

The Importance of Proper Local Cannabis Tax Rates

Issue: Establishing stable tax policy is a key component to local cannabis regulatory efforts. Several local governments have proposed cannabis business taxes over 10 percent of gross receipts for each industry sector and the result of this will be (i) an increased illegal marketⁱ, (ii) failure to attract high quality operators and (iii) ironically, significantly lower tax revenues for the city. Improperly set local tax policy may be the single biggest factor determining whether a jurisdiction can successfully generate tax revenue and police the illegal market for marijuana.

Solutions:

- To avoid multiplicative taxation and attract quality operators, utilize annual property development fees for cultivators, manufacturers and processors. Keep such fees at \$15/sq.ft. or less for cultivators and large manufacturers and \$25/sq.ft. or less for processors or manufacturers. Allow such fees to be paid quarterly.
- If a Gross Sales Tax is used, keep the initial tax rate at 2% or less. Ensure when having voters vote on such tax (as required by Prop. 62/218) ballot measures grant authority to city council to raise and lower such tax to a higher threshold (we suggest 5%).
- Review tax and fee amounts frequently and adjust to the extent enforcement costs are rising rapidly, the illegal market rate is spiking or businesses are opting for nearby jurisdictions.

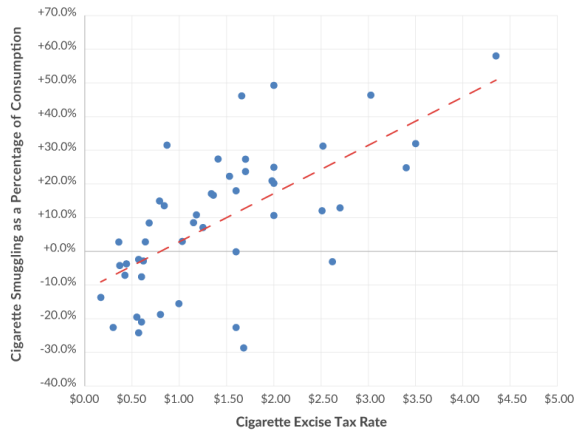
As Taxes Rise, So Do Illegal Market Levels

There is a growing body of research highlighting 1) that consumers in the legalized cannabis market are strongly price sensitive, 2) that taxes significantly increase the legalized market’s price premium, and 3) that police enforcement fails to adequately curb the illegal market if it becomes sizeable. High local taxes can create a permanent and sizeable illegal market in the jurisdiction. The Washington Cannabis Consumption Survey, found if the cost of legal marijuana sold for \$4 more per gram, legal sales would make up less than half of the total market.ⁱⁱ Growing evidence also shows the marijuana consumers are more price sensitive than other consumer groups.ⁱⁱⁱ The charts below demonstrate this effect in both cannabis and tobacco.

City	Est. Illegal MJ Market	Stores per Person ^{iv}	Est. Net Effective Tax Rate
Portland, OR	35% ^v (Note <50% of State allows legal sales)	1/4,688	25 ^{vi}
Denver, CO	20-30% ^{vii}	1/2,887 ^{viii}	31.4 ^{ix}
Boulder, CO	25-35% ^x	1/4,126 ^{xi}	36 ^{xii}
Seattle, WA	55-65 % ^{xiii}	1/10,695	37 ^{xiv} (Originally 44%)

Cigarette Smuggling Rises with Excise Tax Rates

Cigarette Smuggling vs. State Cigarette Excise Tax Rate, 2013



Note: Positive smuggling percentages are inflow to a state; negative percentages are outflow.

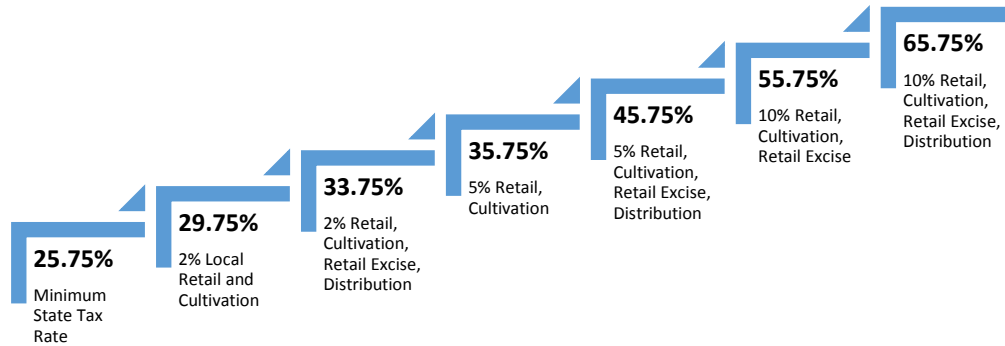
Source: Mackinnac Center for Public Policy; Tax Foundation.

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The Compounding Effect of California State and Local Taxes

Before any local taxes are assessed, marijuana products sold at dispensaries will be charged a minimum 25.75% effective state tax rate.^{xv} A conservative local tax rate set at 2% of gross receipts for cultivation and retail sales increases the effective tax rate to 29.75%. An aggressive local tax rate at 10% of gross receipts for cultivation, retail sales, and distribution and a 10% retail excise tax increases the effective tax rate to 65.75%. The figure below demonstrates effective tax rates at different local taxes levels.

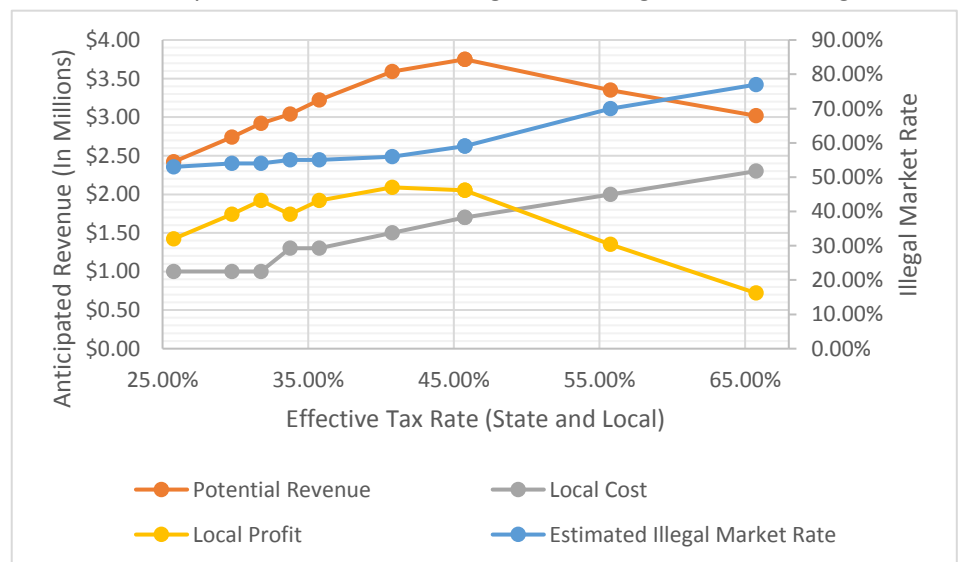


Multiplicative Taxation

One danger with gross revenue taxes on manufacturers, cultivators and processors is that these taxes multiplicatively add to product cost (i.e. as those products move through the supply chain, additional taxes now tax the already taxed amount). So, for instance, a 5% tax on upstream businesses can become a 25.8% net effective tax (without factoring in state, county and local sales and excise tax) if product were to go from a grower, to a processor, to a manufacturer and then to a distributor. If the processor uses a third party to fill vape cartridges or pre-process products intended for edibles you can add even additional layers. For this reason, gross percentage taxes are disfavored up the supply chain.

Tax Revenue Projections

The figure below projects local tax revenue from marijuana businesses, while considering the effect higher prices have on the illegal market and city enforcement costs. The estimates below are conservative on cost as they don't include incarceration costs. As tax rates increase, so does the portion of sales that will go to the illegal market, taking revenue away from state and local governments. Higher illegal market rates decrease revenue while increasing enforcement costs. Costs to enforce local laws on unlicensed businesses are high and can often result in expensive litigation for local governments. Finally, there is a growing body of evidence that when illegal market rates approach 40-50%, law enforcement efforts become futile and slowly cease as police move on to more gainful enforcement efforts.



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- ⁱ Henchman, Joseph. "Marijuana Tax Lessons Learned." *Marijuana Tax Lessons Learned*. November 04, 2016. Accessed May 8, 2017. <https://www.bna.com/marijuana-tax-lessons-n57982082331/>.
- ⁱⁱ Jonathan P. Caulkins et al. *Considering Marijuana Legalization: Insights for Vermont and Other Jurisdictions*, 2015, p. 126.
- ⁱⁱⁱ Gomez, Bethany, and Jamie Schau. "How Cannabis Dispensaries Can Compete with the Black Market." *New Cannabis Ventures*. June 26, 2016. Accessed May 8, 2017. <https://www.newcannabisventures.com/how-cannabis-dispensaries-can-compete-with-the-black-market/>.
- ^{iv} Number of dispensaries determined by the 2013 Census population figure divided by the number of listings on Weedmaps.
- ^v Iboshi, Kyle. "Legal pot businesses struggle to compete with black market." *KGW Portland*. February 24, 2017. Accessed May 8, 2017. <http://www.kgw.com/news/investigations/legal-pot-businesses-struggle-to-compete-with-black-market/413653533>.
- ^{vi} Oregon Department of Revenue. "Marijuana Tax." January 9, 2017, Accessed May 8, 2017. http://www.oregon.gov/DOR/press/Documents/marijuana_fact_sheet.pdf
- ^{vii} Downs, David. "The Economist: pot legalization is crushing black market in Colorado." *SF Gate*. February 17, 2016. Accessed May 8, 2017. <http://blog.sfgate.com/smellthetruth/2016/02/17/economist-pot-legalization-is-crushing-black-market-in-colorado/>.
- ^{viii} Data generated from Weedmaps' databases and Colorado Marijuana Enforcement Division.
- ^{ix} Includes 15 percent state excise tax, 10 percent state Marijuana Tax, 2.9 percent state sales tax, and 3.5 percent Denver city tax.
- ^x Downs, David. "The Economist: pot legalization is crushing black market in Colorado." *SF Gate*. February 17, 2016. Accessed May 08, 2017. <http://blog.sfgate.com/smellthetruth/2016/02/17/economist-pot-legalization-is-crushing-black-market-in-colorado/>.
- ^{xi} Data generated from Weedmaps' databases and Colorado Marijuana Enforcement Division.
- ^{xii} Includes 15 percent state excise tax, 10 percent state Marijuana Tax, 2.9 percent state sales tax, 5 percent Boulder city sales tax, and 3.5 percent Boulder city excise tax.
- ^{xiii} Washington state estimates the overall market value of their cannabis industry is \$1.3 billion. In FY 2016, sales from licensed marijuana dispensaries totaled \$696 million. We estimate, as does Washington State, that remaining sales went to illegal and gray market operators.
- ^{xiv} Washington State Department of Revenue. *Taxes due on marijuana*. August 26, 2016. Accessed May 8, 2017. <http://dor.wa.gov/Content/FindTaxesAndRates/marijuana/Default.aspx>.
- ^{xv} Effective state retail tax rate is made up of 15 percent marijuana retail excise tax, \$9.25 per dry-weight ounce marijuana cultivation tax, and minimum 7.25 percent state sales and use tax.