to purchase legal cannabis. In the context of California's still-robust illicit market, there is no question that higher cannabis taxes discourage participation in the legal market, and incentivize cannabis production that takes place without the stringent environmental and public health protections required under state law.

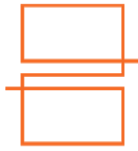
We are concerned by the last-minute increases to the tax rate embedded in the MORE Act and would like to better understand the rationale for an (eventual) 8% federal tax rate.

¹ Zezima, K. "High taxes could drive up marijuana prices and bolster the black market in California, analysis says," Washington Post, October 30, 2017.

<https://www.washingtonpost.com/news/post-nation/wp/2017/10/30/high-taxes-could-drive-up-marijuana-prices-and-bolster-the-black-market-in-california-analysis-says/>

² Romero, D. "California's cannabis black market has eclipsed its legal one," NBC News, September 20, 2019.

<https://www.nbcnews.com/news/us-news/california-s-cannabis-black-market-has-eclipsed-its-legal-one-n1053856>



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- **Amending the MORE Act to include a progressive tax for small and equity businesses will promote equitable outcomes** – the MORE Act proposes that 100% of federal cannabis taxes be reinvested back into communities impacted by the War on Drugs. Of this amount, 40% would be directed specifically to individuals impacted by the War on Drugs who seek to enter the licensed cannabis market.

Rather than taxing equity businesses at a high rate and then redistributing revenue back to these businesses, an alternative approach could involve adopting a lower tax rate on small and equity businesses - or waiving taxes on these businesses altogether - while continuing to direct revenue raised from larger businesses back into the Opportunity Trust Fund. Such a policy would help to materially enact the findings of the MORE Act by lowering barriers to entry and establishing substantive incentives for an equitable cannabis market.

Existing federal policy on beer, which taxes small breweries at one-sixth the rate of large breweries for the first 60,000 barrels removed from the facility, provides one model for a progressive federal cannabis tax rate.³

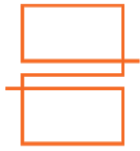
- **The proposed occupational tax is regressive and unclear** – in addition to the proposed 5-8% excise tax, we do not understand the rationale for the proposed \$1,000 occupational tax. We are concerned that this flat tax is regressive and will disproportionately impact small businesses.

Additionally, we would like additional clarity on the occupational tax as described in Section 5913(b): *“whenever more than one of the pursuits or occupations described in this subchapter are carried on in the same place by the same person at the same time, except as otherwise provided in this subchapter, the occupational tax shall be paid for each according to the rates severally prescribed.”* It is unclear to us what activities are included under the “pursuits or occupations described in this subchapter,” and we are concerned that a single farmer engaged in cultivation, harvesting, processing, and packaging could be required to pay four separate \$1,000 occupational taxes.

- **The complexity of the proposed tax creates significant barriers to entry for small businesses. Moving the tax from production to retail could substantially simplify taxes from both an administrative and small business perspective** – 35 pages of new tax law will create major additional compliance burdens for Humboldt’s small and owner-operated farms, which are already tasked with complying with hundreds of pages of state cannabis regulation.

Based on our initial reading, much of the complexity of the proposed tax law appears to stem from the decision to levy this tax on production rather than retail. Production taxes –

³ Tax Policy Center. “What are the major federal excise taxes, and how much money do they raise?” <https://www.taxpolicycenter.org/briefing-book/what-are-major-federal-excise-taxes-and-how-much-money-do-they-raise>



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particularly in an industry where cannabis can pass through five or more independent supply chain businesses before reaching retail – necessitates complex rulemaking on topics including bonding, recordkeeping, tax liability, and arm’s length transactions.

By contrast, a simple percentage-based *ad valorem* tax at retail would eliminate the need for most of these rules.

From an administrative perspective, our experience is that production-based taxes create significant and avoidable problems. We encourage review of the California LAO’s December 2019 analysis of the California cannabis tax, which speaks to the difficulty of administering the existing weight-based cultivation tax and recommends its repeal and replacement with a potency tax or ad-valorem tax, assessed and collected at a single point in the supply chain.⁴

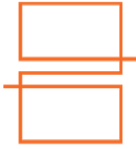
A retail-based tax would significantly decrease the number of total taxpayers: for example, under the current version of the MORE Act, over 5,000 California cultivators, manufacturers, and distributors would be required to be bonded and comply with voluminous tax laws. If this tax were levied on retailers, the number of taxpayers would drop to approximately 1,300, easing administrability of the tax and decreasing burden on most small businesses.

More broadly, the fragmented nature of the California cannabis supply chain significantly complicates the premise of taxing at a production level. It is common for cannabis to pass through many independent businesses before reaching retail: for example, cannabis flower might pass through a nursery (who cultivates immature plants), a cultivator (who grows them to maturity), a processor (who trims the plant), and then multiple distributors before being placed in final packaged form. An edible product might pass through a nursery, then a cultivator, then an extractor (who extracts raw cannabis oil), then an edible-maker (who infuses the oil into a food product), and then several additional distributors before reaching retail.

A tax on production places a heavy administrative burden on each step of this supply chain – which could include many small, independent, and equity businesses – while privileging large, vertically-integrated businesses that can integrate each of these functions and streamline tax compliance under full-time compliance employees.

- **Several details of the proposed tax framework appear unworkable from a technical perspective –**
 - **Tax liability on the packager may not be workable** – the MORE Act requires all producers – including any business involved in cultivation, processing,

⁴ California Legislative Analyst’s Office. “How High? Adjusting California’s Cannabis Taxes,” December 17, 2019. <https://lao.ca.gov/Publications/Report/4125>



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manufacturing, or packaging – to be bonded, and each of these businesses could theoretically be made liable for the cannabis tax. In practice, however, the MORE Act requires the tax to be remitted by the last “producer”: meaning, effectively, the business that places the product in final packaging. This tax appears to be levied on the wholesale price of the final transaction to the packager.

In California, packaging is often conducted by a middleman, typically a distributor. Packaging is frequently performed as a service: the packager often does not take title to the product, and so there is no wholesale transaction to tax on a percentage basis.

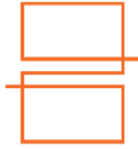
- **Weight-based taxes on cannabis flower are extremely difficult to administer on variable classifications and grades of plant material** – after five years, the MORE Act would convert the 8% tax on the price of flower to an equivalent weight-based tax. Presumably, this means that there would be a set rate (for example, \$10/ounce) applicable to all cannabis flower based on its weight.

In practice, different grades of cannabis flower can command substantially different prices by weight. Flower can be of a certain grade either due to the craft of the grower – where certain growers will produce higher-quality flower – or because, as an agricultural product, certain parts of the plant grown by the same farmer will inherently command different prices. For example, the large buds on the top of the plant draw significantly higher prices than the smaller “B-buds” lower on the plant.

This variability creates a double-bind for tax administrators. If regulators tax all cannabis flower at the same rate by weight, taxes on B-Buds and other less-valued flower will be far too high as a proportion of price, making these products potentially unsellable without incurring a loss. While this problem can be avoided by setting a different rate for different grades of flower, this requires turning the tax administrator into an agricultural grading service, which in our experience (in the context of California’s weight-based cultivation tax) is both outside the competency of tax administrators and too complex to be effectively accomplished.

Unlike tobacco, cannabis is not a commodity: there are vast differences in quality and type of flower. And unlike alcohol products, cannabis is a plant material: it is not manufactured into a homogenous batch, but rather can exist in significantly variable forms even within a certain batch. These qualities make cannabis flower a poor candidate for the weight or volume-based approach utilized for alcohol and tobacco.

5. Other major issues should be considered as part of future federal cannabis legislation.



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- **Enact federal protections for cannabis origins, including appellations, state of origin, county of origin, and city of origin** – in many California regions, the licensed cannabis industry is in a unique position where critical intellectual property is held collectively, rather than with any individual business. This dynamic is especially strong in the Emerald Triangle, comprising Humboldt, Mendocino, and Trinity counties, where nearly 1,800 small-scale cannabis farmers are now working to transition into the legal market. While no one of these farmers controls the resources to make a significant impact in the market, the names of these counties and others are collectively recognized by consumers. Many California cities, including San Francisco, Oakland, and Los Angeles, carry their own substantial reputations.

With adequate legal protection, the ability to use these names in marketing offers an opportunity for farmers and their supply chain partners to develop a niche in cultivating and manufacturing high-quality cannabis on small scales, while simultaneously incentivizing sun-grown cultivation practices that prioritize environmental stewardship.

Establishing state-level IP protections in California for appellations of origin and county of origin have been HCGA's top legislative priority for multiple years, and these protections have now been embedded and detailed in multiple points in California cannabis law including the Medical Marijuana Regulation and Safety Act (2015), Proposition 64 (2016), SB 185 (2019), and SB 67 (2020). As interstate and international commerce emerge, some form of federal protection for this state-recognized IP will be crucial to prevent fraudulent use of city, county, state, and appellation names.

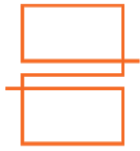
- **Implement strong and unified standards for contaminant testing, including for pesticides, herbicides, and heavy metals** – nearly all states that have adopted a regulated cannabis framework have required stringent contaminant testing on each batch of cannabis. Among cannabis-legal states, California's pesticide testing standards are generally considered to be the strongest.⁵

Strong testing standards serve an important purpose for both environmental protection and consumer safety. Prior to the implementation of state cannabis regulations, some cultivators utilized toxic pesticides and rodenticides that poisoned rivers, fish, and wildlife in addition to consumers.⁶ Since the establishment of cannabis testing standards, the situation has improved drastically. One study found that the rate of cannabis

⁵ Seltnerich N. Into the weeds: regulating pesticides in cannabis. *Environ Health Perspect.* 2019;127(4):42001.

⁶ Wood, Trina. "Pot, Rat Poison and Wildlife Don't Mix." UC Davis, January 23, 2018.

<https://www.ucdavis.edu/one-health/pot-rat-poison-wildlife-dont-mix/>



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contamination fell from 24% to 3% within months of the implementation of state-mandated cannabis testing.⁷

California's high testing standards – which essentially prohibit the use of pesticides and herbicides on cannabis – demonstrate that it is possible to produce an agricultural crop on commercial scales without utilizing chemicals that are toxic to humans and the environment. As interstate commerce initiates a conversation on harmonizing existing and fragmented state-level testing standards, we support strong standards that are based on the California model.

- **Consideration of other environmental issues** – environmental considerations were a driving factor in the adoption of California's regulated cannabis framework and should also be considered as part of federal cannabis policy. In particular, in light of the accelerating climate emergency, federal policymakers should consider whether meeting new legal demand with a proliferation of indoor cultivation facilities, utilizing high-intensity artificial lighting, is an acceptable outcome. Studies have found that widespread adoption of such indoor facilities can consume a tremendous quantity of energy: in 2012, prior to the implementation of state cannabis regulations, indoor cannabis cultivation was estimated to account for 3% of total California electricity demand.⁸ Meeting legal demand with sun-grown cannabis, produced without the use of artificial light, would vastly reduce the industry's energy consumption and GHG emissions.

More broadly, California cannabis law includes stringent standards on water use, pesticide use, and land use. We encourage attention to the environmental aspects of the cannabis industry at the federal level, including baselines for environmentally sustainable production, and consideration for how specific regulatory requirements (such as certain packaging and track-and-trace requirements) incentivize the production of high amounts of plastic waste.

⁷ Adlin, Ben. "Can Washington Fix Its Broken Cannabis Lab Testing System?" Leafly, June 17, 2019. <https://www.leafly.com/news/industry/can-washington-fix-its-broken-cannabis-lab-testing-system>

⁸ Mills, E., Zeramby, S., Corva, D., & Meisel, J. (2020). Energy Use by the Indoor Cannabis Industry: Inconvenient Truths for Producers, Consumers, and Policymakers.