WHAT'S NEW IN THE CANNABIS REGULATION AND TAXATION ACT OF 2021?

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On January 19, 2021, as part of his budget request for 2021, New York State Governor Cuomo released his proposed cannabis legislation. Cuomo has twice before attempted to enact the policy change through previous budgets, but both times his efforts have failed. As for his third attempt, the administration and legislatures seem more confident that the legislation will advance. While a significant portion of the current bill reflects previous versions, there are some differences of note.

The Office of Cannabis Management

Like last year's proposal, the new bill calls for the creation of the Office of Cannabis Management ("OCM"), which would be within the Division of Alcohol Beverage Control. OCM would consist of an executive director and a separate board with one chairperson and four other voting members. The executive director would be tasked with administering the program and appointing a deputy director of health and safety as well as a deputy director of social and economic equity. The members of the board would give approval on matters such as: the social and economic equity program; the types and number of licenses to be issued; and price quotas and controls. Like last year's proposal, the new legislation comprehensively sets out the broad requirements and minimum standards of the program, but leaves the details of the rules and regulations to be promulgated by OCM.

Opt-Out Provision

Like the Governor's previous proposals, the new bill provides an opt-out provision for counties and cities with a population of 100,000 or more. A city or county with a population of 100,000 or more can pass a local law or ordinance that prohibits the adult-use licenses within its borders by a majority vote of their governing body. If a county passes a law to prohibit such licenses, but a city within that county also has a population of 100,000 or more, the county law does not apply to the city. Any county or city that wants to opt out must pass the law or ordinance by December 31, 2021.

Even if they do not opt out, municipalities are still empowered to control time, place and manner of operations through reasonably practicable zoning ordinances.

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Prohibition Against Vertical Integration of Licenses

Like past proposals, the new proposal generally disallows vertical integration for adult-use cannabis businesses, preventing businesses from having ownership over too many aspects of the production to sales process. The proposal creates six separate adult-use licenses for the cultivation, processing, distribution and sale of cannabis to consumers: cultivator license, processor license, distributor license, retail dispensary license, cooperative license, and microbusiness license. In addition, the bill creates a category of "caterer's permit." The licenses and permit are defined as follows:

1. A cultivator license covers planting, growing, cloning, harvesting, drying, curing, grading and trimming.
2. A processor license permits blending, infusing, packing, labeling, branding and making or preparing cannabis products.
3. A distributor license allows licensees to obtain adult-use cannabis and cannabis products from processors and sell those products to retail dispensaries.
4. A cooperative license allows the licensees (operating in accordance with the Seven Cooperative Principles published by the International Cooperative Alliance) to grow, process and sell cannabis at a licensed premises to distributors or retail dispensaries.
5. A retail dispensary license authorizes sale of cannabis products to the consumer on the licensed premises. Unlike last year's bill, the current bill does not provide for licenses which would allow on-site consumption.
6. A microbusiness licensee can cultivate, process, distribute and sell directly to retailers and consumers under one license, but the Board will establish annual caps.
7. A caterer's permit allows the service of cannabis products at a function, occasion or event in a hotel, restaurant, club, ballroom or other premises, where cannabis could be lawfully sold or served during certain hours.
8. The legislation also empowers OCM to create additional license types. This leaves room for the creation of on-site consumption licenses in the future.

The legislation limits the number and type of licenses that can be held by one person or entity. Its goal is to prevent or limit complete vertical integration and the bill generally draws a dividing line between retail licenses and "everything else."

Cultivators, processors and distributors are precluded from holding or having an interest in more than one of the same type of license. They are also precluded from holding or having an interest in retail dispensary license. But they can mix and match other types of licenses. For example, a cultivator can also hold a processor and/or distributor license, and while processors are generally not allowed to conduct other business on the licensed premises, they are allowed to conduct cultivation and/or distribution operations on the premises if licensed to do so.

A retail dispensary licensee must have a separate license for each of its dispensary locations and cannot hold or have an interest in more than three retail dispensary licenses. This part of the bill is clearly targeted at maintaining a diverse market and preventing two or three major retailers from dominating the space.

Registered Organizations

The general ban on vertical integration is not applicable to existing registered organizations operating under the medical cannabis program. OCM will have the authority to hold a competitive bidding process to determine the registered organizations authorized to continue vertically integrated operations in the adult-use market. Unfortunately, the proposal does not offer details on how that process will work, or how many registered organizations will be allowed in the adult-use program.

The proposal does mention, however, that registered organizations with a successful adult-use bid would still have to maintain sufficient supply and distribution of medical cannabis products for certified patients pursuant to regulations.

Alternatively, the proposal permits registered organizations to apply for licensure as an adult-use cultivator, processor and distributor, or as a retail dispensary, subject to the same limitations on vertical integration for normal licensees. So registered organizations that are unable to continue vertically integrated operations will have to consider how to proceed.

Tax Structure

Another significant change to previous proposals is the way in which adult-use cannabis would be taxed. The bill proposes a two-tier tax structure: the first, a tax on the sale from wholesaler to retail dispensary; and the second, a surcharge tax on the sale from dispensary to consumer.

Unlike past proposals which taxed on a dry-weight basis, the new wholesaler to retail dispensary tax would be based on a measurement of milligrams of total THC in adult-use cannabis products, with a different "per gram of total THC rate" dependent on the product category. For example, edibles would be taxed at $0.04 per milligram of THC; concentrates at $0.01 per milligram of total THC; and flower at $0.007 per milligram of THC. The purpose of this structure may be to discourage sale of higher-concentration products.

The second tax is a 10.25% surcharge applied at the time of sale from the retailer to the consumer.

In addition to this two-tier adult-use tax structure, the proposal breaks the news that all adult-use cannabis sales would also be subject to regular state and local taxes, which is a vast change from the proposal in last year's bill to exempt adult-use cannabis from both state and local taxes. But, the inclusion of state and local sales taxes is still cheaper than Cuomo's previous plan, which proposed a statewide tax rate of 20%. Most counties in New York have a combined state and local sales tax rate of 8%, so the majority of adult-use consumers would be taxed at 18.25%. At its most expensive, adult-use cannabis in New York City and Yonkers would be taxed at 18.875%.

Social and Economic Equity Program

Another significant part of the proposal is the social and economic equity plan. The program prioritizes applicants who qualify as a minority and women-owned business, social equity applicant, or disadvantaged farmer. In addition, the program aims to positively impact areas that have been harmed through the disproportionate enforcement of the war on drugs.

A "social equity applicant" is defined as a person who: (1) is a member of a community or area disproportionately impacted by the enforcement of cannabis prohibition, as determined by OCM; (2) has an income lower than 80% of the median income of the county in which the applicant resides; and (3) was convicted of (or had a family member charged with) a marijuana-related offense. Once an applicant is deemed qualified, the applicant is then eligible to access some or all of the available programs based on their qualification criteria. Some of these programs may include: reduced or deferred fees for applications, priority in submission and review for licenses, and access to cannabis workforce development and hiring initiatives. Licenses issued to minority or women-owned businesses and social equity applicants are not transferable for a period of two years except, with approval of OCM, to another qualified minority or women-owned business or social equity applicant.

Beginning in the 2023 fiscal year, revenues from the THC tax and the adult-use surcharge will be distributed to fund the social and economic equity plan in the amount of $100 million over four years. Eventually, $50 million a year will go toward the social and economic equity plan. A portion of the profits from the adult-use registered organization bidding process will also be allocated to the plan's equity programs.

While the proposal acknowledges that financial resources are necessary to implement the social and economic equity plan, there is likely to be a significant amount of pushback regarding the budget. Considering that the Cuomo administration projects the state will take in $350 million annually in marijuana tax revenue once the program is up and running, an allocation of $100 million over four years is a fraction of the funding that is likely necessary.

The next step for the proposal is further negotiation before the budget vote in April. While most of the bill is likely to remain unchanged, nothing will be set in stone until the budget is passed. The most likely topics for debate are the ability and extent to which individual municipalities can opt out of the program and the distribution of tax revenue to social equity programs.

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