

MEMORANDUM

TO: Joint Budget Committee

FROM: Scott Thompson, JBC Staff (x4957)

SUBJECT: Excise Tax Exception for a Transfer of Medical Marijuana to Retail Marijuana

DATE: March 24, 2015

Important Note: After discussions with the Office of Legislative Legal Services, staff notes that any change to how the excise tax is levied on retail marijuana businesses that results in businesses paying more excise tax requires new voter approval.

Background

One of the provisions of Amendment 64 directed the General Assembly to enact an excise tax on the transfer of retail marijuana in business-to-business transactions and further directed the first \$40.0 million derived from the excise tax enacted by the General Assembly to the Building Excellent Schools Today (BEST) Program.

Throughout the stakeholder process the Amendment 64 Task Force (Task Force) discussed how to ensure that retail marijuana stores opening on January 1, 2014 would have retail marijuana to sell. Ultimately, this goal appears to have been met, especially when you compare the news from the first day of retail marijuana sales in Colorado with the first day of retail marijuana sales in Washington. In Washington, there were 24 stores licensed as of the first day of its sales but only four of those stores had product for the first day of sales.

Retail marijuana licenses were issued prior to January 1, 2014, but did not become active until that date. Licensing of retail marijuana businesses was staggered in a way where medical marijuana licensees had an opportunity to apply to become a retail marijuana operation before new marijuana retailers were allowed to apply for licenses. Due to marijuana growth cycles, which take approximately four months to complete, the Task Force ultimately recommended allowing medical marijuana businesses licensed before the passage of Amendment 64 to make a one-time tax-free transfer of medical marijuana to retail marijuana.

Ultimately, the excise tax, codified by the General Assembly in Section 39-28.8-302, C.R.S., only applies to the first sale or transfer of unprocessed *retail* marijuana by a *retail* cultivation facility. The statute provides different treatment for licensees who wish to convert completely to the retail framework and surrender their medical license and for those who wish to operate both retail and medical marijuana businesses. While all medical marijuana is converted to retail marijuana when a medical license is surrendered, those who wish to operate in both retail and medical marijuana must identify the quantity of medical marijuana that will be transferred to retail at the time the retail license become effective.

The excise tax is not the only source of revenue to the BEST Program. By far the biggest contribution to the program in FY 2013-14 comes from proceeds from the State Land Board. The table below summarizes the revenues transferred to the BEST Program in FY 2013-14:

FY 2013-14 BEST Program Transfers	
Source	Transfer
State Land Proceeds	\$85,914,869
Marijuana Excise Tax	3,012,860
Lottery Proceeds	4,735,342
Interest	<u>1,714,872</u>
Total State Transfers	\$95,377,943

Staff disagrees that schools “lost” money as a result of this statute. Schools were never guaranteed a total of \$40.0 million from excise tax collections and the first \$40.0 million of the excise tax *is* being directed into the BEST Program. The fact that some of the transfers are exempt from the excise tax does not mean that schools lost revenue. In fact, Amendment 64 left the question of how the excise tax is levied on transfers up to the General Assembly; it only limited the tax rate. Amendment 64 does not contemplate the statutory authority to transfer marijuana from a medical business to a retail one. This explains part of why the General Assembly had to refer Proposition AA to voters in the first place; Amendment 64 did not authorize a new tax, it directed the General Assembly to levy a new tax.

It is admittedly a bit of a legal fiction because of the fungible nature of marijuana but Amendment 64 provides that the excise tax cannot be levied on marijuana intended for sale at a medical marijuana center. Because marijuana for medical use remains marijuana for medical use until it is transferred to the retail establishment via statute, the Constitution forbids the excise tax to be levied on it.

Colorado Constitution and the Marijuana Transfer

Some advocates for ending the one time excise tax exemption suggest that reclassifying medical marijuana as retail marijuana through statute infringes on the constitutional definition of medical marijuana. Staff does not agree that medical marijuana is defined in the Constitution. Article XVIII, Section 14 of the Colorado Constitution defines medical use of marijuana, but it does not create a special form of marijuana called medical marijuana. The Constitution defines “medical use” of marijuana as “the acquisition, possession, production, use, or transportation of marijuana or paraphernalia related to the administration of such marijuana to address. . .” the needs of a medical marijuana patient.

Therefore, medical marijuana is medical marijuana until it is converted to retail marijuana through the one-time transfer. While JBC staff does not believe the transfer to retail licensees is unconstitutional, whether the policy of allowing a one-time transfer of medical marijuana to a retail licensee is a policy decision for the General Assembly.

Estimated Impact to the BEST Program from the One-Time Transfer

The Department of Revenue estimates that in FY 2013-14 approximately \$3 million of marijuana that would otherwise have been subject to the excise tax was transferred through the one-time allowance. The Department cannot report the exact amount of excise tax that this product would

have been subject to because different components of the marijuana plant have different market rates. The market rate for immature plants is \$9 each and the trim that is removed from the marijuana flowers, often used to make extracts and edibles, has an average market rate of \$296 per pound. The marijuana flower, the part people break up and smoke, commands an average market rate of \$1,876 per pound.

The Department reports that between January through August 2014, 23,011 pounds of medical marijuana had been identified and transferred to the retail marijuana framework. Of the 23,011 pounds, 8,576 pounds were transferred to a retail marijuana cultivation facility and was subsequently taxed at the regular rate when it was sold or transferred to a retail marijuana store.

With this information, staff can estimate that anywhere between \$640,914 and \$4,062,009 of excise tax that otherwise would have been transferred to the BEST Program was avoided by marijuana businesses through August 2014. The Department of Revenue has not completed an updated analysis of the transfers at this time.

Potential to use the Excise-Tax as an Incentive to Move to Retail Marijuana

Throughout many of the marijuana conversations over the past year, there has been a lot of concern over the lack of tax revenue being realized from the retail marijuana program. While staff still believes the retail marijuana tax revenues will continue to grow in the short-term to reflect the maturation of a new industry, the tax revenue collected thus far has generally been lower than originally forecast. News articles and legislators have stated that there is an incentive for any consistent marijuana consumer to apply for and obtain status as a medical marijuana patient. In fact, a medical marijuana patient tends to pay almost half the price for the same or similar marijuana products than retail-marijuana consumers pay and only contribute 2.9 percent regular sales tax.

Using a carrot and stick approach, staff believes there is an opportunity to continue to allow a medical marijuana business a one-time transfer of medical marijuana to retail marijuana if the business discontinues doing business as a medical marijuana licensee. For municipalities that have not yet invited retail marijuana businesses to operate in their jurisdiction, this could have a profound effect on future tax revenue coming from the Proposition AA taxes and therefore the revenues to the BEST Program.