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# Tax and Legal Cannabis Policy

Revenue, Tax and Illegal Market Considerations for a New Era

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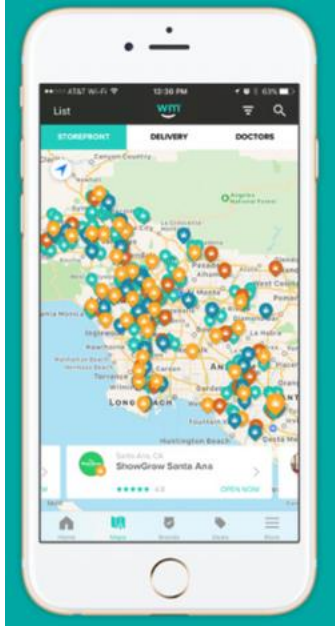
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Chris Beals, President & General Counsel, Weedmaps

Presented to NCSL Task Force on SALT on November 17, 2017

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# What is **weedmaps**®?



- **History:** Founded in 2008, Weedmaps is the oldest and largest cannabis technology company in the world. Almost 400 employees and offices in the United States, Canada and Europe.
- **Core Platform:** Our core platform connects people with local dispensaries, delivery services, doctors, deals, brands, lab data and real-time menus.
- **Other Business Products/Services:**
  - Brands Platform
  - Three POS Systems
  - Doctor Patient Practice Software
  - Marijuana.com/Cannabis.com
  - Next gen data solutions

# Weedmaps Internal Government Relations Team



**Chris Beals, President & General Counsel**

*Formerly: Colbeck Capital Management, Covington & Burling, Davis Polk (New York, NY)*



**David O'Brien, Director of East Coast Government Relations**

*Formerly: Senior Advisor, Barrett Strategies (Boston, MA)*



**Bridget Hennessey, Senior Associate**

*Formerly: Chief of Staff, North County Transit District (San Diego, CA)*



**Dustin McDonald, VP of Government Relations**

*Formerly: Director, Government Finance Officers Association (Washington, DC)*



**Cedric Haynes, Senior Associate**

*Formerly: Subcommittee Director, US House of Representatives (Washington, DC)*



**Jano Dekermenjian, Senior Associate**

*Formerly: Legislative Director, California State Senate/Assembly (Sacramento, CA)*



**Kelli Hykes, Senior Associate**

*Formerly: Director of Public Health Policy, Columbus Public Health (Columbus, OH)*



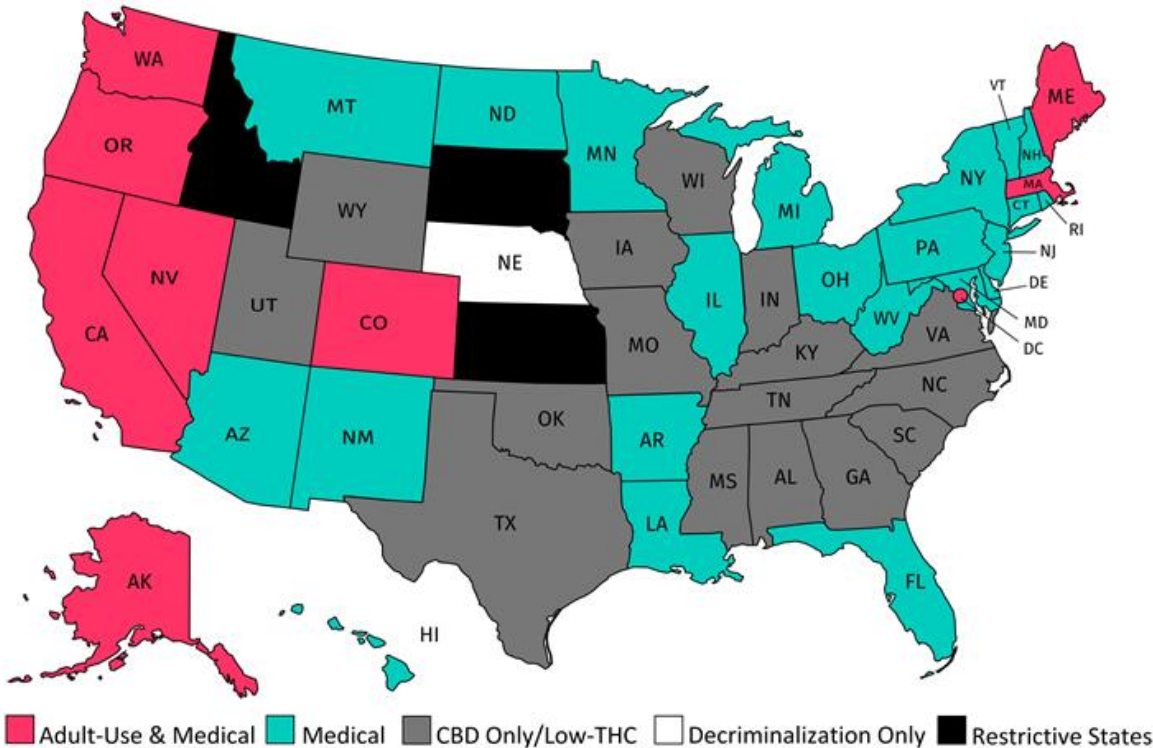
**Ben Mays, Senior Associate**

*Formerly: Michael S. Dukakis Fellow, Nevada Governor's Office/Harvard University (Boston, MA)*

# What is | POLICY?

- Semi-autonomous policy arm of Weedmaps
- Advocating for consumer safety improvements and illegal market reduction
- Key planks of our policy platform include:
  - Minimizing the illegal market in legal states
  - Ensuring safe and convenient access
  - Robust lab testing standards
  - Monitoring/safety regs that balance community safety with cost to operators
  - Development of cannabis IP and licensing policy
  - Organizing sound state and local tax policy to ensure communities hosting licenses see economic benefit
  - Developing strategies to foster local licensee jobs and develop new technology solutions
  - Enforcement strategies that are flexible enough to meet varying illegal market challenges
- Weedmaps is working collaboratively with all levels of government:
  - **National-Level:** United States, Canada, and several European countries
  - **State-Level:** California, Massachusetts, Michigan, and New Jersey—among others
  - **Local-Level:** Los Angeles, Compton, San Diego, and Toronto—among others

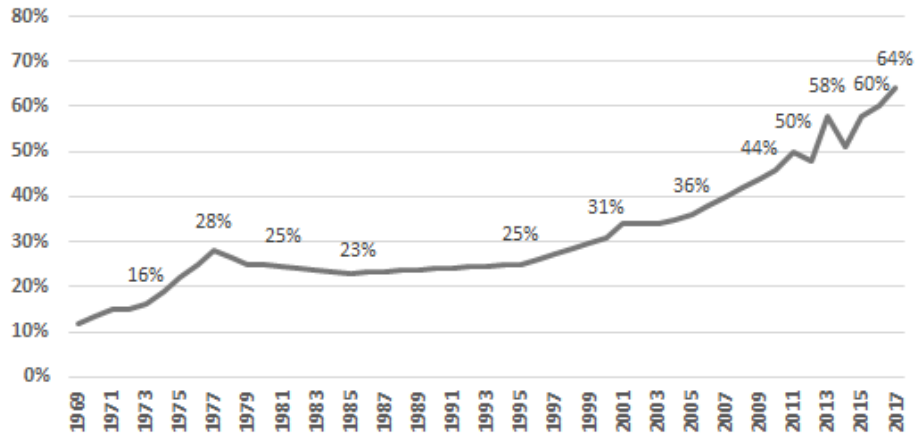
# Overview of State Cannabis Laws



- **Cannabis Regulations:** 46 States & DC
- **Adult-Use & Medical:** 8 States & DC
- **Medical Only:** 22 States
- **CBD Only:** 16 States
- **Decriminalization Only:** 1 State
- **Restrictive States:** 3 States
- **Bottom Line:** Vast majority of states now have legal cannabis access models, and state policymakers can learn from experiences of other jurisdictions

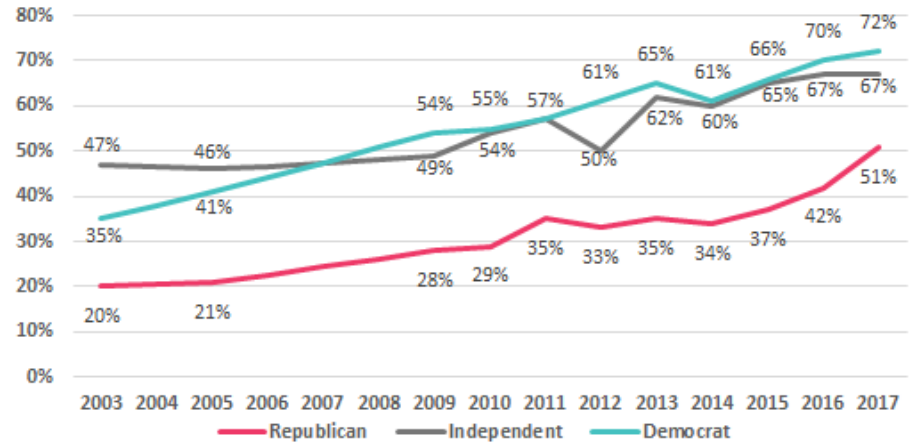
# Public Sentiment on Marijuana

American Support for Cannabis Legalization, 1969-2017



Source: Gallup

American Support for Cannabis Legalization, by Party



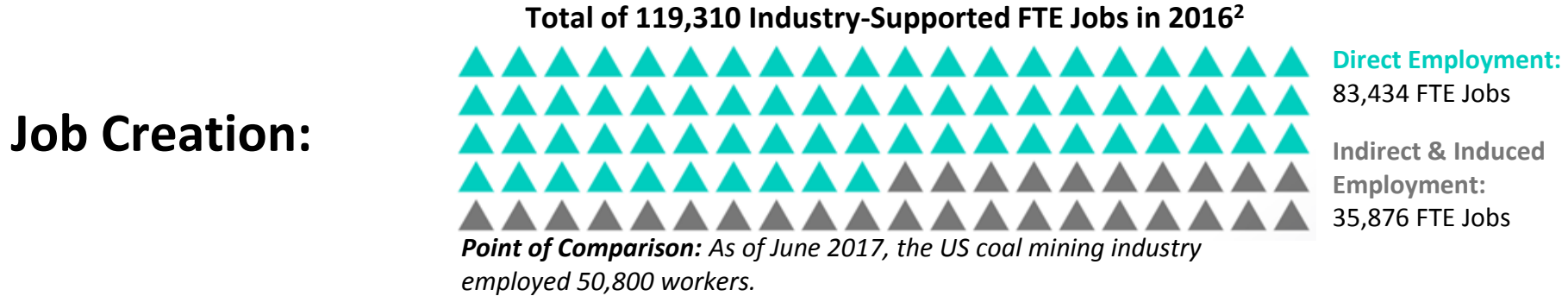
Source: Gallup

- US support for cannabis legalization is at record levels: 64% of Americans support adult-use cannabis legalization
- Support for adult-use cannabis legalization has risen following the implementation of well-regulated state systems
- Strong bipartisan support for adult-use cannabis legalization: 72% Democrats; 67% Independents; 51% Republicans



# Positive Economic Impact of Cannabis Industry (2016)

Revenue: **\$6.6 Billion (Conservative Estimate)<sup>1</sup>**



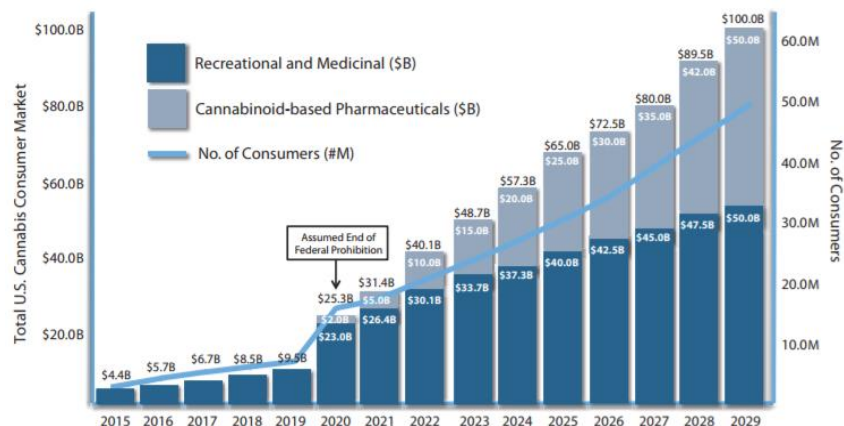
1. New Frontier Data. *The Cannabis Industry Annual Report: 2017 Legal Marijuana Outlook, Executive Summary*, p. 2.

2. Assumes employment levels comparable to those in Colorado. Marijuana Policy Group. *The Economic Impact of Marijuana Legalization in Colorado*, October 2016, p. 5-9.

# Industry Projections

- As existing markets mature and additional states implement medical and adult-use systems, the regulated cannabis industry will grow considerably
  - **2020 Projections:** Industry revenue projections for 2020 range from \$16 billion to \$25 billion
  - **2025 Projections:** Industry revenue projections for 2025 range from \$24 billion to \$65 billion
- At employment levels comparable to those in Colorado, a \$24+ billion industry would employ 300,000+ FTE workers

## Ackrell Capital<sup>1</sup>



## New Frontier<sup>2</sup>

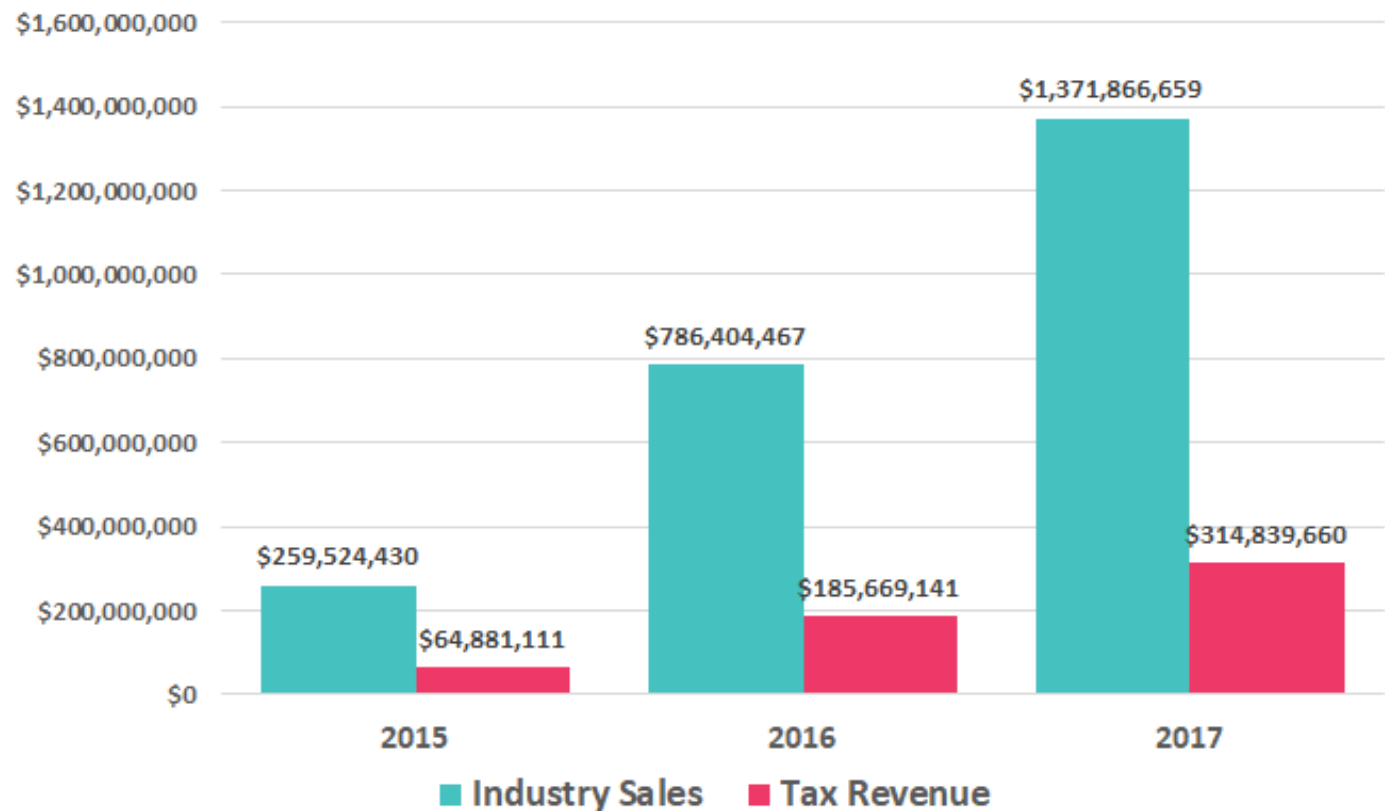


1. Ackrell Capital. *U.S. Cannabis Investment Report 2016*, p. 49.

2. New Frontier Data. *The Cannabis Industry Annual Report: 2017 Legal Marijuana Outlook, Executive Summary*, p. 2.



# Industry Revenue & Tax by FY: Washington State



# Estimating Revenue By License Type (cont'd)

## Cultivation (Indoor)

- Total annual harvest amount is dependent on cultivar and canopy space.
  - Each harvest, on average, yields  $\frac{1}{2}$  - 1 gram of cannabis per watt of light used during flowering stage.
  - Cultivators, on average, use 40 watts per square foot of flowering space.
- Harvests per year: 4.0-5.0
- Wholesale value: \$2,200- \$3,000/pound
- **Example:** 1 acre of indoor canopy will yield \$19-52 million in gross annual revenue.

## Cultivation (Outdoor)

- Total harvest amount is dependent on plant size prior to planting outdoors.
  - Each harvest can yield 28-56 grams per square foot.
- Harvests per year: 1.0
- Wholesale value: \$1,000- \$1,500/pound
- Example: 1 acre will yield \$2.8-8.4 million in gross annual revenue.

# Estimating Revenue By License Type (cont'd)

## Manufacturing

- Revenue is largely dependent on starting material value and desired final product.
  - Material Value: Whole Flower Vs. Trimmed leaves & Biomass
  - Final Product: Specialty Concentrate Vs. Distillate for infused products
- Total Wholesale revenue:
  - Specialty Concentrate Facility that produces 3,000 pounds per year will generate \$27 million in Gross Revenue.
  - Distillate Facility that produces 3,000 pounds per year will generate \$13 million.

## Retail

- Consumer volume is largely dependent on retail density and state consumer count. Tax rate and product quality also have strong influence.
- Assumptions:
  - 600 consumers per day
  - Patients purchase \$120 every two weeks.
- Revenue of \$10 - \$26 million per year.

# CA Revenue Forecasting - Cultivation



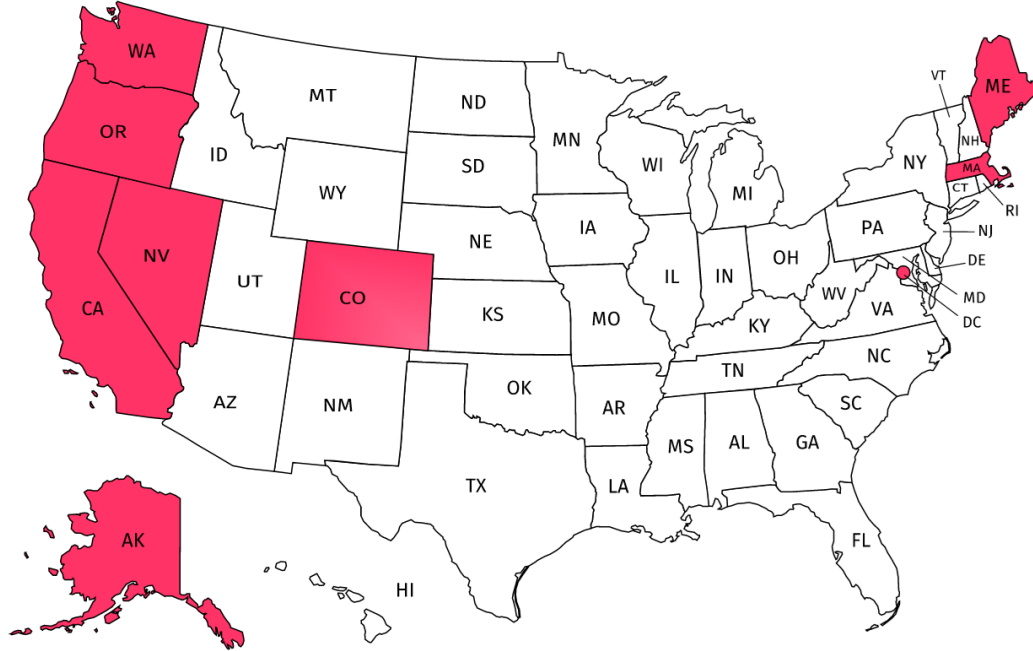
INDOOR CULTIVATION				
Licensing Tier	1A	2A	3A	3A
Canopy Space (sq ft.)	5,000	10,000	22,000	44,000
Employees (Total)	9	19	37	69
Annual Revenue	\$2,359,031	\$4,718,062	\$10,379,736	\$20,759,471
Annual Tax (2%)	\$47,200	\$94,400	\$207,600	\$415,200
Annual Tax (\$10/sq ft.)	50,000	100,000	220,000	440,000

# CA Revenue Forecasting – Retail (Dispensary/Delivery)



Huntington Beach Dispensary Example		
Licenses per population	7,500	15,000
<b>Number of Licenses</b>	<b>27</b>	<b>13</b>
Employees per License	5	5
<b>Total Employees</b>	<b>134</b>	<b>67</b>
Gross Monthly Sales	\$9,638,832	\$4,819,416
Annual Gross Revenue	\$115,665,984	\$57,832,992
Monthly Net Tax (based on 8.9% local tax rate)	\$925,328	\$462,664
<b>Annual Tax</b>	<b>\$11,103,934</b>	<b>\$5,551,967</b>

# Different Taxation Models in Adult-Use States



- Type of Taxation
  - Taxation by Weight (ounce)
  - General State Sales Tax
  - Cannabis-Specific Excise Tax
- Point of Taxation
  - Cultivation/Wholesale
  - Transportation
  - Retail
- Rate of Taxation (low vs. high)
- Local Tax Policy Set by State
  - Set or Capped by State
  - Local



# Net Effective Tax Rates Vary Widely by Jurisdiction

## Net Effective Tax Rates by Jurisdiction

	Cultivation or Wholesale Tax	State Sales Tax	State Excise Tax	Local Excise Taxes	Local Sales Tax	Total State Tax Rate
Portland, OR	0.00%	n/a	17.00%	3.00%	n/a	20.00%
Boston, MA*	0.00%	6.25%	10.75%	3.00%	n/a	20.00%
Clark County, NV	15.00%	6.85%	10.00%	3.00%	1.40%	36.25%
Denver, CO	0.00%	n/a	30.00%	3.50%	3.65%	37.15%
Boulder, CO	0.00%	n/a	30.00%	5.00%	3.50%	38.50%
Seattle, WA	0.00%	n/a	37.00%	n/a	10.10%	47.10%

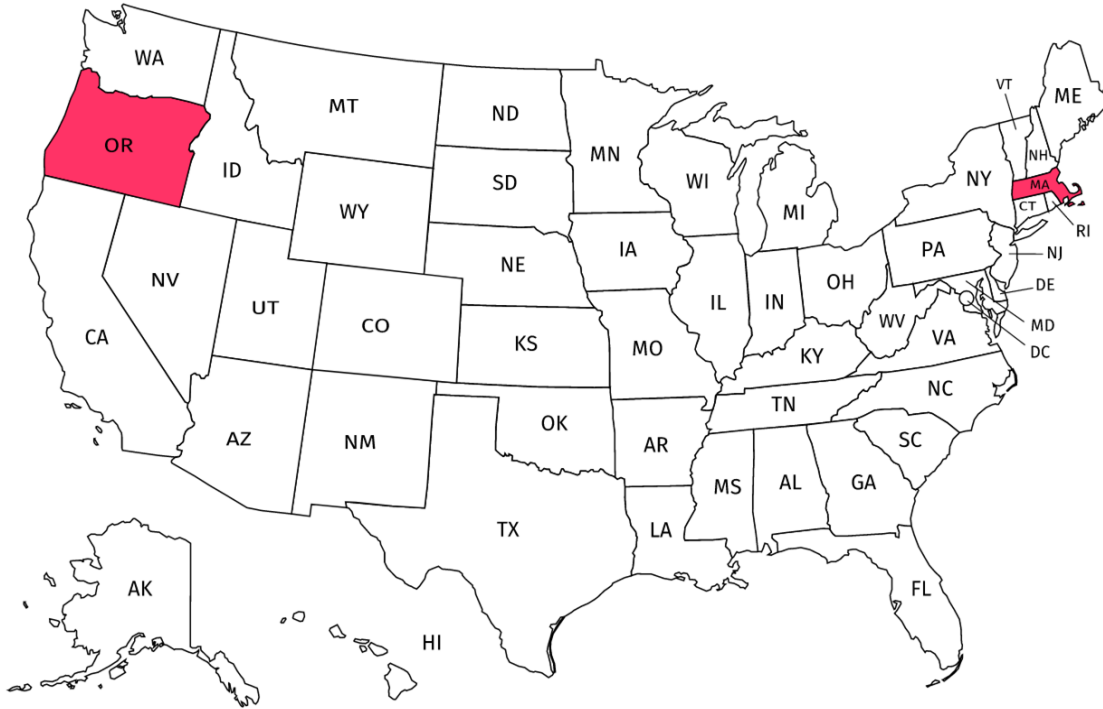
## The Case of California

Form of Taxation	Cultivation or Wholesale Tax
State Wholesale Tax	\$9.25 tax per dry-weight ounce of cannabis flower; \$2.75 per dry-weight ounce of cannabis leaves
State Excise Tax	15.00%
State Sales Tax	7.25%
Local License/Excise	2%-10% (per license)
Local Sales Tax	< 2.5%

*Bottom Line: Net effective tax rates in California are projected to be in the 45-65% range*

\* Projected tax rate based on existing legislation.

# A Trend towards Informed Tax Policy in Recently Legalized States

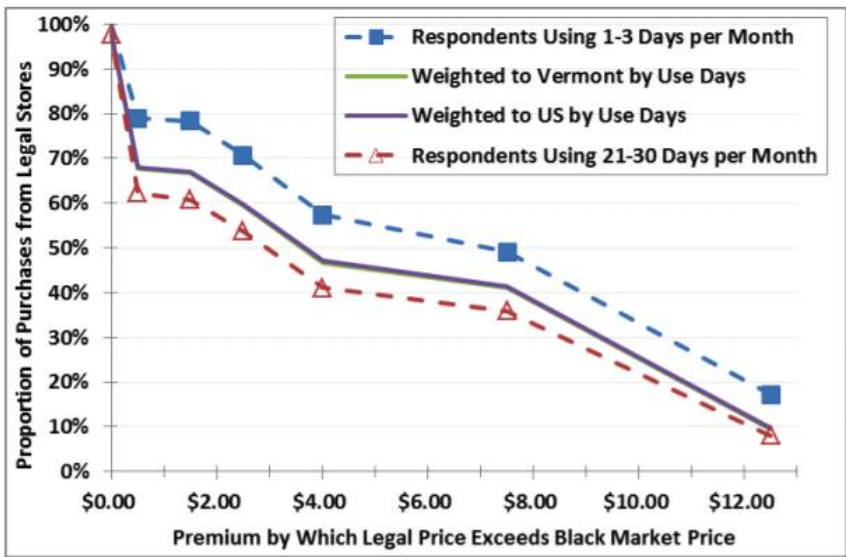


- States that have recently legalized are implementing informed tax policies.
- Oregon
  - All-in 20% Tax Rate
  - Restricted to Final Point of Sale
  - Optional, Capped Local Tax
  - 17% State; 3% Local
- Massachusetts
  - All-in 20% Tax Rate
  - Restricted to Final Point of Sale
  - Optional, Capped Local Tax
  - 17% State; 3% Local

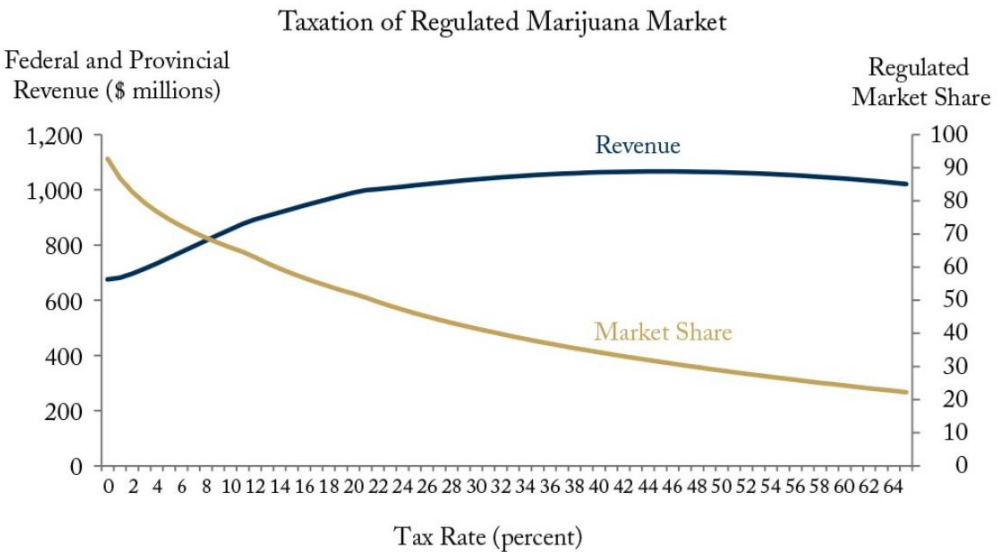
# Sound Tax Policy Is Key for a Functioning Legal Market

- A growing body of research says (1) legalized market consumers are price sensitive, (2) taxes increase the legalized market's price premium, and (3) overly-burdensome tax rates drive consumers to the illegal market

## RAND Corporation Study<sup>1</sup>



## CD Howe Institute Research Brief<sup>2</sup>

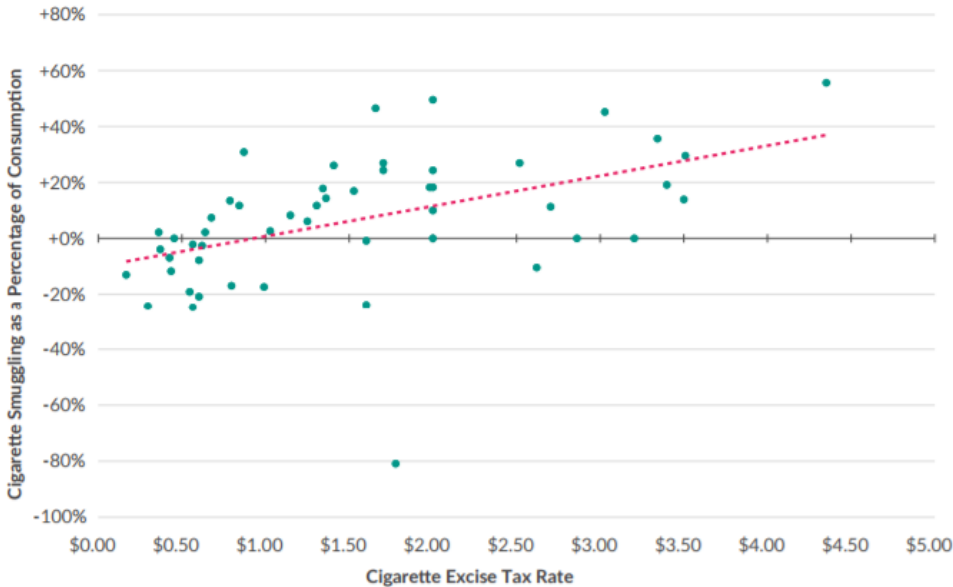


1. Caulkins et. al. *Considering Marijuana Legalization*, 2015, p. 127.  
2. CD Howe Institute. *Intelligence Memo: With Legal Weed the Government Must Choose Revenue or Regulated Market, Not Both*, April 2017, p. 1.

# A Brief Look at Tobacco Excise Taxes

## Cigarette Smuggling Rises with Excise Tax Rates

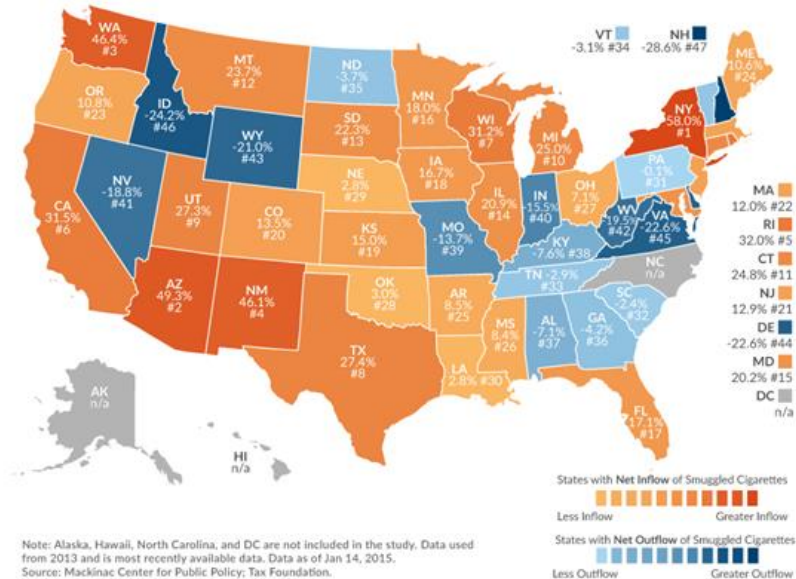
Cigarette Smuggling vs. Cigarette Excise Tax Rates, 2014



Note: Positive smuggling percentages are inflow to a state; negative percentages are outflow.  
Source: Mackinac Center for Public Policy; Tax Foundation.

## Cigarette Smuggling by State

Smuggled cigarettes consumed as a percentage of total cigarettes consumed, 2013



Note: Alaska, Hawaii, North Carolina, and DC are not included in the study. Data used from 2013 and is most recently available data. Data as of Jan 14, 2015.  
Source: Mackinac Center for Public Policy; Tax Foundation.

TAX FOUNDATION

@TaxFoundation

# Fitch Ratings: The Challenge of High Effective Tax Rates



## Local Taxes May Challenge Cannabis Legalization in California

High Tax Rates Likely to Promote Black Market Sales, Limit Governmental Revenues  
Special Report

High effective tax rates on California cannabis may complicate the state's efforts to establish legal markets that are set to open on Jan. 1, 2018. Local business taxes have been adopted in 61 communities to date and are in addition to state taxes on cultivation, a state excise tax, and state and local sales taxes. Fitch Ratings estimates that effective state and local tax rates on nonmedical cannabis could be as high as 45%, which would place California at the upper end of the tax range for states that have legalized nonmedical cannabis.

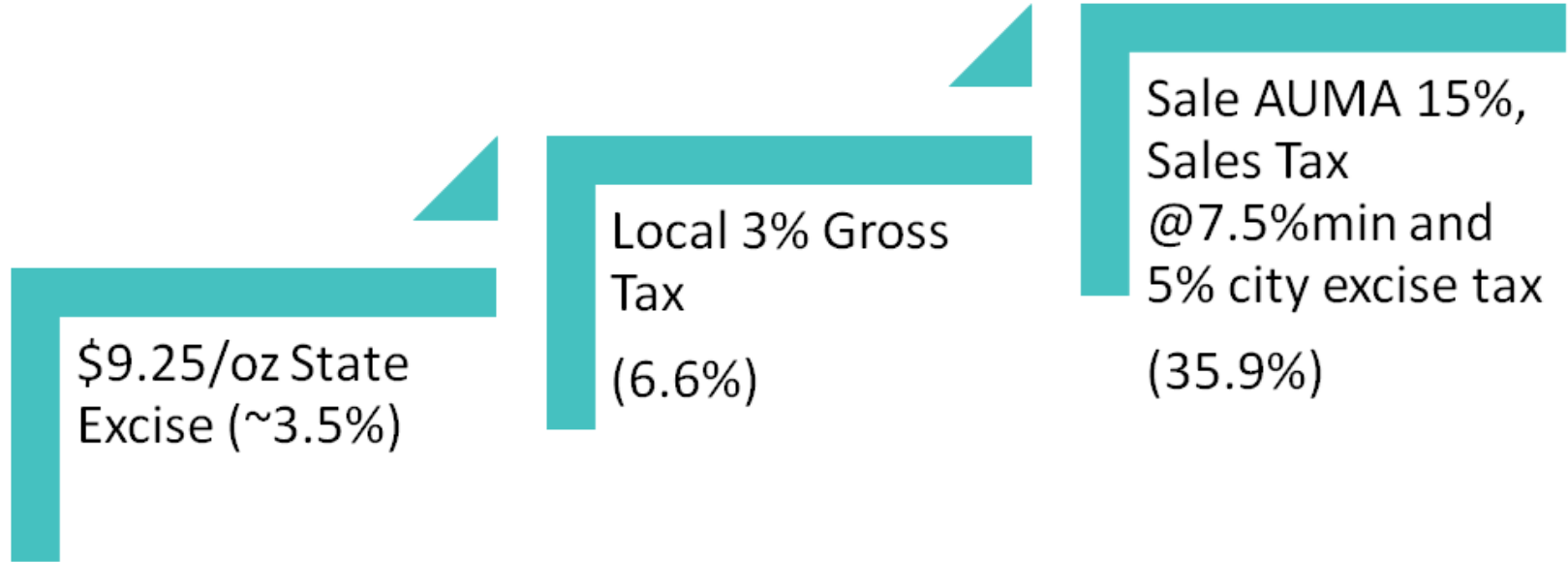
**Boost to Black Market:** High tax rates raise prices in legal markets, reinforcing the price advantage of black markets. California's black markets for cannabis were well established long before its voters legalized cannabis in November 2016 and are expected to dominate post-legalization production. Increased enforcement may ultimately constrain the illegal market, but high taxes may complicate such efforts by diverting in-state sales to the black market.

**Impacts on Governmental Revenues:** Many of California's local governments hope to reap substantial revenues from legal cannabis sales. In the handful of states that legalized nonmedical cannabis prior to 2016, tax receipts have generally outpaced initial revenue estimates and have shown strong year-over-year gains. Revenue gains are not expected to be substantial enough to impact ratings, and over the long term, price declines and black market sales may limit tax growth.

**Patchwork of Local Regulations:** California's framework for the legalization of nonmedical cannabis splits regulatory and taxing authority between the state and its municipalities. Both levels of government have the ability to levy and collect taxes, while cities and counties have the additional authority to impose restrictions on cultivation and sales within their boundaries. These arrangements magnify the uncertainties surrounding cannabis legalization and may contribute to disparate impacts for local governments.

- An August 2017 Fitch Ratings report examined California's tax policy framework
- Report concluded that the combination of high state and local tax rates "may challenge cannabis legalization in California."
- "High effective tax rates on California cannabis may complicate the state's efforts to establish legal markets....Fitch Ratings estimates that effective state and local tax rates on nonmedical cannabis could be as high as 45%, which would place California at the upper end of the tax range for states that have legalized nonmedical cannabis. High tax rates raise prices in legal markets, reinforcing the price advantage of black markets....Increased enforcement may ultimately constrain the illegal market, but high taxes may complicate such efforts by diverting in-state sales to the black market."

# Effective Tax: Simple Low Case (Flower)





# Effective Tax: High Case (Vape Pen)

\$9.25/oz State Excise  
(~3.5%)

Local 6% Gross Tax  
(Cultivator)  
(9.7%)

Local 10% Gross Tax  
Processor (20.6%)

Local 5% Gross Tax  
Filler (26.7%)

[20% Markup  
Distributor (alcohol is  
closer to 30%)]

Sale AUMA 15%,  
Sales Tax @9% and  
City excise @6% e.g.  
L.A. cities (97.7% with  
and 64.7% without  
distributor)

# The Case of Washington State

## The Economist

Legalising cannabis

Reeferegulatory challenge

*A growing number of countries are deciding to ditch prohibition. What comes next?*



- Washington State offers a cautionary tale of the danger of overly burdensome tax rates

- **Seattle, WA:** 47.1% Effective Tax Rate → ~60% Illegal Market Rate<sup>1</sup>
- **Denver, CO:** 37.15% Effective Tax Rate<sup>2</sup> → 20-30% Illegal Market Rate

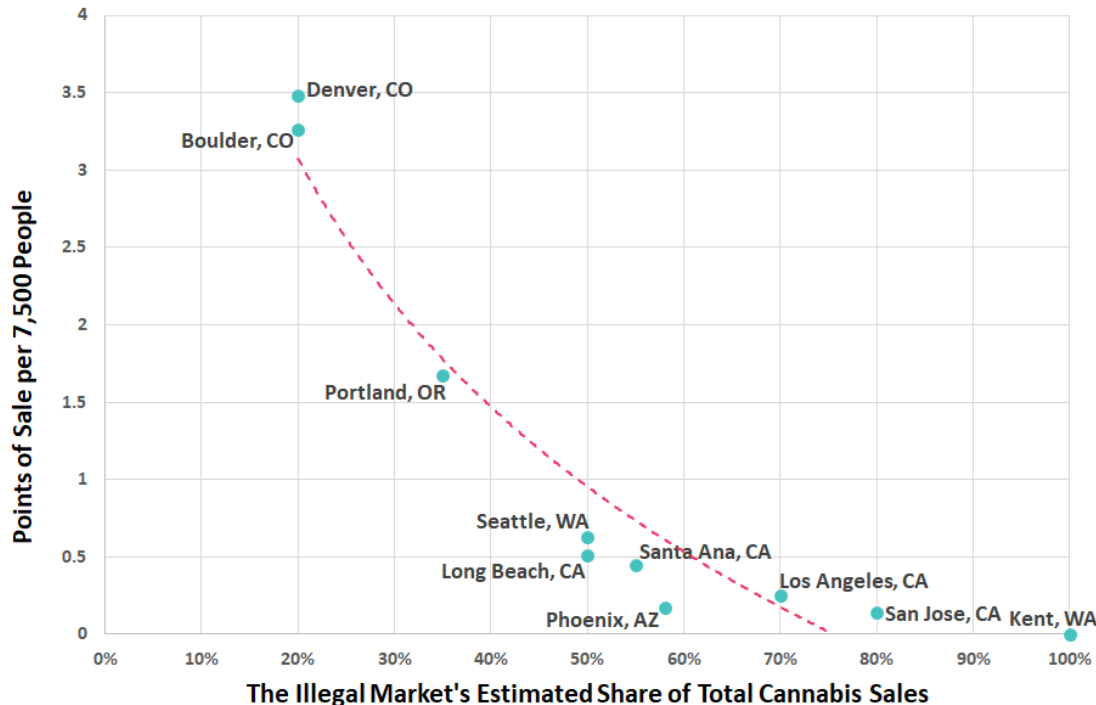
- ***The Economist:*** “The effect on crime seems to have been as one would predict. Colorado’s authorities reckon licensed sales—about 90 tonnes a year—now meet 70% of total estimated demand, with much of the rest covered by a ‘grey’ market of legally home-grown pot illegally sold. In Washington licensed sales accounted for only about 30% of the market in 2014.”

1. The Economist previously estimated Washington State’s illegal market at 60-70%.

2. Effective tax rate in Denver, CO recently increased to 37.15%.

# Proper Local Policy Essential for Functioning Industry

Relationship between Dispensary Density and Illegal Market Size



Source: Weedmaps Analysis.

- Eliminating the illegal market is a key prerequisite for almost all other policy goals (and preventing federal intervention)
- Local governments play central role (zoning, tax policy, etc.)
- Sufficient access is paramount
  - Dispensary density
  - Retail access (and not just in industrial zones)
  - Delivery
  - Product Selection
  - Hours of operation
- Other important factors:
  - Ability to advertise
  - Low tax rates
  - On-site consumption lounges
  - Sufficient supply (cultivation and manufacturing)

# Law Enforcement Alone Will Not Minimize Illegal Market

## » TORONTO STAR «

**Police chief defends marijuana raids at unruly news conference (May 27, 2016)**



- Overly-restrictive regulations (insufficient retail licensing, high tax rates, limited zoning) on cannabis industry can result in a very costly illegal market
- Once illegal market rate exceeds 30%, law enforcement is largely ineffective at reducing number of unlicensed operators (Toronto - Operation Claudia, San Jose, Santa Ana, etc.)
- Enforcement costs can be substantial for local governments and divert limited policing resources from priority enforcement areas
  - Direct Raid Costs: \$50,000-\$100,000 per raid
  - Officer Hours: 500+ per raid
  - 5-10 Raids Per Year: \$375,000-\$750,000
- In Pico Rivera, City Manager Rene Bobadilla reported that shutting a single dispensary down cost \$75,000

# Tax Policy and the Challenge of Standing up the Legal Market

Table 1.1A Types of Illicit Drug Use in Lifetime, Past Year, and Past Month among Persons Aged 12 or Older: Numbers in Thousands, 2015 and 2016

Drug	Lifetime (2015)	Lifetime (2016)	Past Year (2015)	Past Year (2016)	Past Month (2015)	Past Month (2016)
<b>ILICIT DRUGS<sup>1,2</sup></b>	130,610	130,628	47,730	48,501	27,080 <sup>a</sup>	28,564
Marijuana	117,865	118,524	36,043 <sup>a</sup>	37,570	22,226 <sup>b</sup>	23,981
Cocaine	38,744	38,880	4,828	5,071	1,876	1,874
Crack	9,035	8,776	833	882	394	432
Heroin	5,099	4,981	828	948	329	475
Hallucinogens	40,915	41,490	4,692	4,903	1,240	1,390
LSD	25,324	25,861	1,535 <sup>b</sup>	1,896	352	374
PCP	6,323	6,450	120	103	25	21
Ecstasy	18,328	18,459	2,560	2,485	557	619
Inhalants	25,765 <sup>a</sup>	24,404	1,759	1,660	527	600
Methamphetamine	14,511	14,533	1,713 <sup>a</sup>	1,391	897 <sup>a</sup>	667
Misuse of Psychotherapeutics <sup>3,4</sup>	nr	nr	18,942	18,671	6,365	6,207
Pain Relievers <sup>4</sup>	nr	nr	12,462 <sup>a</sup>	11,517	3,775	3,350
Tranquilizers	nr	nr	6,050	6,060	1,874	1,953
Stimulants	nr	nr	5,251	5,647	1,653	1,735
Sedatives	nr	nr	1,511	1,531	446	497
<b>OPIOIDS (HEROIN USE OR PAIN RELIEVER MISUSE)<sup>4</sup></b>	nr	nr	12,693 <sup>a</sup>	11,824	3,963	3,649

\* = low precision; -- = not available; da = does not apply; ne = not comparable due to methodological changes; nr = not reported due to measurement issues.

NOTE: Misuse of prescription psychotherapeutics is defined as use in any way not directed by a doctor, including use without a prescription of one's own; use in greater amounts, more often, or longer than told; or use in any other way not directed by a doctor. Prescription psychotherapeutics do not include over-the-counter drugs.

<sup>a</sup> The difference between this estimate and the 2016 estimate is statistically significant at the .05 level. Rounding may make the estimates appear identical.

<sup>b</sup> The difference between this estimate and the 2016 estimate is statistically significant at the .01 level. Rounding may make the estimates appear identical.

<sup>1</sup> Illicit Drug Use includes the misuse of prescription psychotherapeutics or the use of marijuana, cocaine (including crack), heroin, hallucinogens, inhalants, or methamphetamine.

<sup>2</sup> Illicit Drug Use in Lifetime includes the misuse of prescription psychotherapeutics even though those estimates are not reported due to potential underreporting.

<sup>3</sup> Prescription Psychotherapeutics include pain relievers, tranquilizers, stimulants, or sedatives and do not include over-the-counter drugs.

<sup>4</sup> Prescription psychotherapeutic subtypes were revised in 2016; one effect was the comparability of codeine products between 2015 and 2016.

Source: SAMHSA, Center for Behavioral Health Statistics and Quality, National Survey on Drug Use and Health, 2015 and 2016.

- Last year, 37.6 million Americans consumed marijuana
- Nationally, the consumption rate stands at 13.9 percent
- The vast majority of this consumption occurred through the illegal market
- Tax policy must be designed to transition consumers from the illegal market into well-regulated systems
- Other Factors: Density, Zoning, Delivery, Product Quality, Advertising Laws