



May 21, 2021

WHAT YOU NEED TO KNOW ABOUT **Taxing Marijuana**

PRO POINTS

- **States are looking to draw new tax revenue from marijuana legalization** as they emerge from the coronavirus crisis. But even for mature markets, marijuana revenues remain a tiny portion of state budgets.
- **There are three main ways states approach cannabis taxation:** retail price, weight and THC potency. New York is the first state to enact a tax based on THC potency and will be closely watched as it stands up its recreational program.
- **Federal cannabis legalization, which is still remote and opposed by some Senate Democrats,** would upend state tax regimes. Introducing interstate commerce could potentially shrink revenue for state coffers by driving down cannabis prices.
- **The most mature cannabis markets in Colorado and Washington state** earned the most cannabis tax revenue per capita in 2020 at \$77 and \$86 respectively, according to the Institute on Taxation and Economic Policy, a nonpartisan think tank.

HOW WE GOT HERE

Elected officials across the country pushed marijuana legalization this year as a way to raise new tax revenue when the pandemic cratered the economy and squeezed their state budgets. After having cheered Illinois in 2019 for becoming the first state to approve marijuana through the legislative process, cannabis activists notched three big wins in 2021. Legislatures in New Mexico, New York and Virginia passed recreational marijuana laws this spring as their Democratic governors all touted how regulating marijuana would create steady income for their cash-strapped states.

The argument is gaining a foothold in other places too, including Oklahoma and Pennsylvania. But don't expect legal weed to be a budgetary panacea. Colorado, home to one of the most mature marijuana markets in the country, brought in more than \$387 million in marijuana tax revenue in 2020. With a state budget of \$32.5 billion, however, marijuana tax revenue amounts to a "rounding error" in the grand scheme of things, explained Ulrik Boesen of the Tax Foundation, a Washington, D. C.-based nonpartisan think tank.

How states decide to tax cannabis will ultimately shape their revenue stream in the long term. Broadly speaking, there are three types of cannabis taxes: 1) a sales-based tax determined by the retail price; 2) a fixed-price weight-based tax; and 3) a potency-based tax assessed by the amount of THC in the product.

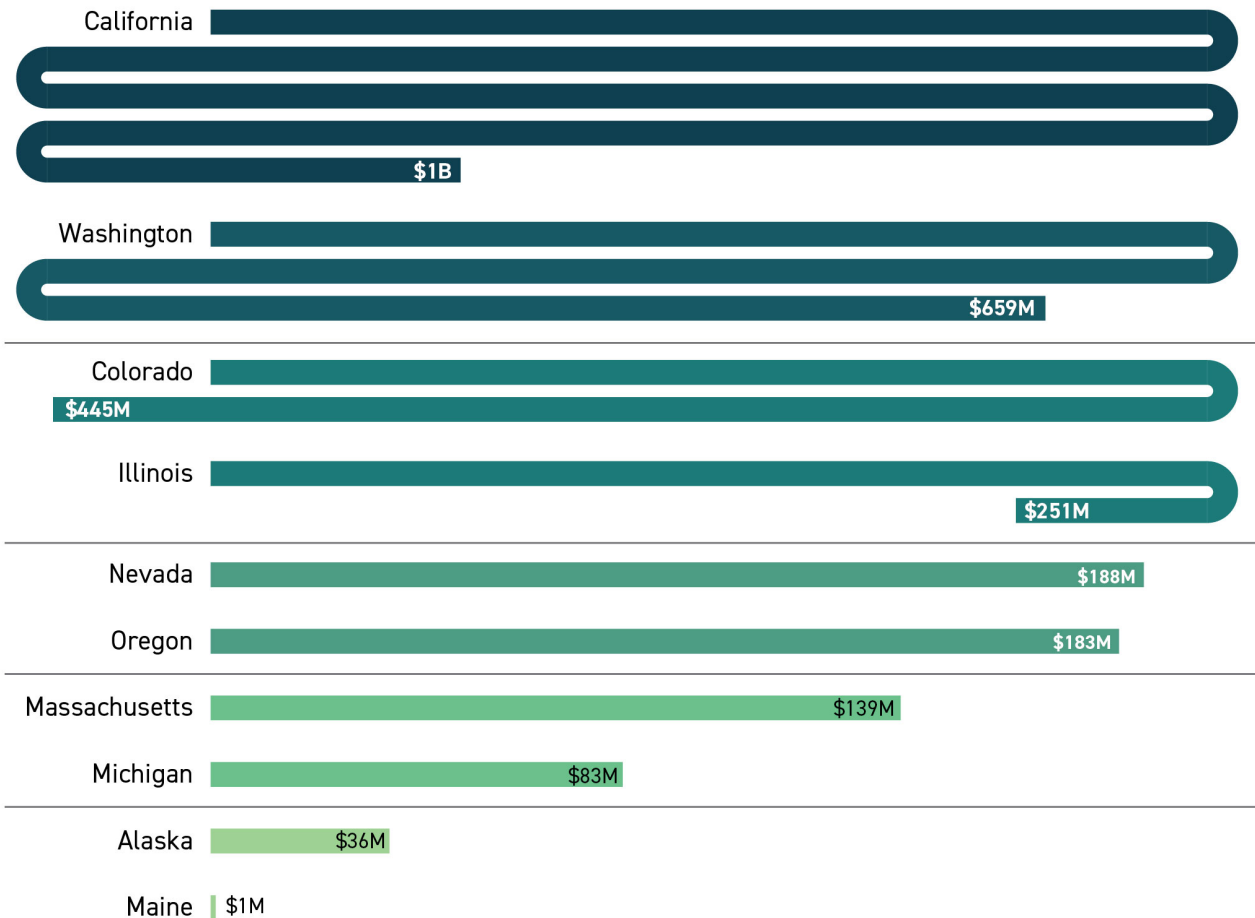
So far, most states have setup a sales tax, a weight-based tax or a combination of the two. The only state to tax marijuana by THC potency is New York, which legalized recreational weed in April but has yet to implement its program. Cannabis tax rates also play a big role in influencing consumer behavior. Marijuana industry advocates in California partly blame the state's high cannabis taxes for sustaining an illicit market there. Cannabis analytics firm New Frontier Data estimated that in 2020, more than 60 percent of marijuana sales in the state were on the illicit market.



California significantly outpaces other states in cannabis tax revenue

2020 TAX REVENUE BY STATE

Cannabis sales spiked in many states as the Covid-19 pandemic unfolded in 2020. However, revenue is expected to continue growing in all states with legal recreational marijuana once the public health crisis subsides.



Note: ITEP did not include revenue from gross receipts taxes, license fees, income taxes and other levies.

Source: Institute on Taxation and Economic Policy

WHAT'S NEXT

Cannabis industry observers are eager to see how New York's proposal plays out as a public health debate about the potency of marijuana intensifies. But some cannabis entrepreneurs and tax attorneys who serve the industry are concerned that a potency-based tax creates too much complexity because there's a lack of standards for lab-testing THC. How New York's approach gets implemented could influence other states as they consider cannabis legalization legislation while threading health concerns.

There's also the possibility of federal legalization. While that prospect remains slim on Capitol Hill despite support from Senate Majority Leader Chuck Schumer, a growing number of lawmakers have grown more cannabis-friendly as their states legalize the drug. If the federal government removes marijuana from the list of controlled substances, it would trigger wide-



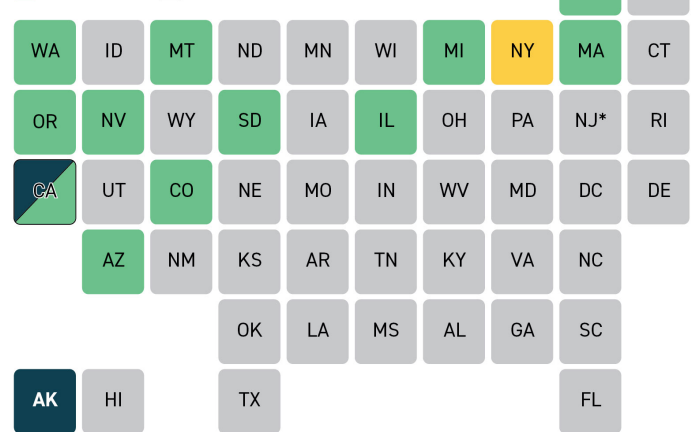
ranging changes to state marijuana markets. Greenlighting interstate commerce is likely to cause prices to plummet, sinking revenues for states that tax marijuana based on price.

Allowing interstate commerce would also upend how states tax marijuana at different points in the supply chain. For example, in Alaska, marijuana is taxed when cultivators sell to wholesalers. And in Oregon, marijuana is taxed at the retail level. If an Oregon dispensary bought marijuana from Alaska, it would be liable for taxes in both states. But if an Alaska dispensary purchased marijuana grown in Oregon, that marijuana wouldn't be taxed at all.

How states tax marijuana

TYPES OF TAXES SET ON RECREATIONAL MARIJUANA

■ Weight-based ■ Percentage ■ N/A
■ THC level □ Multiple colors indicate multiple tax types



*New Jersey has legalized recreational marijuana but has yet to set a tax on sales.

Sources: Tax Foundation, Urban Institute

Most statehouses have adjourned their 2021 sessions but several states are still debating recreational legalization, including Connecticut and Delaware, or plan to have the issue on the ballot for voters.

POWER PLAYERS

- **New York Gov. Andrew Cuomo:** Cuomo's legalization plan was the first to enact a THC potency-based tax. That idea made it into the final compromise legislation, though with much lower rates than he originally proposed. Despite calls for his resignation amid a variety of scandals, the three-term governor has vowed to stay in office and will oversee how the state's recreational program is built.
- **California Treasurer Fiona Ma:** Ma has been a vocal advocate for the state's legal cannabis industry and proposed bills aimed at reducing cannabis taxes she hopes will help regulated businesses compete with the illicit market. So far, her efforts have been stymied by the Assembly Appropriations Committee, which killed a 2019 proposal to temporarily decrease cannabis taxes.
- **New Mexico Gov. Michelle Lujan Grisham:** The first-term governor called lawmakers back for a special session earlier this year with the express purpose of legalizing marijuana to help the state bounce back from the pandemic. New Mexico will phase in its price-based marijuana tax over the span of eight years.