Regulating Marijuana: Taxes, Banking and Federal Laws

By Karmen Hanson

Since voters in Colorado and Washington passed referenda to legalize and regulate marijuana and cannabis products for adult, “recreational” use in 2012, legislators, legislative staff and others interested in state policy have been tracking their progress. Lawmakers have learned many lessons from at least 18 months of legal sales and regulations. Legislators from Colorado and Washington, along with a tax expert, shared their thoughts and experiences during a session, “Legalizing Marijuana: Potholes and Possibilities,” at NCSL’s 2015 Legislative Summit. This is the second of two LegisBriefs examining the lessons they learned. This brief focuses on taxes and federal issues related to state legalization of cannabis.

State Action

After Colorado and Washington’s ground-breaking referenda in 2012, Alaska, Oregon and the District of Columbia followed suit somewhat in the 2014 elections, legalizing small amounts of marijuana for adult recreational use. While some state lawmakers propose legalizing marijuana and others strongly oppose it, there is little doubt this issue will remain on legislative agendas. The following common themes and lessons from Colorado and Washington may prove useful to other states considering these complicated topics.

Taxation. Most states use fees and taxes collected from the cannabis industry to finance program enforcement and public education and prevention campaigns. Generally, lawmakers have tried to balance keeping tax rates at the appropriate level—generating enough revenue to fund regulation, enforcement and education programs, yet low enough to diminish the black market. Senator Jeanne Kohl-Welles described how Washington recently obligated anticipated cannabis tax revenue for the next four years, while Colorado had to lower its revenue estimates to reduce the chances of falling short of budget forecasts. “We have to think very smartly about the tax base, the tax rate, and not just what we’re doing with the revenue,” she said.

Joseph Henchman from the Tax Foundation added that taxing marijuana and cannabis-infused products is difficult because it can be measured in different ways. THC levels, flower product weight, edible products’ volume or potency are all considerations when determining how to tax cannabis products. “So far, states have taken a percentage of the retail price as a kind of proxy for potency,” Henchman said.

For marijuana businesses, taxes are tricky because they must file federal tax returns, but are prohibited from taking the tax deductions offered to other businesses. “The part that amazes me is that the federal government still says marijuana is illegal, but they are fine with taking those [income and business] tax revenues,” said Colorado Representative Polly Lawrence.
Banking. States with legal marijuana programs are working to create a banking system that allows cannabis-based businesses to operate more like traditional businesses. The main obstacle is marijuana’s illegal status at the federal level, and federal laws prohibit criminal drug money laundering. The result is that marijuana businesses in states with legal cannabis, along with financial institutions, run the risk of breaking federal banking laws by processing credit card transactions or accepting cash from the businesses.

Cannabis-based business owners report wanting to be treated like any other regulated business, including having the ability to get business loans, have a checking account, deduct the same types of business expenses, and operate like other companies for state and federal tax purposes. “There are businesses creating millions of dollars in revenue and paying taxes with bags of cash,” said Colorado Representative Dan Pabon. “That’s a problem for the business, and a challenge for the state. It’s hard to hold people accountable when you can’t audit and verify bank records and bank statements. That’s the next biggest place where the federal government will intervene or not.”

Henchman advised that as states design their tax and regulatory system, their primary goal should be to stamp out the black market. If the goal is to limit access to marijuana, punitive taxes could drive buyers to the black market. If the goal is to maximize revenues, safe use may be compromised. A system designed to eliminate the black market would include reasonable taxes and oversight, child-resistant packaging, and processes and products that are tested and approved, he said.

Federal Action
The fact that marijuana possession and use remains illegal under federal law affects both recreational and medical uses. The legislators and tax expert agreed that because marijuana is classified as a Schedule I drug, meaning, among other things, that it has no medical benefits, physicians may not write a traditional prescription for medical purposes. Most states that allow marijuana for medical use refer to physician “referrals” or “recommendations”—and not prescriptions—to allow use for medical reasons. Schedule I status also prohibits the federal government from funding most research on the potential health and social effects of marijuana.

To overcome the banking hurdle, pending federal legislative and administrative measures would consider rescheduling marijuana as a Schedule II product, and allow state-legalized marijuana businesses to bank like other businesses.

The Department of Justice’s Cole Memo and a Department of Treasury Guidance on the Bank Secrecy Act memo stated that their federal agencies or agents would not interfere with marijuana businesses in states where they are legal under certain conditions. They include the state taking adequate steps to protect access by minors, preventing criminal enterprises like gangs and cartels, preventing marijuana use and possession on federal property, keeping the products from being diverted to other states, and other considerations. The treasury department guidance clarifies how financial institutions can provide services to marijuana-related businesses as long as they ensure that the business is operating according to all state laws. States are aware that federal agency directives are subject to change under a new administration.

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Additional Resources