Gangs, Ganjapreneurs, or Government: Marijuana Revenue Up for Grabs

by Pat Oglesby

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Polls say half the nation wants to end the war on marijuana.[1] Legalization could provide new revenue for government, but how? Six 2012 marijuana ballot initiatives show a splintered legalization movement with an amazing range of revenue ideas.[2]

In California one legalization effort contained no marijuana taxes, one would have ruled out any meaningful future taxes, and one would have eliminated even existing taxes immediately. All three failed to make the ballot in 2012.[3] But three states vote on marijuana-related measures on November 6. Colorado's Amendment 64 anticipates taxes and caps them temporarily. Oregon's Measure 80 generates revenue only with a state marijuana monopoly. Washington's Initiative 502, with three levels of excises, contains the highest marijuana taxes ever proposed to voters, and it is officially estimated to bring in new tax revenue of over $500 million a year.

After a description of these revenue plans, a rank ordering of them shows Washington state's plan the strongest and most plausibly acceptable to the federal government.

California

California saw three[4] 2012 legalization petitions fail to obtain enough signatures to make the ballot. Here are their tax elements, with the strongest first.

First, the Repeal Cannabis Prohibition Initiative (RCPI)[5] contains no taxes, but it lets the State Assembly tax anything except noncommercial homegrown cannabis — up to 3 pounds and 100 sq. ft. of plant canopy per adult. In California, failure to include a tax plan is understandable: It allows flexibility. The Assembly can't amend or repeal an initiative statute unless voters approve.[6]

Second, the taxless Regulate Marijuana Like Wine Initiative (Like Wine)[7] ties the hands of the Assembly with these confusing words: "State taxes and regulations which may be similar and apply to the grape farming and wine industries . . . shall apply to marijuana . . . using the grape farming and

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[1]A recent poll showed that 56 percent of voters favored "legalizing and regulating marijuana similar to the way alcohol and tobacco cigarettes are currently regulated," 36 percent were opposed, and 8 percent were undecided. Rasmussen Report, "56 Percent Favor Legalizing, Regulating Marijuana," May 17, 2012, *available at* http://www.rasmussenreports.com/public_content/lifestyle/may_2012/56_favor_legalizing_regulating_marijuana. An earlier poll had support at the 50 percent level. Frank Newport, "Record-High 50 Percent of Americans Favor Legalizing Marijuana Use," Oct. 17, 2011, *available at* http://www.gallup.com/poll/150149/record-high-americans-favor-legalizing-marijuana.aspx.

This article uses the terms "cannabis" and "marijuana" interchangeably. It often uses the present tense, even for proposals that have died. They may come back to life.

[2]An earlier article, "Laws to Tax Marijuana," *State Tax Notes*, Jan. 24, 2011, p. 251, *Doc 2010-26533*, or *2011 STT 15-1* [hereinafter "Laws to Tax"], listed issues for drafters of legislation.

[3]David Downs, "No Initiative: 2012 Will Go Down as the Year of Marijuana Ballot Bummers," *Sacramento News & Review*, Apr. 12, 2012, *available at* http://www.newsreview.com/sacramento/no-initiative/content?oid=5702610. Downs attributes the failures, coming after 46 percent of California voters supported a legalization initiative in 2010, to the lack of interest among big donors.

[4]A fourth unsuccessful petition involved medical marijuana, not legalization. It offered little if any progress in taxation. The Medical Marijuana Regulation, Control, and Taxation Act imposes a small 2.5 percent state tax on retail medical marijuana sales. It allows localities to impose a 2.5 percent supplemental retail tax, with the result of cutting some local rates, which now range as high as 15 percent. *See* letter from Americans for Safe Access, Dec. 19, 2011, *available at*http://ag.ca.gov/cms_attachments/initiatives/pdfs/i1043_11-0098a1s_%7Bmedical_marijuana%7D.pdf.

[5]*See*http://repealcannabisprohibition.org/index.php?page=display&id=1 (last visited May 17, 2012).

[6]Cal. Const. Art. 2, section 10(c).

[7]*See* http://regulatemarijuanalikewine.com/regulate-marijuana-like-wine-act-2012/ (last visited May 24, 2012).

Table 1. Unofficial Estimates for Colorado Amendment 64			
	Through 2016	**2017 Scenario 1**	**2017 Scenario 2**
Wholesale price per pound	$1,000	$900	$900
Wholesale price per ounce	$62.50	$56.25	$56.25
Wholesale tax rate (percent)	15	28	55
Wholesale tax per ounce	$9.38	$15.75	$30.94
Retail price per ounce before sales tax	$133	$133	$160
State sales tax rate (percent)	2.9	2.9	2.9
State sales tax per ounce	$3.86	$3.86	$4.64
Retail price per ounce including sales tax	$136.86	$136.86	$164.64
Wholesale tax receipts	$24,099,000	$40,473,800	$73,173,225
State sales tax receipts	$8,751,533	$8,765,553	$10,271,430
Local sales tax receipts	$14,545,600	$14,568,140	$17,030,140
Total	**$47,396,133**	**$63,807,493**	**$100,474,795**

winery industry as an example." Localities, too, must follow the mysterious "like wine" model — in a state whose powerful wine interests have kept taxes at 20 cents a gallon, ranking last among states.[8]

Third, the California Cannabis Hemp & Health Initiative (CH&HI)[9] takes a step backward, repealing the state sales taxes, local sales taxes, and substantial local excise taxes now imposed on medical marijuana. It includes no new taxes and even caps taxes the Assembly might someday pass at $10 — unindexed — per ounce of marijuana.

The California Legislative Analyst's Office's official revenue estimate for CH&HI says: "To the extent that a commercial marijuana industry further develops in the state . . . *and the Legislature chooses to impose excise taxes on marijuana sales* . . . state and local governments could eventually collect net additional revenues in the low hundreds of millions of dollars annually."[10] The revenue estimate for RCPI and Like Wine are identical: "To the extent that a commercial marijuana industry further develops in the state . . . state and local governments could eventually collect hundreds of millions of dollars annually in net additional revenues."[11]

Having mentioned potential legislative excise taxes for CH&HI, the Legislative Analyst's Office (LAO) could have also done so for RCPI and Like Wine, since all three proposals need legislation to add new taxes. And the estimates for RCPI should show more potential revenue than Like Wine, because RCPI contains nothing like Like Wine's smothering tax cap.

But no harm done. The LAO might have understood that these petitions were going nowhere. No precise analysis was possible. Given the lack of funding in tax-starved California for government work like revenue estimation, the LAO's analysis was close enough.

Colorado

The Colorado Regulate Marijuana Like Alcohol initiative, Amendment 64,[12] would impose no tax. It directs the General Assembly to enact an excise tax of up to 15 percent on producers — but the state's voters must agree.[13] In 2017 the 15 percent cap expires, so taxes may increase then . . . or sooner: Nothing in Colorado law prevents the legislature from amending (or repealing) an enacted Amendment 64.[14] So if the legislature believes that events

[8]Tax Foundation, "State Table Wine Excise Tax Rates, as of January 1, 2012," Feb. 16, 2012, *available at* http://www.taxfoundation.org/taxdata/show/26077.html. Some states use profits from controlled sales rather than taxes to raise revenue from alcohol, but their burdens on consumers are greater than California's.

[9]*See* http://www.youthfederation.com/cchhi2012.html. (Nov. 15, 2011).

[10]Initiative Analysis, California Legislative Analyst's Office, Dec. 22, 2011, *available at* http://www.lao.ca.gov/ballot/2011/110738.aspx (emphasis added).

[11]Like Wine, California Legislative Analyst's Office, Oct. 10, 2011, *available at* http://www.lao.ca.gov/ballot/2011/110613.aspx; RCPI, California Legislative Analyst's Office, Nov. 4, 2011, *available at* http://www.lao.ca.gov/ballot/2011/110650.aspx.

(Footnote continued in next column.)

[12]Amendment 64, the Regulate Marijuana Like Alcohol Act of 2012, *available at* http://www.regulatemarijuana.org/s/regulate-marijuana-alcohol-act-2012 (last visited July 4, 2012). The amendment proposes a new section 16 of Colo. Const. Art. XVIII [hereinafter proposed section 16].

[13]Voters must approve any new tax thanks to Colorado's Taxpayer Bill of Rights, Colo. Const. Art. X, section 20.

[14]Initiative and Referendum Institute, "Comparison of Statewide Initiative Processes," *available at* http://www.iandrinstitute.org/New%20IRI%20Website%20Info/Drop%20Down%20Boxes/Requirements/A%20Comparison%20of%20Statewide%20I&R%20Processes.pdf (last visited Sept. 7, 2012) [hereinafter Comparison].

get out of hand, it can remove the 15 percent tax cap at any time — and see if voters go along.

This wholesale-level tax would exempt up to six plants grown at home, and it would exempt medical marijuana. The first $40 million of tax receipts each year would go for public school capital construction.

No official has had to estimate the revenue effect of a 15 percent excise tax,[15] since the initiative just suggests it. But an unofficial study[16] by the Colorado Center on Law and Policy goes into some detail. It assumes that the legislature and the people will impose a 15 percent tax through 2016. It then considers tax increases to 28 and 55 percent, starting in 2017 (see Table 1, scenarios 1 and 2).

Through 2016, total per-ounce taxes ($13.24) are less than 10 percent of the taxed retail price ($136.86). Even in the aggressive Scenario 2, total per-ounce taxes ($35.18) are less than 19 percent of the taxed retail price ($164.64).

The study reasonably concludes that with these low tax rates, contraband sales will be negligible. The $136.86 (or $164.64) per ounce taxed retail price is so low that it should drive bootleggers out of business — though it probably leaves money on the table and runs the risk of making consumption so affordable that the public may object.

By artful regulation, Colorado might be able to keep prices tolerable for the public. Colorado is the leader in regulating medical marijuana,[17] and Amendment 64 provides broad regulatory latitude.

But in theory, only localities, not the state, would have latitude to keep the industry small: Amendment 64 says, "The department shall . . . issue an annual license to the applicant . . . unless the department finds the applicant is not in compliance with regulations" and unless the applicant's locality objects or has capped the number of marijuana establishments.[18] And the regulations cannot make the marijuana business "unreasonably impractical."[19]

Not trusting the state to live up to its theoretical duty to issue licenses, Amendment 64 allows, but does not require, localities to issue licenses independently if the state drags its feet.[20]

Oregon

The Oregon Cannabis Tax Act, Measure 80,[21] has "tax" in the title — but not in the text. In our time of antitax hysteria, it's a shock and maybe a relief to see proponents call something a tax when it isn't. The act provides for a state monopoly to sell marijuana (and a state monopsony to buy it), but no taxes.

At the beginning of the supply chain, the Oregon Cannabis Commission, a state agency, would buy marijuana from licensed sellers. Licenses would be issued to "any qualified applicant."[22] The commission would "equitably apportion the purchase of cannabis among all licensees" and then "purchase and sell cannabis products of the quality and grade set by market demand."[23] If licensed private businesses proliferated, regulation would be difficult, so the state might have trouble preventing the diversion of product into illegal commerce. The same is true for homegrown marijuana, which Measure 80 allows without limit,[24] and maybe for medical marijuana, which is to be sold at cost.

The commission would sell the cannabis it purchased from licensed sellers through stores it would own. Also, the commission would "set the retail price of cannabis to generate profits for revenue . . . and to minimize incentives to purchase cannabis elsewhere

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[15]2012 "State Ballot Information Booklet," Legislative Council of the Colorado General Assembly, Sept. 10, 2012, *available at* http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251821354194&ssbinary=true, dodges the question. But sales taxes and fees alone are officially estimated to bring in between $5 million and $22 million per year. *Id.*

[16]Christopher Stiffler, "Amendment 64 Would Produce $60 Million in New Revenue and Savings for Colorado," Colorado Center on Law and Policy, Aug. 16, 2012, *available at* http://www.cclponline.org/postfiles/amendment_64_analysis_final.pdf [hereinafter Colorado Policy Report]. Ounces consumed can't be calculated linearly from sales tax receipts on the chart because receipts reflect the number of medical marijuana users who defect to the taxed product. Elasticity assumptions lead the report to find that consumption after legalization increases less than I would have imagined.

[17]Dylan Scott, "Medical Marijuana: Do States Know How to Regulate It?" *Governing*, Aug. 2012, *available at* http://www.governing.com/topics/public-justice-safety/gov-medical-marijuana-becoming-mainstream.html [hereinafter Scott].

[18]Proposed section 16(5)(g), *supra* note 12.

[19]*Id*. section 16(5)(a).

[20]*Id*. section 16(5)(h).

[21]The Oregon Cannabis Tax Act, *available at* http://octa2012.org/oregon-cannabis-tax-act-legislation/ (last visited July 18, 2012) [hereinafter Measure 80].

[22]*Id*.; Proposed Ore. Rev. Stat. section 474.035(2). License fees remain to be determined: "The commission shall collect license fees which shall be calculated and continually appropriated to defray the commission's administrative costs of issuing licenses under this chapter and the Attorney General's costs of litigation in defense of the validity of this chapter's provisions and in defense of persons subjected to criminal or civil liability for actions licensed or required under this chapter." *Id*.; Proposed Ore. Rev. Stat. section 474.075(1).

[23]*Id*.; Proposed Ore. Rev. Stat. section 474.035(2).

[24]*Id*.; Proposed Ore. Rev. Stat. section 474.065(3).

Table 2. Washington Initiative 502: Example With Three Levels of Tax						
	Pretax price per gram	**Excise tax**	**Business and occupation tax**	**State sales tax**	**Average local sales tax**	**After-tax price**
Producer sells to processor	$3.00	$0.75				$3.75
Processor sells to retailer	$6.00	$1.50				$7.50
Retailer sells to consumer	$12.00	$3.00	$0.11	$0.99	$0.37	$16.47

Table 3. Washington Initiative 502: Example With Two Levels of Tax						
	Pretax price per gram	**Excise tax**	**Business and occupation tax**	**State sales tax**	**Average local sales tax**	**After-tax price**
Producer processor sells to retailer	$6.00	$1.50				$7.50
Retailer sells to consumer	$12.00	$3.00	$0.11	$0.99	$0.37	$16.47

or to purchase cannabis for resale or for removal to other states."[25] And the commission would be supposed to "work to promote Oregon cannabis products."[26] Net profits would go 90 percent to the general fund, 7 percent to drug abuse treatment, 2 percent to hemp projects, and 1 percent to drug education in schools.[27]

Measure 80 puts control of the commission in the hands of the marijuana industry. After a brief start-up phase, five of the commission's seven members would be elected by licensed growers and processors. Hmm. Will that commission work to maximize revenue for the state — or to benefit constituents in the marijuana trade? The most plausible defense of that blatant conflict of interest is that it wouldn't last: Oregon's legislature is free to amend (or even overturn) initiatives by simple majority.[28] Maybe the legislature wouldn't sit still for an industry-dominated commission.[29]

No revenue estimate is — or will be — available. According to a Willamette newspaper:

> Art Ayre of the Oregon Department of Administrative Services — who was charged with determining the potential financial effects of the Cannabis Tax Act — says he threw up his hands when it came to estimating potential tax revenue. . . . Ayre subsequently marked all forms of potential revenue as "indeterminate."[30]

The act's general effective date covering possession is January 1, 2013. But sales of marijuana would remain illegal until business licenses are issued. Licenses would be issued by February 28, 2013, by a temporary commission that the governor would appoint by December 31, 2012. That's a tight schedule.

Washington

Washington state is a leader in sin taxes, with the nation's highest liquor excises and fifth highest tobacco excises.[31] This fall's legalization initiative,

[25] *Id.*; Proposed Ore. Rev. Stat. section 474.055. The commission could attempt to impose potency-based pricing, because proposed section 474.095 requires potency testing and disclosure of the test results on all packages sold at retail.

[26] Measure 80, *supra* note 21, section 2.

[27] *Id.*

[28] Comparison, *supra* note 14.

[29] Backers understand the problem. A spokesman for Measure 80 says the makeup of the commission "now will without question change once Measure 80 becomes law." E-mail to the author from Roy Kaufmann, director of communications for Measure 80 (Sept. 7, 2012). Kaufmann adds, "We already have conversations underway with Oregon state legislators about drafting bills to more clearly define the composition and scope of the Commission."

[30] Matthew Korfhage, "Mari-Wanna?" *Willamette Week*, Aug. 29, 2012, *available at* http://www.wweek.com/portland/article-19599-mari_wanna.html. Organizers claim the measure "would generate over $140 million a year by taxing commercial cannabis sales to adults." *available at* http://octa2012.org/about-the-legislation/ (last visited Aug. 28, 2012). But "tax" is not the right word for monopoly profits, and no supporting analysis has been provided.

[31] For liquor, see Tax Foundation, "State Excise Tax Rates on Spirits, as of September 1, 2011," *available at* http://taxfoundation.org/article/state-excise-tax-rates-spirits-september-1-2011; for cigarettes, see Tax Foundation, "State Cigarette

(Footnote continued on next page.)

Table 4. Official Revenue Estimate for Washington Initiative 502		
	Fiscal 2015	**Fiscal 2017**
Business and occupation tax	$9,656,000	$10,244,000
Producer excise tax	$33,362,923	$35,394,763
Processor excise tax	$133,451,693	$141,579,051
Retail excise tax	$266,903,385	$283,158,102
State sales tax	$88,026,000	$93,386,000
Local sales tax	$32,664,000	$34,653,000
Total	**$564,064,001**	**$598,414,916**

I-502,[32] contains the highest marijuana taxes ever submitted to voters. According to an official fiscal note,[33] I-502 would raise some $564 million in taxes in fiscal 2015 — that's over $80 for every woman, man, and child residing in the state, most of them abstainers bearing none of this tax. Extrapolating from that per capita estimate, the revenue figure for the nation would be over $25.7 billion.[34]

If the official estimate is correct, in fiscal 2015 a formula would apportion $214 million to the State Health Plan, $198 million to the general fund, $64 million to fight substance abuse, and $43 million to marijuana education and public health programs. There would be a smattering of scattered uses.[35]

The Initial Operation of the Washington Proposal

I-502 starts by imposing 25 percent excise taxes at three distinct levels: one tax when a producer sells marijuana to a processor, a second tax when a processor sells to a retailer, and a third tax when a retailer sells to a retail purchaser.[36] The proposal retains the general sales tax for marijuana taxes; the sales tax base includes excise taxes.[37] Home-growing is not protected.

Table 2[38] illustrates the operation of the proposal when the producer and the processor are separate.

I-502 bars retailers from integrating with any other outfit in the supply chain. But a processor and a producer may be combined into one entity for purposes of the tax. In that case, the first layer of taxation disappears, as shown in Table 3.

Excise Tax Rates, as of January 1, 2012," *available at* http://taxfoundation.org/article/state-cigarette-excise-tax-rates-january-1-2012. The state's gasoline taxes are ninth highest in the nation. Tax Foundation, "State Gasoline Tax Rates of January 1, 2012," *available at* http://www.scribd.com/doc/82726304/Facts-and-Figures-2012-State-Gas-Tax-Rate.

[32] Initiative Measure 502, An Act Related to Marijuana, *available at* http://newapproachwa.org/sites/newapproachwa.org/files/I-502%20bookmarked.pdf (filed July 8, 2011) (hereinafter I-502). Along with high taxes and restrictions on advertising, I-502 contains, for suspected marijuana-impaired drivers, a blood test that, if failed, proves guilt per se. This blood test scheme has caused many consumers to oppose the initiative. Steve Elliott, "Emery Endorses I-502; Calls Opposition Foolish and Dangerous," Apr. 30, 2012, *available at* http://www.tokeofthetown.com/2012/04/emery_endorses_i-502_calls_opposition_foolish_and.php.

[33] Multiple Agency Fiscal Note Summary, Bill 502 XIL, Mar. 20, 2012 (hereinafter Fiscal Note). That estimate exceeds the expectations of supporters of the initiative, who predicted total revenue of some $215 million a year. New Approach Washington, "Factsheet: A Public Health Approach to Marijuana Use," Feb. 17, 2012, *available at* http://www.newapproachwa.org/sites/newapproachwa.org/files/I-502%20Factsheet%20-%20Public%20Health%20Approach.pdf.

[34] The federal 2011 population estimate for Washington is 6,830,038. *See* http://quickfacts.census.gov/qfd/states/53000.html (last visited May 13, 2012). The per capita revenue figure is thus $82.59. The estimated population of the United States is 311,591,917. *Id*.

[35] Washington State Office of Financial Management, "Initiative 502: Fiscal Impact Through Fiscal Year 2017," pp. 7-8, *available at* http://www.ofm.wa.gov/initiatives/2012/502_fiscal_impact.pdf (last visited Aug. 14, 2012) [hereinafter Fiscal Impact].

[36] Sales from one processor to another, too, are taxed at the 25 percent rate. Since businesses are likely to avoid quadruple taxation, those sales should be rare. Annual license fees for all three levels of the marijuana business are $1,000, not indexed.

[37] I-502, *supra* note 32, section 27(3).

[38] The prices and selling margins in the examples are derived from the fiscal note, *supra* note 33, chart labeled "I-502 Fiscal Note Projections/Consumption, Retail Sales and Excise Taxes/Baseline." An unofficial source suggests much smaller margins (markups): "25% producer markup + 25% excise tax + 15% distributor markup + 25% excise tax + 33% retailer markup + 25% excise tax + sales tax." "The Impacts and Implications of Marijuana Legalization," *available at* http://butwhataboutthechildren.com/sld19.pdf, p. 30 (last visited June 24, 2012). Those numbers are based on Kilmer, Caulkins, Pacula, MacCoun, and Reuter, "Altered State? Assessing How Marijuana Legalization in California Could Influence Marijuana Consumption and Public Budgets," Rand Corp., 2010, *available at* http://www.rand.org/pubs/occasional_papers/2010/RAND_OP315.pdf [hereinafter Altered State].

The fiscal note assumes that producers that are separate from processors (with three levels of tax), and integrated producer/processors (with two levels) will each provide half of production. It assumes further that all the financial benefit of bypassing a level of tax will go to those integrated producer/processors, not to consumers.

With two parallel routes to the consumer, why wouldn't all producers and processors take the short cut, allowing a total tax burden of 36 percent ($5.97/$16.47) of tax-inclusive retail price — simply merging so as to avoid a level of taxation and a total 41 percent ($6.72/$16.47) burden? One answer from a proponent is that some "processors . . . will specialize in edible products and not want to grow. On the other side, there may be growers who won't be interested in dealing with packaging and labeling issues and will prefer simply to deliver bulk quantities of harvested cannabis to processors (like the folks supplying [legal medical marijuana] dispensaries now)."[39]

Qualified applicants would not be automatically entitled to licenses: "The state liquor control board may, in its discretion, grant or deny the renewal or license applied for."[40] I-502 makes no change in Washington's medical marijuana law, which allows growing by patients and primary caregivers. The state liquor board would issue regulations to allow licensing of businesses — and to get the system up and running — by December 1, 2013.

Experience-Based Adjustments in Washington

A key feature of I-502 prompts the Legislature to adjust pricing:

> The state liquor control board shall regularly review the tax levels established . . . and make recommendations to the legislature as appropriate regarding adjustments that would further the goal of discouraging use while undercutting illegal market prices.[41]

In the inevitable price war against bootleggers, the ability to adjust rates is a useful weapon. Ideal adjustments would be as nimble as those in the retail gasoline market.

Adjustments in I-502 are far from ideal, though. For two years after enactment, amending a voter-initiated law requires two-thirds approval by each legislative house. So even shrewd recommendations from the liquor control board could get stuck in the Legislature. But I-502 avoids stepping on legislative toes.[42] And the Legislature would not have to wait for the liquor board; it could step up at will. Though I-502 may suffer from delay and even passive-aggressive legislative sabotage, its focus on price adjustment is a good start to fight bootlegging. Events on the ground could create quick legislative consensus for reaction.

Three separate levels of excise taxation are not optimal administratively. But the Legislature may find, for instance, that collecting early in the supply chain reduces diversion. Early collection may also keep prices up because intermediate sellers tend to seek a profit on the cost of taxes, as they do on any cost. The Legislature is free to reduce the "tax level" — that is, the rate — at one or both later collection points to zero, subject to the supermajority requirement or a two-year wait.

The Washington Revenue Estimate

This section presents the numbers in the official Washington revenue estimate, lists some of its assumptions, and critiques it.

The fiscal note produces the gross revenue numbers shown in Table 4 (previous page),[43] chosen here to compare the first full year of legality with the last year fully estimated.

The assumptions include:

- a baseline consumption level of 85,100,000 grams per year in calendar year 2013 growing to 88,967,795 grams in fiscal 2015. That's less than 13 grams, or less than half an ounce, per inhabitant (not per consumer) in 2013. (The fiscal note also examines an alternative scenario, disregarded here, with 10 percent higher consumption);

[39]E-mail to the author from Alison Holcomb, campaign director, New Approach Washington, Apr. 26, 2012.

[40]I-502, *supra* note 32, at section 2 (Wash. Rev. Code Ann. section 69.50.101, proposed new section 6(1)).

[41]*Id.*, at section 27(5).

[42]An independent rate-setting authority would be more nimble. That idea has been around at least since the Cannabis Revenue and Education Act, HB 1737 (Mass. 1981) , *available at* http://cantaxreg.com/wp-content/uploads/2011/05/Mass19811.pdf, section 405 (proposal of Richard M. Evans).

[43]Miscellaneous inflows add nearly $1 million a year to the total. Washington Office of Financial Management, "I-502 Worksheet," *available at* http://www.ofm.wa.gov/initiatives/2012/I-502_Worksheet.pdf (last visited Aug. 14, 2012).

- 363,000 users in calendar year 2013, an average of two grams per use, and an average of some 124 uses (248 grams) per consumer per year;[44]
- an average post-tax price to the consumer of $16.47 per gram or $467 per ounce,[45] which would not change over time;
- a startling cost per average taxed recreational use of $32.94;
- growth in quantity consumed of 3 percent per year; and
- a marijuana industry consisting of "100 marijuana producers and 55 marijuana processors (half of marijuana producers processing their own product and five additional processors)" — along with 328 retailers.[46]

The fiscal note has flaws. A major problem is that the note does not consider tax evasion.[47] Contraband will lose luster after legalization, to be sure, not just because its taxed competition is legal, but also because that taxed competition comes from a known source that can give assurances of quality and safety. So it is unlikely that a consumer will choose contraband if the taxed price of legal marijuana is low enough.

But if bootleggers come in well below the legal price at first, consumers may buy contraband — and evade taxes. A high after-tax retail price might encourage enough tax evasion to make the $500 million revenue estimate prove too high.

But legal producers may be able to sell for substantially less than the $3 per gram, or $1,360 per pound, that the estimate assumes. Legal prices may then fall to the point that they prevail over contraband competition. But then the tax take, which varies directly with prices, would be much smaller. The $500 million estimate seems too high in that case, too.

In one way, though, the note may understate revenue. It doesn't contemplate out-of-state sales. Sales to residents of border states and to marijuana tourists could push sales and taxes up. And $500 million a year could materialize if pretax prices drop a lot and Washington changes its law to maintain after-tax prices.

Now to quibble: The fiscal note does not account for spoilage, loss, employee pilferage, or theft. That is, every ounce of marijuana that is taxed at the processor level also bears tax at the retail level.[48] (Similarly, every ounce that enters the system at the producer level also bears tax at the processor level.) Those are heroic assumptions, even if a system tracks product well.

The Surviving 2012 Tax Plans Compared With Earlier Plans

By the end of 2012, 11 initiatives to legalize marijuana will have faced voters in the United States. Washington's I-502 contains the highest level of taxation ever proposed (see Table 5, next page).[49]

Judging Plans: The Tax-the-Heck-Out-of-It Voter

Now, to turn from description to judgment, I hypothesize a tax-the-heck-out-of-it voter, who doesn't use or even approve of marijuana, but who is looking for revenue. A voter who cares about revenue may be a liberal wanting to expand government. Or she may be a supply-sider wanting to tax something other than productive income (in reversal of the Progressive Era, when the income tax came in to replace alcohol taxes that Prohibition would repeal). She may be a beneficiary or supporter of specific programs that would be funded by dedicated marijuana revenue, like school construction in Colorado. Or she may be a worried voter eager to do something — anything — to protest the fiscal dysfunction that sends America toward the fate of modern Greece or ancient Rome.

This section starts with the tax-the-heck-out-of-it voter's criteria for a revenue scheme. It then looks at how that voter fits in with other voters, and how her views may align with those of the federal government.

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[44]I-502 Lead Agency Assumptions, Feb. 20, 2012, *available at* http://newtax.files.wordpress.com/2012/04/i502-final-assumptions-recd-march-2012.pdf. Only a remarkably low 5.3 percent of Washington's population would consume legal marijuana. *See supra* note 34.

[45]A PBS report cites a black market price of $291 per ounce in Washington in 2011, as opposed to $467. Marijuana Economics 101, *available at* http://www.pbs.org/wgbh/pages/frontline/the-pot-republic/marijuana-economics/ (July 26, 2011). Using the 2-gram-per-use assumption, each current untaxed use would cost over $20.

[46]Fiscal Impact, *supra* note 35, at 2-3. Those 483 businesses would supposedly split $891,142,924 of gross pretax revenue. (Total tax inclusive revenue would be $1,455,206,925 in fiscal 2015; taxes would take $$564,064,001 of that amount.) Crudely, that's over $1.8 million of gross revenue per licensee. But the harsh no-deduction rule of Internal Revenue Code section 280E should make those businesses less profitable than they might seem.

[47]The lack of discussion of elasticity is also noteworthy.

[48]Here's a fine point: The fiscal note should show that some later-tier taxes show up in later years. Assume with the note that retail taxes in the long run are twice processor taxes. But as taxes kick in, retail level collections in a particular year should be less than two times processor level collections, because taxed product won't move through the supply chain instantaneously.

[49]This chart adapts and adopts with thanks the chart by Russ Belville, "Over 40 Years of Drug War: Just 10 Attempts in 6 States to Legalize Marijuana," Mar. 20, 2012, *available at available at* http://stash.norml.org/over-40-years-of-drug-war-just-10-attempts-in-6-states-to-legalize-marijuana.

Table 5.
Comparison of Marijuana Tax Plans Submitted to State Voters

Year	State and name	Support	Home grow	Taxes	Tax medical marijuana?	Standard sales tax?	Link
1972	California Marijuana Legalization, Proposition 19	33.5%	"Personal Use"	None	N/A	No provision	http://library.uchastings.edu/ballot_pdf/1972g.pdf
1986	Oregon Marijuana Initiative, Measure 5	26.3%	"Personal Use"	None	N/A	State has no sales tax	http://news.google.com/newspapers?id=-VNeAAAAIBAJ&sjid=DWENAAAAIBAJ&pg=6838,152419&dq=oregon+measure+5&hl=en
2000	Alaska Marijuana Decriminalization Initiative, Measure 5	40.9%	"Personal Use"	None	N/A	State has no sales tax	http://www.elections.alaska.gov/doc/oep/2000/bm00.htm#99hemp
2002	Nevada Decriminalization of Marijuana Amendment, Question 9	39.1%	No	Like cigarettes (less than $2 per ounce) at wholesale	No provision	Yes	http://www.leg.state.nv.us/Division/Research/VoteNV/BallotQuestions/2002.pdf
2004	Alaska Legalize Marijuana Act, Measure 2	44.3%	"Personal Use"	Left to Legislature	N/A	State has no sales tax	http://www.elections.alaska.gov/doc/oep/2004/2004_oep_reg_1.pdf
2006	Nevada Marijuana Initiative, Question 7	44.1%	No	$45 per ounce excise at wholesale	No provision	Yes	http://www.leg.state.nv.us/Division/Research/VoteNV/BallotQuestions/2006.pdf
2006	Colorado Amendment 44, Relaxation of Laws on Marijuana Possession	41.1%	No	None	N/A	No provision	http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1231572730749&ssbinary=true
2010	California Proposition 19, the Marijuana Legalization Initiative	46.5%	25 sq. ft.	Left to Legislature and localities	N/A	Yes	http://cdn.sos.ca.gov/vig2010/general/pdf/english/19-title-summ-analysis.pdf
2012	Colorado Amendment 64, Regulate Marijuana Like Alcohol		6 plants	Legislature may tax at wholesale (if voters approve) with 15% cap through 2017	No	Yes, including medical marijuana	http://www.regulatemarijuana.org/s/regulate-marijuana-alcohol-act-2012
2012	Oregon Measure 80, Oregon Cannabis Tax Act		"Personal, noncommercial use"	No tax — state monopoly provides revenue	Sold at cost	State has no sales tax	http://octa2012.org/oregon-cannabis-tax-act-legislation/
2012	Washington Initiative 502, New Approach Washington		Medical only (current law)	25% excise at two or three levels	Yes, if sold	Yes	http://www.newapproachwa.org/sites/newapproachwa.org/files/I-502%20bookmarked.pdf

With a strong tax scheme, an ad for the high-tax Washington initiative says, "We would control the money — not the gangs."[50] To cash in, a state needs to provide strong regulation and enforcement. It also needs to calibrate revenue.

Regulation and Enforcement

The illegal trade is "entrenched, organized, and efficient, with a smoothly operating system of production and distribution."[51] That described the liquor trade just before Prohibition was repealed, and it fits some of the marijuana trade today.

Regulation to protect a revenue scheme is covered in some detail elsewhere.[52] Tough regulation is already happening with medical marijuana. For instance, Colorado dispensaries must now put radio frequency identification chips on each plant and provide regulators with live video feeds of "every inch" of their facilities.[53]

This year's surviving initiatives are silent on most regulatory questions, so regulators would be free to experiment. But the initiatives do answer some questions. Allowing any qualified applicant to get a license (as Oregon's initiative would, Washington's wouldn't, and Colorado's might) fragments the industry and increases the number of sites authorities must supervise.[54] Special rules for medical marijuana (which all three state bills contain or continue) allow leakage. So does home growing (which would be allowed in Oregon and Colorado but not Washington).

Whatever regulations may say and however they may evolve, the tax-the-heck-out-of-it voter can hope that after legalization, enforcement and punishment will strengthen. Law enforcement can concentrate on fewer marijuana cases.

Strong post-legalization regulation, enforcement, and punishment are necessary but not sufficient to create a strong revenue stream.

Most importantly, legalization should bring a change in the public mind-set. After legalization, the illegal marijuana dealer can hardly pose as a freedom-loving rebel fighting questionable rules. He will be identified as a tax cheater motivated by self-interest. Jurors today who think prohibition is stupid can and increasingly do set marijuana defendants free.[55] After legalization, any sympathy for today's marijuana defendants should not carry over to tax cheaters, and jury nullification should grind to a halt. And there should be room in the jails for all convicted tax evaders.

Strong post-legalization regulation, enforcement, and punishment are necessary but not sufficient to create a strong revenue stream. A state also needs a sound substantive scheme that neither collects too little nor aims too high.

Revenue Laws — Setting Rates

How Much Can Government Take? Seizing the Illegality Premium

A priori, government might seem to be able to maintain today's price — and to claim nearly all that price as revenue — by seizing the entire illegality premium that compensates lawbreakers for risk. If lawbreakers can charge high prices, maybe government can, too. According to an analyst from the Colorado Center for Law and Policy quoted in *The Washington Post*:

> Marijuana smokers and dealers . . . pay a premium now because the drug is illegal, and if government can find a way to capture that excess, tax collections should rise. You can

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[50]Television advertisement, *available at* http://www.newapproachwa.org/content/let's-talk-about-new-approach (last visited Aug. 6, 2012)

[51]Tun Yuan Hu, *The Liquor Tax in the United States, 1791-1947: A History of the Internal Revenue Taxes Imposed on Distilled Spirits by the Federal Government* (New York: Columbia University, Graduate School of Business 1950), 64 [hereinafter Hu].

[52]For discussion of regulation, see Robert A. Mikos, "State Taxation of Marijuana Distribution and Other Federal Crimes," *U. Chi. Legal F.* 222 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id= 1549828 [hereinafter Mikos], essential reading for understanding difficulties that will face any marijuana tax. *See also* Caulkins, Hawken, Kilmer, and Kleiman, *Marijuana Legalization: What Everyone Needs to Know* (New York: Oxford University Press 2012) [hereinafter *Marijuana Legalization*], an overview that addresses regulation and taxation among other topics; "Laws To Tax," *supra* note 2. Some regulations, like how many yards from a school marijuana retailers may set up shop, have little to do with revenue, while others, like keeping felons out of the marijuana trade, can help keep a taxed supply chain watertight.

[53]Scott, *supra* note 17.

[54]Fragmentation promotes inefficiency that can keep prices high, though. In tobacco country, federal rules formerly boosted production prices and spread the wealth by limiting farmers to quotas based on acreage, poundage, or both. IRC section 280E leads to fragmentation by denying deductions for expenses, including employee salaries, in trade involving drugs that the federal government bans. That denial should tend to keep mom-and-pop operations from expanding.

[55]And prosecutors are backing off. Paul Butler, "Jurors Need to Know That They Can Say No," *The New York Times*, Dec. 20, 2011, *available at* http://www.nytimes.com/2011/12/21/opinion/jurors-can-say-no.html. Butler, a former federal prosecutor, writes: "If you are ever on a jury in a marijuana case, I recommend that you vote 'not guilty' — even if you think the defendant actually smoked pot, or sold it to another consenting adult."

> basically take advantage of economies of scale, and the [pretax] price of marijuana will go down and government can come in and capture the difference.[56]

But the illegality premium is so big that collecting it may seem implausible.[57] Contraband marijuana is much more expensive by weight and volume than the subjects of other sin taxes — alcohol and tobacco.[58] In percentage terms, no tax on anything anywhere is as high as marijuana taxes may need to be to maintain current prices.[59]

But other products, intangible-intensive ones, depend on the rule of law to protect huge markups between the cost of raw ingredients and the price the consumer pays. The intangible premium for pharmaceuticals is different in some respects from the illegality premium for marijuana, but it is enormous. The main reason that patented pharmaceuticals command high retail prices is not that they are hard to reverse-engineer and manufacture,[60] but that government won't allow unlicensed wildcat producers and sellers to operate openly and freely. To be sure, the rule of law alone does not maintain high retail prices. Packaging, distribution, and marketing costs are high. Legal producers join government in protecting against unauthorized competitors.[61] Branding adds value. Consumers' fear of fake pharmaceuticals drives them into legitimate commerce; sellers of bootlegged marijuana would quickly overcome consumer skepticism and put pressure on legal prices. Significant capital is needed to start copying pharmaceuticals; marijuana production is much easier. But government power forcing commerce into legal channels by shutting down illegal competition is a factor to reckon with.

If the post-legalization taxed price is in the range of today's illegal price, will bootleggers cut prices

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[56]Christopher Stiffler, quoted in Kristen Wyatt and Jonathan J. Cooper, in Associated Press, "Pot Could Be Tax Windfall, but Skeptics Abound," Sept. 19, 2012, *available at* http://seattletimes.com/html/localnews/2019199217_aspusmarijuanataxes.html.

[57]It seems more plausible to collect a smaller amount. For instance, $20 per ounce, "the price gap observed today across the U.S.-Mexico border" for bulk, loose marijuana, has been suggested as "an upper limit on practicable taxation" for marijuana. *Marijuana Legalization*, *supra* note 52, at 168. The argument is this: "The intensity of prosecution of tax cheats probably will not support price gaps between taxed and untaxed marijuana greater than [that $20 difference]." *Id*. at 166. But that price gap at the border crossing reflects only a portion of the total illegality premium. That premium will still show up at every step of the supply chain, not just at the first step from producer to bulk wholesaler. To be sure, the marijuana supply chain may have few links. At an extreme, the small-time grower is a supply chain of only one link, and he may charge less than market prices. But such growers do not dominate the market.

[58]Evasion of cigarettes taxes in the developed world is a circumscribed problem. It typically involves cigarettes that have incurred tax somewhere and that were legal through all but the last steps of the supply chain. A typical transaction involves a pack of cigarettes bought legally and taxed in a low-tax tobacco-producing state and resold illegally without further tax in a high-tax jurisdiction like New York City. Those cigarettes were cost-effectively manufactured by an identifiable, deep-pocketed corporation that tested them for quality — on which its reputation depends. They bore federal tax and the tax of some state (or maybe tax of some country). They are in a recognizable branded package, designed by the manufacturer to prevent counterfeiting. Customers know what they are getting. Analogous jurisdiction-shifting evasion for marijuana will not appear until at least two jurisdictions legalize it. Then bootleggers will be interested in transporting tax-paid marijuana from a low-tax state to a high-tax state.

[59]Even European tobacco taxes don't take much more than 80 percent of what the consumer pays. European Commission, Directorate General, Taxation And Customs Union, Indirect Taxation and Tax Administration, Environment and Other Indirect Taxes, "Excise Duty Tables: Part III — Manufactured Tobacco (Ref 1035)," July 1, 2012, p. 6, column 8, *available at* http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf. In the United States, state and federal taxes usually amount to little more than $2.50 of the average price per pack of $5.98. Campaign for Tobacco-Free Kids, "State Cigarette Excise Tax Rates and Rankings," July 6, 2012, *available at* http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf.

[60]In 2000, an Indian manufacturer made "sildenafil citrate, the active ingredient in Viagra, for 2 cents a pill," with a 10-cent-per-pill selling price in mind. Donald G. McNeil Jr., "Selling Cheap 'Generic' Drugs, India's Copycats Irk Industry," *The New York* Times, Dec. 1, 2000, *available at* http://www.nytimes.com/2000/12/01/world/selling-cheap-generic-drugs-india-s-copycats-irk-industry.html?pagewanted=all&src=pm. But "in January 2005, India amended its patent laws governing pharmaceuticals" to conform with world standards, so "Indian drug markers can no longer manufacture and market reverse-engineered versions of drugs patented by foreign drug producers." *Available at* http://www.usitc.gov/publications/332/working_papers/EC200705A.pdf. Although Viagra is much harder to produce and verify than marijuana, and counterfeits compete with it. Viagra prices are nearly an order of magnitude greater than any prices suggested for taxed marijuana. Viagra comes in 25 mg, 50 mg, or 100 mg pills. Spectrometer-tested Viagra can (but rarely does) sell at retail for as little as $12.50 per 100 mg pill, or $125 a gram. Roger Bate and Kimberly Hess, "Assessing Website Pharmacy Drug Quality: Safer Than You Think?" Aug. 13, 2010, Table 3, *available at* http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2921371/?tool=pmcentrez. *See also* Mary Hiers, "Cost of Viagra at CVS, Walgreens, and Walmart," Apr. 25, 2012, *available at* http://www.accessrx.com/blog/erectile-dysfunction/cost-viagra-cvs-walgreens-walmart/ (online supplier claiming that name-brand retailers charge over $200 per gram).

[61]Illegal copiers of pharmaceuticals may foreshadow another front that bootleggers may open in any price war. Viagra's manufacturer warns consumers of fake packages that "have foil, have holograms, have any sort of trademarking that you'd want to look for." Pfizer Corp., *available at* http://www.youtube.com/watch?v=6S4kuz5Dhm0&feature=youtube (Aug. 22, 2011).

then that they don't cut now? Maybe. They may choose loss mode to try to win a price war against government. But government won the price war after repeal of Prohibition. Under Prohibition:

> The primary objective of spirits taxation in [the] initial post-prohibition period . . . was the elimination of organized bootlegging traffic while at the same time raising the maximum necessary revenue. . . . [Within three years] this two-fold aim may be said to have been well fulfilled.[62]

Contraband marijuana will not benefit from the new economies of scale,[63] lower wage rates, fearless landlords, or other benefits of legalization that drive down legal prices. Consumers will prefer legal, taxed product for reasons of legality and quality control. So on average they will voluntarily pay more for it.

The Ultimate Revenue Machine

In at least one case, government could plausibly take the entire illegality premium. That case is a vertically integrated, seed-to-retail-store state marijuana monopoly. Uruguay may lead the way.[64]

A monopoly could start with a diamond standard for security in grow areas, with secure fencing, constant video surveillance, high-tech searches of departing employees, and more. Leakage from the grow area could be made as rare as leakage at a diamond mine. State-controlled grow areas could even provide safe, healthy, outdoor work to replace the stressful, dangerous jobs of some prison guards whose powerful unions, wanting to keep the prisons full, have worked hard to defeat legalization. The product could be processed, packaged, and labeled on the spot. At the retail level, a monopoly allows instantaneous price shifts to beat any competition from bootleggers.[65]

The entire supply chain would require tight security and careful planning. Even gun stores and pharmacies can't protect all their wares against pilferage and theft. Small packages identified by serial number would put illegal bulk possessors at risk. Small shipments would limit profit for criminals — and revenue loss to the government — if, for instance, a delivery truck got hijacked. No scheme is perfect, and strong measures against bootlegging are vital, but a state monopoly takes every possible dollar for the public sector.

Large-scale revenue from marijuana taxes might not be easy to achieve, but gaining it is not impossible.

How Much Will Government Take?

A revenue scheme might not collect all it can because the government (1) deliberately aims low, (2) sets too low a percentage tax rate because it overestimates legal prices, or (3) aims too high and misses, so bootleggers dominate the market.

Will Government Aim Low?

We live in a time when general antitax hysteria has seized the minds of many honest Americans. That hysteria extends even to excise taxes. Alcohol is notoriously undertaxed, thanks to unindexed rates and powerful lobbies. The voice of the tax-the-heck-out-of-anything voter is faint.

Tax advocates have not led the charge in drafting marijuana initiatives. For whatever reasons, all this year's marijuana revenue schemes could be more ambitious. Those that specify rates have low rates.

Even the most robust, I-502, aims to take only 41 percent of the final price for government. If pre-tax prices fall, tax-the-heck-out-of-it voters in Colorado, Oregon, and Washington must hope that the legislature, like an anchor in a relay race who grabs the baton from an exhausted teammate, can take what the public delivers and advance.

Will Low Legal Prices Undermine Percentage-Based Taxes?

A low tax rate can yield high revenue only with a high tax base. Projected producer prices like $1,453 per pound in the official Washington fiscal note, or even $900-$1,000 a pound in the Colorado Policy Report, may point to high revenue from percentage-based taxes, but some scholars are skeptical.[66] Marijuana is just a plant, after all, and when the illegality premium vanishes, costs will go way down. Economies of scale will kick in, and input costs will shrink as workers and landlords don't demand a risk premium.

Some scholarly estimates of post-legalization production costs come in at $300-$400 per pound for

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[62]Hu, *supra* note 51, at 95.

[63]The Washington regulating board must consider "economies of scale, and their impact on licensees' ability to . . . undercut illegal market prices." I-502, *supra* note 32, Wash. Rev. Code Ann. section 69.50.101, proposed new section 10(6)(c).

[64]"Uruguay Takes 'War on Drugs' in New Direction: State Monopoly Over the Production and Distribution of Marijuana," *Christian Science Monitor*, Sept. 20, 2012, *available at* http://www.rawstory.com/rs/2012/09/20/uruguay-takes-war-on-drugs-in-new-direction-state-monopoly-over-the-production-and-distribution-of-marijuana/.

[65]An economic analysis of revenue and other benefits of a retail monopoly appears in Evan Cohen and Jehan deFonseka, "Tax Policies for Legalized Marijuana in California," June 18, 2010, *available at* http://ssrn.com/abstract=1626985. Retail monopoly alone, on one set of calculations, could create a revenue stream that's 150 percent of what taxes could bring in.

[66]*Marijuana Legalization*, *supra* note 52. That book goes way beyond the narrow tax issues discussed in this report. It's the latest word on the big picture of legalization.

house-based intensive hydroponic production,[67] and at as low as $5-$20 per pound assuming factory farming and mechanized mass production.[68] If costs are that low, can producers increase prices to anywhere near $1,000 per pound? In a competitive market, no: Producers cannot impose profit margins to charge such high prices if they incur such low costs. High pretax prices are likely only if the federal government makes them high.[69]

Quadruple-digit producer prices per pound may be plausible — if only at first — while the federal illegality premium remains in effect. Today, the federal threat keeps retail prices for state-legal medical marijuana high, with estimates of prices over $11 per gram, or some $5,000 per pound.[70] Prices that high under full legalization would happen only with a continued illegality premium. That is, prices that high would involve a scenario like that around medical marijuana today, a scenario in which the federal government gives neither the green light of approval (which would cause legal prices to fall and percentage-based taxes to dwindle) nor the red light of crackdown (which could shut down the market and cause revenue to vanish). Only the yellow light of federal uncertainty seems likely to keep legal, taxed (or monopoly) prices so high. That uncertainty would create an unstable equilibrium, doomed to fade.

> ***Percentage-based taxes with low rates, like those in Colorado's Amendment 64 and Washington's I-502, would likely leave revenue on the table.***

So percentage-based taxes with low rates, like those in Colorado's Amendment 64 and Washington's I-502, would likely leave revenue on the table. If that happens, the state would need to raise the percentage — or adopt another tax base, like potency or weight.

Will Government Aim Too High?

High taxes can backfire, leaving business to bootleggers and keeping revenue down. The 2012 initiatives hardly present that problem. The Colorado initiative wouldn't allow taxes high enough to let bootleggers beat legal prices. Washington's I-502 is a different story. If its projected post-tax legal retail price of $467 per ounce holds, it could drive significant commerce into the illegal channel, in which no one pays tax. But that's a big if. And I-502 urges the Legislature to adjust rates (albeit with a supermajority) to beat bootleggers and to profit when they are beaten.

The 2012 initiatives have flaws, but too-high taxes are not one of them.

The Tax-the-Heck-Out-of-It Voter's Place in the Political Process

Legislatures have steered clear of marijuana legalization, so legalization depends on plebiscites. That's a problem, because plebiscites don't benefit from an iterative and relatively transparent legislative process, and some states make laws enacted by plebiscites hard to fix after enactment.

For many plebiscite voters, taxes are the tail on the dog of legalization. Some voters either oppose or support legalization so much that taxes don't matter. For other voters, nontax factors, like a stiff proposed drugged driving rule in Washington, would drive a yes or no vote. But in a close election, taxes may swing enough votes to bring victory or defeat.

A strong revenue scheme disturbs some voters. It tends to split the marijuana community, because some members oppose particular revenue schemes enough to prefer prohibition. Some of that opposition arises out of routine economic self-interest. "Cannabusinessmen" and "ganjapreneurs" operating in wary violation of federal law under state medical marijuana laws don't want to share with government any more proceeds than they have to. Totally illegal operators fear they may be run out of business.[71] Consumers worry that prices might rise.

> ***A strong revenue scheme disturbs some voters. It tends to split the marijuana community, because some members oppose particular revenue schemes enough to prefer prohibition.***

But opposition goes beyond routine self-interest. Some long-time marijuana fans have come to distrust government as much as the most vehement

[67]Altered State, *supra* note 38, at 19.

[68]*Marijuana Legalization*, *supra* note 52, at 162.

[69]A federal tax burden that's now wreaking havoc with the medical marijuana business will push prices up. IRC section 280E denies deductions for expenses of operating a marijuana business (other than cost of goods sold). Businesses will need enormous profit margins to offset the inability to deduct salaries, rent, utilities, and so on — and to attract capital. Those high margins require unusually high prices, which increase a state tax base to which a percentage rate applies.

[70]*Id*. at 36.

[71]The marijuana industry did not lead the charge for California's failed 2010 legalization initiative. Jane Wells, "Prop 19 Goes Down in Heart of 'Pot Country,'" Nov. 4, 2010, *available at* http://www.cnbc.com/id/40010410/Prop_19_Goes_Down_in_Heart_of_Pot_Country.

Tea Partiers do. They believe government is stupid, deceitful, or both, so funding government is not on their agenda.

But a strong revenue scheme may appeal not just to tax-the-heck-out-of-it voters but also to some folks who don't care about revenue.

At the threshold, strong revenue may help win the money primary analog of having a candidate make it to Election Day in November — getting enough voters to sign petitions to qualify for the ballot. The folks who can come up with six- and seven-figure contributions to fund a campaign are sophisticated enough to want to bet on something that can pass and endure. They are unlikely to support a proposal with narrow appeal that looks like it was drafted in a smoke-filled room.

Strong revenue and high prices can keep consumption down generally, to the relief of voters who don't like marijuana.[72] A body politic that will be comfortable with the following low-revenue scenario is hard to imagine: "Legal pot would be amazingly cheap. In fact, midgrade stuff would be so cheap that it might make sense for businesses to give it away like ketchup packets or bar nuts."[73] The idea of free legal pot seems so provocative that to stop it, voters might call not only for revenue-driven high prices, but also for a regulatory ban[74] — belt-and-suspenders-style prevention.

More specifically, parents and voters sensitive to parents' concerns are a key voting faction. They are the target of a billboard ad in Colorado: "Please, card my son. Regulate the sale of marijuana and help me keep it out of his hands."[75] After legalization, parents will worry about of-age straw buyers who buy legally and resell to kids. Children are notoriously sensitive to price,[76] so strong taxes and concomitant high prices can help limit the problem of reselling, though they won't solve it completely. A state monopoly could add the appeal of eliminating the private profit motive from the marijuana business.

All those potential allies may not care about funding government, but they appreciate the consequences of high revenue.

The Tax-the-Heck-Out-of-It Voter as Proxy for the Federal Government

Context: The Federal Threat

The federal government may shut down any state revenue scheme,[77] so actually collecting revenue requires more than passing a law and willingness to enforce it. U.S. attorneys have already prosecuted big medical marijuana operations. To be sure, as recently as June, Attorney General Eric Holder "insisted the Justice Department has limited its enforcement actions 'to those individuals [and] organizations that are acting out of conformity with state laws.'"[78] And the federal government has done nothing to stop specific excise taxes on medical marijuana in many localities.

But both President Obama and Republican presidential candidate Mitt Romney oppose legalization of even medical marijuana.[79] And medical marijuana rankles the public much less than recreational. In 2010, Holder, opposing California's unsuccessful Proposition 19, vowed to "vigorously enforce the CSA [Controlled Substances Act] against those

[72]The backlash against medical marijuana dispensaries in Los Angeles is about proliferation. It illustrates how the public can demand restrictions. *See* Kate Linthicum, "L.A. City Council Bans Medical Marijuana Dispensaries," *Los Angeles Times*, July 2, 2012, *available at* http://articles.latimes.com/2012/jul/25/local/la-me-0725-pot-ban-20120725.

[73]Matthew Yglesias, "Get High for Free," July 18, 2012, *available at* http://www.slate.com/articles/business/moneybox/2012/07/how_much_would_legal_marijuana_cost_a_new_book_says_it_would_be_nearly_free_. html.

[74]Many jurisdictions prohibit putting even alcohol up for grabs in public. North Carolina doesn't let me buy liquor from a vending machine; maybe no state would. And states ban giveaways: In Alaska, for instance, bars may not "offer or deliver, as a marketing device to the general public, free alcoholic beverages to a patron." Alaska Stat. section 04.16.015(a)(1). Nor offer discounts. Among many restrictions on alcohol, licensed premises may not "sell, offer to sell, or deliver alcoholic beverages to a person or group of persons at a price less than the price regularly charged for the beverages during the same calendar week." Alaska Stat. section 04.16.015(a)(3). Unlike Alaska, many jurisdictions allow happy hours and ladies' nights, but it's hard to imagine that many will allow free legal pot alongside the ketchup packets.

[75]Patrick Svitek, "Marijuana Legalization Campaign Targets Parents," July 2, 2012, *available at* http://www.huffingtonpost.com/2012/07/01/marijuana-legalization-colorado_n_1638818.html.

[76]Office of National Drug Policy, "Marijuana Resource Center: Frequently Asked Questions and Facts About Marijuana," *available at* http://www.whitehouse.gov/ondcp/frequently-asked-questions-and-facts-about-marijuana ("because drug use is sensitive to price, especially among young people, higher prices help keep use rates relatively low") (last visited Sept. 23, 2012).

[77]*See generally* Mikos, *supra* note 52.

[78]Dan Freedman, "Attorney General Defends Medical Pot Crackdown," June 8, 2012, *available at* http://www.sfgate.com/crime/article/Attorney-general-defends-medical-pot-crackdown-3619425.php ("Holder acknowledged the Justice Department had broken with the Bush administration and pledged not to go after anyone acting within state law.")

[79]Republican presidential candidate Mitt Romney, though, has said, "I'm not running on [gay] marriage and marijuana, those are state issues, right?" Sam Stein, "Mitt Romney Gets Testy After Gay Marriage, Immigration, Pot Questions," *Huffington Post*, May 10, 2012, *available at* http://www.huffingtonpost.com/2012/05/09/mitt-romney-gay-marriage-immigration-pot_n_1504805.html.

individuals and organizations that possess, manufacture and distribute marijuana for recreational use, even if such activities are permitted under state law."[80]

Any yes vote in November could put the federal government in a chess game. Each surviving 2012 initiative has a severability rule[81] that would leave marijuana legal if the revenue scheme is outlawed. So shutting down a state's revenue scheme would make marijuana cheap and state-legal. (The federal government cannot easily force states to prohibit anything[82] — New York famously repealed its prohibition of alcohol in 1923, 10 years before the 21st Amendment repealed federal Prohibition.)

So banning a revenue scheme could put the federal government in an awkward position: It alone would bear the burden of street-level enforcement, a burden it has avoided. To fight back, Congress could eventually penalize states that legalize marijuana, as it cut highway funds to states that let 20-year-olds drink. But voter-passed initiatives can't be amended or repealed without voter approval in California and several other states (though none this year).[83] One day, there could be a stalemate.

Congruent Interests: High Taxes and High Prices

Low revenue may cause low legal prices, and low legal prices could bring a federal crackdown (or an eventual public backlash). One federal concern is interstate leakage: Low legal prices in one jurisdiction, allowing bootleggers to use tax-paid product to compete in other, prohibiting states, are likely a showstopper. As an article in *Rolling Stone* put it, "How do you prevent neighboring states, if not the entire country, from getting buried under mountains of cheap Colorado weed? If the state looks like it's becoming the nation's grow house, the feds will probably land hard."[84]

High prices alone won't hold off the federal government, but they are essential to any hope of federal forbearance. Although extensive and expensive regulation or enormous industry profits could push prices up, the easy way to ensure high prices is high state revenue. Marijuana revenue might be small, but states are struggling for revenue, and the federal government doesn't want to bail one out. The goal of the tax-the-heck-out-of-it voter overlaps with concerns of the federal government and of voters who don't want cheap marijuana.

Marijuana revenue laws that find federal favor may not come soon. But to have any hope of federal approval, a strong revenue scheme has got to be part of the deal.

Conclusion

For many people, whether to legalize marijuana is an easy, emotional question. But as young voters replace older ones, "Just Say No" is eroding. How to legalize is a harder question, one that leaves me stumped: My thinking about taxes is primitive, and taxes are only part of the picture — but a part that needs looking at. My one-dimensional tax-the-heck-out-of-it voter finds fault with all six of this year's efforts at legalization. But here's how that voter might rank them, in reverse order:

6. California Cannabis Hemp & Health Initiative

Repealing today's sales and excise taxes on medical marijuana makes California's CH&HI revenue scheme the weakest of the lot. Capping future taxes on marijuana at $10 per ounce doesn't help.

5. California's Regulate Marijuana Like Wine Initiative

Taxing marijuana "like wine" — whatever that means — doesn't leave room for much revenue, especially in the state with the nation's lowest wine taxes.

4. Oregon's Measure 80

Measure 80's marijuana monopoly could send big money to the public purse. But people in the marijuana trade control five of seven seats on the controlling commission. Commission members may direct cash flows not to the state's balance sheet, but

[80]*See* http://www.ofm.wa.gov/initiatives/2012/Holder_Letter.pdf (Oct. 13, 2010). There is no reason to think that Proposition 19's lack of taxes is responsible for the administration's opposition.

[81]Colorado provides for severability in section 8 of the amendment, *supra* note 12. Oregon provides for severability in proposed Ore. Rev. Stat. section 474.325, contained in Measure 80, *supra* note 21. In Washington, Wash. Rev. Code Ann. section 69.50.605 (part of the existing Controlled Substances Act) provides for severability. *See* Justin Butler, "What the End of Prohibition May Look Like: Preemption and the Legalization of Marijuana," *available at* http://norml.org/pdf_files/NORML_What_the_End_of_Prohibition_May_Look_Like.pdf (last visited July 19, 2012).

[82]*See generally* Robert A. Mikos, "On the Limits of Supremacy: Medical Marijuana and the States' Overlooked Power to Legalize Federal Crime," 62 *Vand. L. Rev.* 1421 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1356093.

[83]Comparison, *supra* note 14.

[84]Julian Brookes, "Pot Legalization Is Coming," *Rolling Stone,* July 26, 2012, *available at* http://www.rollingstone.com/politics/blogs/national-affairs/pot-legalization-is-coming-20120726#ixzz23iaj4krQ. Note that Amendment 64 makes shipping out of state a crime.

to the industry's pockets. The only hope for Measure 80 is that Oregon law allows the legislature to fix it.

3. California's Repeal Cannabis Prohibition Initiative

The RCPI punts on revenue, but maybe passivity is OK: California doesn't easily allow amendment of voter-initiated laws. The Assembly is free to enact taxes, except on homegrown. The RCPI leaves existing taxes on medical marijuana in place.

2. Colorado's Amendment 64

Amendment 64's 15 percent cap on taxes through 2016 is low enough to wipe out the illegal sector, though it won't produce much revenue. "Any qualified applicant" may theoretically get a license, so supervision would need to be far flung. But Colorado's medical system shows it can regulate the heck out of marijuana. If problems develop, the legislature can override the 15 percent cap and revise the whole scheme even before 2017 — if voters go along.

1. Washington's I-502

Washington's I-502 sets up a web of taxes. It then affirmatively sets the stage for difficult adjustments that can win the battle against bootleggers, and that can lead to the big revenue voters expect. It's not just this year's best. It's the strongest marijuana revenue plan American voters have ever seen. ✰