

Best Marijuana Taxes Yet: California's Proposition 64

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Two devastating traps threaten taxes on newly legalized marijuana. One is the quicksand of inflexibility, leading to impotence during a whirlwind of market change. The other is playing favorites, opening an abyss of tax evasion. California's [Proposition 64](#),¹ on the ballot in November, avoids those traps better than any marijuana initiative voters have ever seen.

The test of time

Taxing the embryonic legal marijuana industry is like buying clothes for an expected baby. *Prepare for changes.* The marijuana industry will evolve in ways we can't predict. We don't know the best way to tax marijuana, and even if we knew, that way will prove wrong as the market evolves, with free market entrepreneurs pursuing wild ideas, surprising everyone but themselves.

But we can foresee one trend. The early legal market will face a price war from the incumbent black market, but then pre-tax prices will drop, as the legal market is liberated from the "prohibition premium" -- the extra costs and risks of operating illegally. That is, eventually, the legal industry will grow and become efficient, pushing pre-tax prices down -- way [down](#).² Why should cannabis cost so much more than tea? Pre-tax, after federal legalization, it won't.

Taxes calculated as a percentage of price are child's play to create. A price-based tax will start strong. Then, as pre-tax prices collapse, so will price-based tax collections.

And it's not just declining revenue. Wherever *pre-tax* prices may end up, a collapse in *after-tax* prices would bother parents and health workers, who worry about youth use and perceived abuse.

There's yet another problem with price-based taxes: They prove slippery, because prices depend on human relationships and give-and-take. A smart seller and a smart customer can state a price that serves their interests. Think employee discounts, and "Free Pot with Pipe" bundling. Slippery prices are the main way Apple and its ilk have shifted over \$2 trillion to tax havens, beating the Tax Man.

By contrast, an indexed tax based on observable weight is inherently flexible and should survive a price collapse. A weight tax takes time to set up, though, so it's natural for price taxes to lead the way in the "[tax-base march of progress](#)."³ Then taxing by price should become less important over time. (Eventually, taxes on potency -- THC or other chemical composition -- may replace some weight taxes, which tend to go easy on highly potent material.)

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¹ <http://www.yeson64.org/pdfs/AUMA.Amended.12.7.15.Final.pdf>

² Keith Humphreys, <https://www.washingtonpost.com/news/wonk/wp/2016/05/04/the-price-of-legal-pot-is-collapsing/>

³ RAND Report for Vermont, http://www.rand.org/pubs/research_reports/RR864.html

Guess-work-based initial rates might need adjusting [down](#)⁴ temporarily, but marijuana taxes can go up in the long run. Preparing for market changes, some unpredictable and some foreseeable, is the only way to avoid the trap of inflexibility and impotence.

Taxing everyone the same

Someday, medical components of marijuana may be isolated and prescribed. For now, though, raw product and concentrates appeal to both legitimate medical patients and fun-seekers. At one extreme, if [medical](#)⁵ marijuana were tax-free and de facto available to anyone who wanted it, any marijuana tax would be a dead letter. Anyway, deciding who is sick is ordinarily the work of insurance companies and relief agencies – not the Tax Man. So [taxing everyone the same](#)⁶ makes for a sound tax structure, avoiding the trap of tax evasion. Legitimate patients won't suffer in the long run, so long as their after-tax prices are lower than [pre-Legalization prices](#).⁷

Looking at flops

Three failed initiatives offer object lessons to drafters of marijuana tax laws.

Ohio's resoundingly-rejected 2015 [Issue 3](#)⁸ gets an F on flexibility. The state Constitution would have frozen taxes permanently at 15 percent of producer price and 5 percent of retail price, and would have prohibited any other taxes. So taxing by weight was [permanently](#)⁹ banned. Meanwhile, medical marijuana was exempt from the retail tax. Objectionable as they were, inflexible taxes didn't kill Issue 3: The killer argument was that its drafters, by linking to land listed in the initiative that they owned, divided up all growing rights among themselves. That looked greedy, and Issue 3 lost in a 36-64 landslide.

Oregon's unsuccessful 2012 [Measure 80](#)¹⁰ was also a power grab by commercial interests. It contained no taxes – it instead put an [industry-dominated](#)¹¹ commission in charge of setting prices, with some profits dedicated to public uses. Measure 80 gave away the revenue store, ordering the commission to "sell cannabis at cost for medical purposes." (That lost, 47-53, but advocates in Oregon persevered, and succeeded with Measure 91 in 2014.)

A third failed initiative, California's 2010 [Proposition 19](#)¹², is harder to peg. It delegated all tax decisions to state and local authorities. The drafters dodged all tax questions (who, what, when, and where), and left them wide open. That's understandable. Back in 2010, they had almost nothing to go on – just analogies.

⁴ Tax Foundation overlooks Colorado's de facto per-gram marijuana tax, <https://newrevenue.org/2016/08/27/4914/>

⁵ <http://www.latimes.com/politics/la-pol-ca-proposition-64-recreational-pot-opponents-20161004-snap-story.html>

⁶ <https://newtax.files.wordpress.com/2015/01/supplemental-thoughts-about-revenue-from-marijuana-in-vermont-16-january-2015-in-pdf.pdf>

⁷ <http://www.drugsense.org/dpca/votersguide1116.html>

⁸ [https://ballotpedia.org/Ohio_Marijuana_Legalization_Initiative,_Issue_3_\(2015\)](https://ballotpedia.org/Ohio_Marijuana_Legalization_Initiative,_Issue_3_(2015))

⁹ http://www.huffingtonpost.com/pat-oglesby/ohios-marijuana-referendum_8392610.html

¹⁰ [https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative,_Measure_80_\(2012\)#cite_note-BallotTitle-3](https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative,_Measure_80_(2012)#cite_note-BallotTitle-3)

¹¹ <https://newtax.files.wordpress.com/2012/10/gangs-ganapreneurs-or-government-marijuana-revenue-up-for-grabs.pdf>

¹² <http://cdn.sos.ca.gov/vig2010/general/pdf/english/text-proposed-laws.pdf#prop19>

They faced the reality of governing as you learn. Maybe “Wait and See and tax when you understand more” was a plausible tax plan. But that didn’t reassure voters who were nervous. Proposition 19 went down, 46-54.

Laws on the books

Drafters of California’s Proposition 64 had actual laws to look at – and lessons to gain from them.

Alaska’s Ballot Measure 2, passed in 53-47 in 2014, has no tax exemption for medical marijuana. And Alaska’s only tax is based on weight. [The Alaska structure](#)¹³ looks pretty good on paper, although Alaska doesn’t index its weight-based tax. Excise Tax 101 prescribes indexing on the first day of class. But the biggest question mark about the Alaska plan is that it has not gotten underway yet. Oregon, which passed its law on the same day, has been merrily [collecting](#)¹⁴ millions since January.

Oregon’s Measure 91, which passed 56-44 in 2014, included a weight-based tax on producers that exempted medical marijuana, but the Legislature switched to a [17-percent retail price tax](#)¹⁵ for a [variety of reasons](#).¹⁶ A weight-based tax takes more time to set up and run than a price tax, and Measure 91’s [\\$1.23 per gram rate](#)¹⁷ was a high rate to start with. The industry argued that taxing *producers* based on who the consumer is would be *inefficient*. And localities preferred a retail price tax they could piggyback onto with taxes of their own. So Oregon is left for now with tax-exempt medical marijuana and a price-based tax only.

The first two states to legalize and tax offer contrasting strengths. Colorado is pioneering a weight-based tax; Washington’s taxes put users on a more even playing field.

Colorado, whose Amendment 64 passed 55-45 in 2012, has been collecting a [weight tax](#)¹⁸ all along. The rate is now 60 cents a gram for bud, with lower per-gram rates for trim and wet whole plants. The weight tax is a workaround for a nominal but unadministrable 15-percent of price *producer* tax. The workaround is needed because there is no *actual* “producer” price when only one “vertically integrated” company handles marijuana from farm to market – with no buyer at the producer price. Vertical integration is a typical business structure in Colorado. Colorado’s revenue experts have scrambled to get a system up and running and collecting lots of tax. If [federal legalization](#)¹⁹ is the ultimate goal, it makes sense to try to prove the tenability of different taxes, especially the quantity-based kind the federal government uses for tobacco and alcohol. Seeing what taxes work well will give Congress comfort as it confronts a plethora of difficult questions.

But Colorado [exempts](#)²⁰ medical marijuana from both its 10-percent retail excise price tax and its weight tax.

¹³ <http://tax.alaska.gov/programs/documentviewer/viewer.aspx?268s>

¹⁴ http://www.oregonlive.com/marijuana/index.ssf/2016/09/oregon_marks_first_year_of_rec.html

¹⁵ http://www.oregon.gov/DOR/press/Documents/marijuana_fact_sheet.pdf

¹⁶ <https://newrevenue.org/2016/02/09/4518/>

¹⁷ <https://www.oregon.gov/olcc/marijuana/Documents/Measure91.pdf>

¹⁸ <https://newrevenue.org/2016/07/18/4856/>

¹⁹ Jane Gravelle and Sean Lowry, <https://newrevenue.org/2015/01/07/gravelle-lowry-report-federal-proposals-to-tax-marijuana-an-economic-analysis/>

²⁰ <https://www.colorado.gov/pacific/enforcement/laws-constitution-statutes-and-regulations-marijuana-enforcement>

Medical marijuana bears only Colorado's separate 2.9 percent general sales tax. That's a huge tax break – 77.5 percent less than the combined 2.9 percent sales tax and 10-percent retail tax on recreational users. Colorado's exemption of medical product from its 60-cent per gram tax runs the tax break up to around 90 percent. That creates the abyss of a nearly [untaxed parallel market](#)²¹.

Washington's Initiative 502 passed 55-45 in 2012. The Washington Legislature has tweaked the law, but Washington has never had a weight tax. The strength of the Washington tax is that it hardly plays favorites at all: Medical marijuana gets only a relatively small tax break: [Every consumer now pays 37 percent](#)²². Non-medical users pay an extra 6.5 percent – the state's separate general sales tax – so they pay 43.5 percent in total. Washington medical users pay 85 percent of the taxes that recreational users pay, so get only a 15 percent tax break – much less than in Colorado.

California's November Initiative

Here's the story on California's [Proposition 64](#).²³

It contains a standard excise tax at retail, at a 15-percent rate. Getting a fine point right, it prevents "Free Pot with Pipe" bundling as a tax evasion scheme.

Impressively, Proposition 64 has a weight tax -- \$9.25 per ounce of typically smoked "flowers." That's 33 cents a gram, lower than Colorado's current 60-cent per gram rate, and much lower than Alaska's \$1.76 per gram rate, but it makes sense to start low and go slow: A weight tax needs time to implement. Prop 64's 33-cent tax rate is probably a better place to start; Alaska's a better place to end. Unlike Alaska, Proposition 64 remembered to index for inflation.

So are two taxes too many -- belt and suspenders? No. Taxing twice allows the state to keep track of product – and to see which way works best.

Meanwhile, Proposition 64 goes a long way toward taxing everyone the same. Medical marijuana does not incur California's 7.5 percent sales tax, but does incur the more substantial 33-cent a gram and 15-percent retail taxes, which are assessed on the substance, not on the user – treating everyone the same. The tax break for medical marijuana is only 33 percent when you consider only the percentage-of-price taxes. When you consider the weight-based tax, the tax break shrinks more – toward the low Washington range. That's much less of a tax break than the up-to-90 percent that medical marijuana gets in Colorado.

Rachel Barry, my good friend and conscientious colleague on the Newsom-ACLU California Blue Ribbon Commission on marijuana legalization, worries that medical marijuana will get too good a deal as marijuana legalization evolves in California. She and her co-author Stan Glantz, who criticize Proposition 64 severely, [write](#)²⁴ that California "has a stronger medical marijuana advocacy community and industry than Colorado." But so far, the strong California community would get a much smaller tax break from Proposition 64 than

²¹ <http://www.itep.org/pdf/marijuanaissuesreport.pdf>

²² <http://dor.wa.gov/Content/FindTaxesAndRates/marijuana/Default.aspx>

²³ <http://www.yeson64.org/pdfs/AUMA.Amended.12.7.15.Final.pdf>

²⁴

http://www.academia.edu/21732552/A_Public_Health_Analysis_of_Two_Proposed_Marijuana_Legalization_Initiatives_for_the_2016_California_Ballot_Creating_the_New_Tobacco_Industry

Colorado's reportedly weak community gets in that state. That has provoked [opposition](#)²⁵ to Proposition 64 from the other direction, from the California medical community, but speaks well for the ability of California drafters to stick up for sound taxes.

Proposition 64 allows amendments that further its “purposes and intent” to many provisions, including taxes, by vote of 2/3 of each Legislative House. By default, initiatives in California [aren't amendable](#)²⁶ at all by the Legislature – only by later initiative. Drafters deserve some credit for affirmatively overruling that cannot-amend default rule. They would deserve more credit had they allowed amendment by simple majority, but the anti-tax tilt of 1978's Proposition 13, requiring a 2/3 supermajority for tax increases, is sacrosanct to many California voters. Trying to override Proposition 13 could have been a deal-killer. As alternative, a slowly ratcheting phase-up of rates would have been useful, but would have been radical, and controversial.

None of the four other initiatives this year, [Nevada's](#)²⁷ Question 2, [Arizona's](#)²⁸ Proposition 205, [Maine's](#)²⁹ Question 1, and [Massachusetts's](#)³⁰ Question 4, measures up to California's on two key criteria. First, they all tax only by doomed-to-diminish price; none contains a weight-based tax. Second, they all exempt medical marijuana, giving it a 100-percent tax break.

Conclusion

Some voters won't care a whit about a solid tax structure. Some might want to starve the governmental beast; some might prioritize cheap marijuana.

Even the soundest tax structure won't guarantee fiscal success for Proposition 64. Enforcement of tax law is as necessary as sound structure, and enforcement will depend on the now-unknowable future actions of officials, citizens, and jurors. *Long-term* structural soundness will depend on the ability of the Legislature to dodge special interests, and to muster 2/3 supermajorities for mid-course corrections.

Voters should not vote for a marijuana initiative because of its tax structure alone – or even for revenue. But Proposition 64 has a solid, even-handed tax structure. And it's as amendable as California voters might reasonably expect. California's Proposition 64 contains the soundest tax structure ever presented to voters.

²⁵ <http://www.eastbayexpress.com/oakland/proposition-64-leads-in-the-polls-but-insiders-say-weed-prohibitions-end-is-no-sure-thing/Content?oid=4994077&showFullText=true>

²⁶ http://www.iandrinstitute.org/docs/A_Comparison_of_Statewide_IandR_Processes.pdf

²⁷ [https://ballotpedia.org/Nevada_Marijuana_Legalization,_Question_2_\(2016\)](https://ballotpedia.org/Nevada_Marijuana_Legalization,_Question_2_(2016))

²⁸ <https://www.regulatemarijuanainarizona.org/full-initiative-text/>

²⁹ <http://www.regulatemeaine.org/wp-content/uploads/2015/10/initiative-text.pdf>

³⁰ <https://www.regulatemarkachusetts.org/full-initiative-text/>