

# FINAL BILL REPORT

## 2E2SHB 2136

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Synopsis as Enacted

**Brief Description:** Concerning comprehensive marijuana market reforms to ensure a well-regulated and taxed marijuana market in Washington state.

**Sponsors:** House Committee on Appropriations (originally sponsored by Representative Carlyle).

**House Committee on Finance**  
**House Committee on Appropriations**  
**Senate Committee on Ways & Means**

#### **Background:**

##### Overview of Initiative 502.

Initiative 502 (I-502) was a ballot measure approved by Washington voters in November 2012 that: (1) legalized the production, processing, possession and personal use of marijuana; (2) created a framework for a regulatory scheme to be further developed by the Liquor and Cannabis Board (LCB) through its rule-making authority; and (3) revised criminal laws to accommodate such legalization.

Initiative 502 contained the following provisions:

- legalizing the personal use and possession of up to 1 ounce of marijuana, as well as specified products directly related to such marijuana use;
- licensing and regulating marijuana production, distribution, and retailing;
- designating the LCB as the regulatory entity responsible for the implementation of the initiative, including continuing oversight over the commercial practices and conduct of licensed marijuana producers, processors, and retailers;
- providing the LCB with rule-making authority with respect to the development of the requisite regulatory scheme;
- implementing excise taxes on marijuana production, processing, and retailing;
- creating a dedicated marijuana fund for the collection and distribution of marijuana-related tax revenues;
- removing provisions containing criminal or civil penalties for marijuana-related activities authorized by I-502; and
- amending driving under the influence laws to include specific provisions pertaining to driving under the influence of marijuana.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

### Federal Response to Marijuana Legalization by the States.

Washington is one of at least 23 states that have passed legislation allowing the use of marijuana for medicinal purposes and one of four states that allow its recreational use. These activities, however, remain illegal under federal law.

In August of 2013, the United States Department of Justice issued a formal enforcement policy memorandum in response to the legalization of recreational marijuana in the states of Washington and Colorado. In this memorandum, federal prosecutors were instructed to focus investigative and prosecutorial resources related to marijuana on specific enforcement priorities to prevent:

- the distribution of marijuana to minors;
- marijuana sales revenue from being directed to criminal enterprises;
- marijuana from being diverted from states where it is legal to states where it is illegal;
- state-authorized marijuana activity from being used as a cover for trafficking other illegal drugs or other illegal activity;
- violence and the use of firearms in the production and distribution of marijuana;
- drugged driving and other marijuana-related public health consequences;
- the growth of marijuana on public lands; and
- marijuana possession or use on federal property.

With respect to state laws that authorize marijuana production, distribution, and sales, the memorandum states that when these activities are conducted in compliance with strong and effective regulatory and enforcement systems there is a reduced threat to federal priorities. In such instances, the memorandum asserts that state and local law enforcement should be the primary means of regulation. The memorandum, however, affirms continuing federal authority to challenge state regulatory systems and to bring individual enforcement actions in cases in which state regulatory efforts are inadequate.

### Licensing of Marijuana Producers, Processors, and Retailers.

The LCB issues three categories of commercial marijuana licenses: (1) the marijuana producer's license entitles the holder to produce marijuana for sale at wholesale to licensed marijuana processors or other producers; (2) the marijuana processor's license entitles the holder to process, package, and label marijuana for sale at wholesale to marijuana retailers and other processors; and (3) the marijuana retailer's license entitles the holder to sell marijuana products at retail prices in retail outlets.

### Marijuana Research License.

In addition to the marijuana producer, processor, and retail licenses, there is a marijuana research license allowing holders to produce, process, possess, and deliver marijuana for the purposes of:

- testing chemical potency and composition;
- conducting clinical investigations of marijuana-derived drug products;
- conducting research on the efficacy and safety of marijuana use as medical treatment;
- and
- conducting genomic and agricultural research.

The University of Washington and Washington State University may also conduct marijuana research. The Life Sciences Discovery Fund Authority (LSDF Authority) is required to

review all applications for marijuana research licenses. A portion of license fees go into the Life Sciences Discovery Fund (LSDF).

#### Residency Requirements for Marijuana Business License Applicants.

In order to apply for a marijuana producer, processor, or retailer license, a prospective licensee must establish state residency at least three months prior to the submission of the application.

#### Transport and Delivery of Marijuana by Third-Party Carriers.

Transportation or delivery of marijuana and processed marijuana products may be done only by the employees of a licensed producer, processor, or retailer. Other transportation or trucking services may not be used for this purpose.

#### Taxation of Marijuana Producers, Processors, and Retailers.

An excise tax of 25 percent of the sale price must be paid by each of the three categories of licensees at each step of the production, processing, and marketing process:

- producers pay a tax of 25 percent of the wholesale price of the marijuana sold to processors or to other producers;
- processors pay a tax of 25 percent of the wholesale price of the useable marijuana or marijuana-infused products sold to retailers or to other processors; and
- retailers pay a tax of 25 percent of the retail price of the useable marijuana or marijuana-infused products sold to the consumer.

There are no provisions explicitly addressing the taxation of retail sales of medical cannabis by collective gardens or medical cannabis dispensaries.

#### Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use taxes apply to the value of property, digital product, or service, when used in this state. The state, most cities, and all counties levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.1 percent, depending on the location.

#### Dedicated Marijuana Fund.

Initiative 502 created a Dedicated Marijuana Fund, deposited with the State Treasurer that consists of moneys derived from marijuana excise taxes, license fees, penalties, forfeitures, and all other moneys, income, or revenue received by the LCB from marijuana-related activities.

Proceeds from the fund must be distributed every three months by the LCB to specified public entities and in amounts established in statute. Among the distributions is \$5 million annually for the LCB to administer the legal marijuana system.

#### Allowable Uses by the Division of Behavioral Health and Recovery.

The Department of Social and Health Services' Division of Behavioral Health and Recovery (DBHR) may use marijuana revenues for specific programs, specifically for implementation

and maintenance of programs aimed at prevention or reduction of maladaptive substance use, substance abuse, or substance dependence for middle school and high school students.

#### Life Sciences Discovery Fund.

The LSDF was created to promote life science research in Washington. The LSDF may receive tobacco settlement strategic contribution payments and leverage these state contribution payments by providing grant opportunities to support life sciences research and development.

The LSDF is managed by the LSDF Authority, governed by a board consisting of legislators and persons appointed by the Governor. The LSDF Authority solicits and reviews grant applications.

#### Marijuana Retailer Signage and Product Display Requirements.

Marijuana retailers may not display any signage except for one sign, no more than 1,600 square inches, identifying the business by its name. Retailers also must ensure that no marijuana products are visible from a public right-of-way.

#### Marijuana Product Advertising Limitations.

Marijuana retailers are subject to specified restrictions regarding the advertising of marijuana and marijuana-based products. Included in these regulations is a blanket prohibition barring any advertising:

- within 1,000 feet of school grounds, playgrounds, recreation centers, child care centers, public parks, libraries, or specified types of game arcades;
- on or in a public transit vehicle or public transit shelter; or
- on publicly owned property.

A licensee who violates any of these advertising prohibitions is subject to a \$1,000 fine for each violation.

#### Buffer Distances Around Marijuana Businesses.

The LCB may not issue a license to any prospective producer, processor, or retailer whose business premises are located within 1,000 feet of the perimeter of the grounds:

- an elementary or secondary school;
- a playground;
- a recreation center or facility;
- a child care center;
- a public park;
- a public transit center;
- a library; or
- any game arcade, admission to which is not restricted to persons 21 years of age or older.

Federal law imposes additional penalties on the distribution of controlled substances within 1,000 feet of an elementary or secondary school, college, playground, or public housing facility. The same federal penalties are imposed for distribution within 100 feet of a youth center, swimming pool, or video arcade.

### Medical Marijuana Cooperatives.

Effective July 1, 2016, four-member medical marijuana cooperatives are permitted. Up to four patients or designated providers may participate in a cooperative to share responsibility for the production and processing of marijuana for the medical use of its members. The location of the cooperative must be registered with the LCB and is only permitted if it is at least one mile away from a marijuana retailer. The registration must include each member's name and copies of each member's recognition cards. Only registered members may participate in the cooperative or obtain marijuana from the cooperative. If a member leaves the cooperative, no new member may join for 60 days after the LCB has been notified of the change in membership. All members of the cooperative must provide labor; financial compensation is not permitted. Marijuana grown at a cooperative is only for the medical use of its members and may not be sold or donated to another. Minors may not participate in cooperatives. The LCB must develop a seed to sale traceability system to track all marijuana grown by the cooperative.

### Public Use of Marijuana.

It is unlawful to consume or open a package containing marijuana or marijuana products in view of the general public.

### Regulation of Marijuana Businesses by Local Governments.

Many cities and counties throughout the state have enacted ordinances that prohibit the siting of licensed marijuana producers, processors, and retailers within their borders.

Approximately 105 cities and 11 counties in Washington have enacted such a prohibition or moratorium. Other cities and counties have enacted special zoning ordinances limiting the location of recreational marijuana businesses to certain areas or have proposed special licensing requirements.

These actions by Washington cities and counties have given rise to litigation regarding whether or not local governments are preempted from enacting local ordinances that have the effect of preventing or interfering with the siting of state-licensed marijuana businesses authorized under I-502. Courts in Clark County, the City of Fife, the City of Wenatchee, and elsewhere have ruled that state law does not preempt such actions by local governments. In January 2014, the Washington State Attorney General published a formal opinion stating that state law does not preempt local ordinances that impose bans or moratoria regarding the siting of marijuana producers, processors, and retailers.

### Mandatory Minimum Sentence for Misdemeanor Violations.

Any person convicted of a misdemeanor violation of the Controlled Substances Act must receive a minimum 24-hour prison sentence and a fine of at least \$250 or \$500 for a second violation. The sentence and fine may be deferred or suspended in certain circumstances.

### Synthetic Cannabinoids and Bath Salts: Schedule I of the Controlled Substances Act.

Cathinones and methcathinones are stimulants with methamphetamine-like effects. Cathinones may cause hallucinations, agitation, and serious cardiac symptoms. Cathinone derivatives are commonly known as "bath salts."

Synthetic cannabinoids are drugs that target the same brain receptors that interact with the tetrahydrocannabinol present in marijuana that produces a psychoactive effect. Synthetic cannabinoids are often called "spice" or "K2," after popular brands of the substances.

The Pharmacy Quality Assurance Commission addresses the evolving chemistry of illegal controlled substances by classifying or reclassifying new compounds under its rule-making authority.

Cathinones and methcathinones are listed on Schedule I of the Controlled Substances Act, meaning they have no accepted medical value, have a high potential for abuse, and lack accepted safety for use in medical treatment under supervision.

The manufacture, delivery, or possession of a Schedule I controlled substance is a class B felony, punishable by either up to 10 years in prison, a fine of up to \$20,000, or both, plus an additional \$1,000 fine.

### **Summary:**

#### Intent and Tax Preference Performance Statement.

The Legislature declares that its intent and a tax preference performance statement is included for the authorized sales and use tax exemption for qualified patients. The Department of Revenue (DOR) must provide a specific tax reporting line for marijuana retailers to include the amount of exempt sales on their tax return.

#### Marijuana Research Licensees.

One half of the issuance fee for each marijuana research license is directed to the LSDF. The University of Washington and Washington State University may contract with entities licensed by a federally recognized Indian tribe to conduct marijuana research without approval by the LSDF Authority.

#### Residency Requirement for Marijuana Business License Applicants.

The duration of the residency requirement for a marijuana business license applicant is increased from three months to six months.

#### Transport and Delivery of Marijuana by Third Party Carriers.

A licensed marijuana producer, processor, researcher, or retailer may use the services of a common carrier to physically transport or deliver marijuana and marijuana products between licensed entities within the state. The common carrier must be licensed by the LCB and may only transport marijuana between other licensed marijuana businesses. Employees of a licensed common carrier who are involved in the transportation of marijuana or marijuana products must be at least 21 years old.

An employee of a common carrier may not use or carry a firearm while transporting marijuana, unless:

- the LCB explicitly authorizes the carrying or use of firearms by the employee;
- the employee has a private security guard license; and
- the employee is otherwise in full compliance with LCB regulations.

The LCB must establish rules creating an annual licensing procedure for a common carrier who seeking to offer marijuana transportation services. The rules must:

- establish criteria for the approval or denial of a license application;
- provide minimum qualifications for any employee authorized to drive or operate the transportation or delivery vehicle;
- address the safety of the employees transporting or delivering the products, including issues relating to the carrying of firearms by the employees;
- address the security of the products being transported, including a system of electronically tracking all products at both the point of pickup and the point of delivery; and
- set reasonable fees for the application and licensing process.

#### Taxation of Marijuana Producers, Processors, and Retailers.

The 25 percent marijuana excise taxes payable by marijuana producers and processors, respectively, are eliminated. The 25 percent marijuana excise tax on retailers is modified by specifically imposing the tax on the buyer of any marijuana product subject to the excise tax. The rate is changed to 37 percent and applies to the final retail price of marijuana products subject to the tax. This retail marijuana excise tax is designated as a trust fund tax. Trust fund taxes are those taxes collected from the buyer and held in trust by the seller until remitted to the state agency that administers the tax.

This tax is in addition to state retail sales and use tax and must be separately itemized on the sales receipt provided to consumers. The displayed shelf price must illustrate the final price to the consumer, including the marijuana excise tax, but need not include the general retail sales tax.

The LCB may collect and administer the marijuana excise tax. Licensees who have been issued a notice of unpaid marijuana excise taxes may request an adjudicative proceeding.

A sales and use tax exemption for qualifying patients is allowed for patients with a medical cannabis authorization card. Designated providers of qualifying patients are also exempt from retail sales tax when purchasing for a qualifying patient.

#### Bundled Transactions and Conditional Sales.

Marijuana producers and processors may not require the purchase of non-marijuana products or services as a condition precedent to the purchase of marijuana or marijuana products.

Licensed marijuana retailers must collect the marijuana excise tax on the entire sales price of bundled transactions, unless the retailer maintains records that may be used to determine the true value of the marijuana product sold in the bundled transaction.

#### Dedicated Marijuana Account.

The Dedicated Marijuana Fund is renamed the Dedicated Marijuana Account. Monies in the Dedicated Marijuana Account must be appropriated before the distributions may be made.

#### Distribution of Marijuana Excise Tax Revenue.

A portion of marijuana excise tax revenues deposited into the State General Fund is shared with counties and cities. Starting no earlier than fiscal year 2018, distributions to local

jurisdictions may not occur until \$25 million of marijuana tax revenues has been deposited into the State General Fund, at which point 30 percent of the previous fiscal year's marijuana-related State General Fund revenues will be distributed to eligible counties and cities in four installments. Thirty percent of the local distribution must be disbursed to counties, cities, and towns based on the amount of marijuana excise tax revenues attributable to licensed marijuana retailers located within a county, city, or town. The remaining 70 percent must be disbursed based on population, with counties receiving 60 percent of this allocation and cities and towns sharing the remaining 40 percent. Local jurisdiction distributions may not exceed \$15 million per fiscal year for the 2017-2019 biennium and \$20 million per fiscal year thereafter.

Subject to appropriation, at least \$6 million must be appropriated per fiscal year for fiscal years 2016 and 2017 to local governments for marijuana enforcement. The monies must be distributed under a formula based on retail sales within local jurisdictions. If the \$12 million is not appropriated in the operating budget, this requirement is null and void and local governments will not receive the additional funding.

#### Allowable Uses by the Division of Behavioral Health and Recovery.

The types of programs that the DBHR may support using the revenue distributed under I-502 are expanded to include the development and evaluation of programs and practices aimed at prevention or reduction of maladaptive substance use among middle and high school students. The DBHR may also use marijuana tax funds for evidence-based or research-based programs and requires that these programs be deemed cost-beneficial by September 1, 2020.

#### Marijuana Retailer Signage and Product Display Requirements.

Marijuana retailers may only display two signs for purposes of identifying the business. Signs must be permanently attached to a building and must be no larger than 1,600 square inches. No sign may be posted within 1,000 feet of an elementary or secondary school or a playground. Marijuana retailers are no longer required to ensure that product in the store is not visible from a public right-of-way.

#### Signage Requirements for Prospective Licensees.

Applicants for a marijuana producer, processor, researcher, or retailer license must conspicuously display a sign on the outside of the premises to be licensed notifying the public of the application. The LCB must adopt rules to implement siting requirements for the size of the sign and the text thereon, the content of the sign, and any other requirements necessary to ensure that the sign provides adequate notice to the public. The LCB must provide the sign to the applicant, but may charge a fee.

A local jurisdiction may require additional notice by an applicant to any of the following entities located within 1,000 feet of the premises to be licensed:

- elementary and secondary schools;
- playgrounds;
- public parks;
- recreation centers;
- child care centers;
- churches;
- libraries;



- public transit centers; and
- game arcades admitting persons under 21 years old.

#### Buffer Distances Around Marijuana Businesses.

The legislative authority of a county, city, or town may reduce the buffer requirements for licensed marijuana businesses from 1,000 feet to 100 feet from recreation centers, child care centers, public parks, public transit centers, libraries, and certain game arcades (the 1,000-foot buffer requirement for schools and playgrounds is maintained). In order to reduce the buffer requirement, a county, city, or town must pass an ordinance declaring that the reduction will not negatively impact the jurisdiction's law enforcement efforts, public safety, or public health. The LCB may license businesses located in compliance with such an ordinance.

#### Location of Medical Marijuana Cooperatives.

Medical marijuana cooperatives may not be located within one mile of a licensed marijuana retailer or within 1,000 feet of a school, playground, public transit center, recreation center, child care center, public park, library, or certain game arcades. If the cooperative is located in a city, county, or town that has enacted a smaller buffer zone for marijuana retailers, the cooperative may be located in areas not restricted by the ordinance.

#### Public Use of Marijuana.

Consuming marijuana or marijuana products, or opening a package containing marijuana or marijuana products, in a public place or in view of the general public is prohibited. "Public place" includes, among other locations, streets, school facilities, public buildings, restaurants, public parks, and other areas to which the public has an unrestricted right of access. A violation is a class 3 civil infraction, punishable by a fine of \$50, plus applicable local fines.

#### Regulation of Marijuana Businesses by Local Governments.

Cities, counties, and towns may prohibit marijuana production and processing in areas zoned primarily for residential or rural use with a minimum lot size of five acres or smaller.

#### Mandatory Minimum Sentence Repealed.

The mandatory minimum criminal penalties for misdemeanor violations of the Controlled Substances Act are repealed.

#### Synthetic Cannabinoids and Bath Salts

Synthetic cannabinoids are added to Schedule I of the Controlled Substances Act.

Any person who manufactures, sells, or distributes cathinones, methcathinones, or synthetic cannabinoids commits a violation of the Consumer Protection Act.

A person who manufactures, sells, or distributes synthetic cannabinoids, cathinones, or methcathinones must pay a fine between \$10,000 and \$500,000, in addition to other criminal and civil penalties. However, if the person receiving the drug is a minor under 18 years old and at least two years younger than the person violating the law, the minimum fine is increased to \$25,000. Courts may not suspend or defer the fine unless the violator is indigent.

Changes to Marijuana-Related Definitions in the Controlled Substances Act.

The term "marijuana concentrates" in the Controlled Substances Act is redefined to include all concentrates having a tetrahydrocannabinol (THC) concentration greater than 10 percent.

The definition of "marijuana-infused products" in the Controlled Substances Act is revised to reduce the maximum allowable THC concentration in the products from 60 percent to 10 percent.

Cannabis-Based Beauty Aids.

Cannabis health and beauty aids are exempt from all regulations in the Controlled Substances Act pertaining to marijuana, marijuana concentrates, or marijuana-infused products.

"Cannabis health and beauty aid" means a product containing parts of the cannabis plant that:

- is intended for use only as a topical application to enhance appearance;
- contains a THC concentration of no more than 0.3 percent;
- does not cross the blood-brain barrier; and
- is not intended for ingestion by humans or animals.

The LCB is granted expanded rule-making authority over cannabis health and beauty aids.

Marijuana Vending Machines and Drive-Throughs.

Marijuana retailers may not operate a vending machine or a drive-through facility for sale of marijuana or marijuana products.

Marijuana Clubs.

It is a class C felony to operate a business for the purpose of allowing customers to keep or consume marijuana on-site.

**Votes on Final Passage:**

House 67 28

First Special Session

House 70 25

Second Special Session

House 59 38

Senate 36 7

**Effective:** July 1, 2015

July 24, 2015 (Sections 302, 503, 901, 1204, and 1701)

October 1, 2015 (Section 501, 502, 504, and 505)

July 1, 2016 (Sections 203 and 1001)