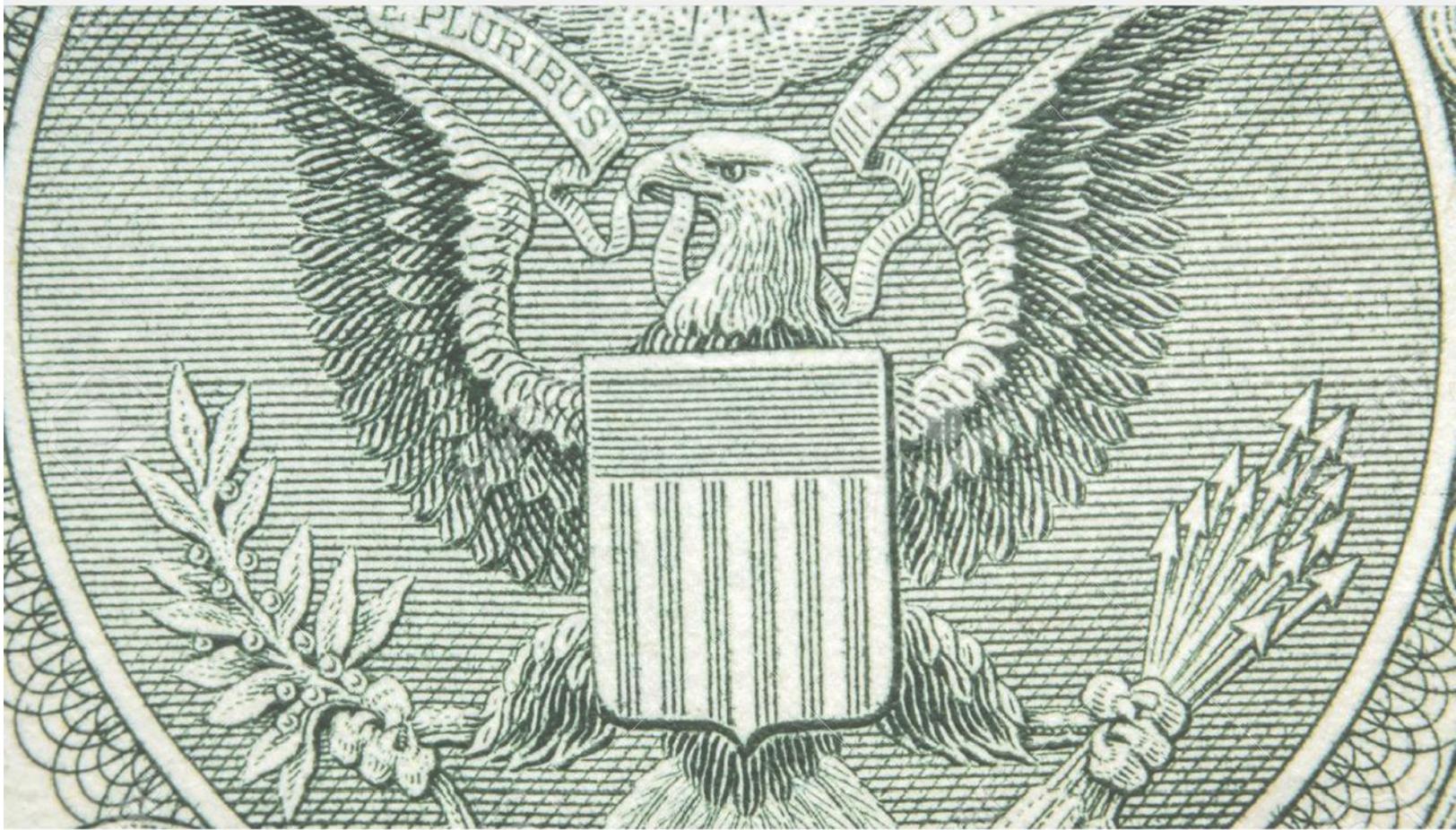


State Taxation of Cannabis



As states head into their 2021 legislative sessions, many will have to grapple with budget shortfalls caused by the coronavirus and efforts to mitigate its spread. For states that need to raise revenue, the legalization and taxation of recreational marijuana sales might be an option many consider.

Marijuana is no longer the flashpoint it once was; 15 states and D.C. have legalized recreational cannabis in some fashion and [two-thirds of the public](#) now supports doing so. Revenue collections in the states with established markets are outstripping alcohol and cigarette tax collections. A [Politico article](#) in March 2020 noted that “Marijuana sales are booming, with some states seeing 20% spikes in sales as anxious Americans prepare to be hunkered down in their homes potentially for months. Weed sellers are staffing up too, hiring laid-off workers from other industries to meet demand.” In 2020 alone, five states legalized it: Arizona, Montana, New Jersey, South Dakota, and Vermont. In four of the five, it was approved by voters at the November ballot by wide margins.

States have not coalesced around a uniform approach to marijuana taxation and many uncertainties linger surrounding the best design. This brief examines some of the most significant considerations and state experiences with legalization.

Tax Type

Most states have chosen to apply an excise tax to the sale of cannabis. (See Table 2 below.) These can be levied at the retail or wholesale level. Several states have excise taxes at both levels. In nine states, the excise tax is levied in addition to the general sales and use tax. Eleven states have also provided for an additional local option tax.

The excise taxes that states have imposed have follow three different approaches.

1. Based on price. In most states, marijuana excise taxes are based on the retail price and is levied at the point of sale.
2. Based on weight. Three states (Alaska, California, and Maine) levy a weight-based excise tax, which is collected by growers and/or processors. Most other sin taxes, like alcohol or tobacco, are based on weight or quantity rather than price. Weight-based taxes vary based on the part of the plant being sold. [Some experts](#) argue that weight-based taxes are more resistant to volatility in the long term as prices are expected to drop when markets mature, although they may incentivize consumption of higher potency products because taxing by weight does not account for quality.
3. Based on potency. Illinois is the only state that taxes marijuana based on its potency. Potency-based taxes are based on the THC (abbreviation of tetrahydrocannabinol, the main psychoactive compound in the marijuana plant) content, which is similar to liquor taxes based on alcohol content. Taxing based on potency allows the quality of the product to be taken into consideration, but it is likely more burdensome from both a compliance and administrative perspective. Furthermore, [studies suggest](#) that THC content is not equivalent to alcohol content and does not necessarily determine potency; it may not be as reliable of a measure as alcohol content is for liquor taxes.

Tax Rates

When it comes to setting tax rates, states have attempted to engage in a balancing act. The rationale for imposing an excise tax on cannabis sales is the same as for any other type of “sin” tax. It is intended to dissuade consumption of the product by raising the price as well as offset costs to society that consumption of the product creates. Young or rare users may find high taxes cost prohibitive.

On the other hand, tax rates that are too high may continue [to allow black markets to thrive](#). When all applicable taxes are combined, the effective tax rates on marijuana in many states are quite high; between 20 and 40 percent in most cases, which can keep black market products more desirable. A [2019 study](#) found that illegal cannabis sellers outnumbered legal and regulated businesses almost 3-to-1 in California.

There is also downward pressure on recreational tax rates from medical marijuana, which typically predates recreational marijuana and is usually subject to lower rates. Furthermore, as more states legalize, significant differences in tax rates could contribute to consumers crossing the border to shop in neighboring states. States that were first to enact marijuana taxes, like Washington and Colorado, have considered lowering them. On the other hand, Massachusetts increased the marijuana excise tax from 3.5% to 10.75% when revenues were perceived to be underperforming relative to other states.

Tax Revenues

Revenue is a primary motivator for legalized recreational marijuana. In the seven states that had programs in place for the full year, marijuana tax revenues represented a small but not insignificant portion, [about 0.36 percent](#), of overall state budgets in 2019. As the table below shows, revenues have grown annually in every state with a longer established market over the last three years. While marijuana has not provided a true windfall, tax collections were particularly resilient through the pandemic, displaying [strong growth](#) in many cases.

Table 1. Select State Marijuana Tax Collections (in millions)

	FY 2018	FY 2019	FY 2020
Alaska	\$11.1	\$19.2	\$24.5
California *	\$397.3	\$636.9	\$778.4
Colorado *	\$266.5	\$302.5	\$355.1
Nevada	\$69.8	\$99.2	\$105.2
Oregon	\$82.2	\$102.1	\$133.2
Washington	\$362.0	\$390.4	\$469.2

*CA and CO numbers are by calendar year, not fiscal year, and do not reflect entirety of 2020.

While robust revenue collections are typically associated with recreational marijuana sales, there are states that are generating a significant amount of revenue from medical marijuana programs as well. For example, Oklahoma medical marijuana generated \$105 million in state and local taxes in the first 10 months of 2020. This is atypical, however. What distinguishes Oklahoma from the other 36 states with medical marijuana programs is that there’s no set of qualifying conditions in order to obtain a medical card and no limit on the number of business licenses that can be granted. [More than 360,000 Oklahomans](#) acquired medical marijuana cards over the last two years and there are now more than 9,000 licensed marijuana businesses in the state.

Forecasting Challenges and Tax Revenue Allocation

While marijuana tax collections have been performing well, it is important that states exercise caution when budgeting for anticipated revenues. The Pew Charitable Trusts [has pointed out](#) that it can be a difficult to accurately forecast marijuana tax revenues; Nevada exceeded initial estimates by 45% in the first six months of collecting marijuana taxes, while California was below projections by 45% in the first six months. Colorado estimated that it would bring in \$67 million in the first full fiscal year of legal cannabis sales, and it collected \$66.1 million. It could be prudent for states to set aside monies in trust fund when revenues are high to provide a buoy during low revenue periods.

For states looking to use marijuana funds to cover shortfalls, it is worth noting marijuana revenues will not materialize immediately. It takes time to develop regulations, issue licenses, and establish a legal market. Implementation typically takes at least several months and it could take years for revenues to mature as markets develop, as experiences documented by states like [Colorado](#) and [Washington](#) illustrate.

The Impact of Future Federal Actions

The growth in state activity around legal marijuana has increased the likelihood of the federal government reexamining the issue. Although the federal government has chosen not to interfere with states that have legalized it, marijuana is still classified as an illegal, schedule one controlled substance. Because of this, state marijuana businesses are not able to access banking services or many federal deductions that are available to most other businesses. As the [Tax Foundation](#) has noted, prices would most likely fall if these barriers were removed. While president-elect Joe Biden has voiced support for decriminalizing marijuana, legalization remains uncertain. Regardless, federal decisions regarding marijuana regulation could have significant impacts on state tax collections.

Table 2. State Taxes on Recreational Marijuana

State	Year	Statutory Citation	Legislative or Voter Initiative	Type of Tax and Tax Rate
Alaska	2014	Alaska Stat. § 43.61.010	Voter Initiative	<ul style="list-style-type: none"> • \$50 per ounce for flowers/mature buds. • \$25 per ounce for immature or abnormal buds • \$15 per ounce for trim • Clones: flat rate of \$1 per clone • Local option retail sales taxes may also apply
Arizona	2020	A.R.S. § 42-5452	Voter Initiative	<ul style="list-style-type: none"> • 16% excise tax at retail • State (5.6%) and local sales tax rates apply
California	2016	Cal. Rev. & Tax Code §§	Voter Initiative	<ul style="list-style-type: none"> • 15% excise tax on retail sales • 7.25% state sales tax

		34011; 34012		<ul style="list-style-type: none"> • Cultivation tax: \$9.25 per ounce for flowers; \$2.75 per ounce for leaves; \$1.29 per ounce of fresh plant. • Local taxes may apply
Colorado	2012	Colo. Rev. Stat. § 39-28.8-302	Voter Initiative	<ul style="list-style-type: none"> • 15% excise tax • 15% retail sales tax • Local excise and sales taxes may apply
District of Columbia	2014	D.C. Code Ann. § 48-904.1	Voter Initiative	Ballot Initiative 71 allowed the possession of less than 2 ounces of marijuana. It did not permit the cultivation, distribution or retail sales.
Guam	2019	Bill No. 32-35	Legislative	<ul style="list-style-type: none"> • 15% excise tax
Illinois	2019	HB 1438	Legislative	<p>Cultivation privilege tax:</p> <ul style="list-style-type: none"> • 7% of the gross receipts from the sale of cannabis by a cultivator or craft grower to a dispensing organization <p>Cannabis Purchaser Excise Tax:</p> <ul style="list-style-type: none"> • 10% of purchase price – cannabis with THC level at or below 35% • 20% of purchase price – all cannabis infused products • 25% of the purchase price – cannabis with THC level above 35% • 6.25% state sales tax • Local option sales taxes may apply
Maine	2016	Me. Rev. Stat. Ann. tit. 28-B, §§ 1001; 1811	Voter Initiative	<ul style="list-style-type: none"> • \$335 per pound excise tax – flower • Excise tax of \$94 per pound – trim • Excise tax of \$1.50 per seedling • Excise tax of \$0.30 per seed • Retail excise tax of 10% • State sales tax 5.5%
Massachusetts	2016	Mass. Gen. Laws Ann. ch. 64N, § 2	Voter Initiative	<ul style="list-style-type: none"> • 10.75% excise tax • 6.25% state sales tax

				<ul style="list-style-type: none"> Local option marijuana sales tax may apply
Michigan	2018	Mich. Comp. Laws § 333.27963	Voter Initiative	<ul style="list-style-type: none"> 10% excise tax 6% state sales tax
Montana	2020	Not yet codified. Initiative 190.	Voter Initiative	<ul style="list-style-type: none"> 20% excise tax at retail
Nevada	2016	Nev. Rev. Stat. § 453D.500	Voter Initiative	<ul style="list-style-type: none"> 15% wholesale excise tax 10% retail tax/consumer sales tax 6.85% state sales tax Local sales taxes may apply
New Jersey	2020	N.J.S.A. Const. Art. 4, § 7, ¶ 13	Voter Initiative	<ul style="list-style-type: none"> 6.625% sales tax rate Local sales taxes up to 2% may apply
N. Mariana Islands	2018	C.N.M.I. Code Ann. tit. 4, § 53001, et seq.	Legislative	<ul style="list-style-type: none"> 10% excise tax
Oregon	2014	Or. Rev. Stat. § 475B.705	Voter Initiative	<ul style="list-style-type: none"> 17% retail tax Local sales taxes may apply
South Dakota	2020	Not yet codified. Constitutional Amendment A.	Voter Initiative	<ul style="list-style-type: none"> 15% excise tax on marijuana sales
Vermont	2018, 2020	Vt. Stat. Ann. tit. 18, § 4230	Legislative	<p>2018 HB 511 only authorized possession. 2020 SB 24 established a tax structure:</p> <ul style="list-style-type: none"> Excise tax of 14% of the sales price State sales tax (6%) Local sales taxes
Washington	2012	Wash. Rev. Code §§ 69.50.535; 69.50.540	Voter Initiative	<ul style="list-style-type: none"> 37% excise tax on retail sales 6.5% state sales tax Local sales taxes may apply

