

Marijuana Legalization and Taxes: Lessons for Other States from Colorado and Washington

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Key Findings

- Marijuana tax collections in Colorado and Washington have exceeded initial estimates, and a nationwide legalization-and-tax regime could see states raise billions of dollars per year in marijuana tax revenue.
- Colorado, Washington, and Oregon have all taken steps to reduce their marijuana tax rates, with Alaska considering it, after initial rates of 30 percent or more did not reduce the black market sufficiently. More recent ballot initiative proposals across the country propose rates between 10 and 25 percent.
- Tax rates on final retail sales have proven the most workable form of taxation. Other forms of taxation that have been proposed, such as taxing marijuana flowers at a certain dollar amount, taxing at the processor or producer level rather than the retail level, or taxing products by their level of THC, have faced practical implementation difficulties.
- Medical marijuana is usually more loosely regulated and less taxed than recreational marijuana. In Washington, moving non-medical sales to the retail market has proven difficult given the enormous differentials in tax rates and regulatory structure, and officials there wish the two systems had been tackled simultaneously.
- While the revenue can be in the tens or even hundreds of millions of dollars, it takes a lead time to develop. Revenues started out slowly in Colorado and Washington, as consumers became familiar with the new system and after state and local authorities spent time and money setting up new frameworks and regulatory infrastructure.
- Significant attention must be given to health, agricultural, zoning, local enforcement, and criminal penalty issues. These important issues have generally been unaddressed in ballot initiatives and left for resolution in the implementation process.

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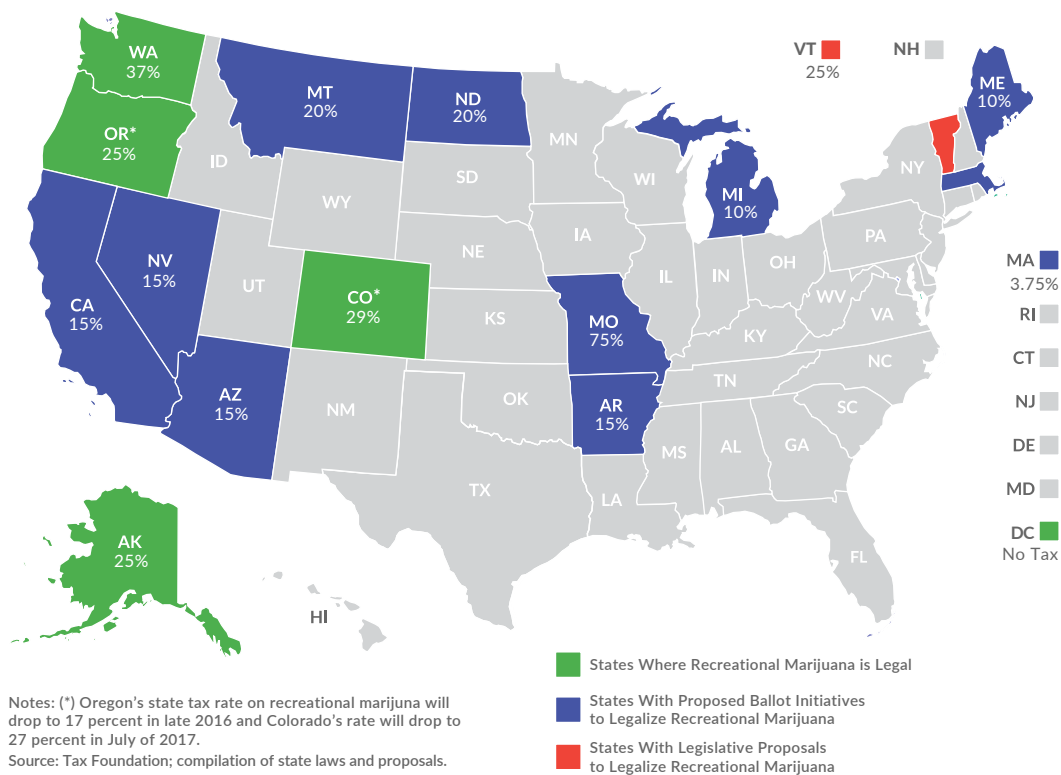
Introduction

Four states and the District of Columbia have legalized the sale of retail marijuana by popular vote, with an additional 25 states permitting medical marijuana or decriminalizing marijuana possession.¹ Beginning in 2011, polls have consistently showed a majority of Americans supportive of legalizing marijuana,² and a number of states are likely to consider legalization ballot initiatives or legislative measures in the next few years.

Creating a legal structure out of whole cloth has been challenging. Colorado and Washington faced challenges in revising health inspection, business regulatory, and criminal enforcement structures for the industry. In both states, sales are for adults age 21 or over, it remains illegal to use in public and to drive under the influence (defined in both states as more than 5 nanograms of THC per mL of blood³), and transporting marijuana outside the state is illegal.

How High Is the Tax on Recreational Marijuana in Your State?

State Excise Tax Rates on Recreational Marijuana, 2016



- 1 Legalization:** Colorado (passed 2012, in effect 2014), Washington (passed 2012, in effect 2014), Oregon (passed 2014, in effect 2015), Alaska (passed 2014, in effect 2016), the District of Columbia (passed 2014, non-sales features in effect 2015, sales features on hold due to congressional opposition). **Medical marijuana:** California (1996), Alaska (1998), Oregon (1998), Washington (1998), Maine (1999), Colorado (2000), Hawaii (2000), Nevada (2000), Montana (2004), Rhode Island (2006), New Mexico (2007), Vermont (2007), Michigan (2008), Arizona (2010), New Jersey (2010), Delaware (2011), the District of Columbia (2011), Connecticut (2012), New Hampshire (2013), Massachusetts (2013), Maryland (2014), Minnesota (2014), New York (2014), Guam (2014), Georgia (2015), Texas (2015). **Decriminalization:** Oregon (1973), Alaska (1975), Colorado (1975), California (1976), Maine (1976), Minnesota (1976), Ohio (1976), New York (1977), North Carolina (1977), Mississippi (1978), Nebraska (1979), Nevada (2002), Massachusetts (2009), Maryland (2014), Delaware (2015), Missouri (2017).
- 2** See Gallup, "Illegal Drugs," <http://www.gallup.com/poll/1657/illegal-drugs.aspx>.
- 3** For more on drugged driving laws, see National Organization for the Reform of Marijuana Laws, *Drugged Driving*, <http://norml.org/legal/drugged-driving>.

(Neighboring states are still impacted, however.⁴) 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 marijuana-infused 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 and employers can still ban use by employees. Both states have also struggled to split enforcement and zoning responsibilities between the state government and local governments, as well as the revenues to pay for it. Washington adopted a strict cap on licensed locations, modeled after its strict licensing of alcohol stores. Colorado relied on local authorities for retail store location decisions.

Taxing marijuana presents unique challenges because the product takes so many different forms.⁵ 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 a vapor, all with a wide variety of concentrations, a specific excise tax is untenable. Each state thus far has framed its tax as a certain percentage of the retail or wholesale sales price (see Table 1).

Table 1.
Recreational Marijuana Tax Rates by State

State	Marijuana Tax	Other Taxes
Colorado	15 percent tax on wholesale marijuana price plus 10 percent state tax on marijuana sales price. 10 percent tax drops to 8 percent effective July 2017.	State and local sales taxes; business license fees; local marijuana taxes.
Washington	37 percent excise tax on marijuana sales price. Previously 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.	State Business & Occupation (B&O) taxes; state and local sales taxes.
Oregon	25 percent excise tax on marijuana sales price. Drops to 17 percent tax when regulatory structure begins operation in late 2016.	Localities can add another 2 percent tax.
Alaska (not yet in effect)	\$50 per ounce on marijuana cultivator, or approximately 20 percent effective tax rate. May change before implementation in late 2016.	
District of Columbia	Federal law currently prohibits DC from taxing marijuana.	

Source: State laws.

4 See, e.g., Joseph Henchman, *U.S. Supreme Court Declines to Hear Case Challenging Colorado Marijuana Law*, Tax Foundation Tax Policy Blog (Mar. 21, 2016), <http://taxfoundation.org/blog/us-supreme-court-declines-hear-case-challenging-colorado-marijuana-law/>; 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.

5 In the 1980s, many states enacted drug tax stamp laws requiring those selling illegal drugs such as marijuana, cocaine, and heroin to pay exorbitant taxes and affix stamps issued by the state to the product. Their underlying purpose was not to achieve compliance but rather to collect additional tax-related fines and penalties for those convicted of drug offenses. The laws fell out of vogue after courts concluded that it violated the Fifth Amendment right against self-incrimination to require purchasing of tax stamps for illegal products unless the state created a “firewall” between revenue officials and drug enforcement officials. See, e.g., *Waters v. Farr*, 291 S.W.3d 873 (Tenn. 2009). Consequently, the drug tax stamp laws and their stamps (which remain on the books in Alabama, Connecticut, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Massachusetts, Minnesota, Nebraska, Nevada, North Carolina, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, and Utah) have essentially become collector’s curiosities.

Additionally, the product is still against federal law, which in turn keeps the nascent industry on a cash basis, results in some account holders hiding the true nature of their business, and may lead to punitive federal tax treatment.⁶

Colorado

Retail marijuana sales in Colorado began on January 1, 2014, after voters approved Amendment 64 legalizing marijuana in November 2012 (55 percent to 45 percent) and Proposition AA establishing marijuana taxes in November 2013 (65 percent to 35 percent).⁷

After an initially slow start (with two in five purchases made by out-of-state visitors), Colorado marijuana tax revenues now greatly exceed original estimates of \$70 million per year. Collections of \$56 million in calendar year 2014 grew to \$113 million in calendar year 2015, and will likely exceed \$140 million in calendar year 2016. The state has scheduled a tax reduction for July 2017, after a state-sponsored study substantiated the claims that high tax rates were permitting the continued existence of black and gray market suppliers. The low tax rate on medical marijuana (2.9 percent) relative to retail marijuana (29 percent) has also resulted in little shift from medical to retail. Finally, harmonizing marijuana taxes with the state's TABOR spending limitation law has resulted in some implementation headaches.

Colorado Effective Tax Rate on Marijuana Totals 29 Percent

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.⁸

Additionally, marijuana retailers must pay state license fees.⁹

⁶ See Joseph Henchman, *Marijuana Legalization and Taxes: The Impact of Section 280E*, Tax Foundation Special Report (Apr. 20, 2016).

⁷ See Ballotpedia, Colorado Marijuana Legalization Initiative, Amendment 64 (2012), [https://ballotpedia.org/Colorado_Marijuana_Legalization_Initiative_Amendment_64_\(2012\)](https://ballotpedia.org/Colorado_Marijuana_Legalization_Initiative_Amendment_64_(2012)); Ballotpedia, Colorado Proposition AA, Taxes on the Sale of Marijuana (2013), [https://ballotpedia.org/Colorado_Proposition_AA_Taxes_on_the_Sale_of_Marijuana_\(2013\)](https://ballotpedia.org/Colorado_Proposition_AA_Taxes_on_the_Sale_of_Marijuana_(2013)). A 2006 initiative legalizing the possession of marijuana had been rejected, 41 percent to 59 percent. See Ballotpedia, Colorado Marijuana Possession, Initiative 44 (2006), [https://ballotpedia.org/Colorado_Marijuana_Possession_Initiative_44_\(2006\)](https://ballotpedia.org/Colorado_Marijuana_Possession_Initiative_44_(2006)).

⁸ See Colorado Department of Revenue, *Information for Cultivators*, <http://www.colorado.gov/cs/Satellite/Revenue/REVMX/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.

⁹ See Colorado Department of Revenue, *Retail Fees*, https://www.colorado.gov/pacific/sites/default/files/MED%20Fee%20Table%20Color%20for%20Invest_1.pdf.

When these taxes are added up, a \$30 eighth of pot (1/8 oz.) will have about \$8.59 in taxes tacked onto it, or about a 29 percent overall effective tax rate.¹⁰ (By comparison, the equivalent Colorado tax on cigarettes is about 31 percent and on beer about 8 percent.) The 10 percent state marijuana tax will drop to 8 percent beginning in July 2017, after concerns that the rate was too high to wipe out the black market.¹¹

Colorado Marijuana Tax Collections Will Likely Exceed \$140 Million per Year

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, leaving \$30 million for enforcement and general state funds.¹² Revenues initially proved disappointing for calendar year 2014, totaling \$56 million in tax revenue on sales of \$304 million.

However, impressive year-over-year growth in calendar year 2015 resulted in \$113 million in retail marijuana tax revenue on sales of \$568 million. In the most recent six months for which data are available (September 1, 2015 to February 29, 2016), Colorado collected \$64 million in retail marijuana tax revenue, up 64 percent from the same period a year earlier. Collections in calendar 2016 will likely be somewhere between \$143 million (assuming the market has stabilized at around \$56 million in monthly sales) to \$185 million (assuming the current growth rate continues). The state received some attention in 2015 when marijuana tax revenues were twice those of alcohol taxes; they may end up quadruple by the end of 2016.¹³

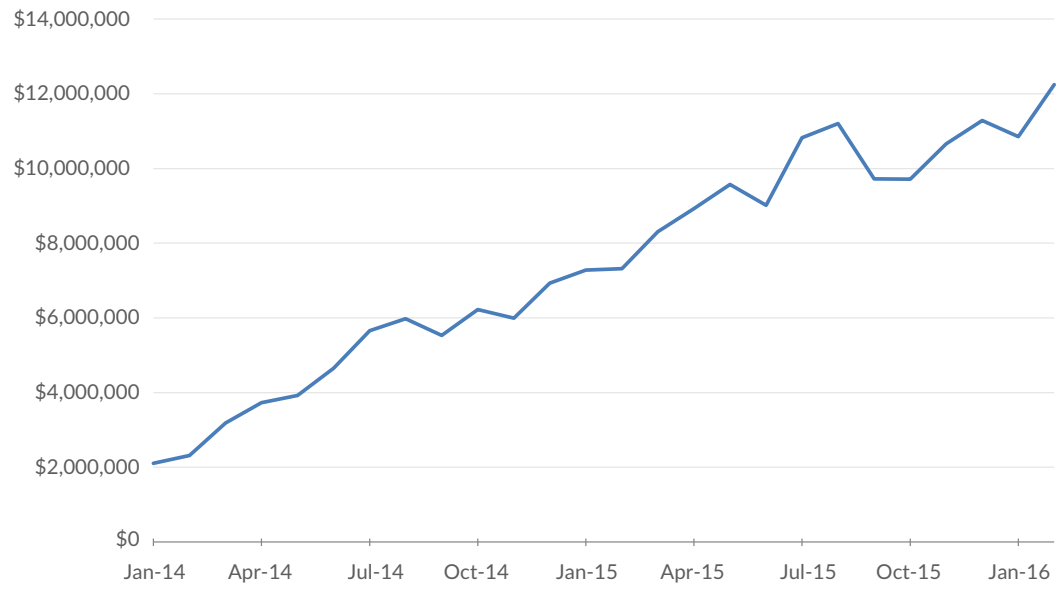
10 See, e.g., Global Index Price for Marijuana, *Colorado, United States*, <http://www.priceofweed.com/prices/United-States/Colorado.html>; John Ingold, *Colorado Voters Approve New Taxes on Recreational Marijuana*, *Denver Post*, Nov. 5, 2013, http://www.denverpost.com/breakingnews/ci_24462839/colorado-voters-approve-new-taxes-recreational-marijuana.

11 See John Frank, *Colorado to offer one-day tax holiday on marijuana*, *DENVER POST* (Jun. 4, 2015) (quoting Governor Hickenlooper: "We still have a black market, and we want to moderate our taxes to make sure that the risk of someone selling illegally. ... We want to eliminate that," Hickenlooper said. "And one way is to make sure there is not as large a price differential."), http://www.denverpost.com/news/ci_28252221/colorado-offer-one-day-tax-holiday-marijuana.

12 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).

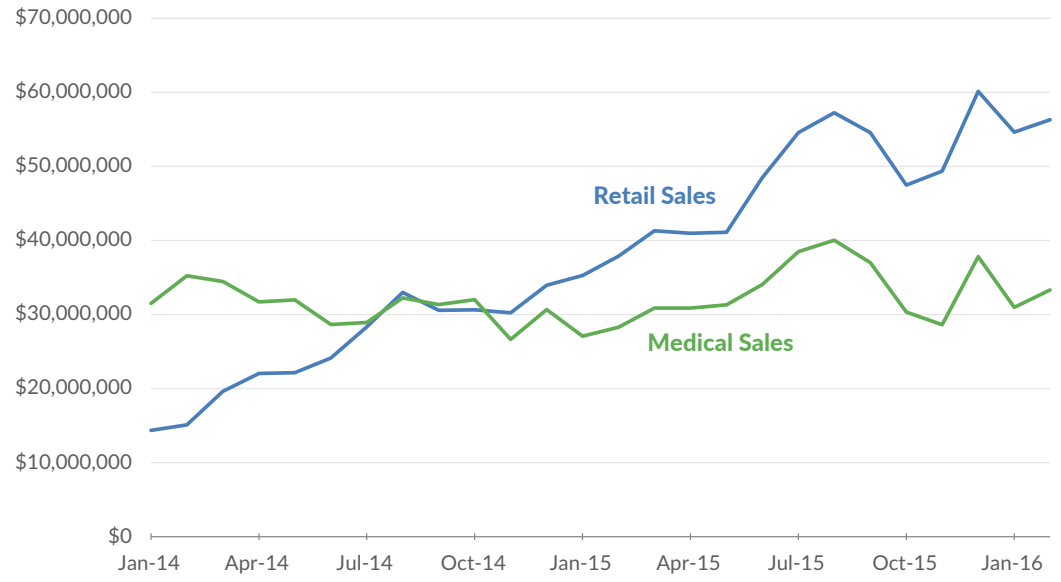
13 See, e.g., Tanya Basu, *Colorado Raised More Tax Revenue From Marijuana Than From Alcohol*, *TIME* (Sep. 16, 2015), <http://time.com/4037604/colorado-marijuana-tax-revenue/>.

Figure 1.
Colorado Retail Marijuana Tax Revenue by Month



Source: Colorado Department of Revenue.

Figure 2.
Colorado Retail Marijuana and Medical Marijuana Sales by Month



Source: Colorado Department of Revenue.

Colorado Has Made Inroads against the Gray and Black Market, but the Tax Differential between Retail and Medical Has Meant that Medical Sales Have Not Dropped

Marijuana demand was estimated at 130 metric tons in a July 2014 analysis by the Colorado Department of Revenue, outstripping legal supply (77 metric tons).¹⁴ The report estimated the balance to be the gray market (home growing and caregivers, some 46 metric tons) and the black market (7 metric tons).¹⁵ Visitors holding an out-of-state identification card have been responsible for 44 percent of retail sales.¹⁶

Colorado also imposes a 2.9 percent sales tax on medical marijuana sales, which pre-existed Amendment 64 and collects approximately \$10 million per year. Medical marijuana sales have been roughly flat year-over-year as the retail market came online, controverting earlier predictions that retail marijuana would cannibalize medical marijuana sales. 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.¹⁷

One way people have been avoiding their tax liability is through marijuana delivery services.¹⁸ These services, often advertised on Craigslist and similar posting websites, do not pay taxes as their products are allegedly “not for sale.” Instead, the delivery service asks for specific “donations” depending on the amount of marijuana the consumer purchases. One Denver advertisement, for example, asks for a \$200 donation for ounce, 21 percent cheaper than the \$243 average price in legal retail stores. Such subterfuge would be unlikely to pass muster before a judge or tax collector.

Harmonizing Marijuana Taxes with Colorado TABOR’s Has Resulted in Implementation Headaches

Colorado’s Taxpayer Bill of Rights (TABOR), enacted in 1992, requires the state to refund taxpayers if the state’s spending or revenue collections exceed the previous projections.¹⁹ Flush state revenues and higher state spending in 2015 triggered this provision for the first time since 2001, which required the marijuana tax (as a newly enacted tax) be reset to zero percent, with all amounts collected be refunded. To prevent this, legislators asked voters to approve a measure that overrides the repeal and refund requirements, permitting the state to keep the \$66 million in marijuana revenue collected up to that point. Voters approved the measure, Proposition BB, in November 2015 by a margin of 69 percent to 31 percent.²⁰

14 See Colorado Department of Revenue, *Market Size and Demand for Marijuana in Colorado* (July 2014), <https://www.colorado.gov/pacific/sites/default/files/Market%20Size%20and%20Demand%20Study,%20July%209,%202014%5B1%5D.pdf>.

15 See *id.*

16 See *id.*

17 See Colorado Department of Revenue, *Market Size and Demand for Marijuana in Colorado* (July 2014), <https://www.colorado.gov/pacific/sites/default/files/Market%20Size%20and%20Demand%20Study,%20July%209,%202014%5B1%5D.pdf>.

18 *Pot Delivery Services Thriving In Colorado’s Black Market*, CBS News, (May 6, 2015), <http://denver.cbslocal.com/2015/05/06/pot-delivery-services-thriving-in-colorados-black-market/>.

19 See Jared Walczak, *Colorado’s Marijuana Revenue High and Pending TABOR Refunds*, Tax Foundation Tax Policy Blog (May 27, 2015), <http://taxfoundation.org/blog/colorados-marijuana-revenue-high-and-pending-tabor-refunds>.

20 See Ballotpedia, *Colorado Marijuana TABOR Refund Measure, Proposition BB* (2015), [https://ballotpedia.org/Colorado_Marijuana_TABOR_Refund_Measure,_Proposition_BB_\(2015\)](https://ballotpedia.org/Colorado_Marijuana_TABOR_Refund_Measure,_Proposition_BB_(2015)).



To satisfy the constitution's requirement that state marijuana taxes be repealed for some length of time, legislators decided to suspend the 15 percent marijuana excise tax and the 10 percent marijuana sales tax (but not the regular state and local sales taxes) for one day, September 16, 2015.²¹ The one-day holiday did not seem to boost sales for the month as a whole.²²

Washington

Retail marijuana sales in Colorado began on July 8, 2014, after voters approved Initiative 502 in November 2012 (56 percent to 44 percent). Medical marijuana had been legal in the state since the passage of Initiative 692 in 1998, and that industry had been a "Wild West" with effectively no state licensing requirements, production standards, agricultural or health regulations, or taxation beyond the regular sales tax. Having separate and parallel medical marijuana and retail marijuana systems proved unworkable, so medical marijuana will fall under a harmonized and merged regulatory framework beginning in July 2016.²³ The new framework also directs 30 percent of marijuana tax revenue (after the first \$25 million) to local governments based on population.

Washington Now Imposes a 37 Percent Excise Tax on Marijuana After Struggling with Separate Taxes on Processors, Retailers, and Sales

As of July 2015, Washington imposes a 37 percent excise tax on the retail marijuana sales, plus the state Business & Occupation (B&O) gross receipts tax, plus the state sales tax of 6.5 percent, plus local sales taxes. The 37 percent excise tax replaces the earlier, more complicated tax structure: 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. The effective tax rate is approximately 37 percent.²⁴ This compares to a 104 percent effective tax rate on cigarettes and 11 percent effective tax rate on beer.²⁵ The 37 percent marijuana tax rate was selected as a revenue-neutral level compared to the earlier taxes, eliminates unintended double-taxation for businesses not set up as vertically integrated producer-processors, and its structure as an excise tax also ensures that retailers will not have collections included as gross income for federal income tax purposes.²⁶

21 See Joseph Henchman, *Colorado Suspends Marijuana Tax for One Day on September 16*, Tax Foundation Tax Policy Blog (Sep. 9, 2015), <http://taxfoundation.org/blog/colorado-suspends-marijuana-tax-one-day-september-16>.

22 See Ricardo Baca, *Colorado monthly marijuana sales slump in September*, THE CANNABIST (Nov. 11, 2015), <http://www.thecannabist.co/2015/11/11/colorado-marijuana-sales-update-september-2015/43676/>.

23 S.B. 5052, the Cannabis Patient Protection Act (signed into law, Apr. 24, 2015).

24 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/>.

25 *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.

26 Cannabis Now, *Washington Reforms Law to 37 Percent Flat Tax on Pot*, (Jul. 2, 2015), <http://cannabisnowmagazine.com/current-events/economics-current-events/washington-reforms-law-to-37-percent-flat-tax-on-pot>.

Revenue Started Slow But is Now Growing Quickly to Perhaps \$270 Million per Year

Voters were told legalization could bring in as much as \$1.9 billion over five years, with 40 percent going to the state general fund and local budgets and the remaining 60 percent intended for substance abuse prevention, research, education, and health care. In its first full year of sales, from July 1, 2015 to June 30, 2016, Washington state collected \$62 million in marijuana excise taxes, \$10 million in state sales taxes, \$1.3 million in state B&O taxes, and \$3.6 million in local sales taxes on \$157 million on retail sales.²⁷ (Medical marijuana generated another \$7 million in sales tax revenue, but this revenue is expected to decline due to medical marijuana law changes.)

Excise tax collection estimates for FY 2016 are \$134 million. Retail sales started very slowly in 2014, growing year-over-year from \$7 million in October 2014 to \$35 million in October 2015. As of April 2016, state sales average over \$2 million a day, which would mean excise tax revenue reaching some \$270 million per year.

Washington Pursued a Strict License System Similar to Previous Liquor Control

Initiative 502 directed the Washington State Liquor Control Board (WSLCB) to license and regulate marijuana retailers. The Board had shed most of its earlier responsibilities following the end of the state's liquor store monopoly in 2012, and its new marijuana responsibilities gave it a new lease on life (and a new name, the Liquor & Cannabis Board, still WSLCB).

The WSLCB set out to establish a "seed to sale" tracking system to control inventory, establish and maintain health standards, and facilitate agricultural and health regulation. The WSLCB had never previously collected taxes and much of that infrastructure had to be built from scratch, including cash collection abilities (opening new offices, buying armored cars, and even installing a teller window at the existing Olympia office). The WSLCB initially capped the number of retail licenses at 334, six more than the number of liquor stores pre-privatization. The number of licenses has since been increased to 556 following the expansion of the regulatory framework to medical marijuana providers.²⁸ Unrestricted medical "collective gardens" have been replaced by cooperatives with a maximum of four patients.²⁹

27 The Liquor & Cannabis Board and Department of Revenue provide separate revenue reports, the former for the excise tax and the latter for the sales taxes and B&O tax. See Washington State Liquor and Cannabis Board, *Weekly Marijuana Report*, <http://lcb.wa.gov/marij/dashboard>; Washington Department of Revenue, *Recreational Marijuana Taxes*, http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/stats_RMJTaxes.aspx.

28 See Washington State Liquor & Cannabis Board, *Board to increase number of retail marijuana stores following analysis of marketplace* (Jan. 6, 2016), <http://www.liq.wa.gov/pressreleases/lcb-to-increase-number-of-retail-mj-stores>.

29 See, e.g., Jayson Chesler, *Washington merges recreational and medical marijuana to stop illegal sales*, News21 (Aug. 15, 2015), [HTTP://WEEDRUSH.NEWS21.COM/WASHINGTON-MERGES-RECREATIONAL-AND-MEDICAL-MARIJUANA-TO-STOP-ILLEGAL-SALES/](http://WEEDRUSH.NEWS21.COM/WASHINGTON-MERGES-RECREATIONAL-AND-MEDICAL-MARIJUANA-TO-STOP-ILLEGAL-SALES/).

After Experience, Washington Modified Its Approaches on Zoning and Tribal Issues

Washington has also encountered implementation issues. Since I-502 provided no implementation funds prior to retail launch, the WSLCB was underfunded, particularly in enforcement and auditing. A state restriction prohibiting marijuana retailers within 1000 feet of schools, playgrounds, recreation centers, child care centers, transit centers, and libraries proved overbroad, and has been replaced with a 100 foot restriction around schools and playgrounds while letting local zoning authorities decide any further limitations. A compact with the Suquamish tribe was approved in September 2015 whereby the tribe and Washington agree to cooperate and collaborate in regulating the production, processing, sale, and taxation of marijuana.³⁰ Similar to tobacco tribal compacts, the tribe will impose its own excise tax to minimize cross-border arbitrage.

Oregon

Retail marijuana sales in Colorado began on October 1, 2015, after voters approved Measure 91 legalizing marijuana in November 2014 (56 percent to 44 percent).³¹ Sales were originally not to start until fall 2016, but legislation allowing existing medical marijuana facilities to sell to all adults was approved in July 2015 in the hopes of stamping out the black market.³² Marijuana possession also became legal in July 2015.

Oregon Has Switched From a Type-of-Product Tax to a 17 Percent Excise Tax

Measure 91 specified a harvest tax to be imposed on growers: \$35 per ounce of marijuana flowers, \$10 per ounce of leaves, and \$5 per immature plant. The tax revenue would be distributed 40 percent to schools, 20 percent to mental health alcoholism and drug services, 15 percent to the state police, 10 percent to cities, 10 percent to counties, and 5 percent to the Oregon Health Authority.

Concerned over the practical enforceability of such a tax system, legislators instead have replaced it with a 17 percent tax on the retail price of recreational marijuana, to take effect when the retail regulatory regime of the Oregon Liquor Control Commission (OLCC) is set up later in 2016. Localities will be able to impose an additional 3 percent tax. In the meantime, the Department of Revenue has been collecting a temporary 25 percent tax since January 1, 2016; sales prior to that date were untaxed.

30 See Brian Bardwell, *Washington Approves Nation's First State-Tribal Marijuana Compact*, STATE TAX NOTES (SEP. 18, 2015).

31 See Ballotpedia, *Oregon Legalized Marijuana Initiative, Measure 91 (2014)*, [https://ballotpedia.org/Oregon_Legalized_Marijuana_Initiative_Measure_91_\(2014\)](https://ballotpedia.org/Oregon_Legalized_Marijuana_Initiative_Measure_91_(2014)). A previous initiative to sell marijuana through state-operated stores was rejected in 2012, 47 percent to 53 percent. See Ballotpedia, *Oregon Cannabis Tax Act Initiative, Measure 80 (2012)*, [https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative_Measure_80_\(2012\)](https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative_Measure_80_(2012)).

32 See Shelby Sebens, *Oregon governor OKs early sales of recreational-use marijuana*, REUTERS (Jul. 29, 2015), <http://www.reuters.com/article/us-usa-marijuana-oregon-idUSKCN0Q404520150730>.

Dispensaries can keep 2 percent of tax collections to compensate them for the cost of collecting and remitting revenue for the state. The use of a sales-based tax is considered politically risky in Oregon, as the state does not have a sales tax and politicians tend to be leery of proposals resembling sales taxes.³³

In January 2016, Oregon collected \$3.48 million in taxes on \$14 million in recreational marijuana sales, three times official revenue projections.³⁴ Only 253 of 309 licensed dispensaries made tax payments; while some may not be selling recreational marijuana, some may not have known of their obligation to collect taxes. If so, future revenue could reach around \$60 million per year, even with the lower tax rate.

Alaska

Retail marijuana sales in Alaska are expected to begin in late 2016, after voters approved Ballot Measure 2 legalizing marijuana in November 2014 (53 percent to 47 percent).³⁵ The Marijuana Control Board, set up in May 2015, adopted regulations effective February 21, 2016 relating to marijuana packaging, store locations, distribution, edibles, and social clubs. The license application period began February 24, 2016, and a marijuana inventory tracking system is scheduled to launch on May 23, 2016.³⁶

Ballot Measure 2 set a \$50 per ounce tax on marijuana, paid by the marijuana cultivator when marijuana is transferred to a retail store or product marketing facility. At current going prices of \$250 per ounce in Anchorage, this would be a 20 percent effective tax rate.³⁷ (However, legislators have explored alternative taxation options.) The state Department of Revenue estimated state tax revenue between \$5.1 million and \$19.2 million per year, with regulatory and enforcement costs between \$3.7 million and \$7 million.³⁸

33 See, e.g., Jeff Mapes, *Marijuana sales tax approved -- with some nervousness -- in Oregon House*, THE OREGONIAN (Jun. 25, 2015), http://www.oregonlive.com/mapes/index.ssf/2015/06/marijuana_sales_tax_approved_.html.

34 See Bryan Darling, *Oregon collects three times expected amount of recreational marijuana taxes in first month*, Eugene Register-Guard (Mar. 18, 2016), <http://registerguard.com/rg/news/local/34174852-75/first-month-of-oregon-recreational-marijuana-taxes-nets-3.48-million.csp>.

35 See Ballotpedia, *Alaska Marijuana Legalization, Ballot Measure 2 (2014)*, [https://ballotpedia.org/Alaska_Marijuana_Legalization,_Ballot_Measure_2_\(2014\)](https://ballotpedia.org/Alaska_Marijuana_Legalization,_Ballot_Measure_2_(2014)). Alaska had previously rejected a legalization initiative in 2004. See Ballotpedia, *Alaska Legalize Marijuana Initiative, Measure 2 (2004)*, [https://ballotpedia.org/Alaska_Legalize_Marijuana_Initiative,_Measure_2_\(2004\)](https://ballotpedia.org/Alaska_Legalize_Marijuana_Initiative,_Measure_2_(2004)).

36 Alaska Alcohol & Marijuana Control Office, *FAQs*, <https://www.commerce.alaska.gov/web/amco/MarijuanaInitiativeFAQs.aspx>.

37 Data for the Price of Weed in Anchorage, <http://www.priceofweed.com/prices/United-States/Alaska.html>.

38 See Laurel Andrews, *The state weighs in: How much money will marijuana bring to Alaska?*, ALASKA DISPATCH NEWS, (Jul. 7, 2015), <http://www.adn.com/article/20150707/state-weighs-how-much-money-will-marijuana-bring-alaska>.

Marijuana legalization became effective in the District of Columbia on February 26, 2015, after voters approved Initiative 71 in November 2014 (70 percent to 30 percent).³⁹ However, Maryland Congressman Andy Harris (R), an opponent of marijuana legalization, inserted a provision into a federal budget bill prohibiting the District of Columbia from using federal or local funds to “enact or carry out any law, rule, or regulation to legalize or otherwise reduce penalties associated with the possession, use, or distribution of any schedule I substance.”⁴⁰ Consequently, while the initiative making marijuana legal has gone into effect, the District is prohibited from establishing any taxation, regulation, or sales structure.

One version of a bill considered by the D.C. Council would have set a 15 percent sales tax on marijuana, generating perhaps \$20 million per year.⁴¹

Other States

Vermont Gov. Peter Shumlin (D) called for the state to legalize and tax marijuana in his 2016 State of the State address, urging a tax rate that is “low enough to wipe out the black market and get rid of the illegal drug dealers.”⁴² Pending legislation, approved by the Vermont Senate and pending in the Vermont House, would impose a 25 percent tax based on the sales price of the product, and take effect July 1, 2016.⁴³

Ohio Issue 3, which would have granted ten monopoly licenses to grow and sell marijuana to retailers, with marijuana production facilities paying a 15 percent gross receipts tax and marijuana retailers paying a 5 percent gross receipts tax, was rejected in November 2015 by a vote of 36 percent to 64 percent.⁴⁴ The monopoly (or technically, oligopoly) structure of the proposal generated substantial opposition even from marijuana legalization proponents.

Nevada voters in November 2016 will consider Question 2, which would legalize marijuana and impose a 15 percent excise tax on the wholesale price of marijuana, plus the state sales tax, with revenue dedicated to K-12 education. Nevada previously rejected legalization proposals in 2006 by a vote of 44 percent to 56 percent, and in 2002 by a vote of 39 percent to 61 percent.⁴⁵

39 See Ballotpedia, Washington D.C. Marijuana Legalization, Initiative 71 (November 2014), [https://ballotpedia.org/Washington_D.C._Marijuana_Legalization_Initiative_71_\(November_2014\)](https://ballotpedia.org/Washington_D.C._Marijuana_Legalization_Initiative_71_(November_2014)).

40 P.L. 113-235, sec. 809, the Consolidated and Further Continuing Appropriations Act, 2015 (Dec. 16, 2014) (the “Cromnibus”).

41 See Mike DeBonis, *Legal marijuana could be \$130 million a year business in D.C., study finds*, Washington Post (Oct. 30, 2014), https://www.washingtonpost.com/local/dc-politics/legal-marijuana-could-be-a-130-million-a-year-business-in-dc-officials-find/2014/10/30/d6f80a52-603d-11e4-9f3a-7e28799e0549_story.html.

42 Neil Downing, *Vermont Governor Proposes to Legalize, Tax Recreational Marijuana*, STATE TAX NOTES (JAN. 11, 2016).

43 S. 241 (Vt. 2016). See also Brian Bardwell, *Marijuana Legalization Advances in Vermont, Hits Roadblock in Massachusetts*, STATE TAX NOTES (Apr. 18, 2016), <http://www.taxnotes.com/state-tax-today/excise-taxes/marijuana-legalization-advances-vermont-hits-roadblock-massachusetts/2016/04/18/18459616>.

44 See Ballotpedia, *Ohio Marijuana Legalization Initiative, Issue 3 (2015)*, [https://ballotpedia.org/Ohio_Marijuana_Legalization_Initiative_Issue_3_\(2015\)](https://ballotpedia.org/Ohio_Marijuana_Legalization_Initiative_Issue_3_(2015)).

45 See Ballotpedia, *Nevada Marijuana Initiative, Question 7 (2006)*, [https://ballotpedia.org/Nevada_Marijuana_Initiative_Question_7_\(2006\)](https://ballotpedia.org/Nevada_Marijuana_Initiative_Question_7_(2006)); Ballotpedia, *Nevada Decriminalization of Marijuana Amendment, Question 9 (2002)*, [https://ballotpedia.org/Nevada_Decriminalization_of_Marijuana_Amendment_Question_9_\(2002\)](https://ballotpedia.org/Nevada_Decriminalization_of_Marijuana_Amendment_Question_9_(2002)).

Ballot initiatives are circulating for signatures for the November 2016 election in nine states:⁴⁶

- **Arizona:** Proposed initiatives legalize marijuana and impose an excise tax ranging from 10 percent to 15 percent. State Rep. Mark Cardenas (D) has proposed a legislative alternative.
- **Arkansas:** A proposed initiative legalizes marijuana and imposes an excise tax of 5 percent.
- **California:** Proposed initiatives legalize marijuana and impose an excise tax ranging from 5 percent to 15 percent. California previously rejected legalization ballot initiatives, in 2010 by a vote of 46 percent to 54 percent, and in 1972 by a vote of 33 percent to 67 percent.⁴⁷
- **Maine:** A proposed initiative legalizes marijuana and imposes an excise tax of 10 percent, with the legislature having discretion to adjust the tax rate after 2022.
- **Massachusetts:** A proposed initiative legalizes marijuana and imposes an excise tax of 3.75 percent, with cities and towns permitted to impose an additional 2 percent tax. A study conducted by the Special Senate Committee on Marijuana, chaired by state Sen. Jason Lewis (D), estimated tax revenue of \$50 million to \$60 million.⁴⁸
- **Michigan:** One proposed initiative legalizes marijuana and specifies that it shall be subject to no tax, fines, or regulations. Another proposed initiative imposes an excise tax of 10 percent, with 40 percent of proceeds dedicated to transportation, 40 percent to education, and 20 percent to localities.
- **Missouri:** Proposed initiatives legalize marijuana and impose an excise tax ranging from 25 percent to 75 percent.
- **Montana:** A proposed initiative legalizes marijuana and imposes an excise tax of 20 percent.
- **North Dakota:** A proposed initiative legalizes marijuana and authorizes an excise tax of no more than 20 percent.

In the following table, we estimated the potential tax revenue for each state based on sales per capita observed so far in Colorado and Washington. If every state imposed a retail marijuana tax, total collections could range from \$5.3 billion at a 15 percent rate to \$8.8 billion at a 25 percent rate. Lower tax rates may capture more of the gray and black market than Colorado and Washington have to date, and state revenues in that circumstance could reach as much as \$18 billion.⁴⁹

⁴⁶ See Ballotpedia, Marijuana on the ballot, https://ballotpedia.org/Marijuana_on_the_ballot.

⁴⁷ See Ballotpedia, California Proposition 19, the Marijuana Legalization Initiative (2010), [https://ballotpedia.org/California_Proposition_19_the_Marijuana_Legalization_Initiative_\(2010\)](https://ballotpedia.org/California_Proposition_19_the_Marijuana_Legalization_Initiative_(2010)); Ballotpedia, California Marijuana Legalization, Proposition 19 (1972), [https://ballotpedia.org/California_Marijuana_Legalization_Proposition_19_\(1972\)](https://ballotpedia.org/California_Marijuana_Legalization_Proposition_19_(1972)).

⁴⁸ See Adam Vaccaro, *Senators say marijuana legalization is not a pot of gold*, Boston.com (Mar. 8, 2016), <https://www.boston.com/news/local-news/2016/03/08/senators-say-marijuana-legalization-is-not-a-pot-of-gold>.

⁴⁹ See W. Gavin Ekins & Joseph Henchman, *Marijuana Legalization and Taxes: Federal Revenue Impact*, Tax Foundation Fiscal Fact (Apr. 20, 2016).

Table 2.
Potential Recreational Marijuana Tax Revenue by State,
Based on Colorado and Washington Demand

State	15% tax	20% tax	25% tax
Alabama	\$80	\$107	\$134
Alaska	\$12	\$16	\$20
Arizona	\$113	\$150	\$188
Arkansas	\$49	\$66	\$82
California	\$646	\$861	\$1,076
Colorado	\$90	\$120	\$150
Connecticut	\$59	\$79	\$99
Delaware	\$16	\$21	\$26
District of Columbia	\$11	\$15	\$18
Florida	\$334	\$446	\$557
Georgia	\$169	\$225	\$281
Hawaii	\$24	\$31	\$39
Idaho	\$27	\$36	\$46
Illinois	\$212	\$283	\$354
Indiana	\$109	\$146	\$182
Iowa	\$52	\$69	\$86
Kansas	\$48	\$64	\$80
Kentucky	\$73	\$97	\$122
Louisiana	\$77	\$103	\$128
Maine	\$22	\$29	\$37
Maryland	\$99	\$132	\$165
Massachusetts	\$112	\$149	\$187
Michigan	\$164	\$218	\$273
Minnesota	\$91	\$121	\$151
Mississippi	\$49	\$66	\$82
Missouri	\$100	\$134	\$167
Montana	\$17	\$23	\$28
Nebraska	\$31	\$42	\$52
Nevada	\$48	\$64	\$79
New Hampshire	\$22	\$29	\$37
New Jersey	\$148	\$197	\$246
New Mexico	\$34	\$46	\$57
New York	\$327	\$436	\$544
North Carolina	\$166	\$221	\$276
North Dakota	\$12	\$17	\$21
Ohio	\$192	\$255	\$319
Oklahoma	\$65	\$86	\$108
Oregon	\$66	\$89	\$111
Pennsylvania	\$211	\$282	\$352
Rhode Island	\$17	\$23	\$29
South Carolina	\$81	\$108	\$135
South Dakota	\$14	\$19	\$24
Tennessee	\$109	\$145	\$182
Texas	\$453	\$604	\$755
Utah	\$49	\$66	\$82
Vermont	\$10	\$14	\$17
Virginia	\$138	\$184	\$231
Washington	\$118	\$158	\$197
West Virginia	\$30	\$41	\$51
Wisconsin	\$95	\$127	\$159
Wyoming	\$10	\$13	\$16
All States	\$5,304	\$7,071	\$8,839

Note: millions of dollars

Federal law remains an obstacle to these state efforts in two major ways. First, marijuana remains on Schedule I of the Controlled Substances Act, the category reserved for dangerous drugs with a high potential for abuse and no accepted medical use. Because federal law trumps state law, those selling and possessing marijuana would get no protection from state legalization as long as those activities violate federal law.⁵⁰ In August 2013, however, the Deputy Attorney General issued guidance to U.S. attorneys (federal prosecutors) to focus marijuana enforcement efforts on criminal trafficking, use by minors, and activities on federal land; a second memo in 2014 added financial crimes such as money laundering.⁵¹ Beginning with its Fiscal Year 2015 appropriations law, Congress has now prohibited the Justice Department from interfering with state laws implementing medical marijuana.⁵² However, the continued status of marijuana as illegal under federal law has resulted in state-authorized marijuana retailers encountering difficulty accessing banking services, mailing customers, and securing and enforcing lease agreements.⁵³

Tax law is the second major federal obstacle to state efforts to construct a legal marijuana industry. 26 U.S.C. § 280E singles out legal marijuana retailers for a significantly higher income tax burden relative to other types of legal businesses. All businesses, including illegal businesses, are required to pay income tax on the difference between their revenue and their expenses.⁵⁴ Section 280E was enacted in 1982 to deny the deduction of business expenses to those selling drugs on Schedules I and II of the Controlled Substances Act. While intended to punish drug dealer kingpins from deducting expenses like guns and yachts used in smuggling operations, the IRS applies it to state-authorized marijuana retailers, punishing taxpayers trying to comply with the law and creating a competitive advantage for the very drug dealer kingpins that Section 280E was enacted to penalize.

50 Constitutional challenges to the federal government's power to prohibit sale or possession of illegal drugs have not succeeded. See *United States v. Oakland Marijuana Buyers Cooperative*, 532 U.S. 483 (2001) (rejecting medical necessity defense against federal marijuana laws); *Gonzales v. Raich*, 545 U.S. 1 (2005) (upholding federal prohibition of non-sold intrastate marijuana as within the Constitution's interstate commerce clause; 6-3 decision). See also *United States v. Doremus*, 249 U.S. 86 (1919) (upholding the Harrison Narcotics Act's banning of heroin sales as validly incidental to the taxing power; 5-4 decision); *Linder v. United States*, 268 U.S. 5 (1925) (questioning the constitutional scope of the Harrison Narcotic Act but not invalidating it); *Casey v. United States* (1928) (upholding the use of the Harrison Narcotic Act to criminalize possession of drugs notwithstanding any evidence relating to tax stamps or payment of revenue; 5-4 decision); *Nigro v. United States* (1928) (upholding the Harrison Narcotic Act's narrowing of legal distribution of narcotics designed to prohibit the products as a valid exercise of the taxing power; 6-3 decision); *Leary v. United States*, 395 U.S. 6 (1969) (striking down the Marijuana Tax Act of 1937 as necessarily violating the Fifth Amendment right against self-incrimination; Congress responded by enacting direct regulation of dangerous drugs through the Comprehensive Drug Abuse Prevention and Control Act of 1970, which includes the Controlled Substances Act of 1970).

51 See Office of the Deputy Attorney General, "Guidance Regarding Marijuana Enforcement," Aug. 29, 2013; Office of the Deputy Attorney General, "Guidance Regarding Marijuana Related Financial Crimes," Feb. 14, 2014.

52 Consolidated and Further Continuing Appropriations Act, 2015, P.L. 113-235, section 538, 128 Stat. 2217 (Dec. 16, 2014); extended in full by Continuing Appropriations Act, 2016, P.L. 114-53, 129 Stat. 505 (Sep. 30, 2015).

53 See, e.g., Jacob Sullum, "The Federal Ban on Medical Marijuana Was Not Lifted," REASON MAGAZINE (Jan. 4, 2016), <http://reason.com/archives/2016/01/04/the-federal-ban-on-medical-marijuana-was>; Jacob Sullum, "Colorado Settlement Suggests RICO Nuisance Suits Will Hinder Legal Pot Industry," REASON MAGAZINE (Dec. 31, 2015), <https://reason.com/blog/2015/12/31/settlement-suggests-rico-nuisance-suits>; Jacob Sullum, "Marijuana Ads are 'Nonmailable,' but That Doesn't Mean You Can't Mail Them," REASON MAGAZINE (Dec. 18, 2015), <https://reason.com/blog/2015/12/18/marijuana-ads-are-nonmailable-but-that-d>; Jacob Sullum, "Cannabis Cash Conundrum, Continued," REASON MAGAZINE (Sep. 22, 2014), <http://reason.com/archives/2014/09/22/cannabis-cash-conundrum-continued>.

54 Senator John Sharp Williams of Mississippi, who managed the floor debate in favor of the 1913 federal income tax law, opposed amendments to limit business deductions only for "lawful" and "legitimate" businesses: "The object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all." See also *United States v. Sullivan*, 274 U.S. 259 (1927) ("We see no reason [...] why the fact that a business is unlawful should exempt it from paying the taxes that, if lawful, it would have to pay."); *Commissioner v. Tellier*, 383 U.S. 687 (1966) ("We start with the proposition that the federal income tax is a tax on net income, not a sanction against wrongdoing[...] Income from a criminal enterprise is taxed at a rate no higher and no lower than income from more conventional sources.").

16 Conclusion

At an August 2015 session at the annual summit of the National Conference of State Legislatures, a roomful of state legislators from all over the country listened to the experiences of Colorado and Washington legislators. When asked what they would do differently if they were to do it all over again, the Colorado and Washington legislators said they would have preferred to enact legalization by legislation rather than by ballot initiative, due to the difficulty of changing inflexible language approved by voters. The audience was also polled as to the likelihood of voters legalizing marijuana in their state; almost to a person, attendees said that was likely to happen.

The experience of the states that have already legalized marijuana should prove instructive to the states that follow. Five key lessons should be kept in mind:

- **The marijuana tax rate should not be so high as to prevent elimination of the black market.** Colorado, Washington, and Oregon have all taken steps to reduce their marijuana tax rates, with Alaska considering it. Colorado concluded with strong evidence that its 30 percent tax rate did not sufficiently reduce the black market, and more recent ballot initiative proposals all over the country propose rates between 10 and 25 percent.
 - **Tax rates on final retail sales have proven the most workable form of taxation.** Other forms of taxation have been proposed, such as taxing marijuana flowers at a certain dollar amount, taxing at the processor or producer level rather than the retail level, or taxing products by their level of THC. Driving factors have included the difficulties with practical implementation of these ideas, the danger of double-taxing some businesses if vertically integrated businesses get a tax benefit, and the favorable federal tax treatment for excise taxes as opposed to business taxes.
 - **Be conscious of the medical marijuana market.** Medical marijuana is usually more loosely regulated and less taxed than recreational marijuana. In Washington, moving non-medical sales to the retail market has proven difficult given the enormous differentials in tax rates and regulatory structure, and officials there wish the two systems had been tackled simultaneously.
 - **Be cautious with revenue estimates.** While the revenue can be in the tens or even hundreds of millions of dollars, it takes a lead time to develop. Estimating the size of an illegal market is difficult, as is estimating how many consumers will switch to the legal market when it is available. Revenues started out slowly in Colorado and Washington, both as consumers became familiar with the new system and after state and local authorities spent time and money setting up new frameworks and regulatory infrastructure.
 - **Resolve health, agricultural, zoning, local enforcement, and criminal penalty issues.** These important issues have generally been unaddressed in ballot initiatives and left for resolution in the implementation process.
-