The Daily Dish

The Dope on Cannabis and Taxes

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Eakinomics: The Dope on Cannabis and Taxes

There is a rich history of taxation at the intersection of law and disorder. The most obvious is the Boston Tea Party, a protest against the taxes in the Townshend Act (and, more precisely, the exemption of the East India Company from those taxes). The first federal excise tax, a tax on whiskey, spawned the Whiskey Rebellion (my western Pennsylvania people, God bless them). And Al Capone dodged the law until he was famously convicted of income tax evasion.

Which brings Eakinomics to the latest two papers by AAF's Gordon Gray: a primer on federal taxation of cannabis and survey of state-level taxation of cannabis. Starting with the latter, 18 states and the District of Colombia have "decriminalized" the recreational use of cannabis products and started retail sales to adults. Since taxes are irresistible, they have also begun taxing products by sale price, weight, or to some degree, potency. Thus, cannabis taxes can be thought of as another "sin tax" similar to alcohol or tobacco. On average, these state taxes amount to 18.8 percent. But the table below (Table 4 of Gray's paper) displays the bottom line effectively: "Compared to alcohol, cannabis is much more heavily taxed, but it is more lightly taxed than cigarettes."

States	Effective Tax Rates for State-Level Cannabis Taxes (%)	Effective Tax Rates for State-Level Beer Taxes (%)	Effective Tax Rates for State-Level Wine Taxes (%)	Effective Tax Rates for State-Level Liquor Taxes (%)	Effective Tax Rates for State-Level Cigarettes Taxes (%)
Alaska	17.46	2.21	3.71	9.44	20.96
Arizona	16.00	0.42	1.25	2.21	25.38
California	19.60	0.57	0.30	2.43	32.25
Colorado	32.25	0.19	0.47	1.68	26.36
Connecticut	15.52	0.64	1.17	4.38	40.32
Illinois	17.70	0.66	2.06	6.30	30.66
Maine	18.73	0.77	0.89	n.a.	26.28
Massachusetts	10.75	0.25	0.82	2.99	34.01
Michigan	10.00	0.58	0.76	n.a.	26.08
Montana	20.00	0.32	1.57	n.a.	24.46
Nevada	26.50	0.33	1.04	2.65	25.07
New Jersey	11.38	0.27	1.30	4.06	30.65
New Mexico	12.00	0.89	2.52	4.47	26.46
New York	21.36	0.31	0.45	4.75	39.33
Oregon	17.00	0.17	0.99	n.a.	39.36
Vermont	14.00	0.58	0.82	n.a.	32.77
Virginia	21.00	0.68	2.24	n.a.	9.30
Washington	37.00	0.55	1.29	10.52	32.92

All of this is interesting in its own right. But it is even more fascinating in light of the federal primer that makes the point that the "manufacture, distribution, and possession of cannabis remains a federal crime under the Controlled Substances Act. Under federal law, cannabis is a Schedule 1 controlled substance, and anyone involved in its distribution is, all else equal, a drug dealer subject to severe criminal penalties." So, at some level, these states are involved in their own cannabis rebellion.

It gets better. As Al Capone learned the hard way, one must report and pay federal income taxes on income from illegal activities. In addition, the tax law now has its own calculation of income for cannabis sellers. As Gray notes, "In a 1981 U.S. Tax Court Opinion, the court held that a taxpayer who 'was self-employed in the trade or business of selling amphetamines, cocaine, and marijuana' was entitled to claim travel, rent, packaging costs, and other similar costs as expenses deductible against his otherwise taxable income from being a drug dealer." That got the economics right, but Congress added section 280E to the tax code in 1982 with the result that today cannabis distributors cannot use credits and deductions. So, no tax credits and no deduction for employee salaries, rent, or utilities.

There have been many proposals to reform the federal taxation of cannabis. One would be to allow deductions and credits to cannabis sellers, something that would be a $5 billion tax cut for the industry. Another would be to remove cannabis from the Controlled Substances

Act entirely, which would render section 280E moot. Finally, there are also proposals to impose a federal excise tax like the state-level taxes discussed above. Nevertheless, Gray concludes: “Since major congressional action on federal cannabis policy and taxation is unlikely in the near term, however, states and localities will continue to serve as the policy laboratories on the cannabis front.”