

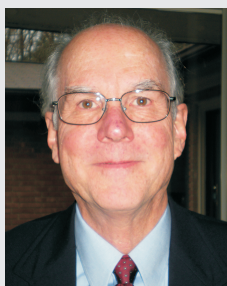
Marijuana Taxes — Present and Future Traps

by Pat Oglesby

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In this viewpoint, Oglesby discusses marijuana taxes in the states, including an evaluation of recently enacted initiatives, criteria by which tax schemes should be judged, and potential federal involvement in state marijuana legalization.

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State marijuana taxes are a work in progress. Voters liked them enough to propel recreational marijuana legalization to victory in eight states. Understandably, though, early taxes may suffer from a feeble tax base, inflexibility, and carveouts. Essential enforcement can't be guaranteed. And a tax that sputters along today could conk out if an interstate race to the bottom or competing federal taxes materialize. This article will examine:

- the facts on the ground for recreational marijuana taxes;
- inherent weaknesses in early taxes;
- three problems voters may overlook when legalizing marijuana;
- the specifics of 12 state legalization initiatives; and
- three potential post-enactment problems.

I. The Facts on the Ground

Voters said yes in November to taxed recreational marijuana in California, Maine, Massachusetts, and Nevada.¹ In

earlier years, voters in Colorado, Washington, Alaska, and Oregon approved recreational marijuana measures.

Taxes are the tail on the dog of marijuana legalization,² but there's real money already available. Colorado³ and Washington,⁴ the states that legalized it first, are each pulling in more than \$100 million a year from taxes on recreational marijuana. Congress denies tax deductions for marijuana advertising and selling expenses.⁵ The federal government won't say how much it's now getting from that no deductions for pot ads rule, but industry figures indicate it will be \$1.3 billion a year by 2020.⁶ On national legalization, the nominally nonpartisan, but not nonideological, Tax Foundation⁷ estimates a total tax take of \$28 billion a year.⁸

Voters like stand-alone marijuana taxes enough to produce ballot landslides that many politicians only dream

Marijuana," *State Tax Notes*, Jan. 24, 2011, p. 251 [hereinafter "Laws to Tax"], with errata at "Mistakes in 2011 'Laws to Tax Marijuana,'" *Newrevenue.org*, Jan. 28, 2015; Jonathan P. Caulkins et al., "High Tax States: Options for Gleaning Revenue From Legal Cannabis," 91 *Or. L. Rev.* 1041 (2013); Richard Phillips, "Issues With Taxing Marijuana at the State Level," *The Institute on Taxation & Economic Policy*, May 2015; and Christopher Law, "Legalized Recreational Marijuana and the Black-Market Challenge: Early Lessons for Future Pot Laws," *Newrevenue.org*, June 15, 2015.

²The metaphor comes from Colorado official Andrew Freedman. Mary Serreze, "Colorado Marijuana Czar: Massachusetts Should Craft Pot Regulations Now," *MassLive*, June 15, 2015. Freedman's point is that states should not legalize for revenue alone.

³Alicia Wallace, "Colorado Pot Shops Sold a Record-Breaking Amount of Marijuana in August 2016," *The Cannabist*, Oct. 13, 2016.

⁴Kate Smith, "Washington Expects Pot Sales Tax Revenue Surge to \$1 Billion," *Bloomberg*, Oct. 23, 2016.

⁵The federal tax rule already raking in cash is Section 280E, enacted in 1982. Oglesby, "How Bob Dole Got America Addicted to Marijuana Taxes," *Brookings Institution* (Dec. 18, 2015). States whose income tax rules conform to section 280E are bringing in cash, also.

⁶Oglesby, "280E revenue cost," *Newrevenue.org*, Nov. 17, 2016.

⁷From the left, Matthew Yglesias describes the Tax Foundation as a "libertarian group." See Yglesias, "Tax Foundation Reveals Scant Link Between Taxes and Prosperity," *Slate*, Oct. 9, 2013. Libertarianism is not for everyone, but it can bring rigor to the debate.

⁸Gavin Ekins and Joseph Henchman, "Marijuana Legalization and Taxes: Federal Revenue Impact," *Tax Foundation* (May 12, 2016). Some preliminary criticism of that Tax Foundation analysis appears at Oglesby, "Chump Change From Tax Foundation," *Newrevenue.org*, May 16, 2016. The Tax Foundation's \$28 billion per-year number may

(Footnote continued on next page.)

¹Taxes on medical marijuana are widespread but are not the focus here. For earlier work on marijuana taxation, see Oglesby, "Laws to Tax

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about.⁹ For many voters, “Don’t tax you, don’t tax me, tax the man behind the tree” points to the woods where marijuana grows.¹⁰ But legalization, even with taxation, does not always win at the ballot box. Voters have said no in Arizona (2016), Ohio (2015), Oregon (2012), and California (2010). And no state legislature has legalized recreational marijuana.

Marijuana legalization is at a crossroads. A new administration could put an end to marijuana commerce and taxes with the stroke of a pen.¹¹ But if that doesn’t happen, marijuana taxes aren’t likely to go away. Indeed, Americans for Tax Reform’s antitax spokesman Grover Norquist has said marijuana taxes don’t violate his no-tax pledge.¹² If state legislatures consider marijuana legalization, tax issues will be a challenge.

II. Inherent Weaknesses in Early Tax Laws

Marijuana taxes are still primitive for at least two reasons.

First, any state’s legal marijuana industry is like a newborn baby, and tax laws are like its clothing. Whatever you start with won’t last.¹³ The industry in any state is likely to grow — but no one knows in what ways, or how much. The market will evolve, as it has already, with concentrates and

edibles having seized surprising market shares.¹⁴ More unpredictable changes — unknown unknowns — are inevitable. We don’t know the best way to tax marijuana, and even if we knew at first, that way would soon prove wrong.

Then there are problems that plague any new tax law. The amount of tax to levy is a value judgment — there is no clear “right” tax burden. Potentially conflicting goals such as minimizing black market purchases, raising revenue, offsetting youth use, and addressing other negative externalities complicate the analysis.¹⁵ Technical errors and drafting blunders will complicate the work.

Second, some folks — no surprise — may like weak taxes. This includes the marijuana sellers and consumers who have been among the instigators of legalization initiatives.¹⁶

Many taxes on recreational marijuana seem to have been designed, at least in part, as bait for voters. That is, activists don’t like marijuana taxes, but they use taxes to get voters to support legalization.¹⁷ So it’s predictable that taxes that look acceptable on the ballot may be weak in practice. But activists might temporarily overshoot and make taxes too

be in the ballpark for state and federal taxes combined, though it includes only a tiny federal excise tax of \$500 million and implicit repeal of IRC section 280E.

⁹In November 2016, stand-alone marijuana taxes in 110 Oregon localities won voter approval, none by less than 64 percent to 36 percent. No measures lost. See “2016 General Election, Oregon Marijuana Measures,” available at <http://gov.oregonlive.com/election/2016/general/marijuana-results/> (last visited Dec. 17, 2016). In California, stand-alone marijuana taxes in 43 localities won voter approval, and only medical marijuana is now legal in California. Drug Policy Forum of California, “Voters Guide to Drug Policy Reform Candidates and Measures” (Nov. 2016) [hereinafter Guide]. The only losing California local tax, in Colfax, got 63 percent approval but needed two-thirds.

¹⁰Joel Warner, “California Marijuana Legalization 2016: Growers and Officials Struggle Over Making Pot Farms Environmentally Friendly,” *International Business Times*, Nov. 24, 2015. The saying is attributed to former Louisiana Sen. Russell Long. But some voters won’t care a whit about a solid tax structure. Some might want to starve the governmental beast, while others might prioritize cheap marijuana or a robust marijuana industry.

¹¹Kristen Wyatt, “Chugging Along: The Weed Legalization Train Could Get Derailed, Here’s How,” *The Cannabist*, Nov. 28, 2016. The federal executive branch could quickly override state tax schemes by adjusting prosecutorial discretion.

¹²Jacob Sullum, “Grover Norquist Says Taxing Pot Is Not a Tax Hike,” *Forbes*, Oct. 30, 2013. For someone with libertarian views, taxed legalization may seem better than prohibition.

¹³Initial taxes on any commodity may begin in a primitive way. Most soda taxes don’t consider sugar density yet. Donald Marron, “Building a Better Soda Tax,” Tax Policy Center, Urban Institute & Brookings Institution (Dec. 12, 2016). I’m unaware of an e-cigarette tax that considers nicotine content. Oglesby, “Proposals to Tax E-Cigarette Nicotine Juice: NC (low) and WA (high),” *Newrevenue.org*, May 15, 2014.

¹⁴Steve Raabe, “Consumer Demand for Pot Edibles Spurs Denver Manufacturing Surge,” *Denver Post*, Aug. 15, 2014.

¹⁵A valuable Congressional Research Service report elaborates on one goal this way: “set the tax so that the price of marijuana does not fall substantially with legalization and expanded demand.” Jane Gravelle and Sean Lowry, “Federal Proposals to Tax Marijuana: An Economic Analysis,” CRS (Nov. 13, 2014) (“The policy question then, may be how much of a tax burden should be placed on non-responsive [to price] adult users to limit consumption of youth”).

¹⁶A California Blue Ribbon Commission, a project of Lt. Gov. Gavin Newsom (D) and the American Civil Liberties Union of Northern California, sought to bring policy thinking to the attention of drafters of California’s Proposition 64, discussed below. See <https://www.safeandsmartpolicy.org>, last visited Dec. 17, 2016. I was a member of the commission, and co-chair, with professor Sam Kamin, of its Regulatory and Tax Structure Working Group, but not a coauthor of its final report. Proposition 64 followed some of the commission’s recommendations. In Canada, a task force is studying legalization and making recommendations to the government. Task Force on Cannabis Legalization and Regulation, “A Framework for the Legalization and Regulation of Cannabis in Canada” (Nov. 30, 2016) [hereinafter Canadian Task Force]. There’s precedent for this type of study. In 1933 Congress examined the taxation of alcohol, which had been recently re-legalized. Tax on Intoxicating Liquor, Joint Hearings Before the Committee on Ways and Means, House of Representatives and the Committee on Finance, United States Senate, 73d Congress, Interim, 1st and 2d Sessions (Dec. 11–14, 1933) [hereinafter Hearings].

¹⁷Consumers don’t seek high taxes, but they don’t necessarily seek zero taxes, either. Allen St. Pierre, former head of consumer lobby National Organization for the Reform of Marijuana Laws, said: “Consumers will pay whatever vice tax society wants so long as the taxes are sufficiently low enough so as not to foster an untaxed and unregulated black market in cannabis production and sales.” Quoted in Oglesby, “Whatever Vice Tax Society Wants,” *Newrevenue.org*, Apr. 12, 2016. Many marijuana sellers support modest taxes, even on medical marijuana. See Peter Hecht, “Marijuana Businesses Line Up Behind Sacramento Tax Initiative,” *The Sacramento Bee*, May 25, 2016.

strong at first. If so, that reinforces the first reason — it's hard to know how to tax marijuana.¹⁸

III. 3 Problems Voters May Overlook

Though voters may like marijuana taxes, they may not focus on three structural weaknesses¹⁹:

- taxing only by price;
- anti-amendment rules; and
- playing favorites.²⁰

These three weaknesses will be examined below, followed by a state-by-state analysis of how initiatives have succumbed to or avoided them.

A. Taxing Only by Price

The simplest way to tax marijuana is ad valorem — just tack on a percentage of sales price. The first cannabis tax in the United States,²¹ agreed to by 80 percent of Oakland voters in 2009, was on the price at retail.²² It applied only to medical marijuana.²³ Because taxes on a nascent industry need to start low, the rate was just 1.8 percent.

That low tax helps the early legal market fight against the incumbent black market. But pretax legal prices will almost certainly drop as sellers are liberated from the “prohibition premium” — the extra costs and risks of operating illegally. Eventually, if left alone by government, the legal industry will grow and become efficient, pushing pretax prices down — way down.²⁴ As pretax prices collapse, so will price-based tax collections.²⁵ Declining revenue is not the only problem with taxing by price. Wherever pretax prices may end up, a

collapse in after-tax prices would bother parents and public health advocates, who worry about youth use and substance abuse.²⁶

Price-based taxes are not just flimsy, they can be slippery, because prices depend on relationships and give-and-take. A smart seller and a smart customer may state a price that serves their interests — think employee discounts and “free pot with pipe” bundling. Slippery prices are the main way Apple Inc. and its ilk have shifted more than \$2.6 trillion to tax havens, beating the tax man.²⁷

But all that worry about prices being too low takes a long view. Taxing by price presents a more immediate difficulty. In the early confusion about what tax the market may bear, some marijuana advocates may have overshot, giving voters too much bait. They may have proposed taxes that in the short run are so high as to be counterproductive. The industry will need high pretax prices to survive as it incurs start-up costs and attempts to climb the learning curve. Price-based taxes will magnify those pretax prices. So early after-tax prices may be high, and many people may not pay them. That's because the black market will not vanish immediately after legalization.²⁸ Legislatures in Colorado²⁹ and Oregon³⁰ have actually reduced the tax burdens that voters approved in initiatives.

Other than a price base, what else is there? Non-price amounts — such as volume, for alcohol and fuel, or weight — for tobacco form the base for sophisticated excise taxes such as those levied by the federal government. A weight base, if indexed, addresses the problem created by vanishing price-based taxes. But weight-based taxes encourage highly potent products. Different marijuana products (with different potency or perceived quality) need different weight-based taxes. Already Colorado imposes weight-based taxes on three categories of products,³¹ but that doesn't totally solve the problem. A weight-based tax treats products of different potency the same, so long as they weigh the same. If weight-based taxes put financial and administrative burdens on producers, they will object. Still, for marijuana, a

¹⁸It's so difficult to tax marijuana that state monopoly sales would seem preferable. Oglesby, “States May Be Stuck With Second-Best Marijuana Taxes,” *State Tax Notes*, June 2, 2014, p. 539. But libertarians don't like government in business, and liberals, with nullification and interposition in mind, are skeptical of deliberate state violations of federal law.

¹⁹This list is not exhaustive. More traps loom, such as commercial diversion from untaxed home grows. See Part I.B. of Oglesby, “Supplemental Thoughts About Revenue From Marijuana in Vermont,” *New revenue.org*, Jan. 16, 2015 [hereinafter Vermont Supplement].

²⁰Voters may not focus on any details of legalization initiatives, tax or nontax. Legalization opponent Kevin Sabet says, “Content of initiatives may not have anything to do with [electoral] outcomes. Very few people read initiatives,” email to author (Nov. 29, 2016).

²¹A 19th-century tax on “ganja” in India predates all Western Hemisphere taxes. Dale Gieringer, “Revenues From Legalization,” *Norml.org*, June 1994.

²²“Oakland Marijuana Tax, Measure F, July 2009,” *Ballotpedia*, available at <http://bit.ly/2hScwT7> (last visited Dec. 13, 2016).

²³The appeal of marijuana taxes to citizens is illustrated by the many taxes imposed on medical marijuana. Taxes on medical marijuana are generally outside the scope here, but have proliferated wildly. See, e.g., Marijuana Policy Project, “Medical Marijuana Dispensary Laws: Fees and Taxes,” available at <http://bit.ly/2hTkysL> (last visited Dec. 11, 2016).

²⁴Keith Humphreys, “The Price of Legal Pot Is Collapsing,” *The Washington Post*, May 4, 2016.

²⁵Five technical measures to drive the tax burden higher over time without new legislation are suggested in Jonathan P. Caulkins et al.,

(Footnote continued in next column.)

“Considering Marijuana Legalization: Insights for Vermont and Other Jurisdictions,” *RAND Report* (Jan. 2015), at 89-92 [hereinafter *RAND Insights*].

²⁶*Id.* at 31-42. My coauthors come from the field of drug policy and often work on policy for alcohol and opioids, which are more dangerous than marijuana. Many drug policy scholars believe that alcohol is severely undertaxed at the federal level.

²⁷Oglesby, “Repatriation to the Tune of ‘Revolution,’” *Tax Notes*, July 2, 2012, p. 123.

²⁸Tom James, “The Failed Promise of Legal Pot,” *The Atlantic*, May 9, 2016.

²⁹Kristen Wyatt, “Legal Weed in Colorado Doesn't Curb Alcohol Sales,” *denver.cbslocal.com*, Sept. 15, 2015.

³⁰Noelle Crombie, “Legal Pot in Oregon: One Year Later,” *Oregon Live*, June 30, 2016.

³¹As of late 2016. “Average Market Rate Change Fact Sheet” (June 2016), available at <http://bit.ly/2hTrfe0> [hereinafter *Colorado Rate Sheet*]. The rates will be updated over time.

tax based on weight could better survive a price collapse than taxes based on price. Weight taxes take time to set up, though so it's natural for price taxes to lead the way.³²

An even more sophisticated base is in the discussion stage. Eventually, taxes on potency may prove more useful than weight taxes, which tend to undervalue highly potent material. Potency taxes involve measuring THC, marijuana's main intoxicant, or other chemical components.³³ This corresponds with the federal liquor tax, which taxes alcoholic beverages by ethanol content. But potency may be measurable, as a practical matter, only for concentrates and their derivatives, like edibles. Measuring chemical composition of dried plant matter may not aim at the right target, or it may prove too random or gameable. No known jurisdiction in the world taxes tobacco by measuring tar or nicotine content in dried plant matter.³⁴

Taxes tend to evolve and become more sophisticated in a "tax-base march of progress."³⁵ Over time, new taxes can supplement and replace early taxes. Taxing by price can become less important. In the long run, taxing by price is too flimsy and too slippery to be the only tax on marijuana. But price-based taxes are an obvious starting point. And they will likely endure as various taxes proliferate. Several states are using two tax bases — weight and price. But isn't that too many, a belt-and-suspenders approach? Taxing twice allows the state to keep track of product — and to see which way works best. And if federal legalization 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 reassure Congress as it confronts a plethora of difficult questions.

B. Anti-Amendment Rules

State constitutions may say the legislature can't easily amend tax laws, initiative-passed laws, or both.³⁶ Tax in-

creases have long been a sore spot, and initiatives present a special problem. Voters have worried, naturally enough, that legislatures will amend or even repeal laws that they didn't pass themselves. Take redistricting reform, for example. If voters think lawmakers are protecting their seats, limiting legislative power to tamper with voters' plans may seem appropriate. But marijuana taxes are still being developed. With the world in the learning stage, rules that freeze those taxes are risky. Having lawmakers' hands tied is a problem — if you see lawmakers as the people's servants. The resulting inflexibility can lead to impotence in the face of declining prices or during a whirlwind of unpredictable market change.

C. Playing Favorites

If medical marijuana were tax-free and available to anyone who wanted it, any marijuana tax would be a dead letter. That's a killer trap. Taxing everyone the same³⁷ favors simplicity over fairness. If everyone pays the same tax, tax authorities need not — indeed, should not — categorize people. No tax would be evaded by a claim of bodily pain that, as a practical matter, is both unprovable and irrefutable. True patients will pay what everyone else pays, and recreational users will gain nothing by phony claims of illness. Someday, medical components of marijuana may be isolated and prescribed. For now, raw product and concentrates appeal to both legitimate medical patients and recreational users.

Patients object to paying tax.³⁸ But deciding who is sick is ordinarily the work of insurance companies and relief agencies. That kind of decision is not ordinarily the work of the tax man — not for such low stakes. Taxing everyone the same will not hurt legitimate patients in the long run, so long as their after-tax prices are lower than pre-legalization prices.³⁹

IV. The Specifics of 12 State Initiatives

In all eight states where voters have legalized recreational marijuana, plausible-looking taxes have been part of the deal. And failure to tax proved an initiative-killer in California in 2010 and Oregon in 2012. But plausible-looking

³²Minimum unit pricing, analogous to a dollar floor per ounce of alcohol, would keep prices up, but it would direct money that could go for public purposes to swell sellers' profits. Minimum *transaction* pricing, with no sale of any amount for less than, say, \$30, might deter young users — but only slightly.

³³Canada's Task Force recommends a potency-based tax scheme. Canadian Task Force, *supra* note 16.

³⁴Oglesby, "Tax Marijuana by Potency? Probably Not," New revenue.org, Mar. 20, 2013.

³⁵RAND Insights, *supra* note 26, at 90. See generally Alvin Rabushka, *Taxation in Colonial America* (Princeton University Press, 2008). "Progress" may be a euphemism. Through time, taxes may travel an arc from simplicity, the enemy of fairness, to complexity, the friend of special interests. Another kind of tax burden — a higher rate on marijuana income — seems unlikely. But to be complete, the 1933 Rockefeller Report on ending Prohibition suggested taxing income from alcohol sales more highly than other income. R. B. Fosdick and A.L. Scott, *Toward Liquor Control* (Harper & Brothers 1933), at 121-125.

³⁶Initiative and Referendum Institute, "Comparison of Statewide Initiative Processes," available at <http://bit.ly/2hTnJ3m> (last visited

(Footnote continued in next column.)

Dec. 9, 2016). See also National Conference of State Legislatures, "Limiting the Legislature's Power to Amend and Repeal Initiated Statutes" (updated June 28, 2011), available at <http://bit.ly/2hr8YUw>. Of all enacted marijuana legalization schemes, only Colorado's was passed via Constitutional initiative.

³⁷For a detailed look at tax exemption vs. nontax relief for medical marijuana, see Part I.A. of Vermont Supplement, *supra* note 19. Canada's Task Force on Cannabis Legalization and Regulation recommends that that country "apply the same tax system for medical and non-medical cannabis products." Canadian Task Force, *supra* note 16, at Chapter 5. See also Laws to Tax, *supra* note 1, at 271-274.

³⁸Patrick McGreevy, "The Push to Legalize Pot for All Has Deeply Divided the Medical Marijuana Community," *Los Angeles Times*, Oct. 16, 2016.

³⁹Guide, *supra* note 9.

marijuana taxes are insufficient to pull legalization through to victory, as seen in failed initiatives in Arizona in 2016 and Ohio in 2015.

A. Pre-2016 Defeated Initiatives

Two pre-2016 failed initiatives didn't tax marijuana. In a third failed initiative, taxes seemed only a side issue.

1. California 2010

California's 2010 Proposition 19,⁴⁰ defeated by voters 46-54, contained no taxes. The drafters dodged all tax questions and left the issue wide open. State and local governments could have imposed taxes, but they didn't have to, and California makes it hard for governments to tax.⁴¹ In 2010, initiative drafters had nothing to go on in figuring out how to tax marijuana — only analogies. They faced the reality of governing as you learn. Perhaps voters were nervous about having no tax plan.

2. Oregon 2012

Oregon's 2012 Measure 80,⁴² which was defeated 47-53,⁴³ also contained no taxes. Measure 80 would instead have put an industry-dominated commission in charge of setting prices at state stores, with some profits possibly dedicated to public uses. It created a discount for medical marijuana, with the commission to "sell cannabis at cost for medical purposes." Measure 80 was roundly condemned as a power grab.⁴⁴ Oregon marijuana advocates persevered, however, and succeeded by enacting Measure 91 in 2014.

3. Ohio 2015

Ohio's Issue 3,⁴⁵ the victim of a 36-64 landslide defeat in 2015, 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. Taxing by weight was permanently⁴⁶ banned and medical marijuana was exempt from the retail tax. Flawed as the taxes were, they might have seemed plausible enough to voters. An amendment killer was that its

drafters, by linking land listed in the initiative to land they already owned, divided up all growing rights among themselves.⁴⁷ One longtime legalization advocate put it this way: "The public outcry against the self-serving aspects of the initiative was clearly the reason the proposal did so poorly. . . [G]uaranteeing millions to . . . already rich investors was clearly not acceptable."⁴⁸

B. Pre-2016 Laws on the Books

Drafters of 2016's initiatives had four enacted laws to look at and learn from. The two states that voted to legalize and tax first, in 2012, offer contrasting strengths. Colorado is pioneering a weight-based tax, while Washington's taxes put users on a more even playing field.

1. Colorado 2012

Colorado, whose Amendment 64 passed 55-45⁴⁹ in 2012, has collected a weight tax⁵⁰ all along. As of late 2016, the rate was 60 cents a gram (\$17.03 per ounce) for bud,⁵¹ with lower per-gram rates for trim and wet whole plants. The weight tax, on producers, is a workaround for a nominal but inadministrable 15 percent of price tax.

The price tax is inadministrable because vertical integration — when one company handles marijuana from farm to market, with no intermediaries — is a typical business structure in Colorado. In fact, Colorado law once required vertical integration. With vertical integration, there is no *actual* producer price, because the producer is also the retailer. If Colorado were to try to determine, out of thin air, a producer price to tax, it would run into the kind of transfer pricing problem that is largely responsible for the shifting of trillions of dollars to tax haven subsidiaries of U.S. multinational corporations. Instead, Colorado's revenue experts have scrambled to get a de facto workaround up and running and collecting lots of tax — by weight.⁵²

⁴⁷Keith Stroup, "Concern About the Industry Influence in the Legalization Movement," NORML, Dec. 7, 2015.

⁴⁸*Id.*

⁴⁹Colorado Marijuana Legalization Initiative, Amendment 64 (2012), *available at* <http://bit.ly/2ifuJGQ>.

⁵⁰Oglesby, "Colorado Tax Rates Set High and Low Records," *newrevenue.org*, July 18, 2016.

⁵¹Colorado Rate Sheet, *supra* note 31.

⁵²A Tax Foundation report not only omits all mention of the de facto Colorado weight tax, it states that such a tax is "untenable." Joseph Henchman and Morgan Scarboro, "Marijuana Legalization and Taxes: Lessons for Other States From Colorado and Washington," Tax Foundation (Apr. 20, 2016) ("Because marijuana can be purchased as a cigarette, an edible, a liquid, or a vapor, all with a wide variety of concentrations, a specific [amount-based] excise tax is untenable"). But that particular argument fails, because weighing and tax assessment are taking place, in both Colorado and Alaska, before processing into edibles or other products. And different rates apply in each state to different raw products such as potent bud and less potent trim.

⁴⁰Proposition 19, *available at* <http://bit.ly/2h1OOPW> (last visited Nov. 14, 2016).

⁴¹Andrew Baker et al., "Legalizing Marijuana in California: A Review of Policy Considerations," Stanford Law School Law and Policy Lab (undated), at 47, *available at* <http://stanford.io/2hUZNPN>. This lab project was supervised by professor Rob MacCoun.

⁴²Letter From Secretary of State Kate Brown (Jan. 18, 2011), *available at* <http://oregonvotes.org/irr/2012/009text.pdf>.

⁴³Oregon Cannabis Tax Act Initiative, Measure 80 (2012), *available at* <http://bit.ly/2hHCijz> (last visited Dec. 20, 2016).

⁴⁴Oglesby, "Gangs, Ganjapreneurs, or Government: Marijuana Revenue Up for Grabs," *State Tax Notes*, Oct. 22, 2012, p. 255; and Editorial, "Vote No on Pro-Pot Measure 80; It's a Hot Mess," *Corvallis Gazette Times*, Oct. 4, 2012.

⁴⁵See <http://bit.ly/2hHJKEc>.

⁴⁶Oglesby, "Ohio's Marijuana Referendum: Watch the Money," *The Huffington Post*, Oct. 27, 2015.

In an overt nod to flexibility, Colorado's 2012 constitutional amendment legalizing marijuana allowed the legislature to increase the 15 percent nominal producer rate starting in 2017, subject to approval under Colorado's Taxpayer Bill of Rights. More subtly, the amendment did not prohibit the General Assembly from adding a new tax, which it did, with a 10 percent retail tax approved by voters under TABOR and later reduced to 8 percent.

But Colorado exempts medical marijuana from both its 10 percent retail excise tax and its nominal 15 percent weight tax. Medical marijuana bears only Colorado's separate 2.9 percent general sales tax. That saves 25 percent of price,⁵³ with recreational buyers paying nominally 27.9 percent instead. And there's a problem beyond low-taxed medical marijuana sales. Colorado sometimes lets caregivers and patients grow 99 plants tax-free, which creates the abyss of a huge untaxed parallel market for marijuana diverted to recreational users.⁵⁴

2. Washington 2012

Washington's Initiative 502⁵⁵ passed 56-44⁵⁶ in 2012. The Legislature can amend an initiative during its first two years only by two-thirds supermajority.⁵⁷ After the supermajority requirement expired, the Legislature, seeking revenue neutrality, repealed a tax on typically consolidated producer-processors and increased the retail tax rate. Washington has never had a weight tax.

The strength of the Washington tax is that it hardly plays favorites: Medical marijuana gets only a relatively small tax break, since every consumer now pays at least 37 percent of the retail price.⁵⁸ Nonmedical users pay an extra 6.5 percent — the state's separate general sales tax.⁵⁹ The 6.5 percent tax break for medical marijuana pales in comparison to the 25 percent break in Colorado.

⁵³The 25 percent figure for savings glosses over two offsetting factors. On one hand, a 15 percent producer price tax applies to a lower base than a 15 percent retail price tax would. On the other hand, a producer tax would be marked up in the supply chain, increasing the cost to the consumer.

⁵⁴The Colorado medical marijuana rule, a constitutional provision that predates recreational legalization, can allow "marijuana patients and caregivers to grow up to 99 plants in a residential setting." State of Colorado, Office of the Governor, "Marijuana Grey Market" (Aug. 16, 2016).

⁵⁵Initiative Measure 502 (July 8, 2011), *available at* <http://bit.ly/2h1Sscs>.

⁵⁶Washington Marijuana Legalization and Regulation, Initiative 502 (2012), *available at* <http://bit.ly/2h1GIXE>.

⁵⁷Initiative and Referendum Institute, *supra* note 36.

⁵⁸Department of Revenue, Washington State, "Taxes Due on Marijuana" (last accessed Dec. 20, 2016).

⁵⁹This analysis does not consider local taxes.

3. Alaska 2014

Alaska's Ballot Measure 2,⁶⁰ which passed 53-47 in 2014,⁶¹ has no tax exemption for medical marijuana. Alaska's tax is based on weight and the initiative may be amended at any time. Growers must pay taxes on sales and transfers of marijuana — \$1.76 per gram (\$50 an ounce) for bud.⁶² The Alaska structure looks good on paper, although the state doesn't index its weight-based tax. After lagging behind Oregon in implementation, Alaska started collecting its tax in December 2016.

4. Oregon 2014

Oregon's Measure 91,⁶³ which passed 56-44 in 2014,⁶⁴ included a \$1.23-per-gram (\$35 per ounce) tax on producers that exempted medical marijuana. Then the Legislative Assembly, unhampered by constitutional restrictions, switched to a 17 percent retail price tax⁶⁵ for a variety of reasons.⁶⁶ Oregon is left for now with tax-exempt medical marijuana and a price-based tax only. But Oregon has been merrily collecting⁶⁷ millions since January — even as Craigslist brazenly offers tax-evading competition.⁶⁸

C. The 2016 Initiatives

Voters approved four of five marijuana legalization initiatives on the ballot in November. All five had plausible-looking taxes; California's victorious initiative had a particularly robust tax structure.

⁶⁰Alaska Marijuana Legalization, Ballot Measure 2 (2014), *available at* <http://bit.ly/2hcxxIT> (last visited Dec. 14, 2016).

⁶¹*Id.*

⁶²The statute allows lower rates for designated parts of the plant, and regulations make the rate \$15 an ounce for parts of the plant other than bud. Becky Bohrer, "This Is How Alaska Businesses Will Have to Make Marijuana Tax Payments to the State," *The Cannabist*, Nov. 17, 2016.

⁶³Measure 91, *available at* <http://bit.ly/2hTBSH6> (last visited Dec. 11, 2016).

⁶⁴Oregon Legalized Marijuana Initiative, Measure 91 (2014), *available at* <http://bit.ly/2h1U6Lv> (last accessed Dec. 20, 2016).

⁶⁵Oregon DOR, "Marijuana Tax," *available at* http://www.oregon.gov/DOR/press/Documents/marijuana_fact_sheet.pdf (last visited Dec. 10, 2016).

⁶⁶A weight-based tax takes more time to set up and run than a price tax. With medical marijuana exempted, the industry argued that taxing *producers* based on who the *consumer* is would be inefficient. And localities preferred a retail price tax that they could piggyback onto with taxes of their own. For more detail, see Oglesby, "Why Oregon Taxes Marijuana by Price," *Newrevenue.org*, Feb. 9, 2016.

⁶⁷Noelle Crombie, "Big Winners After One Year of Recreational Pot Sales: Consumers, Tax Coffers," *Oregon Live*, Sept. 30, 2016.

⁶⁸Jonathan Bach, "Oregon Marijuana Ads Flourish on Craigslist," *Statesman Journal*, Dec. 8, 2016.

1. Arizona — failed

The only initiative that failed, Arizona Proposition 205,⁶⁹ would have taxed only by price, at 15 percent of retail. Standard sales tax of 5.6 percent would have applied to both recreational and medical marijuana. So medical marijuana would have had a 15 percent price break. The Arizona Constitution allows no change to initiatives there without a three-fourths vote in each legislative house.

The failure of the Arizona initiative by a vote of 49 percent to 51 percent⁷⁰ can hardly be blamed on ultra-weak taxes. Its tax structure was much like that of the Nevada initiative that passed. Plausible-looking taxes seem necessary, but not sufficient, for an initiative to pass. Nontax factors seem responsible for the defeat of Proposition 205. The opposition was unusually well funded,⁷¹ and Arizona was the only state where recreational marijuana was on the ballot where Donald Trump defeated Hillary Clinton.⁷²

2. Nevada — passed

Nevada's successful Question 2,⁷³ which passed 54-46,⁷⁴ taxes only by price, at 15 percent of producer price. Nevada avoids Colorado's transfer-pricing trap of nonexistent producers by preventing vertical integration — by not allowing producers to sell to consumers.⁷⁵ Standard sales tax of 6.85 percent applies to both recreational and medical marijuana, so medical marijuana gets a 15 percent price break. The Nevada Constitution allows no change to initiatives for three years after passage.

3. Massachusetts — passed

Under Massachusetts's Question 4,⁷⁶ recreational marijuana bears the standard sales tax of 6.25 percent, plus a tiny new 3.75 percent marijuana excise tax. Question 4, which passed 54-46,⁷⁷ contains no weight tax, and zero sales tax on medical products — medical marijuana gets a 10 percent price break. Question 4 provides the lowest revenue potential of any initiative this year. But rates need to start low. A saving grace is that the legislature can amend it freely. Even

before passage, Massachusetts's governor, Senate president, and House speaker were proposing significant tax increases.⁷⁸

4. Maine — passed

Maine's Question 1⁷⁹ barely passed, with 50.17 percent approval.⁸⁰ With a 10 percent total recreational retail tax (stated as excise only and in lieu of standard sales tax), no weight tax, and only 5.5 percent sales tax on medical products, its revenue potential is low, and its tax structure is weak. Medical marijuana gets a 4.5 percent price break — less than in Massachusetts. But rates need to start low. As in Massachusetts, the Legislature can amend the tax freely.

5. California — passed

California's Proposition 64⁸¹ seems the most robust of last year's marijuana measures. First, it is the only 2016 initiative with a weight tax — 33 cents a gram (\$9.25 per ounce) of typically smoked flowers.⁸² That's 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. Unlike Alaska, Proposition 64 indexes for inflation. It also contains a typical marijuana excise tax at retail, at a 15 percent rate. So California follows the Colorado two-tax model.

Meanwhile, Proposition 64 goes a long way toward uniform taxation. Medical marijuana incurs the 15 percent marijuana excise tax and the weight tax, like recreational pot does. It does not incur California's 7.5 percent sales tax, so that's the extent of its tax break. California "has a stronger medical marijuana advocacy community and industry than Colorado," according to Rachel Barry, a member of the California Blue Ribbon Commission on marijuana legalization, and her coauthor Stan Glantz.⁸³ But so far, California medical users would get a much smaller tax break than Colorado's reportedly weak medical community gets in that state. That provoked opposition⁸⁴ to Proposition 64 from

⁶⁹Full Text of Proposition 205, *available at* <http://bit.ly/2h1VLAy> (last visited Dec. 17, 2016).

⁷⁰Arizona Marijuana Legalization, Proposition 205 (2016), *available at* <http://bit.ly/2bGYeSb> (last visited Dec. 17, 2016).

⁷¹Howard Fischer, "Foes of Legalized Recreational Marijuana in Arizona Have Cash Edge," *Tuscon.com* (Oct. 2, 2016). Thanks to marijuana policy scholar Philip Wallach of the Brookings Institution for pointing that out.

⁷²"Cannabis vs. Trump 2016 Election Results" (Nov. 30, 2016), *available at* <http://bit.ly/2i0YOe2>.

⁷³Nevada Marijuana Legalization, Question 2 (2016), *available at* <http://bit.ly/2c2Ew04> (last visited Dec. 17, 2016).

⁷⁴*Id.*

⁷⁵*Id.*, section 3.9 of Question 2.

⁷⁶Yes on 4, "Full Initiative Text," *available at* <http://bit.ly/2hcLLt1> (last visited Dec. 15, 2016).

⁷⁷Massachusetts Marijuana Legalization, Question 4 (2016), *available at* <http://bit.ly/2c6hHd4> (last visited Dec. 18, 2016).

⁷⁸Jessica Bartlett, "Mass. Pols Say Marijuana Taxation Still Needs to Be Hashed Out," *The Business Journals*, Oct. 28, 2016.

⁷⁹*Available at* <http://bit.ly/2i0WC6q> (last visited Dec. 15, 2016).

⁸⁰Maine Marijuana Legalization, Question 1 (2016), *available at* <http://bit.ly/2e9BMBo> (last visited Dec. 19, 2016).

⁸¹*Available at* <http://bit.ly/2hTHGHw> (last visited Dec. 15, 2016).

⁸²In all states with weight-based taxes, lower rates are available for less-potent trim or leaves.

⁸³Barry and Glantz, "A Public Health Analysis of Two Proposed Marijuana Legalization Initiatives for the 2016 California Ballot: Creating the New Tobacco Industry" (Feb. 2016), *available at* <http://bit.ly/2hTe2SE>. The authors critically assess the claims made by Proposition 64 from a public health perspective, and cover far more than taxation.

⁸⁴David Downs, "Proposition 64 Leads in the Polls. But Insiders Say Weed Prohibition's End Is No Sure Thing," *East Bay Express*, Oct. 5, 2016.

State Marijuana Tax Issues				
	Weight Tax?	Can Legislature Amend Taxes in Initiative?	Tax Break for Medical Marijuana?	Ratio of Medical Tax To Recreational Tax
Alaska	Yes, unindexed	Yes	0	100%
California	Yes, indexed	Needs 2/3 of each House	7.5%	>67%
Colorado	Yes, de facto	Voter approval needed for new or higher taxes	25%	10%
Maine	No	Yes	4.5%	55%
Massachusetts	No	Yes	10%	0
Nevada	No	Only after 3 years	15%	31%
Oregon	No	Yes	17%	0
Washington	No	Needs 2/3 of each House for first two years.	6.5%	85%

the California medical community; the small break speaks for the ability of California drafters to stick up for sound taxes.

Proposition 64 allows amendments that further its “purposes and intent,” including changes to taxes by a vote of two-thirds of each legislative house. By default, initiatives in California aren’t amendable⁸⁵ 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 antitax tilt of 1978’s Proposition 13, which requires a two-thirds supermajority for tax increases, is sacrosanct to many California voters. Trying to override Proposition 13 could have been a deal-killer. As an alternative, a slowly ratcheting phase-up of rates would have been useful, but would have been radical and controversial.

The need for that kind of flexibility turned up even before Election Day, because drafters erroneously⁸⁶ repealed the sales tax on medical marijuana before its replacements took effect. An opponent of Proposition 64 suggested that that blunder could cost \$50 million.⁸⁷ Supporters of Proposition 64 are calling for the Legislature to quickly correct that error.

D. Evaluating Marijuana Taxes

It’s hard to rank the enacted state tax schemes even on paper, because so much depends on enforcement. But looking for the three structural criteria discussed above — a non-price tax base, amendability, and uniform taxation, I would rank the tax schemes:

1. Alaska⁸⁸

⁸⁵Comparison, *supra* note 36.

⁸⁶Oglesby, “\$50 Million ‘Blunder’ in Prop 64?” Newrevenue.org, Nov. 12, 2016.

⁸⁷*Id.*

⁸⁸Initially, I ranked California’s law as stronger than Alaska’s, in part because Alaska’s law was delayed in implementation, with the

(Footnote continued in next column.)

2. California
3. Colorado and Washington(tie)⁸⁹
5. Maine
6. Massachusetts
7. Oregon
8. Nevada

Let’s be clear — those rankings are only about taxes. And taxation is only one problem among many in legalization. To promote debate, any readers’ rankings sent to po@newrevenue.org will be published at www.newrevenue.org.

V. 3 Problems That May Follow Enactment

At least three problems with marijuana taxes have not been ripe for a ballot solution so far.

First, adequate enforcement cannot be guaranteed by ballot measure.⁹⁰ A tax burden is not too high in isolation. Equally important to tax collection, and to defeating the black market, is enforcement of tax laws.⁹¹ So the trap of inadequate enforcement lurks after enactment.

Enforcement will take time and will depend on future public attitudes. In 1933 Congress heard about alcohol from tax man Luther Gulick:

Bootlegging cannot be stamped out in the United States by low taxes. [An initially] low tax rate will not

same start date as Oregon. Oglesby, “Best Marijuana Taxes Yet: California’s Proposition 64” (Oct. 6, 2016), *available at* <https://ssrn.com/abstract=2848932>. The current ranking reflects that Alaska’s law is operational and that the drafting error in California’s law does not inspire confidence. *See* Oglesby, *supra* note 86.

⁸⁹Before enactment, I ranked Washington’s tax structure as sounder than Colorado’s. Oglesby, *supra* note 44. That was before it became apparent that Colorado would tax by weight.

⁹⁰Adequate penalties are a factor in enforcement, but are beyond the scope here. Honest players in the legal marijuana industry might be torn between high penalties, which penalize cheaters, and low penalties, in case they worry about committing unintended violations.

⁹¹*See* fuller discussion at Part II of Vermont Supplement, *supra* note 19.

solve the problem by itself. It has got to be solved by law enforcement and by the recognition by the citizens of this country that they have more today to gain than they have to lose by buying legitimate liquors through legitimate channels. . . . Therefore, it is not only necessary to have taxes, but it is necessary to have rigid enforcement, and a new attitude on the part of the public at large. It seems to me there is an opportunity for that new attitude.⁹²

Second, state producer taxes will fade if the federal government legalizes marijuana. Producers are a long-term source of revenue only for a jurisdiction that prohibits imports.⁹³ Federal legalization will change everything. Legalizing states can try to prohibit sales of marijuana grown or processed elsewhere — and they all do. States can prohibit that interstate commerce because the federal commerce clause does not apply to marijuana, so long as it is federally illegal. Once federal illegality disappears, legal interstate commerce will begin.

My state of North Carolina doesn't tax tobacco grown here or cigarettes manufactured here unless the ultimate retail purchase happens here. That's because production is more mobile than consumers. If North Carolina tried to tax farmers or manufacturers, those functions would disappear here and thrive in a state that would keep taxes low — perhaps Virginia. So state weight and THC taxes will tend to be imposed and collected by the state of consumption, or its stand-in, the state of retail purchase.

Third, as more states legalize, interstate tax competition will open the door to interstate retail tax arbitrage, as with tobacco taxes.⁹⁴ Already, Washington is seeing evidence that low-taxed marijuana in Oregon is hurting Washington

sales.⁹⁵ Unless federal taxation dominates, a race to the bottom may put every competing jurisdiction's marijuana taxes at risk. Marijuana is enormously more valuable by weight and volume than tobacco. Therefore, the economic incentive to buy low-taxed cigarettes at retail in Virginia and to resell illegally in New York may be dwarfed by the incentive to buy marijuana at retail in a low-tax state to resell in a high-tax state. A high federal tax, high enough to dominate the field, would address that problem.⁹⁶ A credit for state taxes paid might leave state tax burdens in place.⁹⁷ A more likely scenario is that states would need to adjust by scaling back.

VI. Summing Up

It's unclear that marijuana taxes will stand the test of time. Legal commerce itself could fade away with a new administration. If for-profit marijuana commerce endures, some kind of marijuana taxes will too. The tax base march of progress is likely to continue. And the tax burden can go up too.

The soundness of state marijuana taxes will depend on the ability of legislatures to dodge special interests and to make midcourse corrections. But state constitutions make some initiative-passed laws inherently inflexible. Like initiatives, legislation faces threats from medical tax breaks and reliance on flimsy price-based taxes. Post-enactment, any tax scheme faces the threat of inadequate enforcement. Interstate commerce will threaten state producer taxes, and federal tax dominance could vitiate even the soundest state tax.

Voters like marijuana revenue for government. But state marijuana tax laws are likely to remain works in progress for a long time. ■

⁹²Statement of Luther Gulick, Director of the Institute of Public Administration, Hearings, *supra* note 16, at 147-48. Luke Bruner, co-founder of California Cannabis Voice Humboldt, suggests that consumers could perceive branded, tested product as worth a big price premium.

⁹³Similarly, local canopy taxes on growers in California will fade as localities, which cannot ban product grown elsewhere in California, compete to offer low taxes. But producer taxes are susceptible of being made progressive. Witness the federal tax breaks for small brewers and winemakers.

⁹⁴Mark A.R. Kleiman, "Did Tobacco Taxes Really Kill Eric Garner?" *The National Review*, Dec. 12, 2014 ("it's not the absolute level of taxation that creates most of the problem. . . . The problem is the difference in tax levels between the states").

⁹⁵Washington State Economic and Revenue Forecast (Sept. 2016) at 79.

⁹⁶The federal government could distribute the proceeds to states, but unless it does the collecting of its own tax, states might well race to the bottom. But the federal burden would need to dominate state tax burdens. The Tax Foundation suggests a 5-cent-per-gram marijuana excise tax (stated as \$23 per pound). Ekins and Henchman, *supra* note 8. The Foundation projects that tax would bring in \$500 million annually for the federal government. That federal take would be dwarfed by the \$13 billion in annual excise taxes the Foundation suggests that state governments might raise. A race to the bottom could be expected from that setup.

⁹⁷*Cf.* Keith Humphreys, "What Tobacco Tax Advocates Can Learn From American Drug Policy," *The Huffington Post*, June 12, 2014.

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