Tax and Legal Cannabis Policy

Revenue, Tax and Illegal Market Considerations for a New Era

Chris Beals, President & General Counsel, Weedmaps

Presented to NCSL Task Force on SALT on November 17, 2017
What is *weedmaps*®?

- **History:** Founded in 2008, Weedmaps is the oldest and largest cannabis technology company in the world. Almost 400 employees and offices in the United States, Canada and Europe.

- **Core Platform:** Our core platform connects people with local dispensaries, delivery services, doctors, deals, brands, lab data and real-time menus.

- **Other Business Products/Services:**
  - Brands Platform
  - Three POS Systems
  - Doctor Patient Practice Software
  - Marijuana.com/Cannabis.com
  - Next gen data solutions
Weedmaps Internal Government Relations Team

Chris Beals, President & General Counsel  
Formerly: Colbeck Capital Management, Covington & Burling, Davis Polk  
(New York, NY)

Dustin McDonald, VP of Government Relations  
Formerly: Director, Government Finance Officers Association  
(Washington, DC)

Kelli Hykes, Senior Associate  
Formerly: Director of Public Health Policy, Columbus Public Health (Columbus, OH)

David O’Brien, Director of East Coast Government Relations  
Formerly: Senior Advisor, Barrett Strategies  
(Boston, MA)

Cedric Haynes, Senior Associate  
Formerly: Subcommittee Director, US House of Representatives  
(Washington, DC)

Ben Mays, Senior Associate  
Formerly: Michael S. Dukakis Fellow, Nevada Governor’s Office/Harvard University  
(Boston, MA)

Bridget Hennessey, Senior Associate  
Formerly: Chief of Staff, North County Transit District  
(San Diego, CA)

Jano Dekermenjian, Senior Associate  
Formerly: Legislative Director, California State Senate/Assembly  
(Sacramento, CA)
What is Weedmaps Policy?

• Semi-autonomous policy arm of Weedmaps
• Advocating for consumer safety improvements and illegal market reduction
• Key planks of our policy platform include:

  ➢ Minimizing the illegal market in legal states
  ➢ Ensuring safe and convenient access
  ➢ Robust lab testing standards
  ➢ Monitoring/safety regs that balance community safety with cost to operators
  ➢ Development of cannabis IP and licensing policy
  ➢ Organizing sound state and local tax policy to ensure communities hosting licenses see economic benefit
  ➢ Developing strategies to foster local licensee jobs and develop new technology solutions
  ➢ Enforcement strategies that are flexible enough to meet varying illegal market challenges

• Weedmaps is working collaboratively with all levels of government:
  ○ National-Level: United States, Canada, and several European countries
  ○ State-Level: California, Massachusetts, Michigan, and New Jersey—among others
  ○ Local-Level: Los Angeles, Compton, San Diego, and Toronto—among others
Overview of State Cannabis Laws

- **Cannabis Regulations:** 46 States & DC
- **Adult-Use & Medical:** 8 States & DC
- **Medical Only:** 22 States
- **CBD Only:** 16 States
- **Decriminalization Only:** 1 State
- **Restrictive States:** 3 States

**Bottom Line:** Vast majority of states now have legal cannabis access models, and state policymakers can learn from experiences of other jurisdictions.
Public Sentiment on Marijuana

- US support for cannabis legalization is at record levels: 64% of Americans support adult-use cannabis legalization
- Support for adult-use cannabis legalization has risen following the implementation of well-regulated state systems
- Strong bipartisan support for adult-use cannabis legalization: 72% Democrats; 67% Independents; 51% Republicans
Positive Economic Impact of Cannabis Industry (2016)

Revenue: $6.6 Billion (Conservative Estimate)\(^1\)

Job Creation: Total of 119,310 Industry-Supported FTE Jobs in 2016\(^2\)
- Direct Employment: 83,434 FTE Jobs
- Indirect & Induced Employment: 35,876 FTE Jobs

Point of Comparison: As of June 2017, the US coal mining industry employed 50,800 workers.

Tax Revenue Generation:
- Colorado: $198.5 Million
- Washington: $185.7 Million
- Oregon: $60.2 Million

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Industry Projections

• As existing markets mature and additional states implement medical and adult-use systems, the regulated cannabis industry will grow considerably

  ➢ **2020 Projections:** Industry revenue projections for 2020 range from $16 billion to $25 billion

  ➢ **2025 Projections:** Industry revenue projections for 2025 range from $24 billion to $65 billion

• At employment levels comparable to those in Colorado, a $24+ billion industry would employ 300,000+ FTE workers

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Industry Revenue & Tax by FY: Washington State

- **2015**
  - Industry Sales: $259,524,430
  - Tax Revenue: $64,881,111
- **2016**
  - Industry Sales: $786,404,467
  - Tax Revenue: $185,669,141
- **2017**
  - Industry Sales: $1,371,866,659
  - Tax Revenue: $314,839,660
Estimating Revenue By License Type (cont’d)

**Cultivation (Indoor)**
- Total annual harvest amount is dependent on cultivar and canopy space.
  - Each harvest, on average, yields $\frac{1}{2}$ - 1 gram of cannabis per watt of light used during flowering stage.
  - Cultivators, on average, use 40 watts per square foot of flowering space.
- Harvests per year: 4.0 - 5.0
- Wholesale value: $2,200 - $3,000/pound
- **Example:** 1 acre of indoor canopy will yield $19,525 million in gross annual revenue.

**Cultivation (Outdoor)**
- Total harvest amount is dependent on plant size prior to planting outdoors.
  - Each harvest can yield 28-56 grams per square foot.
- Harvests per year: 1.0
- Wholesale value: $1,000 - $1,500/pound
- **Example:** 1 acre will yield $2.8-8.4 million in gross annual revenue.
Estimating Revenue By License Type (cont’d)

Manufacturing

- Revenue is largely dependent on starting material value and desired final product.
  - Material Value: Whole Flower Vs. Trimmed leaves & Biomass
  - Final Product: Specialty Concentrate Vs. Distillate for infused products
- Total Wholesale revenue:
  - Specialty Concentrate Facility that produces 3,000 pounds per year will generate $27 million in Gross Revenue.
  - Distillate Facility that produces 3,000 pounds per year will generate $13 million.

Retail

- Consumer volume is largely dependent on retail density and state consumer count. Tax rate and product quality also have strong influence.
- Assumptions:
  - 600 consumers per day
  - Patients purchase $120 every two weeks.
- Revenue of $10 - $26 million per year.
## CA Revenue Forecasting - Cultivation

### INDOOR CULTIVATION

<table>
<thead>
<tr>
<th>Licensing Tier</th>
<th>1A</th>
<th>2A</th>
<th>3A</th>
<th>3A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canopy Space (sq ft.)</td>
<td>5,000</td>
<td>10,000</td>
<td>22,000</td>
<td>44,000</td>
</tr>
<tr>
<td>Employees (Total)</td>
<td>9</td>
<td>19</td>
<td>37</td>
<td>69</td>
</tr>
<tr>
<td>Annual Revenue</td>
<td>$2,359,031</td>
<td>$4,718,062</td>
<td>$10,379,736</td>
<td>$20,759,471</td>
</tr>
<tr>
<td>Annual Tax (2%)</td>
<td>$47,200</td>
<td>$94,400</td>
<td>$207,600</td>
<td>$415,200</td>
</tr>
<tr>
<td>Annual Tax ($10/sq ft.)</td>
<td>50,000</td>
<td>100,000</td>
<td>220,000</td>
<td>440,000</td>
</tr>
</tbody>
</table>
### Huntington Beach Dispensary Example

<table>
<thead>
<tr>
<th></th>
<th>Licenses per population</th>
<th>7,500</th>
<th>15,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Licenses</strong></td>
<td>27</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td><strong>Employees per License</strong></td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td><strong>Total Employees</strong></td>
<td>134</td>
<td>67</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Monthly Sales</strong></td>
<td>$9,638,832</td>
<td>$4,819,416</td>
<td></td>
</tr>
<tr>
<td><strong>Annual Gross Revenue</strong></td>
<td>$115,665,984</td>
<td>$57,832,992</td>
<td></td>
</tr>
<tr>
<td><strong>Monthly Net Tax</strong></td>
<td>$925,328</td>
<td>$462,664</td>
<td></td>
</tr>
<tr>
<td><strong>Annual Tax</strong></td>
<td>$11,103,934</td>
<td>$5,551,967</td>
<td></td>
</tr>
</tbody>
</table>
Different Taxation Models in Adult-Use States

- **Type of Taxation**
  - Taxation by Weight (ounce)
  - General State Sales Tax
  - Cannabis-Specific Excise Tax

- **Point of Taxation**
  - Cultivation/Wholesale
  - Transportation
  - Retail

- **Rate of Taxation (low vs. high)**

- **Local Tax Policy Set by State**
  - Set or Capped by State
  - Local
Net Effective Tax Rates Vary Widely by Jurisdiction

### Net Effective Tax Rates by Jurisdiction

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Cultivation or Wholesale Tax</th>
<th>State Sales Tax</th>
<th>State Excise Tax</th>
<th>Local Excise Taxes</th>
<th>Local Sales Tax</th>
<th>Total State Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portland, OR</td>
<td>0.00%</td>
<td>n/a</td>
<td>17.00%</td>
<td>3.00%</td>
<td>n/a</td>
<td>20.00%</td>
</tr>
<tr>
<td>Boston, MA*</td>
<td>0.00%</td>
<td>6.25%</td>
<td>10.75%</td>
<td>3.00%</td>
<td>n/a</td>
<td>20.00%</td>
</tr>
<tr>
<td>Clark County, NV</td>
<td>15.00%</td>
<td>6.85%</td>
<td>10.00%</td>
<td>3.00%</td>
<td>1.40%</td>
<td>36.25%</td>
</tr>
<tr>
<td>Denver, CO</td>
<td>0.00%</td>
<td>n/a</td>
<td>30.00%</td>
<td>3.50%</td>
<td>3.65%</td>
<td>37.15%</td>
</tr>
<tr>
<td>Boulder, CO</td>
<td>0.00%</td>
<td>n/a</td>
<td>30.00%</td>
<td>5.00%</td>
<td>3.50%</td>
<td>38.50%</td>
</tr>
<tr>
<td>Seattle, WA</td>
<td>0.00%</td>
<td>n/a</td>
<td>37.00%</td>
<td>n/a</td>
<td>10.10%</td>
<td>47.10%</td>
</tr>
</tbody>
</table>

### The Case of California

<table>
<thead>
<tr>
<th>Form of Taxation</th>
<th>Cultivation or Wholesale Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Wholesale Tax</td>
<td>$9.25 tax per dry-weight ounce of cannabis flower; $2.75 per dry-weight ounce of cannabis leaves</td>
</tr>
<tr>
<td>State Excise Tax</td>
<td>15.00%</td>
</tr>
<tr>
<td>State Sales Tax</td>
<td>7.25%</td>
</tr>
<tr>
<td>Local License/Excise</td>
<td>2%-10% (per license)</td>
</tr>
<tr>
<td>Local Sales Tax</td>
<td>&lt; 2.5%</td>
</tr>
</tbody>
</table>

*Projected tax rate based on existing legislation.*

Bottom Line: Net effective tax rates in California are projected to be in the 45-65% range.
A Trend towards Informed Tax Policy in Recently Legalized States

- States that have recently legalized are implementing informed tax policies.

- Oregon
  - All-in 20% Tax Rate
  - Restricted to Final Point of Sale
  - Optional, Capped Local Tax
  - 17% State; 3% Local

- Massachusetts
  - All-in 20% Tax Rate
  - Restricted to Final Point of Sale
  - Optional, Capped Local Tax
  - 17% State; 3% Local
Sound Tax Policy Is Key for a Functioning Legal Market

• A growing body of research says (1) legalized market consumers are price sensitive, (2) taxes increase the legalized market’s price premium, and (3) overly-burdensome tax rates drive consumers to the illegal market

RAND Corporation Study¹

CD Howe Institute Research Brief²

A Brief Look at Tobacco Excise Taxes

Source: Tax Foundation.
Fitch Ratings: The Challenge of High Effective Tax Rates

- An August 2017 Fitch Ratings report examined California’s tax policy framework.
- Report concluded that the combination of high state and local tax rates “may challenge cannabis legalization in California.”
- “High effective tax rates on California cannabis may complicate the state’s efforts to establish legal markets....Fitch Ratings estimates that effective state and local tax rates on nonmedical cannabis could be as high as 45%, which would place California at the upper end of the tax range for states that have legalized nonmedical cannabis.

Boost to Black Market: High tax rates raise prices in legal markets, reinforcing the price advantage of black markets. California's black markets for cannabis were well established long before its voters legalized cannabis in November 2016 and are expected to dominate post-legalization production. Increased enforcement may ultimately constrain the illegal market, but high taxes may complicate such efforts by diverting in-state sales to the black market.

Impacts on Governmental Revenues: Many of California’s local governments hope to reap substantial revenues from legal cannabis sales. In the handful of states that legalized nonmedical cannabis prior to 2016, tax receipts have generally outpaced initial revenue estimates and have shown strong year-over-year gains. Revenue gains are not expected to be substantial enough to impact ratings, and over the long term, price declines and black market sales may limit tax growth.

Patchwork of Local Regulations: California's framework for the legalization of nonmedical cannabis splits regulatory and taxing authority between the state and its municipalities. Both levels of government have the ability to levy and collect taxes, while cities and counties have the additional authority to impose restrictions on cultivation and sales within their boundaries. These arrangements magnify the uncertainties surrounding cannabis legalization and may contribute to disparate impacts for local governments.
Effective Tax: Simple Low Case (Flower)

- $9.25/oz State Excise (~3.5%)
- Local 3% Gross Tax (6.6%)
- Sale AUMA 15%, Sales Tax @7.5%min and 5% city excise tax (35.9%)
Effective Tax: High Case (Vape Pen)

- Local 6% Gross Tax (Cultivator) (9.7%)
- Local 10% Gross Tax Processor (20.6%)
- Local 5% Gross Tax Filler (26.7%)
- [20% Markup Distributor (alcohol is closer to 30%)]
- Sale AUMA 15%, Sales Tax @9% and City excise @6% e.g. L.A. cities (97.7% with and 64.7% without distributor)
- $9.25/oz State Excise (~3.5%)
The Case of Washington State

- Washington State offers a cautionary tale of the danger of overly burdensome tax rates

  - **Seattle, WA**: 47.1% Effective Tax Rate → ~60% Illegal Market Rate
  - **Denver, CO**: 37.15% Effective Tax Rate → 20-30% Illegal Market Rate

- **The Economist**: “The effect on crime seems to have been as one would predict. Colorado’s authorities reckon licensed sales—about 90 tonnes a year—now meet 70% of total estimated demand, with much of the rest covered by a ‘grey’ market of legally home-grown pot illegally sold. In Washington licensed sales accounted for only about 30% of the market in 2014.”

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1. The Economist previously estimated Washington State’s illegal market at 60-70%.
2. Effective tax rate in Denver, CO recently increased to 37.15%.
Proper Local Policy Essential for Functioning Industry

- Eliminating the illegal market is a key prerequisite for almost all other policy goals (and preventing federal intervention)
- Local governments play central role (zoning, tax policy, etc.)
- Sufficient access is paramount
  - Dispensary density
  - Retail access (and not just in industrial zones)
  - Delivery
  - Product Selection
  - Hours of operation
- Other important factors:
  - Ability to advertise
  - Low tax rates
  - On-site consumption lounges
  - Sufficient supply (cultivation and manufacturing)

Source: Weedmaps Analysis.
Law Enforcement Alone Will Not Minimize Illegal Market

- Overly-restrictive regulations (insufficient retail licensing, high tax rates, limited zoning) on cannabis industry can result in a very costly illegal market.

- Once illegal market rate exceeds 30%, law enforcement is largely ineffective at reducing number of unlicensed operators (Toronto - Operation Claudia, San Jose, Santa Ana, etc.).

- Enforcement costs can be substantial for local governments and divert limited policing resources from priority enforcement areas.

  ➢ Direct Raid Costs: $50,000-$100,000 per raid
  ➢ Officer Hours: 500+ per raid
  ➢ 5-10 Raids Per Year: $375,000-$750,000

- In Pico Rivera, City Manager Rene Bobadilla reported that shutting a single dispensary down cost $75,000.
Tax Policy and the Challenge of Standing up the Legal Market

- Last year, 37.6 million Americans consumed marijuana
- Nationally, the consumption rate stands at 13.9 percent
- The vast majority of this consumption occurred through the illegal market
- Tax policy must be designed to transition consumers from the illegal market into well-regulated systems
- Other Factors: Density, Zoning, Delivery, Product Quality, Advertising Laws