

Taxing Marijuana: The Washington and Colorado Experience

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Key Findings

- Because marijuana can be purchased as a cigarette, an edible, a liquid, or vapor, all with a wide variety of concentrations, a specific excise tax is untenable.
- Colorado collects tax revenue from marijuana sales through a 15 percent excise based tax on the average wholesale market rate; a 10 percent state tax on retail marijuana sales; a state sales tax of 2.9 percent; varied local sales taxes; and local marijuana taxes such as a 3.5 percent tax in Denver.
- Washington State collects tax revenue from marijuana sales through a 25 percent tax on producer sales to processors; a 25 percent tax on processor sales to retailers; a 25 percent tax on retailer sales to customers; a state Business & Occupation (B&O) gross receipts tax; a state sales tax of 6.5 percent; and varied local sales taxes. The total effective tax rate to be about 44 percent.
- Tax collections in Colorado have fallen short of projected revenue estimates, whereas collections in Washington have fallen within the wide range of project revenue estimates.
- Colorado's marijuana revenue shortfall is due to incorrect projections about the switch from lower-taxed medical marijuana to higher-taxed retail marijuana by consumers.
- States with possible upcoming ballot initiatives should take note of effective and ineffective methods of taxing marijuana as the issue is likely to expand.

In November 2012, voters in Colorado and Washington State approved legal retail sales of marijuana, with Colorado sales starting January 1, 2014 and Washington sales starting June 1, 2014. The ballot initiatives passed by strong margins (Colorado Amendment 64 passed 55 percent to 45 percent; Washington Initiative 502 passed 56 percent to 44 percent). Retail sales would be separate from each state's preexisting medical marijuana programs.

Creating a legal structure out of whole cloth has been challenging. In both states, sales are for adults age 21 or over, it remains illegal to use in public and to drive under the influence, and taking marijuana outside the state is illegal. (Neighboring states are still impacted, however.¹) In Washington, adults can purchase up to one ounce of "bud" (the flowering part of the plant), 16 ounces of edible solids, 72 ounces of edible liquids, or 7 grams of concentrates or lotions. In Colorado, residents can purchase up to one ounce of any kind of marijuana product and non-residents can purchase up to a quarter of an ounce. Sellers must be licensed and must meet health and safety requirements, employers can still ban use by employees, and Washington capped the number of retail locations. The product is still against federal law, which in turn keeps the nascent industry on a cash basis and may lead to punitive federal tax treatment.²

Taxing marijuana presents unique challenges, because the product takes so many different forms. Excise taxes on other products are historically imposed at a specific amount regardless of the retail price. Examples include the federal gasoline tax of 18.4 cents per gallon and the federal cigarette tax of \$1.0066 per pack. Because marijuana can be purchased as a cigarette, an edible, a liquid, or vapor, all with a wide variety of concentrations, a specific excise tax is untenable.

Colorado

Colorado's marijuana tax is structured as a 15 percent excise tax on the "average market rate" of wholesale marijuana, plus a 10 percent state tax on retail marijuana sales, plus the state sales tax of 2.9 percent, plus local sales taxes, plus local marijuana taxes such as a 3.5 percent tax in Denver.³ When these taxes are added up, in Denver for example, a \$30 eighth of pot (1/8 oz.) will have about \$8.59 in taxes tacked onto it, or about a 29

1 See, e.g., Trevor Hughes, *In tiny Nebraska towns, a flood of Colorado marijuana*, USA TODAY, June 11, 2014, <http://www.usatoday.com/story/news/nation/2014/06/11/colorado-marijuana-exports/9964707/>; Harriet Baskas, *Marijuana at airports: Colo., Wash. adjust to new law*, USA TODAY, June 20, 2014, <http://www.usatoday.com/story/travel/flights/2014/06/18/marijuana-colorado-washington-tsa-airports/10681759/>; Matt Ferner, *Keep Your Legal Weed in Colorado, Say Cops in Neighboring States*, HUFFINGTON POST, May 28, 2014, http://www.huffingtonpost.com/2014/05/28/colorado-marijuana_n_5405422.html;

2 See, e.g., Joseph Henchman, *Tax Code Disallows Business Deductions for Marijuana Sales*, TAX FOUNDATION TAX POLICY BLOG, FEB. 6, 2014, <http://taxfoundation.org/blog/tax-code-disallows-business-deductions-marijuana-sales>; Tyler Dennis & Scott Eastman, *IRS Penalties Force Colorado Marijuana Retailers to Face Higher Tax Burdens*, TAX FOUNDATION TAX POLICY BLOG, July 11, 2014, <http://taxfoundation.org/blog/irs-penalties-force-colorado-marijuana-retailers-face-higher-tax-burdens>.

3 See Colorado Department of Revenue, *Information for Cultivators*, <http://www.colorado.gov/cs/Satellite/Revenue/REXX/1251649610680>; Jeremy P. Meyer, *Denver Voters Backing 3.5 Percent Tax on Pot*, DENVER POST, Nov. 5, 2013, http://www.denverpost.com/breakingnews/ci_24461037/denver-voters-weigh-3-5-percent-marijuana-tax.

percent overall tax rate.⁴ (By comparison, the equivalent tax on cigarettes is about 31 percent and on beer only about 8 percent.⁵)

Six months of legal retail marijuana sales have generated \$21.8 million in tax revenue plus another \$10.1 million in taxes on medical marijuana in that time period (see Table 1).⁶ For the new fiscal year that began July 1, 2014, state analysts project \$30.6 million in revenue.⁷ These amounts have fallen short of earlier estimates. During the initiative campaign, voters were told marijuana excise taxes would boost revenues by \$70 million per year, with the first \$40 million each year dedicated to school construction and leaving \$30 million for enforcement and general state funds.⁸ As early as April 2013, the nonprofit research group Colorado Futures Center prophetically warned that actual revenue would be unlikely to even meet that \$40 million need each year, leaving nothing for enforcement costs.⁹

State officials are investigating the causes for the revenue shortfall. Retailers were slow to open, impacting revenue collections. State economists say they were wrong in assuming that retail marijuana would cannibalize medical marijuana sales, which have actually remained steady.¹⁰ The Department of Revenue suggests that tax differentials are a key reason, because medical marijuana purchases are subject only to state and local sales taxes (after paying a \$15 registration fee), a tax rate one-third of that imposed on retail marijuana.¹¹ Visitors holding an out-of-state identification card have been responsible for 44 percent of retail sales.¹² The analysis found a disconnect between legal supply (77 metric tons) and surveyed demand (130 metric tons), estimating that the gray market (home growing and caregivers) is supplying approximately 46 metric tons and the black market is supplying approximately 7 metric tons (6 percent of total demand).¹³

4 See, e.g., Global Index Price for Marijuana, *Colorado, United States*, <http://www.priceofweed.com/prices/United-States/Colorado.html>; John Ingold, *Colorado Voters Approve New Taxes on Recreational Marijuana*, DENVER POST, Nov. 5, 2013, http://www.denverpost.com/breakingnews/ci_24462839/colorado-voters-approve-new-taxes-recreational-marijuana.

5 Cigarette tax calculations derived from Campaign for Tobacco-Free Kids, *State Excise and Sales Taxes Per Pack of Cigarettes* (June 20, 2014), <http://www.tobaccofreekids.org/research/factsheets/pdf/0202.pdf>.

6 See Colorado Department of Revenue, *Colorado Marijuana Tax Data*, <http://www.colorado.gov/cs/Satellite/Revenue-Main/XRM/1251633259746>.

7 See Colorado Legislative Council Staff, Economics Section, *Focus Colorado: Economic and Revenue Forecast* (June 20, 2014) at 29-30, [http://www.leg.state.co.us/lcs/econforecast.nsf/vwFile/1406/\\$File/14JuneForecast.pdf#page=29](http://www.leg.state.co.us/lcs/econforecast.nsf/vwFile/1406/$File/14JuneForecast.pdf#page=29).

8 See Joseph Henchman, *Colorado Begins Legal Marijuana Sales, Collecting Marijuana Tax*, TAX FOUNDATION TAX POLICY BLOG, Jan. 1, 2014, <http://taxfoundation.org/blog/colorado-begins-legal-marijuana-sales-collecting-marijuana-tax>.

9 See Colorado Futures Center, Charles Brown & Phyllis Resnick, *The Fiscal Impact of Amendment 64 on State Revenues* (Apr. 24, 2013), <https://webcom.colostate.edu/coloradofutures/files/2013/04/CFC-Amendment-64-Study-final2.pdf>.

10 See, e.g., John Ingold, *Colorado Lawmaker Seeks Marijuana Tax Review Amid Disappointing Sales*, DENVER POST, Aug. 13, 2014, http://www.denverpost.com/news/ci_26323416/amid-disappointing-sales-colorado-lawmaker-seeks-marijuana-tax.

11 See Colorado Department of Revenue, *Market Size and Demand for Marijuana in Colorado* (July 2014), <http://goo.gl/yM5T3i>.

12 See *id.*

13 See, e.g., Matt Ferner, *Colorado's Black Market Is More Complicated Than It Looks*, HUFFINGTON POST, Aug. 13, 2014, http://www.huffingtonpost.com/2014/08/13/colorado-marijuana-black-market_n_5669302.html.

Table 1. Colorado Tax and License Collections from Marijuana Sales, 2014 (\$ thousands)

	Jan	Feb	Mar	Apr	May	Jun	Total
15% Wholesale Tax	195	339	609	734	1,135	969	3,983
10% Retail Tax	1,401	1,434	1,898	2,217	2,070	2,473	11,496
2.9% Sales Tax							
Medical	913	1,022	999	919	927	830	5,612
Retail	416	438	569	639	642	700	3,406
Licenses							
Medical	496	754	794	622	867	1,040	4,573
Retail	96	103	108	139	72	507	2,932
Total	3,519	4,092	4,980	5,273	5,715	6,522	32,002

Note: Retail license total includes \$1.9 million in startup revenue collected prior to January. Totals may not sum due to rounding.

Source: Colorado Department of Revenue.

Washington

Washington State imposes a 25 percent tax on producer sales to processors, another 25 percent tax on processor sales to retailers, and a further 25 percent tax on retailer sales to customers, plus the state Business & Occupation (B&O) gross receipts tax, plus the state sales tax of 6.5 percent, plus local sales taxes. Moody's calculated the total effective tax rate to be about 44 percent.¹⁴ By comparison, Washington taxes cigarettes at about 104 percent and beer at about 11 percent (recently cut from 16 percent).¹⁵

The first month of legalization resulted in \$3.8 million in sales and about \$1 million in tax revenue. The Washington State Liquor Control Board, in charge of the program, estimates two-year marijuana tax revenue for the 2015-17 biennium will be \$122,459,893; for the 2017-19 biennium it will be \$336,898,396. Voters were told legalization could bring in as much as \$1.9 billion over five years; Sharon Foster of Washington State Liquor Control Board notes that many people took that as the revenue estimate. So while actual collections are within the wide range suggested to voters, they will likely be on the lower end.

Other Jurisdictions

Other jurisdictions are considering joining Colorado and Washington in votes on November 4 of this year. Alaska voters will decide Measure 2, which legalizes marijuana and imposes a \$50 per ounce wholesale tax (equivalent to about a 21 percent tax).¹⁶ Oregon voters will decide Measure 91, which legalizes marijuana and imposes a \$35 per

14 See Niraj Chokshi, *Moody's: Washington might not see the marijuana tax windfall previously projected*, WASHINGTON POST, JULY 22, 2014, <http://www.washingtonpost.com/blogs/govbeat/wp/2014/07/22/moodys-washington-might-not-see-the-marijuana-tax-windfall-previously-projected/>.

15 Cigarette tax calculations derived from Campaign for Tobacco-Free Kids, *State Excise and Sales Taxes Per Pack of Cigarettes* (June 20, 2014), <http://www.tobaccofreekids.org/research/factsheets/pdf/0202.pdf>; *Washington state House Democrats drop beer tax, other revenue proposals*, ASSOCIATED PRESS, Apr. 23, 2013, http://www.oregonlive.com/politics/index.ssf/2013/04/washington_state_house_democra.html.

16 See Ballotpedia, *Alaska Marijuana Legalization, Ballot Measure 2 (2014)*, [http://ballotpedia.org/Alaska_Marijuana_Legalization_Ballot_Measure_2_\(2014\)](http://ballotpedia.org/Alaska_Marijuana_Legalization_Ballot_Measure_2_(2014)).

ounce wholesale tax (equivalent to about a 15 percent tax).¹⁷ The District of Columbia will decide Initiative 71, which legalizes possession of small amounts of marijuana, and the D.C. Council is considering a separate regulation and tax bill.¹⁸

These proposals are likely just the beginning. Joe Brenzy of the Nevada Cannabis Industry Association told legislators at the Council of State Governments annual meeting that proponents are pushing ballot initiatives in the near future for Arizona, California, Maine, Massachusetts, Minnesota, and Nevada, and legislative efforts in Delaware, Hawaii, Maryland, New Hampshire, Rhode Island, Texas, and Vermont. Brenzy also predicted the end of federal marijuana prohibition by 2020, based on how long it took alcohol prohibition to end in the 1930s. When asked by a legislator why marijuana proponents are going around legislators, Brenzy said they have been given no choice. He expressed eagerness to work with legislators, but in states where a majority of people support legalization and legislators won't consider it, proponents have the resources to go straight to voters and will do so. He said 25 states will have legal retail marijuana sales within 5 years, which can be interpreted as either a prediction or a goal.

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¹⁷ See Ballotpedia, *Oregon Legalized Marijuana Initiative, Measure 91 (2014)*, [http://ballotpedia.org/Oregon_Legalized_Marijuana_Initiative,_Measure_91_\(2014\)](http://ballotpedia.org/Oregon_Legalized_Marijuana_Initiative,_Measure_91_(2014)).

¹⁸ See Ballotpedia, *Washington D.C. Marijuana Legalization, Initiative 71 (November 2014)*, [http://ballotpedia.org/Washington_D.C._Marijuana_Legalization,_Initiative_71_\(November_2014\)](http://ballotpedia.org/Washington_D.C._Marijuana_Legalization,_Initiative_71_(November_2014)); Drug Policy Alliance, *Marijuana Initiative Qualifies for Washington, D.C. November Ballot*, Aug. 6, 2014, <https://www.drugpolicy.org/news/2014/08/marijuana-initiative-qualifies-washington-dc-november-ballot>.