

Is marijuana a good tax?

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Abstract

*“There is no such thing as a good Tax.”
Winston Churchill*

Decades ago, marijuana was a highly controversial and illegal drug in the United States. Although still controversial, some states have come to legalize it despite that it is still considered illegal on a federal level. The legalization of the drug does not come without burden. Now states must control, regulate, and tax the product. Each state has come up with its unique structure to maximize the revenue they could get from the commercialization of the product while maintaining a fair game. Since taxing, in general, have always raised citizen scrutiny, it is imperative that the tax is considered “good” by all. Throughout the years, scholars have debated the core qualities that tax should demonstrate to be appealing to citizens: Adequacy, fairness, simplicity, transparency, and collectability. This paper analyses the tax on marijuana with those core qualities as metrics to determine that the tax is indeed “a good tax”.

Introduction

The levy of taxes has been the main source of revenue for local, state, and federal governments. This task has been surrounded by much controversy considering that neither government nor citizens are comfortable with the concept. Local, state, and federal governments have, throughout the years, established policies that determine, what can they taxed, and how they will levy those taxes. In present time, there is a myriad of services and products that are taxed at all levels of government, such as property, income, consumer goods. Among consumer goods, one has been controversial for years, “recreational marijuana”. The product is considered a mild drug and is illegal federally, but several states have moved forward with legalization. The move comes with the burden of control for the government. Aside from bringing considerable revenue, taxes seem to be a fair tool. Nevertheless, one question remained: Could a tax on Marijuana be considered a “good” tax?

Proposals to judge tax systems have been created with ranging concern for the abuse that could take place when taxing the people. Although those standards have evolved along the years, their essence remain constant, and there seems to be a consensus on the following concepts: *adequate, fair, simple, transparent, and easily collectable*.

How is marijuana tax structured?

Marijuana tax is not a flat rate across states; neither are they levied the same way in all states. Those taxes varied in a range between 10 to 37 percent. States levied on marijuana 3 ways. **Percentage-of- price**, like the retail sale tax, is levied on the wholesale transaction. This cost is presumed to be passed on the consumer later. Some other state’s tax is **weight-based**. Those states set rates for the different product type (whether it is the flower, leaves or plant extract). A few other states tax marijuana on **Potency**. Those state tax the product on its level of THC

(tetrahydrocannabinol) which is the psychoactive compound in cannabis that is responsible for the *high* feeling. Sellers collect the charges as they would do for the general sales taxes, and they will later remit it to the state. Some other states apply their general sale tax on marijuana purchases, in addition to the excise tax. Furthermore, some states would allow localities to levy additional charges, as excise taxes on retail sales. In some other states, they apply their general sale tax on marijuana purchases, in addition to the excise tax.

Below a breakdown on how taxes are levied in most states where marijuana is legal:

Table 1 Marijuana Tax Rate

State	Grower Flower Tax	Grower Tax Trim	Excise and Sales Taxes
Alaska	\$50/oz	\$15/oz	By Locality
California	\$9.25/oz	\$9.25/oz	By locality
Colorado	None	None	15% on sales from grower to retailers; 15% on retail sales
Massachusetts	None	None	10.75% state excise tax; local sales tax capped at 3%
Nevada	None	None	15% on sales from grower to retailers; 10% on retail sales
Oregon	None	None	17% state excise tax; locale sales taxes capped at 3%
Washington State	None	None	37% of state sales taxes

Source: Tax Policy Center

As demonstrated in Table 1, most states levy a selective excise tax on recreational marijuana consumption. Some levy only excises taxes, but others combine it with state and local retail taxes. Mikesell (2018) states that selective excises apply differential tax treatment to

particular products or services, causing those purchasing or selling them to bear a greater tax burden than general indicators of tax-bearing capacity (income, wealth, or total consumption) would otherwise indicate (p. 471). Therefore, consumers of marijuana bear a higher tax burden on this product. As most tax on consumption, it will tend to be more regressive, considering that there will be a more significant burden on a family with a lower income.

Although states are legalizing recreational marijuana, there is nevertheless concern about its effect on one's wellbeing, especially teens. It is reported that use of marijuana by teenagers can cause adverse effects such as interfering with cognitive function such as loss of memory and other motor function such as coordination. Repetitive use might result in long lasting changes in brain function that could impede with educational, professional, and social accomplishments (Volkow and Al., 2014). Those characteristics have put marijuana among those goods who are further taxed because of the perceived threat to society. Hence, the additional excise tax imposed. The sumptuary excise tax, also referred to as sin tax is imposed on good that the government deem harmful to citizen's health to reduce their consumption. An example of this tax would be the taxes impose on tobacco and alcohol. Mikesell (2018), stated that "although these excises seldom yield enough revenue to be a major factor for general government operations, their major attractiveness often lies on other grounds or with other special purposes" (p. 486). The base for those taxes is restricted. Only a few goods are subject to this tax, therefore substantial revenue is not expected from it. Their purpose rely more on reducing the use of said product by imposing an extra cost. In this case, the special purpose would refer to the negative effect that smoking Marijuana might have on the individual.

Nevertheless, as studies proved, demand for those goods cited earlier, is seldom insensitive to price in the short term, therefore consumption usually merely changes. Which brings us the ask

the question, if the higher price of the good does not reduce consumption as expected, why continue the use of those excise taxes? Morse (2009) stated, “that an examination of the legislative history of various sin taxes will reveal that, no matter the justifications offered to the public, governments enacted sin taxes when they are having budget crises and need money” (p.206). Monetary gains are the primary reasons behind every tax proposed and enacted. Although the concept of sin tax has revealed ineffective in reducing consumption on previous goods, this has not stop legislator from using the tax on new products. Thus, the imposition of those taxes is hardly to prevent health issues but rather to boost state revenues to fund their activities.

Now, as for the revenue from the tax, most states (Colorado, Massachusetts, Nevada, Oregon, and Washington) allocate a percentage of those revenues to specific programs such as education, drug prevention, health care, public safety. Alaska sends half of the revenues to its general funds. California pays for the administrative burden of legalizing marijuana, and they allocate the excess to various other programs

Adequacy of the Tax

As of April 2020, recreational marijuana has been legalized in 11 states. Colorado set the path in 2012 for other states to levy taxes on the plant, such as Alaska, California, Massachusetts, Michigan, Nevada, Oregon. Some states have not set up any tax systems yet, like Vermont, Washington, District of Columbia, Illinois, and Maine. Marijuana taxes are as complicated as taxes on alcohol and tobacco. The base for the tax continually varies depending on what actual demand on the market is for that period. Therefore, while revenue from marijuana tax could be high for a period, the fee levied, or other market constraints could affect demand, and a reduction in sales would inevitably result in a loss of revenue for the state. According to the Institute on Taxation and Economic Policy ITEP’s 2019 report, “most states with legal recreational cannabis

levy their taxes as a percentage of the product's price at either the wholesale or retail level. This means that the price of cannabis is usually a major driver of the amount of revenue that can be gained through taxation" (p.26). This only implies that states will be able to bring substantial revenue, only if they can fix a price for cannabis fair enough to drive high level of projected purchases.

The concept of adequacy of a tax responds to an important question. [Is] "the tax levied for revenue... capable of raising sufficient revenue so that spending on services for the current generation will not place an undue burden on future generations" (Mikesell, 2018, p.365). Marijuana taxes can raise substantial revenue for states even though this tax did not exist more than a decade ago. Its share of projected revenue seems to be enough to cover current budgetary gap faced by government entity. Every year, the market for marijuana experiences substantial growth. According to the Institute on Taxation and Economic Policy (ITEP), in those states that allow the taxation of Cannabis (Recreational Marijuana), "annual excise tax revenues (\$1.04 billion) already rival total excise taxes collected from all kind of alcohol (\$1.16 billion)" (Davis et al. , 2019, p. 20). And, they are projected to experience higher growth in the future. Now, if the government legalizes recreational marijuana nation-wide, excise taxes from this product are expected to be approximately \$11.9 billion. Income from the states who did have a sales tax on recreational marijuana was \$54.6 million in excise taxes in 2014. This figure has seen a substantial growth the following year of 400%, raising approximately \$218.5 million as the market grew in those two states (Davis et al., 2019). So, as we expect the market to expand, so will the excise revenue from the taxation of marijuana.

Furthermore, a few states do allow, either state or local sales taxes, which were not included in the revenues mentioned earlier, and those taxes should raise revenues of about \$300 million in

additional projected revenue in 2018. Therefore, taxes levied on marijuana sales seem to be adequate and consistent enough in bringing in revenues that states could finance programs that lacked funding within states and local government, as they are free to allocate that revenue as they see fit.

Fairness

To define what level of tax is deemed fair for everyone would be a herculean task. Most individuals would rather someone else pay taxes while they ought to benefit from government services. Generally taxes' fairness have been judge on two approaches “ 1) according to taxpayers' benefits from or usage of the public service (*benefits received*) and (2) according to taxpayers' capabilities to bear the burden (*ability to pay*) (Mikesell, 2018, p. 372). The fist point insinuates that it is only fair for citizen to pay an amount proportional to the amount of service they would receive. Therefore, no if no service is received, no share of taxes out to be paid. The second would suggest that if an individual is barely able to sustain himself, he is not fit to pay any taxes. Although, the revenue from marijuana is earmarked for socially good causes, such as homelessness and education, the tax itself is nevertheless regressive. The burden of the tax is higher on poorer families and households. For the same amount of the product, lower income families will use a higher share of their income compared to higher income families. Most taxes on consumption are regressive, therefore the tax on recreational marijuana was not expected to be any less.

Simplicity and Transparency

A tax is considered simple and transparent if it is relatively easy for common citizens to understand, does not require extensive paperwork when filing and information is universally accessible by everyone. The tax on Cannabis is *ad volorem*, which means that is obtained by multiplying the final price of a product by the tax rate in use. It is the most common way of

applying taxes for products meant for consumption. As seen above, when discussing how the tax is structured in most states, they only imposed a percentage of the product price as tax or excise. It is an easy process to understand by citizens and does not require extensive government implication. Furthermore, it does not require too much paperwork for taxpayers (citizen), because the tax is levied by retailers on the spot and remitted to the corresponding authorities later. When it comes to transparency, there is an infinite amount of articles on the subject and most states have displayed on their website information about the tax. Information available ranges from projected revenues for what else the revenue is expected to be used.

Collectability (Administrative ease)

The great expectation when it comes to taxes is to lower the administrative cost related to said tax. It would be counterproductive, if most of the revenue obtained would go to the cost of administering the tax instead of benefiting citizens wellbeing. As Mikesell (2018) states, “tax and provisions should be designed to keep total tax collection cost as low as possible within the constraint of satisfactory equity and economic impact” (p. 387). Indeed, if the purpose of raising taxes is to pay for citizen services, it will defeat its purpose, if the cost of levying the tax would be higher or equal to the amount of tax raise. Hence, why it is preferable to design tax system to incur the minimum cost possible. Considering the simple nature and structure of the marijuana tax, it should be easy for citizen and companies to comply with the law, without too much intervention from government entities to ensure that taxes are being levied properly. Some states have a tax structure that allows for easier tracking of the product by administering tax at each major transfer point of the product which are production, wholesale, and retail.

Marijuana taxes can also have a major impact on the economy. If states are imposing a higher tax rate on marijuana, whether it is on the grower, wholesaler, or retailer, they might drive

away their consumers who would instead buy on the black market, which is not subject to such regulations. Alexander (2014) explains that if a state increases the rate of excise taxation, there is a risk of driving transactions underground. Evidence suggests that a correlation exists between excessive excise taxation (driving prices higher) and an increase in black market sales. He further added, “When the price of an item increases substantially, it can induce people to shop on the black market” (Alexander, 2014, p. 142). Another more significant question is: Will regular users of marijuana who were used to getting the product for a much lower price on the black market be willing to pay a higher price for the ability to get a clean product under legal circumstances?

Another point to consider is how some states have made a bit complicated to evade the tax system and supply the black market of the product. Imposing excise taxes at the beginning of the process such, as excise for growers of the plant, establish a particular record that growers will have to account for when they are remitting their taxes. This step makes it more challenging to defer payments to the government.

Conclusion

Taxing marijuana is extremely complicated. The tax has a substantial capacity of raising revenue that states or local government desperately need to balance their budget. Those revenues could be allocated to numerous social programs, such as schools, libraries, and health programs. Considering that demand does not fall for this good, there is room for consistent growth, although there is no guarantee for sustainability. We can rule out serious issues of equity for this tax, as households are not obliged to by this product. It is mostly a preference of the consumer, notwithstanding that, there is indeed a greater burden for low-income families. States have been straight forward with information regarding marijuana and the tax does not represent complexity of any sort. Citizens who want to purchase the product know what to expect in terms of price, and

they are aware of the regulations. The tax being collected mostly by retailers does not require any effort from the citizen when it comes to collections. The way the tax is structured in most states allows for a comprehensive review, an audit, and does not require extensive cost for the government when it comes to compliance. Overall, the tax on marijuana could be considered “a good tax”.

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