TAXES TODAY

eNewsletter for Tax Professionals

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Growing Like a Weed

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Smoking pot is now legal in ten states.

And 15 other states have decriminalized recreational cannabis usage. However, what is seemingly now a bigger question is how marijuana sales are taxed.

One clear reality is that states will continue to "go their own way" in determining how cannabis cultivators and consumers will be taxed.

TABLE 1
Marijuana Tax Rates

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State	Taxes	Legalization Date
Alaska	Cultivators pay $50 per ounce for bud/flowers and $15 per ounce for remainer of plant Localities can levy an excise tax on retail sales	2014
California	15% state excise tax on retail sale Cultivators pay $9.25 per ounce for flowers and $2.75 per ounce for leaves Localities can levy an excise tax on retail sales	2016
Colorado	15% state excise tax on retail sale 15% marijuana tax on contract price (cultivator) Localities can levy both a retail and/or cultivator tax	2012
District of Columbia	Prevented from taxing sales	2014
Maine	No tax system in place	2016
Massachusetts	10.75% state excise tax on retail sale Local excise taxes on retail sales capped at 3%	2016
Michigan	No tax system in place Ballot initiative proposed 10% excise tax on retail sale	2018
Nevada	15% state excise tax on wholesale sale (cultivator) 10% state excise tax on retail sale Localities can levy an excise tax on retail sales	2016
Oregon	17% state excise tax on retail sale Local excise taxes on retail sales capped at 3%	2014
Vermont	No tax system in place	2018
Washington	37% state excise tax on retail sale	2012

Source: State government websites.
Notes: Some states also levy their general sales tax on marijuana purchases. The legalization date is when the law passed and not when taxable sales began.

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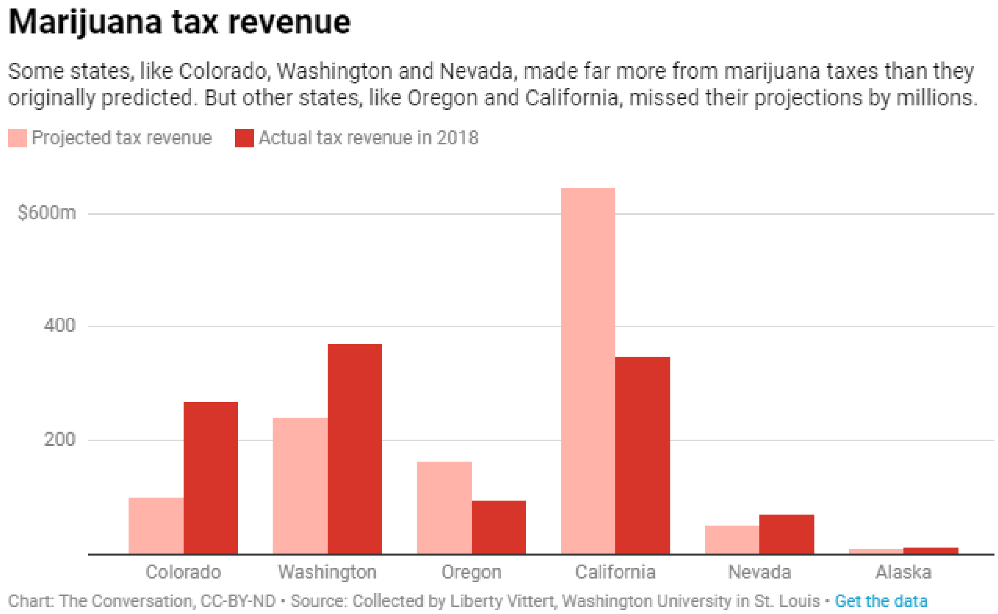
The chart above shows this state-by-state variability. On one extreme end, Alaska passes the entire tax through to cultivars and on the other end, Washington taxes consumers at an astonishingly high rate of 37%.

California uses a hybrid approach. California cannabis cultivators are taxed $9.25/ounce on flowers and $2.75/ounce on leaves, and consumers pay a 15% sales tax on purchase, Further, California cities and counties have the option to add their own excise taxes on top of these. The result for some California counties is an aggregate tax as high as 45%.

And while regulatory "red tape" has been a significant headwind for marijuana growers and dispensaries in all states where recreational cannabis can be legally grown and sold, the greatest threat to long-term success of legal marijuana sales in California is the prohibitive taxes.

Unsurprisingly, studies have shown that California's high marijuana tax rate is providing a significant boon to illegal cultivation and sales. In fact, according to a recent study by New Frontier Data, as much as 80% of the marijuana sold in California comes from the black market.

Another way to see the impact of these high taxes is the graph below:



As the graph shows, California's actual 2018 revenue from marijuana taxes significantly lagged projected results. Most experts interpret this to mean that cannabis sales on the black market were much higher in 2018 than expected. And compared to the other states shown on the chart, California's results are certainly a cause for concern.

To curb the black market sales of marijuana, California's state legislature introduced Assembly Bill 286, known more commonly as the Temporary Cannabis Tax Reduction Bill, in early 2019. The passing of

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this bill would reduce the cannabis sales tax from 15% to 11% – a high rate still but enough to help close the gap between legal and illegal sales.

To read more about California's prohibitive marijuana tax rates and the possible solutions to this problem, please read the article *"California's Ridiculous Marijuana Calls for Drastic Action."*

Another significant challenge California's (and other states') legal cannabis growers are facing is the federal government's classification of marijuana dispensaries as drug trafficking companies.

The result of this classification is that the IRS continues to levy federal income taxes on marijuana dispensaries (as it does with all illegal streams of income) but at the same time, often disallows these dispensaries from deducting standard business expense items.

If you have clients in the cannabis industry, we recommend working with them to analyze their position relative to Section 280E of the Internal Revenue Code. This section focuses on the tax deduction limits imposed on businesses the federal government considers drug traffickers.

Note: We use cultivate and grow interchangeably in this newsletter (although there are slight differences in meaning). Also, mentions of the marijuana industry in this refer to recreational use and not medical.

We are here to help.

*As always, please feel free to reach out and call (**916-405-9166**) or email (**spitchford@towerpointwealth.com**) with any questions, thoughts, or needs you may have. At Towerpoint Wealth, we are happy to be a direct and no-strings-attached resource for you.*

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