COLORADO AND WASHINGTON GOT TOO HIGH: THE ARGUMENT FOR LOWER RECREATIONAL MARIJUANA EXCISE TAXES

By: Jeremy P. Gove[*]

[*] B.A. University of Michigan; J.D. Vanderbilt University Law School; LL.M. in Taxation, New York University School of Law. The Author would like to thank Jenna for her support, and Katie for making this possible.

I. LEGAL MARIJUANA USE IS HEATING UP

As you read this, citizens of both Colorado and Washington are smoking legalized recreational marijuana.[1] Cannabis tourists are flocking to these states as well because the legalization of recreational marijuana has spawned a cottage industry of marijuana tourism, which has blossomed in both states.[2] This holds true especially for Colorado with its already significant tourism industry based around its skiing industry.[3] Legal recreational marijuana has been embraced by citizens of Washington and Colorado, and greeted by marijuana enthusiasts widely as a harbinger of changing national sentiment toward marijuana.[4]

State lawmakers, however, have wrestled with how this new resource can be taxed and monetized to generate revenue for the state. This debate issue is already critical in Washington, as the recreational marijuana industry has already been deemed a "tourist novelty" due to the onerous taxes regulations.[5] This article discusses the tax schemes of newly legal recreational marijuana in both Colorado and Washington and how these taxes are similar to other taxes the state levies. This article then examines the policies behind the taxation of marijuana, including competing theories of taxation. Finally, this article concludes that while both states succeed in generating revenue, the taxing scheme employed fails to optimize revenue, creating deadweight loss for both the state economy and the recreational marijuana market.

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[1] *See* Ricardo Baca, *$573 Million in Pot Sales: Here are 12 Stats that Define the Year in Marijuana*, THE CANNABIST, Dec. 26, 2014, http://www.thecannabist.co/2014/12/26/pot-sales-taxes-statistics/26031 (describing that 485,000 citizens of Colorado use marijuana regularly, with 111,550 smoking marijuana on a daily basis).

[2] Kevin Fixler, *Pot Tourism: How to Buy Marijuana in Colorado*, FODOR'S TRAVEL, Mar. 26, 2014, http://www.fodors.com/news/pot-tourism-how-to-buy-marijuana-in-colorado-10403.html; Anna Maria Stephens, *Pot Tourism: How to Buy Marijuana in Washington State*, FODOR'S TRAVEL, Sept. 25, 2014, http://www.fodors.com/news/pot-tourism-how-to-buy-marijuana-in-washington-state-10842.html.

[3] Baca, *supra* note 1.

[4] *See* Bill Chappell, *Marijuana Votes: Oregon and D.C. Legalize; Florida Says No to Medical*, NPR, Nov. 4, 2014, http://www.npr.org/blogs/thetwo-way/2014/11/04/361533318/marijuana-on-the-ballot-d-c-voters-ok-legalization (detailing how in November 2014 ballot initiatives in Alaska, Oregon, and Washington, D.C. all voted to legalize recreational marijuana).

[5] Lawrence Downes, Op-Ed., *The Great Colorado Weed Experiment*, N.Y. TIMES, Aug. 2, 2014, at SR10, *available at* http://www.nytimes.com/2014/08/03/opinion/sunday/high-time-the-great-colorado-weed-experiment.html.

II. BACKGROUND AND HISTORY LEADING TO LEGALIZATION AND TAXATION OF RECREATIONAL MARIJUANA

Understanding Colorado and Washington's state taxing schemes and history with marijuana is necessary to evaluating and understanding how Colorado and Washington arrived at legalized recreational marijuana and the attendant taxing schemes each state chose for marijuana. To that end, this section analyzes both Colorado and Washington's greater sales tax regime, any history the state has with legalizing marijuana, how marijuana is taxed, and what the results of those taxes are. In addition, this section looks at the United States' fiscal history of dealing with drugs, and marijuana particularly.

A. The Mile High State: Colorado and Marijuana

Colorado imposes a state-wide sales and use tax rate of 2.9%.[6] In addition to the statewide sales tax, Colorado employs a "Home Rule" system, allowing each city and county to impose its own municipal sales taxes.[7] Consequently, sales tax rates in Colorado vary from 2.9% up to 10.4%.[8] This tax must be separately stated on a patron's receipt[9] and may not be absorbed or refunded by the retailer.[10]

Colorado first legalized medical marijuana in 2000 through an amendment to the state constitution approved by 54% of voters.[11] This amendment authorizes marijuana consumption for individuals a doctor determines suffer from "debilitating medical condition[s]."[12] While the purchase of marijuana is only subject to the applicable state and local sales tax, the businesses running medical marijuana dispensaries are subject to a $7,000 to $15,000 application fee, $5,200 to $13,200 registration fee, and a $5,800

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[6] COLO. REV. STAT. § 39-26-106(1)(a)(II) (2015).

[7] COLO. REV. STAT. § 29-2-102(1) (2015).

[8] *Sales & Lodging Tax*, THE TOWN OF SNOWMASS VILLAGE, http://www.tosv.com/index.aspx?NID=141 (last visited Apr. 19, 2015) (including the state, county, and transportation authority, the town of Snowmass Village, Colorado levies a total sales tax of 10.4%).

[9] COLO. CODE REGS. § 39-26-106(a) (2015).

[10] COLO. CODE REGS. § 39-26-108 (2015).

[11] COLO. CONST. art. XVIII, § 14;
Colorado Medical Use of Marijuana, Initiative 20 (2000), BALLOTPEDIA, http://ballotpedia.org/Colorado Medical Use of Marijuana, Initiative 20 (2000) (last visited Oct. 15, 2015).

[12] COLO. CONST. art. XVIII, §14(1)(a). (Defining Debilitating Medical Conditions, which range from HIV and AIDS to "a chronic or debilitating disease or medical condition . . . which produces, for a specific patient . . . severe pain.")

to $13,800 license renewal fee.[13] The state made $7,340,000 from application fees in the first year alone.[14]

These fees are not labeled "taxes," but they function in the same manner. As these fees exceed the government's cost to regulate the industry, the additional generated revenue accrues to the state's general fund.[15] In addition, there is no law prohibiting the business from passing on these costs and fees to the consumer, potentially shifting the incidence of the fees to the consumer through a price markup. This experience of revenue generation helped whet the state's appetite for the financial possibilities of wider legalization.

Multiple proposals to legalize the consumption and possession of marijuana were submitted to the state's review board in order to appear on the 2012 ballot.[16] After receiving board authorization, Amendment 64 to the Colorado Constitution was submitted to voters as part of the November 6, 2012, election.[17] Over 55% of Colorado voters approved this amendment, making it the one of the first two states to legalize marijuana.[18]

The amendment approved by voters laid out the state's intentions to tax the new industry in order to fund its regulation, as well as requiring the first $40 million in revenue raised annually from the taxes to be earmarked for public school construction.[19] Following statewide legalization, the Colo-

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[13] *Medical Marijuana Dispensary Laws: Fees and Taxes*, MARIJUANA POLICY PROJECT 1 (last updated Feb. 9, 2015), https://www.mpp.org/issues/medical-marijuana/medical-marijuana-dispensary-laws-fees-and-taxes/ [hereinafter Medical Marijuana Dispensary Laws].

[14] *Colorado Nets $7.34 Million From Medical Marijuana Dispensary License Applications*, MARIJUANA POLICY PROJECT, http://www.mpp.org/states/colorado/co/colorado-nets-734-from.html (last visited Oct. 15, 2015).

[15] *Medical Marijuana Dispensary Laws, supra* note 13.

[16] Tim Hoover, *8 Initiatives to Legalize Pot Seek Spots on 2012 Colorado Ballot*, DENV. POST (May 20, 2011), http://www.denverpost.com/headlines/ci_18101154.

[17] *Colorado Marijuana Legalization Initiative, Amendment 64 (2012)*, BALLOTPEDIA, http://ballotpedia.org/Colorado_Marijuana_Legalization_Initiative,_Amendment_64_(2012) (last visited Apr. 17, 2015) [hereinafter *Colorado Marijuana Legalization Initiative*].

[18] Sadie Gurman, *Coloradans Say Yes to recreational Use of Marijuana*, DENV. POST (Nov. 6, 2012), http://www.denverpost.com/ci_21941918/nation-watches-colorados-marijuana-legalization-vote.

[19] The proposal asked voters, "Shall there be an amendment to the Colorado constitution concerning marijuana, and, in connection therewith, providing for the regulation of marijuana; permitting a person twenty-one years of age or older to consume or possess limited amounts of marijuana; providing for the licensing of cultivation facilities, product manufacturing facilities, testing facilities, and retail stores; permitting local governments to regulate or prohibit such facilities; requiring the general assembly to enact an excise tax to be levied upon wholesale sales of marijuana; requiring that the first $40 million in revenue raised annually by such tax be credited to the public school capital construction assistance fund; and requiring the general assembly to enact legislation governing the cultivation, processing, and sale of

rado legislature approved a 15% excise tax and a 10% special sales tax to be levied on recreational marijuana sales, in addition to the state and local sales taxes.[20]

The 15% excise tax is imposed on the first sale or transfer of the marijuana.[21] The transaction subject to the excise tax may be the sale from retail marijuana cultivation facility to a retail marijuana store, a marijuana processing facility, or the sale to another cultivation facility.[22] At the beginning of Colorado's allowance of legal recreational marijuana, the state extended a medical marijuana law already in place requiring retailers to grow 70% of what they sold.[23]

A retailer growing 70% of their own marijuana means that for 70% of their customers, the first sale or transfer comes directly with the consumer. This allows retailers to pay the excise tax or shift the incidence of the excise tax directly on consumers.[24] But as that rule has been repealed for recreational marijuana retailers, the first retail sale often now comes earlier in the stream of commerce, between cultivators and retailers. While this tax is paid by the retailer, the retailer is permitted to shift the incidence of the tax to the consumer through higher prices to compensate the retailer for initially paying the tax.

As a result of Colorado's "home rule" system, municipalities are allowed to impose their own special sales tax on marijuana sales.[25] Denver residents approved a ballot measure allowing an additional city sales tax on marijuana sales of 3.5%, but that number can be increased by the city government up to 15% without further voter approval.[26] This adds up to a con-

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industrial hemp?" *Results for Proposed Initiative #30*, COLO. SEC'Y OF STATE, http://www.sos.state.co.us/pubs/elections/Initiatives/titleBoard/results/2011-2012/30Results.html (last visited Apr. 19, 2015).

20 SARAH SCHMITT ET AL., EARLY LESSONS FROM LEGALIZED MARIJUANA: AN ANALYSIS OF COLORADO'S POLICY DECISIONS 9 (Colo. Health Inst. ed., 2014).

21 *Excise 23: Excise Tax on Retail Marijuana*, COLO. DEP'T OF REVENUE 1 (Apr. 2014), https://www.colorado.gov/pacific/sites/default/files/Excise23.pdf.

22 *Id.*

23 Kristen Wyatt, *Colorado's Pot Market Getting New Competition*, YAHOO! NEWS, Sept. 30, 2014, http://news.yahoo.com/colorados-pot-market-getting-competition-201414075--finance.html.

24 *See Marijuana Taxes: Quick Answers*, COLO. DEP'T OF REVENUE, https://www.colorado.gov/pacific/tax/marijuana-taxes-quick-answers (last visited May 1, 2015). "As a consumer of RETAIL marijuana, how much tax will I be charged on my purchase [?] When purchasing retail marijuana, the purchase is subject to the 10% state marijuana, 2.9% state sales tax and a 15% excise plus any local sales taxes." *Id.*

25 *See* Jeremy P. Meyer, *Denver Voters Backing 3.5 Percent Tax on Pot*, DENV. POST, Nov. 5, 2013, http://www.denverpost.com/breakingnews/ci_24461037/denver-voters-weigh-3-5-percent-marijuana-tax.

26 *Denver Additional Marijuana Sales Tax, Question 2A (November 2013)*, BALLOTPEDIA, http://ballot

sumer in Denver purchasing recreational marijuana paying: the 4.75% Denver city sales tax,[27] the 2.9% state sales tax, the Denver 3.5% marijuana sales tax, the 10% special state marijuana sales tax, and effectively bearing the 15% excise tax. This results in a total tax on Denver consumers of 36.15%.

During the debate surrounding the potential tax scheme for recreational marijuana the government forecasted $70 million in additional revenue through the special marijuana sales and excise taxes, not including ordinary sales tax.[28] The Colorado Center on Law & Policy released a study concluding the state would generate total revenue of $47.2 million including: $24 million in excise tax revenue, $8.7 million in state sales tax revenue, and $14.5 million in local sales tax revenue through the year 2016.[29] This revenue forecast also did not include any potential savings from legalizing recreational marijuana. Colorado State University's Colorado Futures Center placed its total tax revenue estimate at $101.8 million.[30] The actual revenue received was lower than projected. For calendar year 2014, Colorado collected only $44 million from the marijuana sales and excise taxes, grossed up to $76 million when including business licensing fees and the general state sales tax.[31] The reason for this shortfall, and how tax policy

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pedia.org/City_of_Denver_Additional_Marijuana_Sales_Tax,_Question_2A_(November_2013) (last visited Apr. 17, 2015).

27 Treasury Div., *Denver Combined Tax Rates*, DENVER DEP'T OF FIN. (last updated Nov. 21, 2014), http://www.denvergov.org/Portals/571/documents/Denver_Combined_Tax_Rates_2015.pdf.

28 Abby Haglage, *Colorado's Pot Revenue Goes Up in Smoke*, THE DAILY BEAST, Feb. 12, 2015, http://www.thedailybeast.com/articles/2015/02/12/colorado-s-pot-revenue-goes-up-in-smoke.html.

29 CHRISTOPHER STIFFLER, COLO. CTR. ON LAW & POLICY, AMENDMENT 64 WOULD PRODUCE $60 MILLION IN NEW REVENUE AND SAVINGS FOR COLORADO 8, 12 (2012) *available at* http://cclponline.org/wp-content/uploads/2013/11/amendment_64_analysis_final.pdf (finding that additional millions will also be saved as courts and prisons are now dealing with significantly fewer marijuana related arrests and proceedings).

30 CHARLES BROWN & PHYLLIS RESNICK, COLO. FUTURES CTR., COLO. STATE UNIV., THE FISCAL IMPACT OF AMENDMENT 64 ON STATE REVENUES 1, 3, 6-7 (2013) *available at* https://webcms.colostate.edu/coloradofutures/media/sites/76/2015/09/Marijuana-Economic-Study-Update.pdf (predicting $22.1 million in excise tax revenue, $61.75 million in special sales tax revenue, $17.9 million in regular sales tax revenue) (assuming base assumptions regarding how many of marijuana users will transition from medical marijuana to recreational marijuana, annual average consumption for those individuals, the cost of production, and a retailer's average markup for customers).

31 Kristen Wyatt, *Colorado Pulls in $76M in Marijuana Taxes and Business Fees for 2014*, THE CANNABIST, Feb. 10, 2015, http://www.thecannabist.co/2015/02/10/colorado-pot-tax-44-million-recreational-taxes-2014/29510/; *See* Dep't of Revenue, *Marijuana Taxes, Licenses, and Fees Transfers and Distribution*, STATE OF COLORADO (Feb. 2015), *available at* https://www.colorado.gov/pacific/sites/default/files/1214%20Marijuana%20Tax%2C%20License%2C%20and%20Fees%20Report.pdf.

could be used to address this problem is addressed in greater detail in Part IV.[32]

B. The Evergreen State: Washington and Weed

Washington's statewide sales tax is 6.5%.[33] Like Colorado, local municipalities are free to impose additional local sales tax, with rates climbing as high as 9.6%.[34] The significant number of Native American tribes in Washington adds complexity, as sales taking place in "Indian Country" to tribe members are not taxed while sales in "Indian Country" to non-tribe members are.[35] As in Colorado, the sales tax in Washington must also be stated separately and is not refundable to the purchaser.[36]

In 1998, Washington voters cast ballots on a measure to allow medical marijuana to be used by citizens suffering from "certain terminal or debilitating conditions."[37] Over 58% of Washington voters supported this measure, removing criminal penalties for patients covered by the proposal, and allowing patients to possess a sixty-day supply of marijuana.[38] Confusion ensued over the meaning of the term "sixty-day supply."[39] Clarification did not come until the Washington Senate requested the Washington Department of Health adopt rules quantifying "sixty-day supply"[40] that were later

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[32] *See infra* Part IV.

[33] WASH. REV. CODE § 82.08.020(1) (2015).

[34] WASH. REV. CODE § 82.14.030 (2015); LOCAL SALES AND USE TAX RATES BY CITY/COUNTY, WASH. DEP'T OF REVENUE 3 (Apr. 14, 2015), *available at* http://dor.wa.gov/Docs/forms/ExcsTx/LocSalUseTx/LocalSlsUseFlyer_15_Q2_alpha.pdf (last visited Oct. 15, 2015). (stating that Seattle is one of two municipalities in Washington charging a 9.6% sales tax, levying a 3.1% municipal sales tax as part of the Seattle Transportation Benefit District).

[35] *Retail Sales Tax*, WASH. DEP'T OF REVENUE, http://dor.wa.gov/content/FindTaxesAndRates/RetailSalesTax (last visited Oct. 16, 2015); *Indian Tax Guide*, WASH. DEP'T OF REVENUE, http://dor.wa.gov/content/FindTaxesAndRates/RetailSalesTax/Indians/IndianTaxGuide (last visited Oct. 16, 2015).

[36] WASH. REV. CODE § 82.08.050(9) (2015); WASH. REV. CODE § 82.08.120 (2015).

[37] WASHINGTON OFFICE OF THE SEC'Y OF STATE, VOTERS PAMPHLET: GENERAL ELECTION, NOV. 3, 1998 8 (1998), *available at* https://wei.sos.wa.gov/agency/osos/en/press_and_research/PreviousElections/documents/voters%27pamphlets/1998%20wa%20st.pdf (last visited Oct. 22, 2015). The individuals being covered by the Washington medical marijuana statute are similar to those covered by the Colorado medical marijuana statute. *See* COLO. CONST. Art. XVIII, §14, *supra* note 11; *Colorado Medical Use of Marijuana, Initiative 20*, *supra* note 11; MARIJUANA POLICY PROJECT, *supra* note 13.

[38] *Washington Medical Marijuana, Initiative 692 (1998)*, BALLOTPEDIA, http://ballotpedia.org/Washington_Medical_Marijuana,_Initiative_692_(1998) (last visited Oct. 16, 2015).

[39] Sara Jean Green, *State Rule Clarifies 60-Day Supply of Medical Marijuana*, SEATTLE TIMES (Oct. 3, 2008), http://www.seattletimes.com/seattle-news/state-rule-clarifies-60-day-supply-of-medical-marijuana.

[40] S. Res. 6032, 60th Leg., Reg. Sess. (Wash. 2007), *available at* http://medicalmarijuana.procon.org/sourcefiles/SB6032WA.pdf (last visited Oct. 16, 2015).

codified by the state legislature.[41] Although medical marijuana was now permissible in the state, without state sanctioned retailers, Washington was unable to accumulate the sales taxes and licensing fees Colorado collected through its medical marijuana program.

Then in 2011, the legislature approved large changes to the state's governance of medical marijuana. This included a state-wide licensing scheme, allowing the state to begin collecting revenue comparable to that generated by medical marijuana in Colorado.[42] Washington Governor Christine Gregoire approved portions of the law, sanctioning "community gardens" for up to ten patients to grow marijuana.[43] Utilizing the line-item veto, the Governor rejected all sections of the statute sanctioning state licensed producers, processors, and dispensaries.[44] She cited the United States Attorneys for the Eastern and Western District of Washington not ensuring immunity from federal prosecution for state employees working on this issue and collecting the revenue.[45]

By vetoing this measure, Governor Gregoire foreclosed the opportunity for the state to begin collecting state licensing fees from retailers that Colorado has been collecting for years. Additionally, Washington was not collecting state and local sales tax on the medical marijuana being consumed. Therefore, the revenue effect of medical marijuana to the Washington government was minimal.

On December 29, 2011, supporters of Initiative 502 to legalize recreational marijuana submitted the proposal to the Washington Secretary of State's office with the necessary signatures.[46] Pursuant to state law the initiative was then sent to the state legislature, which had the power to directly reject the measure, enact it into law, or refer it to statewide election.[47] The

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[41] WASH. REV. CODE § 69.51A.040(1) (2015).
[42] *See* S. Res. 6032, 60th Leg., Reg. Sess. (Wash. 2007), *available at* http://medicalmarijuana.procon.org/sourcefiles/SB6032WA.pdf.
[43] Scott Gutierrez & Vanessa Ho, *Gregoire Vetoes Some Medical Marijuana Reforms*, SEATTLE POST INTELLIGENCER, Apr. 29, 2011, http://www.seattlepi.com/local/article/Gregoie-vetoes-medical-marijuana-reforms-1358951.php.
[44] Jonathon Martin, *Gregoire Vetoes Bill but Vows to Push Feds on Medical Marijuana*, SEATTLE TIMES, Apr. 29, 2011, http://www.seattletimes.com/seattle-news/gregoire-vetoes-bill-but-vows-to-push-feds-on-medical-marijuana.
[45] Vitaliy Mkrtchyan, Note*, Initiative 692, Now and Then: The Past, Present, and Future of Medical Marijuana in Washington State*, 47 GONZ. L. REV. 839, 866 (2012).
[46] Joel Connelly, *Marijuana Measure Headed for Ballot?*, SEATTLE POST INTELLIGENCER, Dec. 20, 2011, http://blog.seattlepi.com/seattlepolitics/2011/12/20/marijuana-measure-headed-for-ballot.
[47] *Id.*

Washington legislature adjourned its legislative session in April without taking any action on the proposal, resulting in the initiative being placed on the November 2012 ballot for a state-wide vote.[48]

In the November 2012 election, 56% of Washington voters chose to make recreational marijuana legal.[49] This result aligned with what pre-voting polls indicated.[50] Washington voters embraced the potentially large taxes and fees generated by the marijuana industry as a way to deal with recent state budgetary shortfalls.[51]

Under Washington's legal regime, producers, processors, and retailers are all subject to a $250 application fee and a $1,000 license issuance and renewal fee.[52] Under the legislation passed after Initiative 502, the first layer of taxation was a 25% excise tax levied and collected from marijuana producers on each producer's wholesale sale "to a licensed marijuana processor or another licensed marijuana producer."[53] The second tax was another 25% excise tax on the sale from processors to licensed retailers.[54] The final excise tax was 25% of the retail selling price to the consumer.[55]

The retail sale of marijuana is also subject to the general state and local sales taxes on tangible property.[56] The state and local sales tax is levied on both the retail price as well as the final excise tax.[57] Despite being imposed earlier in the chain of commerce, the Washington Department of Revenue instructs consumers that each excise tax is included in the retail purchase price of recreational marijuana.[58] This tax regime potentially shifted the in-

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[48] Christina Salerno, *Special Year in Review Edition of Legislative Review*, CAPITOL RECORD, Apr. 13, 2012, http://www.capitolrecord.org/2012/04/special-year-in-review-editon-of-legislative-review.

[49] *Washington Marijuana Legalization and Regulation, Initiative 502 (2012)*, BALLOTPEDIA, http://ballotpedia.org/Washington_Marijuana_Legalization_and_Regulation,_Initiative_502_(2012) (last visited Nov. 13, 2015).

[50] *Id.*

[51] Aaron Smith, *Marijuana Legalization Passes in Colorado, Washington*, CNN MONEY, Nov. 8, 2012, http://money.cnn.com/2012/11/07/news/economy/marijuana-legalization-washington-colorado.

[52] *Initiative 502 – Fiscal Impact Statement*, WASH. OFFICE OF FIN. MGMT, http://www.ofm.wa.gov/ballot/2012/502_fiscal_impact.pdf 2 (last visited Apr. 18, 2015) [hereinafter *Fiscal Impact Statement*].

[53] WASH. REV. CODE § 69.50.535(1) (2014). "This tax is the obligation of the licensed marijuana producer." *Id.*

[54] WASH. REV. CODE § 69.50.535(2) (2014). "This tax is the obligation of the licensed marijuana processor." *Id.*

[55] WASH. REV. CODE § 69.50.535(3) (2014). "This tax is the obligation of the licensed marijuana retailer." *Id.*

[56] *Id.*

[57] *Id.*

[58] *Taxes Due on Recreational Marijuana*, WASH. DEP'T OF REVENUE, http://dor.wa.gov/content/find

cidence of all recreational marijuana taxation onto the consumer. A Seattle recreational marijuana consumer, therefore, could pay up to 84.6% tax on legally purchased recreational marijuana, composed of the 9.6% state and local sales tax, the 25% producer excise tax, the 25% processor excise tax, and the 25% retailer excise tax according to these laws. Washington now imposed a 37% excise tax on each retail sale.[59]

Because of this high tax rate, and not having to account for tax revenue already being collected through the medical marijuana system, Washington's revenue estimates were aggressive. State revenue estimates ranged from $297 million[60] up to $600 million in the first year of legalization.[61] The state also expected to generate $16.3 million in local sales and business tax revenue in the first year of legalization.[62] In total, the Washington government's state and local revenue projection from legalizing the sale of marijuana was $2.06 billion over the first five fiscal years of legalization, while not accounting for saved expenses associated with legalizing marijuana.[63]

Washington is on pace to collect less revenue than initially predicted. The state's Economic and Revenue Forecast Council adjusted its state revenue projection to $694 million in state revenue through fiscal year 2019.[64] While this adjustment is an increase over a previous prediction of $636 million, even accounting for two additional years it is a 66% decrease from initial revenue projections. For the state's next two-year budget cycle ending in fiscal year 2017, $237 million is anticipated to come from recreational marijuana, with $415 million budgeted for the following cycle ending in 2019.[65]

C. Federal Law and Federal Taxation of Recreational Marijuana Businesses

taxesandrates/marijuana/default.aspx (last visited Nov. 13, 2015).

59 WASH. REV. CODE § 69.50.535(1) (2015).

60 *Fiscal Impact Statement*, *supra* note 52.

61 Salerno, *supra* note 48.

62 *Fiscal Impact Statement*, *supra* note 52.

63 *Fiscal Impact Statement*, *supra* note 52 (including estimate which runs through fiscal year 2017).

64 Rachel La Corte, *Legal Pot in Washington Bringing in More Revenue than Predicted*, THE HUFFINGTON POST, Jan. 20, 2015, http://www.huffingtonpost.com/2014/11/20/legal-pot-washington-market-tax-revenue_n_6191848.html.

65 *Id.*

Despite the legalization of recreational marijuana in Colorado and Washington, the drug remains illegal at the federal level.[66] Marijuana is a Schedule I narcotic according to the Controlled Substances Act.[67] As such, an individual not violating state law by possessing or consuming marijuana, is still violating federal law. The same applies for individuals producing, processing, or selling marijuana.

The Supreme Court has held that the Controlled Substances Act governs and criminalizes entirely intrastate growers and consumers of marijuana.[68] In *Gonzales v. Raich*, two California individuals were growing state-sanctioned medical marijuana at their residence only for personal consumption in compliance with California law.[69] The Supreme Court held that to be a violation of the Controlled Substances Act.[70] The Court relied on precedent in extending federal commerce clause jurisdiction over an entirely intrastate activity.[71] The Court's holding in *Raich* opens the door for federal regulation of intrastate recreational marijuana businesses in Colorado and Washington. While the federal government has the power to regulate recreational marijuana in this way, it has yet to exercise that power in a meaningful way.

When determining taxable income, taxpayers are allowed to reduce their unrecovered investment in property from the amount received in a transaction in the form of basis.[72] Basis functions as a tax credit for previously taxed income invested in the property. Business taxpayers are also entitled to deduct all ordinary and necessary expenses incurred in a taxable year in order to determine taxable income.[73] Deductions are only a matter of "legislative grace", however, and the burden rests with the taxpayer to demonstrate qualifying for the deductions it takes.[74] Congress also has the ability to take deductions away. As such, Congress prohibits any deduction or credit "incurred in carrying on any trade or business if such trade or business . . . consists of trafficking in controlled substances (within the meaning

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66 21 U.S.C. § 812(c) (2012).
67 *Id.*
68 Gonzales v. Raich, 545 U.S. 1, 32-33 (2005).
69 *Id.* at 6-7.
70 *Id.* at 9. (noting that the Court admittedly did not reach whether it was wise for Congress to exercise its powers in this way over marijuana, only that Congress could exercise this power).
71 *Id.* at 17-21 (discussing *Wickard v. Filburn*'s similarities and precedential value to the case at hand).
72 I.R.C. §1011(a) (2012).
73 *Id.* at §162(a).
74 New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934).

of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law."[75]

In *Olive v. Commissioner*, a California medical marijuana shop owner was charged with income tax deficiencies partially arising from disallowed business deductions under § 280E.[76] The business owner petitioned the tax court for a re-determination of the tax liability, asserting California's legalization of medical marijuana as evidence the business was not engaged in "illegal trafficking in a controlled substance."[77] The Tax Court affirmed the Service's position, that regardless of a state's laws on marijuana, selling it is "trafficking" as stated in § 280E.[78] As such, all federal tax deductions for marijuana businesses are prohibited.

The court's reliance on *Raich*,[79] and its holding that § 280E includes marijuana as an illegal substance under federal law, dictates this outcome for all marijuana businesses. The court did allow the taxpayer in *Olive* to utilize the inventory's basis when calculating taxable income.[80] Consequently, recreational marijuana producers, processors, and retailers, in Colorado and Washington are not able to deduct their state taxes, licensing fees, and salaries in determining federal taxable income. Even though the incidence of the state taxes and fees may be shifted to the consumer, the producer, processor, and retailer, as nominal payor of the taxes would typically be entitled to a deduction.[81]

D. The National War on Drugs

The United States has been fighting the "war on drugs" since Richard Nixon occupied the Oval Office.[82] On July 17, 1971, President Nixon declared in a press conference that drug addiction had "assumed the dimensions of a national emergency."[83] As a result, President Nixon asked for an

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[75] I.R.C. § 280E (2012).
[76] Olive v. Comm'r, 139 T.C. 19 (2012).
[77] *Id.* at 38.
[78] *Id.*
[79] *Id.* (citing *Raich*).
[80] *Id.* at 36.
[81] Businesses would not be entitled to a deduction for the excise tax levied directly on the consumer and only collected by the retailer, such as Colorado's special 10% marijuana sales tax. COLO. REV. STAT. § 39-28.8-202 (2015).
[82] Ed Vulliamy, *Nixon's 'War on Drugs' Began 40 Years Ago, and the Battle is Still Raging*, THE GUARDIAN, July 23, 2011, http://www.theguardian.com/society/2011/jul/24/war-on-drugs-40-years.
[83] Conor Friedersdorf, *The War on Drugs Turns 40*, THE ATLANTIC, JUN. 15, 2011,

initial $84 million for "emergency measures" to fight the problem.[84] Four decades later, President Nixon's declaration of war has cost $1 trillion and resulted in fewer victories than hoped for. Colorado and Washington are the first states to embrace a new tactic in fighting this war–legalization–in the hope it addresses the fiscal casualties this war has wrought on the federal, state, and local governments.[85]

1. The Drug Wars' Effect on Drug Use and Prison Population in America.

In the over four-decade long time-span since President Nixon first declared America's "war on drugs", much has changed. In 1980, the United States had between 40,000 to 50,000 individuals imprisoned as a result of drug crimes.[86] There are now 500,000 individuals incarcerated in federal, state, and local jails and prisons because of drug crimes—an increase of approximately 1,000%.[87]

This surge in incarcerated individuals has led the United States to have the largest prison population in the world.[88] Despite comprising only 5% of the global population, individuals incarcerated in the United States' represent 25% of the world's prison population.[89] The United States' prison rate

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http://www.theatlantic.com/politics/archive/2011/06/the-war-on-drugs-turns-40/240472.

84 Vulliamy, *supra* note 82.

85 Jeffrey A. Miron & Katherine Waldock, *The Budgetary Impact of Ending Drug Prohibition*, CATO INST. 1 (2010), http://object.cato.org/sites/cato.org/files/pubs/pdf/DrugProhibitionWP.pdf. "Legalization would reduce state and federal deficits by eliminating expenditure on prohibition enforcement— arrests, prosecutions, and incarceration—and by allowing governments to collect tax revenue on legalized sales." *Id.*

86 Richard Branson, *War on Drugs a Trillion-Dollar Failure*, CNN.COM, Dec. 7, 2012, http://www.cnn.com/2012/12/06/opinion/branson-end-war-on-drugs (citing 40,000 prisoners for committing drug crimes in 1980); *Wasted Tax Dollars*, DRUG POL'Y ALLIANCE, http://www.drugpolicy.org /wasted-tax-dollars (citing 50,000 prisoners for committing drug crimes in 1980).

87 Branson, *supra* note 86.

88 Adam Liptak, *U.S. Prison Population Dwarfs That of Other Nations*, N.Y. TIMES, Apr. 23, 2008, http://www.nytimes.com/2008/04/23/world/americas/23iht-23prison.12253738.html.

89 *Id.*; Michelle Ye Hee Lee, *Does the United States Really Have 5 Percent of the World's Population and One Quarter of the World's Prisoners?*, WASH. POST, Apr. 30, 2015, https://www.washingtonpost .com/news/fact-checker/wp/2015/04/30/does-the-united-states-really-have-five-percent-of-worlds-population-and-one-quarter-of-the-worlds-prisoners. China is a distant second place on this notorious list, with a population for times larger than the United States' but a prison population with almost 560,000 fewer people. *Highest to Lowest – Prison Population Total*, WORLD PRISON BRIEF, http:// www.prisonstudies.org/highest-to-lowest/prison-population-total?field_region_taxonomy_tid=All (last visited Nov. 14, 2015).

is second throughout the world, with 698 Americans in prison for every 100,000 people.[90]

This dramatic increase in the United States' prison population over the past forty years is a direct result of the war on drugs. The prison population, however, cannot be the only measure of the successes and failures of the war on drugs. Another critical metric gauging the country's progress from July 17, 1971, is whether drug use has changed.

Rather than achieve its desired result, the incarceration increase has not led to a corresponding decrease in drug consumption.[91] Marijuana use specifically has increased, while consumption of other illicit drugs has largely stabilized.[92] As drug use has increased, so has the number of individuals being arrested for drug crimes.

According to the Federal Bureau of Investigation's Uniform Crime Report, there were a total of 14,209,365 arrests made by federal, state, and local law enforcement in 2007.[93] Of this total, 1,841,182 individuals were arrested for drug violations.[94] When analyzing only the state and local level, 42.1% of all drug possession related arrests in the United States are related to marijuana possession.[95] The consequence of this number is that 5.46% of all state and local arrests in the United States are for marijuana possession.[96]

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[90] *Highest to Lowest – Prison Population Rate*, WORLD PRISON BRIEF, http://www.prisonstudies.org/highest-to-lowest/prison_population_rate?field_region_taxonomy_tid=All (last visited Nov. 14, 2015). This rate is second globally behind only Seychelles, an African archipelago in the Indian Ocean with a total population of 91,530. *Data: Seychelles*, WORLD BANK, http://data.worldbank.org/country/seychelles (last visited Nov. 14, 2015).

[91] *DrugFacts: Nationwide Trends*, NIH: NAT'L INSTITUTE ON DRUG ABUSE, (June 2015), https://www.drugabuse.gov/publications/drugfacts/nationwide-trends. According to the National Institute of Health's National Survey on Drug Use and Health, since 2002 illicit drug use has increased from 8.3% to 9.4% of the American population age 12 or older. *Id.*

[92] *Id.* Marijuana use has increased the most of all illicit drugs surveyed, increasing from 5.8% of the population using marijuana in 2007 to 7.5% in 2013. *Id.* "'Illicit' refers to use of illegal drugs, including marijuana according to federal law, and misuse of prescription drugs. *Id.*

[93] *Estimated Number of Arrests: United States, 2007*, FED. BUREAU OF INVESTIGATION, https://www2.fbi.gov/ucr/cius2007/data/table_29.html (last visited Nov. 14, 2015). The Uniform Crime Report "counts one arrest for each separate instance in which a person is arrested, cited, or summoned for an offense." *Persons Arrested*, FED. BUREAU OF INVESTIGATION, https://www2.fbi.gov/ucr/cius2007/arrests (last visited Nov. 14, 2015).

[94] *Estimated Number of Arrests: United States, 2007*, *supra* note 93. (noting that this amount comprises 12.9% of the total number of arrests made in America in 2007 at the federal, state, and local level.)

[95] Miron & Waldock, *supra* note 85, at 3.

[96] Miron & Waldock, *supra* note 85, at 3.

Following all the arrests, 9.64% of all felony convictions in state and local courts are due to marijuana law violations.[97]

All of these marijuana related arrests and convictions come at a cost: the costs of policing, enforcing, adjudicating, and imprisoning these individuals. The annual cost just for state and local courts pursuing marijuana convictions is $1.66 billion.[98] These are cost borne both directly and indirectly by the citizens of every state in the country, including Colorado and Washington.

2. The Explicit and Implicit Costs of the War on Drugs

The United States has borne both implicit and explicit costs stemming from the four-decade war on drugs. Since the war began, the bill totals $1 trillion, with new costs incurred daily.[99] Annually, the United States spends more than $40 billion on drug prohibition.[100] This amount includes only the explicit costs, omitting all implicit costs such as violence, diminished international reputation, and the potentially deteriorating effects on local economies.[101] Despite that money being spent on policing, enforcement, and imprisonment, the illegal drug trade generates an estimated $322 billion annually.[102]

In addition to the vast explicit costs of the drug war, there are also wide-ranging implicit costs that result from the war on drugs. As with any illicit product it fuels crime, and in the case of drugs, it generates higher profits and enhanced power for organized crime.[103] Another unfortunate implicit cost is the increased homicide rate the country has experienced during our

97 Miron & Waldock, *supra* note 85, at 3.

98 Miron & Waldock, *supra* note 85, at 3.

99 Branson, *supra* note 86.

100 Rosalie Liccardo Pacula, *About the Reasonableness of the Current Priorities of National Drug Control*, RAND CORP., 1 (Mar. 12, 2008), http://www.rand.org/content/dam/rand/pubs/testimonies/2008/RAND_CT302.pdf.

101 *Id.*

102 *Thematic Debate of the 66th Session of the United Nations General Assembly on Drugs and Crime as a Threat to Development on the Occasion of the UN International Day Against Drug Abuse and Illicit Trafficking*, GEN. ASSEMBLY UNITED NATIONS (June 26, 2012), http://www.un.org/en/ga/president/66/Issues/drugs/drugs-crime.shtml.

103 Allison Schrager, *The Economic Case for the US to Legalize All Drugs*, QUARTZ, June 7, 2013, http://qz.com/91642/the-economic-case-for-the-us-to-legalize-all-drugs.

prolonged fight against drugs.[104] The homicide rate is between 25-75% higher than it would be in the absence of drug prohibition.[105]

These are the results of the illegal nature of the drug market. Without the government being able to enforce private contracts, individuals must take enforcement into their own hands.[106] This individual enforcement fosters the environment wherein explicit and implicit fiscal externalities are created. By Colorado and Washington making recreational marijuana legal, this explicit and implicit revenue will then begin accruing to state and local governments rather than drug sellers, who are by definition criminals.

III. UNDERSTANDING MARIJUANA TAXATION THROUGH TAX POLICY

Myriad taxing and economic principles are incorporated in the state taxation of recreational marijuana. In this section, this article analyzes the concepts of incidence and elasticity that are intimately related to marijuana tax policy. Excise taxes are then examined, and the developing marijuana tax system is compared to common excise tax regimes. Finally, libertarian and redistribution theories of taxation are utilized to help inform the recreational marijuana taxation debate.

A. Incidence of Recreational Marijuana Excise Taxes

Incidence of taxation is the most important topic in public finance, "for, in every system of taxation, the cardinal point is its influence on the community."[107] The person originally paying the tax bears the "original" incidence,[108] such as marijuana producers and the Washington's initial 25% excise tax on production.[109] The incidence of a tax may be economically transferred to a subsequent purchaser through charging more for the goods or services sold. The tax may be borne by that second individual, or it may be effectively transferred further down the stream of commerce through

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104 Jeffrey A. Miron, *Violence and U.S. Prohibitions of Drugs and Alcohol*, NAT'L BUREAU ECON. RES. 1 (Feb. 1999), http://www.nber.org/papers/w6950.pdf. The homicide rate experienced during the war on drugs rivals the murder rate observed during prohibition. *Id.*

105 *Id.* Controlling for other variables does not alter this number in a statistically significant way.

106 *See id.* at 3. (positing that because the drug market is illegal the methods available to enforce private contracts are also illegal).

107 EDWIN R. A. SELIGMAN, THE SHIFTING AND INCIDENCE OF TAXATION 1 (5th ed., rev. Columbia Univ. Press 1927) (1899).

108 *Id.* at 2. (presenting the idea of the original incidence but rejecting it).

109 WASH. REV. CODE ANN. § 69.50.535 (West, Westlaw through 2015 3d Spec. Sess.).

subsequent price increases. Where the tax burden finally resides is the true incidence of the tax.[110] Only upon understanding the true incidence of taxation, can the effects of a tax be contextualized.

Excise taxes are taxes "imposed on the manufacture, sale, or use of goods . . . or on an occupation or activity (such as a license tax . . .)."[111] The Service defines excise taxes as those taxes paid on specific goods, services, and activities, and are often included in the price paid.[112] One of the earliest adopters of the excise tax was Thomas Hobbes in his canonical *Leviathan*.[113] Hobbes' reasoning is that all people consume, so taxing consumption cannot be evaded.[114] While excise taxes cannot be evaded, the true incidence of that taxation can be shifted.

Excise taxes generally serve two state goals: discouraging consumption or use of the taxed item,[115] and generating revenue.[116] Excise taxes are used when the government wants to discourage certain behaviors, such as consumption of tobacco, alcohol, or soda.[117] That model of taxation requires consumers to be rational actors, "maximiz[ing] utility over time."[118] If consumers are not rational actors, the tax will not serve a deterrent function and

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110 SELIGMAN, *supra* note 107.

111 BLACK'S LAW DICTIONARY 684–85 (10th ed. 2014).

112 *Excise Tax*, IRS, http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Excise-Tax (last visited Nov. 13, 2015).

113 THOMAS HOBBES, THE LEVIATHAN 386 (C.B. MACPHERSON ED., PENGUIN BOOKS 1968) (1651).

114 "[T]he Equality of Imposition, consisteth rather in the Equality of that which is consumed, than of the riches of the persons that consume the same. For what reason is there, that he which laboureth much, and sparing the fruits of his labour, consumeth little, should be more charged, then he that living idlely, getteth little, and spendeth all he gets; seeing the one hath no more protection from the Common-wealth, then the other? But when the Impositions, are layd upon those things which men consume, every man payeth Equally for what he useth: Nor is the Common-wealth defrauded, by the luxurious waste of private men." *Id.* at 386–87.

115 *See*, *e.g.*, Tony Nitti, *Tanning Tax is Here to Stay as IRS Publishes Final Regulations*, FORBES, June 12, 2013, http://www.forbes.com/sites/anthonynitti/2013/06/12/tanning-tax-is-here-to-stay-as-irs-publishes-final-regulations (documenting the Affordable Care Act's 10% excise tax on indoor tanning services as a means to discourage their use); s*ee also Indoor Tanning Services Tax Center*, IRS, https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Excise-Tax-on-Indoor-Tanning-Services-Audit-Technique-Guide.

116 *See Excise Tax*, *supra* note 112.

117 Laura Mandaro, *Nation's First Soda Tax is Passed*, USA TODAY, Nov. 5 2014, http://www.usatoday.com/story/news/nation-now/2014/11/05/berkeley-passes-soda-tax/18521923 (citing the nation's first soda tax as a way to discourage consumption of the beverage many critics link to obesity); s*ee also* BERKELEY, CAL. MUN. CODE, ch. 7.72, § 2 (Jan. 1, 2015); BERKELEY, CAL. MUN. CODE, ch. 7.72, § 7.72.010 (Jan. 1, 2015) http://codepublishing.com/ca/berkeley/ (follow to "Title 7 Finance, Revenue, and Taxes;" then Chapter 7.72 "Sugar-Sweetened Beverage Product Distribution Tax").

118 Gary S. Becker & Kevin M. Murphy, *A Theory of Rational Addiction*, 96 J. POL. ECON. 675, 694 (1988).

will only generate revenue. The non-rational actor model could serve as one reason for states imposing excise taxes on tobacco, alcohol, and now recreational marijuana, because it is believed consumers will not rationally respond and no deterrence will result. This theory fuels the notion of raising sin taxes to address revenue shortfalls.

True incidence of the tax is also critical to understanding its effect. If the full burden of excise taxes imposed earlier in the stream of commerce comes to bear on the final consumer through higher prices, it may discourage consumption.[119] The practice of shifting incidence to the consumer also has been shown to increase prices consumers pay beyond just the amount of tax imposed.[120] Shifting the incidence of tobacco excise taxes reduces producer revenue by only eight cents for every dollar increase in tax revenue.[121]

When states increase excise taxes on cigarettes consumption does go down.[122] As a result of tobacco demand elasticity being low, tobacco excise tax increases are viewed as a frequently available source of revenue.[123] Tobacco consumption declines as excise taxes increase, but those quitting do not offset the revenue gain from tax increases.[124] This evidence reinforces the notion that tobacco demand elasticity is low. While tobacco is legal nationwide, state and federal public policy frequently acts to reduce tobacco consumption (and budget deficits) through increased excise taxes.[125]

The goal of increasing state revenue through marijuana taxation is in tension with the states' Prohibition-style approach of imposing a high rate of tax to moderate consumption of a recently-legalized product.[126] Despite

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[119] Andrew Hanson & Ryan Sullivan, *The Incidence of Tobacco Taxation: Evidence from Geographic Micro-Level Data*, 62 NAT'L TAX J. 677, 677 (2009).

[120] Using the tobacco tax increase in Wisconsin as an experiment, the authors found an 8-17% overshift beyond the excise tax amount to consumers. *Id.* at 695.

[121] William N. Evans, Jeanne S. Ringel & Diana Stech, *Tobacco Taxes and Public Policy to Discourage Smoking*, 13 TAX POL'Y & ECON. 1, 1 (1999).

[122] *Id.* at 16.

[123] *Id.* at 31.

[124] Andy Marso, *Researcher: Tobacco Tax a Reliable Revenue Source*, KANSAS HEALTH INSTITUTE, March 9, 2015, http://www.khi.org/news/article/researcher-tobacco-tax-a-reliable-revenue-source.

[125] *See, e.g.*, Nicholas Confessore, *Cigarette Tax Increased to Keep State Running*, N.Y. TIMES, June 21, 2010, http://www.nytimes.com/2010/06/22/nyregion/22budget.html; *see also* Andy Marso, *Lower Revenue Numbers Could Force New Talks on Tobacco Tax*, KANSAS HEALTH INSTITUTE, Apr. 21, 2015, http://kcur.org/post/lower-kansas-revenue-numbers-could-force-new-talks-tobacco-tax.

[126] Vikas Bajaj, *Rules for the Marijuana Market*, N.Y. TIMES, Aug. 4, 2014, http://www.nytimes.com/2014/08/05/opinion/high-time-rules-for-the-marijuana-market.html (recognizing that Colorado and Washington are implementing a Prohibition-era system to allow consumption, while also discouraging it through taxes); *see also* Joseph Henchman, *Lessons on Legalizing and Taxing Marijuana from the Colo-*

embracing legalization in lieu of criminalization, the states are still attempting to use taxes to modify consumer behavior and prevent over-consumption or dependence.[127] The tax revenue being generated in Colorado and Washington may not alone close budget shortfalls, but it does help solve budget problems.[128] The taxes levied on the marijuana industry, and borne by marijuana consumers through shifting incidence, dwarfs comparable excise taxes in both Colorado and Washington.[129]

In Colorado, a pack of cigarettes is subject to an eighty-four cent state tobacco excise tax, the state and local sales tax, as well as the $1.01 federal tobacco tax.[130] This approximate 40% tax is matched by the 40% tax levied on all other tobacco products.[131] Only half of that tax revenue, however, is Colorado's as the other half is a federal tax. Colorado's alcohol excise tax is levied on wholesalers at a rate of eight cents per gallon for beer and twenty-eight cents per gallon for wine.[132] By comparison, Colorado's excise tax on marijuana reaches up to 36.15%, exceeding the state's excise tax rate on both tobacco or alcohol.[133]

Washington imposes a $3.025 state excise tax on a pack of cigarettes, in addition to state and local sales tax, and the federal tobacco tax.[134] Tobacco consumers in Washington pay the state a 67% tobacco excise tax. Beer is not subject to state excise taxes in excess of state and local sales taxes in Washington, and wine is subject to an 86.8 cents per gallon excise tax in

rado and Washington Experience, TAX FOUND., Oct. 30, 2014, http://taxfoundation.org/article/lessons-legalizing-and-taxing-marijuana-colorado-and-washington-experience-testimony-district.

[127] *E.g.*, Bajaj, *supra* note 126.

[128] Benjamin Fearnow, *Marijuana to Boost Washington State Tax Revenue by $25M in the Next Year*, CBS SEATTLE, Sept. 18, 2014, http://seattle.cbslocal.com/2014/09/18/marijuana-to-boost-washington-state-tax-revenue-by-25m-in-the-next-year.

[129] The Washington Department of Revenue states that recreational marijuana excise tax is "going from 25 percent (at each level) to 37 percent on the retail customer." *Taxes Due on Recreational Marijuana*, *supra* note 58.

[130] *Cigarette Tax File*, COLO. DEP'T REVENUE, https://www.colorado.gov/pacific/tax/cigarette-tax-file (last visited Nov. 13, 2015); *see* Jolie Lee, *How Pot Tax Compares with Other 'Sin" Taxes*, USA TODAY, Nov. 4, 2013, http://www.usatoday.com/story/news/nation/2013/11/04/marijuana-tax-colorado/3344129. On a $5 retail pack of twenty cigarettes, the consumer will pay a total of $7. *Id.*

[131] Lee, *supra* note 130.

[132] *Colorado Liquor Excise Taxes*, COLO. DEP'T REVENUE, https://www.colorado.gov/pacific/revenue/colorado-liquor-excise-taxes (last visited, Nov. 13, 2015).

[133] Over half of the revenue collected from the excise tax on tobacco is a federal excise tax, making the total Colorado tobacco excise and sales tax approximately 20%. *See* Lee, *supra* note 130.

[134] *Cigarette Tax*, WASH. DEP'T REVENUE 1 (Mar. 2015), http://dor.wa.gov/Docs/Pubs/CigarTax/CigaretteTax.pdf.

addition to the state and local sales tax.[135] Thus, Washington's marijuana excise tax from Initiative 502 of up to 84.16% is still greater than both the state's tobacco or alcohol excise tax rate. Washington has begun addressing the revenue shortfall generated by the onerous marijuana taxes by replacing the original tax regime with a 37% tax only on the retail customer.

Colorado and Washington may be enabled to levy their highest excise tax on marijuana because they are both one of the few places in the United States to legally purchase marijuana. This allows Colorado and Washington to tax marijuana like an exclusive natural resource. By doing so, they must also evaluate how potential consumers respond to these taxes. The tax rate disparity between recreational marijuana and tobacco and alcohol raises the possibility of a substitution effect, considering alcohol and tobacco bear similarities to marijuana. The substantial difference in tax rate may encourage potential marijuana consumers to alter their consumption pattern. Consequently, appraising Colorado and Washington's marijuana excise taxes requires an evaluation of the market's elasticity.

B. Elasticity and its Effect on Marijuana

Elasticity is the "measure of a variable's sensitivity to a change in another variable."[136] For the purposes of this article's analysis, elasticity is the measure of how demand and supply change in relation to changes in price and levels of taxation. In a perfect marketplace, without taxes, the demand curve and supply curve meet one another to arrive at the market's equilibrium.[137] When taxes are levied on buyers, however, and the overall price of goods increases, consumer surplus decreases.[138] Conversely, when taxes are levied on suppliers their producer surplus also decreases.[139] Deadweight loss is the reduction in total consumer and supplier surplus resulting from a market distortion.[140]

Elasticity measures how demand and supply change as a result from the government's alteration of the price through taxes. Regardless of whom a

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[135] *Liquor Pricing Information*, WASH. LIQUOR CONTROL BOARD, http://liq.wa.gov/stores/liquor-pricing (last visited Nov. 13, 2015).
[136] *Elasticity*, INVESTOPEDIA, http://www.investopedia.com/terms/e/elasticity.asp (last visited Nov. 13, 2015).
[137] N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 76 (3d ed. 2004).
[138] *Id.* at 161.
[139] *Id.*
[140] *Id.* at 163.

tax is levied on, or who bears the tax's incidence, both buyers and sellers share the tax's burden as supply and demand respond to the tax.[141] One example of a market distortion are the excise taxes Colorado and Washington impose on marijuana.

Inelastic supply occurs when despite alterations in price the quantity supplied does not change.[142] Inelastic demand is when consumer's desire for a product is unaffected by increases in price.[143] If supply or demand is inelastic, tax increases result in little deadweight loss, whereas elastic supply or demand results in large deadweight loss.[144] The challenge for Colorado and Washington is gauging the elasticity for both supply and demand of marijuana and the amount of deadweight loss created by the marijuana excise taxes.

There is evidence that demand for legally purchased marijuana is relatively elastic. In Colorado there remains an active black market trade in marijuana.[145] State officials estimate that only 60% of the marijuana consumed in Colorado is sold legally.[146] Influencing the persistence of the black market in Colorado, despite legal alternatives, is the price difference between black market marijuana and its more expensive legal counterpart.[147] The price discrepancy arising between the two marketplaces is fueled by the state's excise taxes placed on marijuana produced and sold at retail. In addition, questionable medical marijuana establishments are aiding the thriving black market.[148]

As in Colorado, Washington's demand for legal marijuana is also elastic.[149] In Washington, "some pot delivery services brazenly advertis[e] that they sell outside the legal system" allowing those businesses to massively

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141 *Id.* at 160.
142 *Inelastic Supply*, BUS. DICTIONARY, http://www.businessdictionary.com/definition/inelastic-supply.html (last visited Nov. 1, 2015).
143 *Inelastic Demand*, BUS. DICTIONARY, http://www.businessdictionary.com/definition/inelastic-demand.html (last visited Nov. 1, 2015).
144 MANKIW, *supra* note 137, at 165.
145 Deborah Camiel, *Underground Weed: Colorado's Black Market*, CNBC, Dec. 17, 2014, http://www.cnbcprime.com/marijuana/video/pot-after-hours-the-black-market.
146 *Id.*
147 *Id.* (stating that marijuana purchased on the black market can be as much as one-third of the price of legally purchased marijuana from a state licensed retailer).
148 Gene Johnson, *Legalizing Marijuana in Washington and Colorado Hasn't Gotten Rid of the Black Market*, BUS. INSIDER, Jan. 2, 2015, http://www.businessinsider.com/legal-marijuana-in-washington-and-colorado-hasnt-gotten-rid-of-the-black-market-2015-1.
149 *Id.*

undercut competitors on price.[150] The cited reason in Washington for the black market's influence is the taxes placed on retail marijuana.[151] Consequently, many of the retail consumers in Washington are tourists, whereas many individuals continue utilizing black market means to obtain marijuana, including those businesses openly flouting state law.[152]

The result of this demand elasticity is increased deadweight loss in both Colorado and Washington. Consumers are not entering the legal marketplace because their demand is price sensitive, showing that state excise taxes help create the prohibitively high barrier to entry. Business owners who entered the retail marijuana market cannot compete for customers as they are being undercut on price.

Evidence supports the legal recreational marijuana supply curve is elastic, however, it is relatively more inelastic than the demand curve. As a result of the lengthy process to become a licensed marijuana retailer, the demand curve is more fluid than the supply curve. Also, the actual crop supply is initiated months prior to its retail sale, so the true supply is not instantly responsive to customer demands.[153] This phenomenon, mixed with the active marijuana black market, is the cause of Washington's excess marijuana supply.[154]

The elasticity in both the supply and the demand curve creates deadweight loss.[155] The deadweight loss is borne by all parties involved in retail marijuana transactions: the producers, processors, retailers, and customers, as well as state governments collecting tax revenue.[156] It is in both Colorado and Washington's best interest to reduce this deadweight loss in order to maximize the legal market and minimize its illegal counterpart, while still collecting sufficient tax revenue and maximizing cost savings from le-

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150 *Id.*
151 *Id.*
152 *Id.*
153 Jane Wells, *Washington Has More Pot Than It Can Smoke*, NBC NEWS, Feb. 11, 2015, http://www.nbcnews.com/business/consumer/washington-has-more-pot-it-can-smoke-n304436.
154 *See* Gene Johnson, *Washington's Marijuana Growers Struggle to Sell Product*, PORTLAND PRESS HERALD, Jan. 17, 2015, http://www.pressherald.com/2015/01/17/washingtons-marijuana-growers-struggle-sell-product (stating that the supply is so excessive that some producers may actually be going out of business).
155 *See* MANKIW, *supra* note 137, at 166.
156 *See* MANKIW, *supra* note 137, at 163–65.

gal marijuana. How the states should go about doing this is the subject of Part IV of this article.[157]

C. Rawls, Nozick and the Theories behind Marijuana Excise Taxation

John Rawls and Robert Nozick espouse opposing theories about taxation and its purpose. These competing theories apply to the principles undergirding the excise taxation schemes levied by Washington and Colorado on recreational marijuana. Once understood, these theories of taxation and social justice may then be employed to create a more optimal excise tax system.

1. Rawlsian Philosophy and Marijuana Taxes

In Mr. Rawls's famous work, *A Theory of Justice*, he puts forth two theories of justice. First, "each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others [,]" and second, social and economic inequalities are to be arranged so that they are to anyone's advantage.[158] Rawls allows for long run inequalities only if they are to the benefit of those in the worst position.[159] Thus, a society is just only if "it is engaged in redressing social inequalities, if it serves to benefit those [Rawls] calls the least advantaged."[160]

Appraising the marijuana excise tax through a Rawlsian framework requires evaluating whether the current excise taxing regime in Colorado and Washington creates more inequality than the system prior to legalization of retail marijuana. The taxes in Colorado and Washington do create inequality in the marketplace, affecting both suppliers and consumers. The black market is still active because of the price discrepancy between taxed legal marijuana and the untaxed illegally obtained marijuana. Inequality also arises from more well-off customers being able to pay higher prices, and in turn gain the benefits of government protected commerce. Whereas the lesser advantaged consumers must forego the privileges of purchasing legal marijuana and continue to traffic in the black market in exchange for a reduced price.

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[157] *See infra* Part IV.
[158] JOHN RAWLS, A THEORY OF JUSTICE 53 (Harvard Univ. Press rev. ed. 1999) (1971).
[159] ADAM SWIFT, POLITICAL PHILOSOPHY 52 (3d ed. 2014).
[160] STEVEN B. SMITH, POLITICAL PHILOSOPHY 186 (2012).

According to Rawls, if inequality is created it must benefit society's least advantaged.[161] This tenant of Rawls' philosophy requires a balancing test as a large portion of the money being collected in Colorado is going toward public school construction. That money also may be coming from less advantaged individuals and making up a larger portion of their income, as excise and consumption taxes disproportionately affect lower income taxpayers.[162] The Rawlsian balancing test must also account for retail marijuana being a luxury item. If marijuana itself is a necessity for an individual, both Washington and Colorado have programs for persons with chronic problems to obtain medical marijuana without paying the excise taxes.[163]

It is arguable that the current system is best for all involved. Those with means can afford to pay higher legal prices, while those without are able to continue obtaining marijuana in the same way used prior to legalization. Additionally, even though marijuana is purchased illegally, personal consumption is now legal, so illegal purchasers still receive some of the law's benefits. Notwithstanding this possibility, these facts may serve to underscore the inequality existing in Washington and Colorado because of the current approach. With the higher purchase price comes the benefit of police and contract enforcement, as well as safety and health verifications that are not provided in the black market.

Finally, the same good could be achieved for everyone's goals without creating inequality.[164] The current goals of taxing marijuana are to raise revenue, while also imposing a stringent enough excise tax to discourage over-consumption,[165] much in the same way state and local governments have handled alcohol taxation.[166] Lowering the rate of excise tax on marijuana has the potential to expand the base of taxpayers participating in the legal system. This reduces inequality by making private retail businesses more competitive while benefitting consumers of less financial means as they may participate in the regulated and protected marketplace.

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[161] RAWLS, *supra* note 158, at 53–54.
[162] "There is nothing inherently regressive about a sales tax or even a poll tax. They are regressive because income is unequally distributed, and the more unequally income is distributed, the more regressive they become." Daniel B. Suits, *Measurement of Tax Progressivity*, 67 AM. ECON. REV. 747, 752 (1977).
[163] *See Taxes Due on Recreational Marijuana*, *supra* note 58; *Marijuana Taxes: Quick Answers*, *supra* note 24.
[164] Decreasing equal liberty "cannot be justified, or compensated for, by greater social and economic advantages." RAWLS, *supra* note 158, at 53-54.
[165] *See* Bajaj, *supra* note 126.
[166] *See* Confessore, *supra* note 125.

2. Nozick and the States' Marijuana Taxation Policies

Three characteristics of Nozick's libertarian philosophy of social justice are directly applicable to the debate pertaining to levels of excise tax on recreational marijuana. First, Nozick believes that individuals are entitled to own goods that they acquire from legitimate owners in a voluntary transfer.[167] Second, Nozick favors a reduced role for the state, limited to narrow functions of protecting against force, theft, fraud, and the enforcement of contracts.[168] Lastly, Nozick supports the minimal state because it hinders the government's ability to redistribute wealth.[169]

According to Nozick, individuals are entitled to own goods legitimately acquired.[170] Legitimate acquisition also includes producing goods if the necessary resources were also legitimately acquired.[171] As legitimate owners, the state has the right to tax (or charge for the privilege) for the use of anything it owns legitimately.[172] In Colorado and Washington, it is legal to produce, process, and sell marijuana, so it may be assumed that the means of production have been legitimately acquired. These means of production were legally granted in consideration for the state collecting taxes on them. In one respect, Nozick's principles claim the state should not interfere with the chain of voluntary sales transactions through taxation.

The marijuana excise taxes may be unjust to Nozick because it taxes individuals for the right to process and possess a substance state law says each has a right to. The right to marijuana production and consumption, however, was granted by the state so that it could be taxed. Thus, there is an argument supporting taxing legitimacy as it was granted by the state as a condition of decriminalization, but removing government interference with

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167 *See* Ralf Bader, *Robert Nozick*, *in* 11 MAJOR CONSERVATIVE AND LIBERTARIAN THINKERS 39 (John Meadowcroft ed., 2010); *see generally* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA (1974).

168 NOZICK, *supra* note 167, at 26.

169 *See* NOZICK, *supra* note 167, at 168. (stating, "Patterned principles of distributive justice necessitate *re*distributive activities. . . . From the point of view of an entitlement theory, redistribution is a serious matter indeed, involving, as it does, the violation of people's rights.").

170 Bader, *supra* note 167, at 38.

171 NOZICK, *supra* note 167, at 177; *see* Bader, *supra* note 166, at 39. (explaining Nozick's critique of John Locke's theory of appropriation: [P]rivate ownership of a resource must be sufficiently beneficial to ensure that those who are no longer at liberty to use the resource are not worsened by the appropriation. This condition should not be understood as a utilitarian justification of property but as a condition that ensures that others are not harmed by an appropriation.

172 *See generally* NOZICK, *supra* note 167.

the legitimate owners of marijuana also aligns with Nozick's libertarian philosophy of social justice.

An alternative approach views the state as also having the right to legitimately tax or charge for the use of the land within its borders. One could view the state as the original owner and contributor of land within its borders. This view justifies the state having an ability to charge greater property tax from those using property to cultivate and sell marijuana. This approach would continue raising revenue but in a different manner. Although such an approach does not satisfy Nozick's views on property ownership, as the individual becomes the legitimate land owner upon purchase. This is similar to the state decriminalizing marijuana in exchange for the ability to impose a tax on it. Also, this method of tax does not remedy the issues presented by the marijuana excise taxes. While being a potential alternative, it does not closely conform to Nozick's libertarian view.

Libertarian philosophy also favors a minimal role for the state to ensure social justice.[173] A minimal state limited to narrow functions protecting against force, theft, and fraud, while enforcing contracts is justified whereas any more extensive state violates citizen's rights.[174] Nozick's main goal of the minimalist state is to avoid the government's tendency toward redistributing wealth and restricting individual freedoms.[175] "Noteworthy implications are that the state may not use its coercive apparatus for the purpose of getting some citizens to aid others, or in order to prohibit activities to people for their *own* good or protection."[176] Thus, free market mechanisms are socially just.

Now that retail marijuana is legal in Colorado and Washington, the debate regarding its illegality and Nozick's libertarian view on that matter is beyond the scope of this article. The excise tax on marijuana in Colorado and Washington expands the scope of the states' taxing authority. The move to decriminalize marijuana, however, reduces overall state coercion in the marijuana economy. Both states' governance of marijuana becomes primarily through the tax system and generating revenue, rather than through the criminal justice system spending revenue. The states' decision

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173 *See generally* NOZICK, *supra* note 167.

174 *See generally* NOZICK, *supra* note 167.

175 *See e.g.,* RALF M. BADER, ROBERT NOZICK 112 (John Meadowcroft ed., Continuum Press 2010) ("[Nozick] places great importance on individual rights and the need to respect the separateness and dignity of persons.").

176 *See* NOZICK, *supra* note 167, at ix.

to decriminalize marijuana conforms to Nozick's narrow definition of the legitimate functions of government. Despite the positives resulting from marijuana decriminalization, libertarianism still views the excise taxes as an illegitimate redistribution of wealth. The redistribution is accomplished by restricting consumers and suppliers from arriving at a mutually agreeable free market price for the product through government intervention.

Nozick is a proponent of the minimal state because it hinders the government's ability to redistribute wealth.[177] "Redistribution is serious matter indeed, involving . . . the violation of people's rights."[178] This supports the view of the free market being just, and interferences in the free market being unjust.[179] Placing excise taxes at different levels of marijuana commerce is unjust to Nozick because it inhibits the good from being sold at the free market price. Excise taxes artificially inflating the price create deadweight loss in the market. That deadweight loss is the charge being levied on the economy through the government's taxation policy.

The deadweight loss is evidenced in Washington by the surplus of legally grown marijuana that cannot be sold.[180] It is also evidenced in the persistent existence of the black market in both Colorado and Washington as black market dealers are able to sell at lower prices than legal establishments encumbered by excise taxes.[181] Nozick's philosophy dictates both producers and consumers are better off with decriminalized marijuana but would be even better without the imposition of marijuana excise taxes. This would allow the socially just free market to determine the optimal levels of production, consumption, and price.

Rawls's and Nozick's views oppose one another and cannot be completely reconciled, but embracing the tension between their viewpoints helps reach a more optimal system of marijuana excise taxation. The discussed economic principles of elasticity, incidence, and deadweight loss animate those philosophies in creating the better system of marijuana excise taxation. By incorporating these philosophical and economic frameworks, an optimal tax system for recreational marijuana may now be determined.

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[177] NOZICK, *supra* note 167, at 111-115.
[178] NOZICK, *supra* note 167, at 168.
[179] NOZICK, *supra* note 167, at 159.
[180] *See generally* Johnson, *supra* note 154 *see also* Wells, *supra* note 153.
[181] *E.g.*, Camiel, *supra* note 145.

D. Cost Savings of Legalized Marijuana in Colorado and Washington

In addition to taxes generated, there are also a plethora of cost savings for state and local governments that are generated by legalizing recreational marijuana. These savings are generated by a decreased need for police, and the reduction in prosecutorial, judicial, incarceration, and probationary expenses that result.[182] Across the United States, an estimated $8.7 billion in annual savings would be generated by legalizing recreational marijuana.[183] This estimate, however, is the topmost cost savings that could be expected if all state and local governments legalized recreational marijuana.[184]

At the state and local government level across the entire United States, 42.1% of all drug possession related arrests are related to marijuana possession.[185] The upshot of that number is that 5.46% of all state and local arrests in the United States, for every possible infraction, are for marijuana possession. Eliminating marijuana arrests saves $2.67 billion annually from prosecutorial and judicial budgets that otherwise is spent on the resulting criminal cases, with an additional $1.14 billion saved on reduced corrections budgets.[186] The net savings to state and local governments for legalizing recreational marijuana is $5.39 billion, which includes the reduction in fines collected from defendants and assets seized by police in relation to marijuana arrests.[187]

The Colorado state and municipal governments spent over $74 million

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[182] Miron & Waldock, *supra* note 85, at 2 (Stating that state and local government savings are generated by "the reduction of expenditures of police resources from eliminating drug arrests; the reduction in prosecutorial and judicial resources from eliminating drug prosecutions; and the reduction in correctional resources from eliminating drug incarcerations.").

[183] Miron & Waldock, *supra* note 85, at 1. (The study's state and local government savings are estimated using a procedure wherein: "It estimates the percentage of state and local arrests for drug violations and multiplies this percentage by the state and local budget for police (subject to one adjustment discussed below). It estimates the percentage of state and local felony convictions for drug violations and multiplies this percentage by the state and local budget for prosecutors and judges (subject to one adjustment described below). It estimates the percentage of state and local incarcerations for drug violations and multiplies this percentage by the state and local budget for prisons. It then sums these components to estimate the overall reduction in state and local government expenditures. Under plausible assumptions, this procedure yields a reasonable estimate of the cost savings from drug legalization.") Miron & Waldock, *supra* note 85, at 2.

[184] Legalization as understood by Miron and Waldock is the removal of all penalties associated with smuggling and selling of recreational marijuana. Miron & Waldock, *supra* note 85.

[185] Miron & Waldock, *supra* note 85, at 3.

[186] Miron & Waldock, *supra* note 85, at 4.

[187] Miron & Waldock, *supra* note 85, at 5.

annually attributable to marijuana prohibition.[188] Washington state and local governments spent an even greater sum—over $98.9 million.[189] In part, this money paid for the attendant costs of all marijuana arrests in both states—which make up 2.79% of all Colorado arrests each year,[190] and 3.15% of all Washington arrests.[191] Consequently, Colorado and Washington should respectively realize an additional gain of $74 million and $98.9 million in the form of reduced police, prosecutorial, and judicial expenses.

These savings, however, are not fully realized because of the ample black market resulting from both states' inefficient taxation of marijuana.[192] As long as a thriving black market exists for the sale and production of illegal marijuana, Colorado and Washington will incur unintended expenses in trying to eliminate it. Until there is an efficient allocation of resources, which eliminates the necessity of the black market, Colorado and Washington will still incur policing, prosecuting, and judicial expenses for marijuana, albeit less than before.

IV. HOW A MODIFIED TAXING APPROACH CAN REDUCE DEADWEIGHT LOSS AND REALIZE INCREASED REVENUE FOR COLORADO AND WASHINGTON.

This article establishes the system of recreational marijuana excise taxes in Washington to be less successful at revenue generation than anticipated and a handicap to creating a competitive legal marketplace with the illegal market. The tax system in Colorado is less onerous and has proven to be moderately more in accordance with state revenue projections as it features lower rates.[193] Decreasing the rates further, however, could benefit all market participants—including the government. The initial attempts at marijuana excise taxation developed an understanding of its economic effects and its philosophical underpinnings. Using this knowledge, a better system of taxation is proposed.

Colorado and Washington currently have little recourse to combat the

[188] Miron & Waldock, *supra* note 85 (according to statistics based on 2008).
[189] Miron & Waldock, *supra* note 85, at 6.
[190] Miron & Waldock, *supra* note 85, at 18–19.
[191] Miron & Waldock, *supra* note 85 at 20–21.
[192] *See supra* text accompanying notes 145–52.
[193] *See supra* text accompanying notes 26–27; *see also Fiscal Impact Statement, supra* note 52 (Washington's top tax rate on recreational marijuana is 84.6% versus Colorado's highest rate of 36.15%).

lack of allowable federal deductions for legal marijuana businesses in their state.[194] One potential alternative is to allow businesses a credit on their state income tax return in an amount equal to the disallowed federal deduction. This option has little viability as the state would be robbing itself of the revenue lower tax rates generate for it. This discrepancy between legal marijuana purveyors and other businesses is actually of little concern though, because all legal marijuana businesses in the two states are bound by the same laws. Of greater import is using the state's excise tax system to aid legal marijuana businesses, contemporaneously squashing their untaxed illegal counterparts.

The presence of a flourishing illegal marijuana trade is evidence of deadweight loss, with consumers opting to purchase illegal black market marijuana when they know they could purchase legal marijuana.[195] This deadweight loss indicates that among other things, the optimal tax system has not been found.[196] By reducing the retail price through decreasing taxes, the legal market becomes a more viable alternative to the black market. This reduces the market's deadweight loss that fuels the black market.[197] As more consumers transition to the legal market, the tax base expansion then partially compensates for the revenue foregone by lowering the tax rates. This process becomes a positive feedback cycle, as more revenue is generated for the government it can better combat the black market, in turn creating more legal customers and generating more revenue. Another beneficiary of that process is legal producers, as more customers fuel greater demand for legal alternatives.

The incidence of tax would continue to rest on the consumer if the Washington and Colorado laws still allow taxes to be shifted down the stream of commerce.[198] Laws could be enacted saying the tax must be separately stated, or not passed on, but policing the transfer of actual incidence is difficult. The producer, processor, and retailer, would still have the ability to gross-up prices to accommodate for the tax being levied at each phase of production even if not explicitly passed on. Under current laws, this gross-up will still come to rest on the consumer as each gross-up encompasses the

[194] I.R.C. § 280E (West 2015).
[195] Camiel, *supra* note 145 at 1 (quoting a black market patient stating price difference is one reason he purchases on the black market versus using a licensed retail store).
[196] *See supra* text accompanying notes 145-148.
[197] *See* Mankiw, *supra* note 137, at 76.
[198] *Taxes Due on Recreational Marijuana*, *supra* note 58 (stating specifically that the purchase price paid by the Washington consumer includes the producer's, processor's, and retailer's excise tax).

previous step's price increase.[199] A lower rate at each step, however, would exponentially reduce the impact on the consumer. Washington is already attempting such a change, by shifting all the taxes onto the consumer, but at a lower rate.[200] The success of this approach remains to be seen, as the rate may still be too high to generate the change necessary to effect consumers' elastic demand curve.

Marijuana consumers also demonstrate an elastic demand curve. Fueling this elasticity, consumers have the option of purchasing less highly taxed substitution products like alcohol and tobacco, as well as black market marijuana.[201] The high taxes on legal marijuana and its readily available and cheaper black market alternative contributes to this elasticity.[202] Anyone with an internet connection has access to a plethora of illegal marijuana sellers, all selling below the price available at retail.[203] Reducing excise taxes on marijuana also helps address this elastic demand curve.

Consumers choosing the black market will be incentivized to purchase legal retail marijuana as its prices become more competitive with the illegal options. Consequently, consumers will respond with greater demand when prices decrease. This increased demand creates a wider taxing base, facilitating the reduced tax rate while still collecting substantially similar revenue. The wider base with a reduced rate potentially does not generate the same amount of gross revenue as the higher tax rate does, but it could lead to similar or greater net budgetary benefits. The expanded legal retail marijuana market diminishes the persistent black market. This results in fewer law enforcement resources being required to deal with the shrinking black market. Those reduced budgets contribute to the net revenue resulting from a lower rate that expands the net revenue generation.

The elasticity in the supply curve would also respond to decreasing taxes. Each link in the production chain could now potentially charge less as the

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199 *Taxes Due on Recreational Marijuana*, *supra* note 58.

200 *See Taxes Due on Recreational Marijuana*, supra note 58. (stating that this approach has already being tested in Washington as it has lowered its excise tax rate from 25% at each level to a flat 37% on the consumer.)

201 Camiel, *supra* note 145.

202 *See, e.g.,* Free MJ for Legal Adults w/ Donation! - $10 (Colfax & Wadsworth), CRAIGSLIST, https://denver.craigslist.org/hab/5271932913.html (last visited Nov. 1, 2015, 2:52) (advertising free "greenery" for legal adult Denverites on Craigslist).

203 *See, e.g.,* MJ, CRAIGSLIST, http://denver.craigslist.org/search/haa?sort=rel&query=MJ (last visited Nov. 1, 2015) (showcasing many different options for purchasing illegal marijuana in Denver classified on Craigslist as a "health and beauty" product).

government is taking a smaller amount. The legal market's increased customer demand would help make up lost revenue from price reduction. Government may in turn be tempted to regulate the price that each producer, processor, and retailer could charge as a means of addressing its reduced role in the market. This would distort the supply curve, recreating the deadweight loss this proposal remedies.

Government price controls would largely defeat the approach of lowering taxes to increase the base. A central premise of lowering taxes is increasing competition between the legal and illegal markets. This effect inherently drives prices to the level where supply meets consumer demand, reducing the market's current deadweight loss. Shrinking the deadweight loss drives up the number of consumers purchasing legal retail marijuana, making the overall marketplace function more efficiently. A greater number of consumers enables the government to collect similar revenue from more patrons than the present approach. More consumers utilizing the legal market also results in fewer resources necessary to police the shrinking black market.

Lowering the excise tax on recreational marijuana to expand the tax base satisfies both Rawls and Nozick. It satisfies Rawls's desire for a redistributive system aiding society's worst off, but also appeases Nozick's desire to decrease the role of government in the marketplace.[204] Decreasing the excise tax also has the inherent advantage of increasing the market's economic efficiency. First, lowering the taxes will lower the retail price retailers charge. This will encourage additional consumers to utilize the legal marketplace, which offers customers governmental protection policing the transactions and ensuring safety of the product being sold.

Rawls acknowledges the societal problems of inequality, but his actual mechanism for solving those problems is inadequate.[205] The taxation schemes Colorado and Washington use do not remedy inequality.[206] The governments taxing marijuana in exchange for its decriminalization may satisfy Nozick, but further reducing the government's role in the marketplace also conforms with Nozick's libertarian beliefs.[207] The proposal of

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[204] *See supra* text accompanying note 158, 167.
[205] *See* SMITH, supra note 159, at 187.
[206] *See* SMITH, supra note 159, at 187.
[207] "Taxation of earnings from labor is on par with forced labor." NOZICK, supra note 166, at 262. ("Those who need to earn more money to satisfy their desires will have to pay more income tax which means that they will have to work more for purposes that others have set for them.") BADER, supra note

lowering the tax rate does potentially appease both philosophies.

A lower rate that creates an expanded base offers the state the potential for similar revenue. This may appease Rawls's desire for redistribution as the governments of Washington and Colorado now have additional money. The government is also then using fewer resources to address the shrinking black market. How this newly generated money is used is the determining factor for Rawls. In Colorado the first $40 million is earmarked for public school construction.[208] This is a form of Rawlsian redistribution, potentially benefiting the least well off in society by providing benefits to all public school students in Colorado. Rawlsian philosophy also welcomes the benefits of government policed transactions being expanded to more individuals, now the least well off are not forced to the lawless black market in order to obtain the product affordably. Instead, the least well off benefit from the redistribution occurring through government tax collection and also from a lower retail price, enabling more consumers to utilize the legal marketplace.

Nozick's libertarian viewpoint welcomes less government intrusion into the socially just free market.[209] A lower tax rate helps restore all participant's rightful entitlement to ownership, as the government takes less from each private transaction. The lower rate also serves Nozick's second goal of minimizing the role of the state.[210] Less use of the state's coercive taxing authority allows the supply and demand curves to more closely approach natural equilibrium. Even though the state would generate similar amounts of revenue, appeasing Rawls by still being able to redistribute wealth, it would also satisfy Nozick's desire to decrease the redistribution occurring in each transaction. While the Nozickian utopia of minimal government interference is not perfectly achieved, a lower tax rate brings the status quo closer to his goal than the current system does. Decreasing the marijuana excise taxes in Colorado and Washington potentially appeases the fundamental tenants of Rawls's philosophy through revenue generation and distribution. Nozick is satisfied through less state interference with private transactions and the expanding legal market resulting from the shrinking dead weight loss and the black market it feeds.

166, at 55.

[208] *Supra* note 19, and accompanying text.

[209] NOZICK, *supra* note 167, at 113.

[210] NOZICK, *supra* note 167, at 118–19.

V. CONCLUSION

Colorado and Washington were trailblazers in legalizing recreational marijuana. As such it is to be expected that its implementation would not be flawless. The most important area for reform is the current tax system, because of its effects on each part of the interrelated marketplace. Reducing marijuana excise taxes potentially decreases gross revenue as the customer base expansion may not offset the rate reduction. Net revenue accrues from the rate reduction, however, may not be widely dissimilar from current tax collection levels, and potentially increased. This comes from the accompanying reduction in the size of the black market which necessitates fewer enforcement, prosecutorial, and judicial resources. A more efficient tax system helps create a more efficient marketplace, benefiting all legal market participants.