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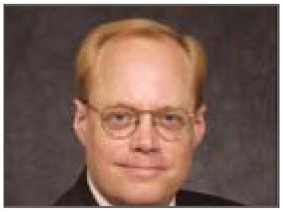

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Who Shares In Marijuana Taxes? The Surprising Answer

Taxes on marijuana are big, and it's easy to see why. A discussion about legalizing marijuana often segues into one about tax revenues. Marijuana for medical use is legal in 23 states and the District of Columbia. Recreational marijuana is legal in DC and in four states, Colorado, Washington, Oregon and Alaska. More states will be coming.

In the meantime, cannabis—even for medical use—remains illegal under federal law. That leads to numerous legal woes for operations that are legal under state law. One sweet spot among legislators is tax revenue. It is a boon for the states. It could be a boon for the feds too.

The proposed Marijuana Tax Equity Act (H.R. 501), if passed, would end the federal prohibition on marijuana and allow it to be taxed. Growers, sellers and users would not to fear violating federal law. But dealing with taxes would be another story.The bill would impose an excise tax of 50% on cannabis sales and an annual occupational tax on workers in the field of legal marijuana.

Even if passed, one wonders if such high taxes could be collected. In the meantime, Colorado has trumpeted its tax revenues, though perhaps prematurely. It turned out that the $33.5 million Colorado *projected* to collect in the first six months of 2014 was too optimistic. When the smoke cleared, Colorado was missing $21.5 million in pot taxes! Yet the math isn't difficult.

There's a 2.9% sales tax and a 10% marijuana sales tax. Plus, there is a 15% excise tax on the average market rate of retail marijuana. If you add them up, it's 27.9%. But much of the volume goes to black market buys where sales taxes aren't paid. But that could change.

In fact, Colorado is making some marijuana businesses happy with its rebate program. Sales tax applies to marijuana sales and vendors are required to collect and remit the tax to the state. However, Colorado rewards all businesses with a rebate for the prompt payment of taxes, letting businesses keep a percentage each month. Calling it a 'vendor fee,' Colorado allows businesses to keep 3.3 percent of the 2.9 percent state sales tax.

According to estimates by the Denver Post, Colorado's medical and recreational marijuana stores have collected—and kept—over $447,000 in sales taxes in the 10 months ended October 31, 2013. That could mean more than 400 marijuana stores in the state will end up clearing approximately $575,000 for all their trouble. It is what has allowed pot shops to keep more than $500K in sales tax.

That's not bad, and at least it is something for their trouble. The idea that retailers should get a little sweetener for collecting sales tax is nothing new. But in the marijuana context, it can be especially attractive precisely because it would otherwise be hard to collect.

Already, with typically higher taxes for recreational than medical use, there is a clear incentive to resort to the illegal market. The Marijuana Policy Group suggested that only 60% of purchases in Colorado may be made through legal channels. One reason is price, another is taxes.

And the taxes are still being contested. The Colorado tax on marijuana has been upheld despite claims that paying it amounts to self-incrimination violating the Fifth Amendment. The plaintiffs wanted the recreational pot taxes outlawed, reasoning that they require businesses and consumers to implicate themselves in federal crimes. The plaintiffs lost on getting an injunction, but challenges to the taxes are continuing. On the other hand, under a state refund program, Colorado residents may get a "marijuana tax" refund.

The 2.9% medical marijuana tax compared with 27% on the recreational variety is a big spread. Some patients could be reselling their 2.9% medical stock to the public. But the sales tax rebate may be one of the few places marijuana businesses feel fairly treated. After all, under federal law, marijuana is still illegal, classified as a controlled substance, even for medical use.

Thus, even legal medical marijuana businesses have federal income tax problems. Section 280E of the tax code denies even legal dispensaries tax deductions, and the IRS says it must enforce the tax code. Dispensaries can deduct expenses from other businesses distinct from dispensing marijuana. If a dispensary sells marijuana and is in the separate business of care-giving, the care-giving expenses are deductible. Some marijuana sellers operate as nonprofit social welfare organizations, as cooperatives or collectives.

This isn't the only context raising the conflicting federal and state laws over marijuana. Yet as medical marijuana has gained widespread acceptance and even recreational marijuana is taking hold, the federal vs. state conflict grows deeper.

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