



Wood LLP

Tax Alert



Robert W. Wood

THE TAX LAWYER

TAXES 9/02/2014

\$21.5 Million In Marijuana Taxes Just Went Up In Smoke

You have to hand it to Colorado for propelling legalized marijuana into the mainstream. In addition to medical marijuana, Colorado legalized recreational use, trumpeting the tax revenue it *knew* would be piling in. In Colorado, 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 that up, it's 27.9%.

Just think of all that tax revenue! Like a closer Amsterdam, Colorado would be on the New Pot Trail, getting marijuana tourists in addition to locals imbibing. Legalize and tax it, they said. But it turns out the \$33.5 million Colorado projected to collect in the first six months of 2014 was a little too rosy. It's now the next morning, so to speak, and [Colorado is missing \\$21.5M in pot taxes!](#)

One explanation is that old habits die hard. With all those [taxes](#), many smokers are still buying on the black market. Go figure. The state thought more people would migrate out of the black market.

In fact, only an estimated 60% of purchases in Colorado this year will be through legal channels, according to the Marijuana [Policy](#) Group. One big reason appears to be price. Legal marijuana is considerably more expensive than the black market variety.



(MARCEL VAN HOORN/AFP/Getty Images)

And a recently contested tax is one of the culprits. So far, the Colorado tax on marijuana has been upheld despite claims that paying it amounts to self-incrimination violating the Fifth Amendment. Plaintiffs want the taxes on recreational pot outlawed, reasoning that they require businesses and consumers to implicate themselves in federal crimes.

It's a clever argument given the conflict between state and federal law. Still, the plaintiffs lost on getting an injunction. Yet that doesn't mean the lawsuit is over; [the lawsuit challenging the taxes](#) will continue and the stakes are high.

There's a growing relationship between the 2.9% medical marijuana tax and the 27% recreational variety. This rather big spread suggests that some patients could be reselling their 2.9% medical stock to the public. How tightly is the medical variety regulated? Not very, it turns out.

You visit a doctor, but the hurdle isn't high nor is the cost. A medical marijuana card costs \$15. About 23% of the estimated marijuana users in Colorado have medical cards, according to the Marijuana Policy Group. It isn't clear whether medical marijuana cards spiked when recreational pot was legalized.

But any way you slice smoke it, the state's economists may have committed more than a rounding error. Still, state law requires a [refund to taxpayers](#) if the government collects more than expected. Some say fear of refunds made for big estimates.

Well, taxes aren't even clear on the federal side. Marijuana remains illegal nationally. As a result, even legal medical marijuana businesses have federal income tax problems. That's because [Section 280E](#) of the tax code denies even legal dispensaries tax deductions.

The IRS says it has no choice but to enforce the tax code. One answer is for dispensaries to 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.

If only 10% of the premises are used to dispense marijuana, most of the rent is deductible. In allocating expenses between businesses, good record-keeping is essential. But there is only so far one can go. Some marijuana sellers operate as nonprofit social welfare organizations or as cooperatives or collectives.

The proposed [Marijuana Tax Equity Act](#) would end the federal prohibition on marijuana and allow it to be taxed. That way growers, sellers and users would not fear of violating federal law. The bill would also impose an excise tax on cannabis sales and an annual occupational tax on workers in the [growing field of legal marijuana](#).

Colorado's tax law is bringing in revenue, just not as much as touted. As medical marijuana has gained widespread acceptance and even recreational marijuana is taking hold, the federal vs. state conflict grows deeper. And with a 2.9% to 27% spread, it looks like there's yet another conflict to be sorted out.

Contact me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.