



With Legal Marijuana Taxes Set, All Eyes on Colorado and Washington

By: Jake Grovum – November 19, 2013

Colorado voters overwhelmingly approved a plan for taxing their state’s legal marijuana market earlier this month. And Washington state will start issuing licenses to retailers next month to sell recreational marijuana.

Washington and Colorado are set to provide a case study in the debate over legalization. That debate is expected to spread to other state legislatures next year – advocates have identified Rhode Island and Maine as potential targets – and also to foreign countries like Uruguay.

It’s unlikely the outcome in Colorado or Washington will settle the issue. But both sides agree the stakes are high.

“Reformers look at these two states as literally laboratories,” said Allen St. Pierre, executive director of NORML, a group that backs marijuana legalization. And if things go well, he said, “This is largely the beginning of the end of cannabis prohibition.”

Opponents aren’t giving up. They, too, see the start of legal markets as a turning point, one that will confirm warnings about ill effects and dash promises of new revenues. They plan to highlight missteps and problems that arise as legalization becomes a reality.

“I don’t accept that marijuana legalization is inevitable,” said David Evans of the Drug Free America Foundation, which opposes legalization. “The states that have legalized it are going to serve as an example of what not to do.”

Already, opponents have seized on anecdotal evidence of increasing use among young people – as chronicled by The Denver Post last week for example – in the 20 states plus the District of Columbia that allow medical marijuana.

Supporters balk at the connection, saying marijuana use among teens is hardly a new phenomenon. They also point to areas where medical marijuana businesses exist that haven’t seen new crime waves or other side effects.

Legal or not, young adults continue to experiment: An annual survey shows 18.7 percent of young adults ages 18 to 25 used marijuana in 2012, compared to 16.1 percent in 2004.

Both Colorado and Washington set 21 as the age for legal marijuana use.

Revenue Watch

Revenue is one measure that both sides will be watching closely as a way to evaluate legalization.

Estimated income in Washington and Colorado varies widely, from tens of millions of dollars in the first few years to as much as \$2 billion in the first half-decade of legalization. The disparity comes, in part, over uncertainty about demand.

State officials have been left guessing. Colorado has made no official estimate. A study from the Colorado Center on Law and Policy projected the tax could produce \$60 million in new revenue and savings annually in the first years of legalization.

Washington predicted a “fully functioning” market could bring in \$1.9 billion in five years, although the state isn’t counting on those dollars in future budgets.

The revenue swing could ultimately prove crucial to the future of legalization and it is one reason the stakes were so high for the ballot question in Colorado on Nov. 5.

The measure offered a two-tiered tax scheme, as approved by the legislature. It passed the House 37-27 with solely Democratic support, although a handful of Republicans backed it in the Senate. The question fell under Colorado’s strict anti-tax policies, which require revenue-raising proposals to go before voters, who gave it 65 percent support this month.

The approved tax includes a 15 percent assessment on the wholesale price of retail marijuana, with the first \$40 million set aside for education. Then there’s a 10 percent sales tax, in addition to the state’s 2.9 percent sales tax, with proceeds earmarked for regulation, public health and police activities related to the legal pot market.

In Washington state, recreational marijuana was approved last year with 55 percent of the vote. It will be taxed 25 percent three separate times: producer to processor, processor to retailer, and retailer to consumer. The effective tax for consumers ends up being between 35 percent and 45 percent, depending on how many transfers are involved and other variables. Washington’s tax was subjected to less public scrutiny than in Colorado since it didn’t require a separate vote.

The Colorado tax on marijuana passed by a nearly 2-to-1 margin in the same election in which voters also easily defeated a \$1 billion proposal to increase the state’s flat income tax and earmark those dollars for education. The pot tax gained more support than legalization itself saw just a year earlier when it was approved by 55 percent of voters.

Had the tax failed, legal marijuana potentially would have been subject to only a 2.9 percent sales tax, short-circuiting one of the key arguments for legalizing the drug in the first place: revenue.

High Tax Concerns

The Colorado measure saw wide support from state lawmakers and Democratic Gov. John Hickenlooper, despite many of them publicly opposing legalization itself. They said the levy fulfilled the promise of the legalization campaign a year earlier.

Opponents, however, see a downside in high tax levies that they say could possibly cause a “gray market,” in which some drug sellers become tax evaders, depressing revenues from the legal market.

“The fact that the government set the taxes so high, paradoxically, is going to reduce the revenue because cheating will be widespread,” said Robert Corry, Jr., an attorney who was involved in the campaign against the marijuana tax measure. “The shops will lose a lot of the market to the gray market.”

Colorado allows home-growing of as many as six plants, while Washington does not, leading to more concern about a “gray market” cutting into tax revenue. Other factors: Washington will not allow pot growers to sell directly to consumers, while Colorado will, and Washington is doing away with much of its medical marijuana system, while Colorado’s medical market will continue alongside the recreational market.

Corry and others said the dual tax system in Colorado could mean the medical marijuana market, which will be taxed much less than the recreational one, could flourish, with recreational marijuana mainly purchased by tourists and other out-of-state consumers.

Federal Uncertainty

Ultimately, it may be the federal government that weighs most heavily on the success or failure of marijuana legalization. It’s still not clear, for instance, if the new retailers and customers will be able to use banking services related to their business.

Observers on all sides have been awaiting word from the Justice Department on whether banks and credit card companies will be allowed to process transactions or even keep deposits from these businesses. For now, it’s likely even an armored car service contracted to move cash could find itself violating federal law for working with a marijuana business.

The broader treatment of marijuana, too, is a wildcard. Federal law enforcement officials have said they don’t plan to go out of their way to crack down on the new markets in the two states, but it’s not clear how much leeway that would ensure, since federal raids on casual users and small-time sellers are already a rarity.

Other cautions: It would only take one incident – not to mention a new administration in Washington – to change that understanding, potentially upsetting any marketplace that’s been established.

“Until the federal law is completely clear, I think any prudent marijuana producer, even in a state where it’s legal, is going to have some concerns about how visible they make their industry,” said Jeffrey Miron, a Harvard economist and analyst at the libertarian Cato Institute. “If it’s illegal federally, it’s really hard for a state to really, in a clean and unambiguous way, try to legalize it.”