

# ANALYSIS

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## Proposition AA Retail Marijuana Taxes

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Proposition AA

### Proposition AA, if approved, would:

- ◆ impose a 15 percent state excise tax on the average wholesale price of retail marijuana when the product is first sold or transferred by a retail marijuana cultivation facility, with public school construction receiving the first \$40 million of any annual tax revenues collected;
- ◆ impose a 10 percent state sales tax on retail marijuana and retail marijuana products, in addition to the existing 2.9 percent state sales tax, to increase funding for the regulation and enforcement of the retail marijuana industry and to fund related health, education, and public safety costs;
- ◆ direct 15 percent of the revenue collected from the 10 percent state sales tax to cities and counties where retail marijuana sales occur; and
- ◆ allow the state legislature to increase or decrease the excise and sales taxes on retail marijuana so long as the rate of either tax does not exceed 15 percent.

### Summary and Analysis

**Why is this measure on the ballot?** Proposition AA relates to another measure passed by the voters in November 2012, Amendment 64. Amendment 64 allows for an adult 21 years of age or older to consume or possess up to one ounce of marijuana and requires the state to establish a regulatory structure for the retail marijuana industry. Amendment 64 also requires the state legislature to enact an excise tax on retail marijuana to fund public school construction; however, the Colorado Constitution requires a statewide vote to approve new taxes. The state legislature approved and the Governor signed into law a bill that proposes two new state taxes: an excise tax to be applied to the average wholesale price of retail marijuana when first sold or transferred by a retail marijuana cultivation facility; and a sales tax on retail marijuana and retail marijuana products to increase funding for regulation. Therefore, the state

legislature is submitting to the voters the question of whether to approve additional taxes on retail marijuana. These taxes will not apply to medical marijuana. Regardless of whether the measure passes, beginning on January 1, 2014, existing medical marijuana stores will be eligible for a retail marijuana license unless a city or county has imposed a ban. After October 1, 2014, all applicants are eligible for licensure where no local ban is in place. Without approval of the sales and excise taxes, the new regulatory structure will have to be funded by eliminating or cutting state programs.

**Excise taxes.** An excise tax is a tax on the use or consumption of certain products such as gasoline, alcohol, or cigarettes. The tax is generally collected at the wholesale level and passed on to consumers in the retail price. Retail marijuana cultivation facilities will pay the 15 percent state excise tax when they first sell or transfer marijuana to retail marijuana product manufacturing facilities, retail marijuana stores, or other retail marijuana cultivation facilities. Every six months, the Colorado Department of Revenue will determine an average wholesale price for unprocessed retail marijuana sold by retail marijuana cultivation facilities, and all unprocessed retail marijuana will be taxed at this price. Medical marijuana is not subject to the state excise tax created by the measure, or to any existing state excise tax.

Under Amendment 64, the state excise tax is limited to 15 percent until January 1, 2017, and the state legislature can seek voter approval through another ballot measure to raise the excise tax rate above 15 percent to be effective on or after that date. Each year, the first \$40 million in revenue raised by the excise tax will be credited to the Building Excellent Schools Today program for constructing public schools. The excise tax revenue is estimated to be less than \$40 million annually for at least the first two years. If the amount collected is greater than \$40 million, the excess will be used for marijuana regulation.

**School construction funding through the Building Excellent Schools Today program.** In 2008, the state legislature enacted the Building Excellent Schools Today program to address the limited capacity for many public schools to renew or replace deteriorating facilities with local resources. The program prioritizes funding awards based on issues such as asbestos removal, building code violations, overcrowding, and poor indoor air quality. Program grants are available to public school districts, charter schools, boards of cooperative services, institute charter schools, and the Colorado School for the Deaf and the Blind. Under current law, funding is provided from the State Land Trust, Colorado Lottery spillover funds,

the applicants' matching funds, and interest accrued within the fund itself. Between 2008 and 2012, the program received \$2.15 billion in requests and awarded \$686 million for school construction projects, with local governments allocating an additional \$293 million in matching funds.

**Sales taxes.** The measure also adds a state sales tax to be applied when a consumer purchases retail marijuana or retail marijuana products at a licensed retail marijuana store. The sales tax rate will initially be set at 10 percent. The state legislature can raise or lower the tax rate at any time through legislation, but cannot increase it above 15 percent without further voter approval. The 10 percent state sales tax on retail marijuana is in addition to current state and local sales taxes, which are applied to most retail purchases. All sales taxes will be applied to the retail price paid by the consumer, which includes the 15 percent state excise tax created by the measure. Medical marijuana is not subject to the additional sales tax created by the measure, but remains subject to the existing 2.9 percent state sales tax.

Amendment 64 permits cities and counties to ban retail marijuana cultivation, processing, and sales. However, cities and counties that allow retail marijuana sales to consumers will receive 15 percent of the revenue collected from the 10 percent state sales tax on retail marijuana. The proceeds will be divided according to the percentage of retail marijuana sales within each jurisdiction. The measure is silent on the use of this revenue by cities and counties. Beginning on or before April 1, 2014, and annually through April 1, 2016, the state legislature is required to determine if the percentage of revenue allocated to cities and counties is set at the appropriate level.

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**Regulatory activities funded by sales tax revenue.** The Marijuana Enforcement Division (MED) in the Colorado Department of Revenue regulates the cultivation, processing, and sale of both medical and retail marijuana. Medical marijuana licensees are currently operating, but the licensing program for retail marijuana establishments is still being developed. In cities and counties that currently allow medical marijuana sales, licensed retail marijuana stores are authorized to sell retail marijuana beginning on January 1, 2014, unless a local ban is imposed. Revenue generated by the 2.9 percent state sales tax on both medical and retail marijuana and marijuana products, plus revenue from application and licensing fees paid by medical and retail marijuana establishments, will be used to fund the MED. This revenue will fund the regulation of marijuana establishments, including

enforcement of the laws for the testing, tracking, and labeling of retail marijuana and measures to prevent the diversion of retail marijuana to individuals under 21 years old. The revenue from the proposed 10 percent state sales tax will also be used to fund the regulatory structure, as well as related costs for health, education, and public safety, which are not currently funded. The total costs to the state for the implementation of Amendment 64 are projected to be millions of dollars annually.

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*For information on those issue committees that support or oppose the measures on the ballot at the November 5, 2013, election, go to the Colorado Secretary of State's elections center website hyperlink for ballot and initiative information:*

*[www.sos.state.co.us/pubs/elections/Initiatives/InitiativesHome.html](http://www.sos.state.co.us/pubs/elections/Initiatives/InitiativesHome.html)*

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## **Arguments For**

1) A majority of Colorado voters approved Amendment 64 to allow the sale of retail marijuana within a regulated and taxed market, and passage of this measure is expected to generate the revenue necessary to support the robust regulation of this market. In addition, an effective regulatory system may discourage federal interference with the industry, as the sale of marijuana remains illegal under federal law. Adoption of the additional 10 percent state sales tax is important because the current funding structure for the regulatory system may not be adequate and may require funds to be diverted from other state priorities such as education, public safety, and health care. Without revenue from the 10 percent sales tax, studies that address public safety concerns and educational efforts aimed at preventing the use of marijuana by children may not be adequately funded. As recent audits of the medical marijuana regulatory system have demonstrated, current fees and sales tax revenue may not be adequate to ensure a safe and effective regulatory structure.

2) Colorado schools have a projected \$17.9 billion in school construction needs through 2018, and the proposed state excise tax will make more funding available for these needs, as intended by Amendment 64. This additional funding will help modernize older schools, build new schools, and alleviate health and safety concerns. Also, by increasing the number of projects funded, the school construction industry may see an increase in jobs.

## Arguments Against

1) The new state taxes created by the measure may be so high that they undercut one of the intended purposes of Amendment 64, which is to encourage consumers to purchase marijuana from licensed stores rather than from the underground market. When marijuana is purchased from licensed stores, sales are taxed and limited to consumers 21 years of age or older. By overtaxing a product that is readily available in the underground market, the measure may limit sales from licensed stores and keep consumers in the underground market.

2) Amendment 64 requires the establishment of an excise tax, but does not require the sales tax created by this measure. This second tax was not anticipated by supporters of Amendment 64 and is an unfair tax burden on consumers of marijuana. The state legislature's plan for implementing Amendment 64 includes measures that exceed what is essential to regulate the industry. Revenue from application and licensing fees, as well as the existing 2.9 percent state sales tax on marijuana, can adequately satisfy the regulatory requirements of Amendment 64.

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## **Estimate of Fiscal Impact**

**State and local revenue.** As shown in Table 1, passage of Proposition AA is estimated to increase state tax revenue by \$67 million annually, which includes \$27.5 million in excise tax revenue and \$39.5 million in state sales tax revenue. Local governments where retail marijuana stores are operating will receive a proportionate share of \$6.0 million based on the percentage of sales in each jurisdiction.

In FY 2011-12, Colorado's medical marijuana industry sold \$199.1 million worth of marijuana to 109,000 patients. Under Amendment 64, retail marijuana sales will be made up of marijuana consumers who transition from the medical marijuana industry, marijuana consumers who currently use unregulated marijuana, and visitors to the state. The revenue estimates assume a wholesale price of \$93.75 per ounce for unprocessed retail marijuana and a retail price of \$201.56 per ounce, of which \$14.06 is excise tax. It is estimated that 2 million ounces of marijuana will be sold by retail marijuana stores each year. The total taxable value of retail marijuana at the wholesale level is estimated to be about \$183.5 million per year, with sales to consumers of retail marijuana totaling approximately \$394.6 million per year.

**Table 1. Estimated State Revenue from Proposition AA  
for Calendar Year 2014**

	<b>Wholesale Sales Subject to Excise Tax</b>	<b>Retail Sales Subject to Sales Tax</b>
Average price per ounce	\$93.75	\$201.56
Total sales	\$183.5 million	\$394.6 million
Tax rate	15%	10%
Total taxes	\$27.5 million	\$39.5 million
Excise taxes to Building Excellent Schools Today Program	\$27.5 million	
Sales taxes to state government (85%)		\$33.5 million
Sales taxes to local governments (15%)		\$6.0 million

**State spending.** The Colorado Department of Revenue will develop a computer system and hire staff to collect, monitor, and enforce both the 15 percent excise tax and the 10 percent sales tax on retail marijuana. The staffing, computer system, and operating expenses are estimated to cost \$4.2 million in the first year of implementation and \$1.3 million annually thereafter. The department is expected to add approximately 22 staff to implement the measure. The remaining funding will be used to fund the regulation of marijuana establishments, including enforcement of the laws for the testing, tracking, and labeling of retail marijuana, measures to prevent the diversion of retail marijuana to individuals under 21 years old, and costs for health, education, and public safety.

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## State Spending and Tax Increases

The state constitution requires that the following fiscal information be provided when a tax increase question is on the ballot:

- 1) the estimated or actual state spending under the constitutional spending limit for the current year and each of the past four years with the overall percentage and dollar change; and
- 2) for the first full year of the proposed tax increase, an estimate of the maximum dollar amount of the tax increase and of state fiscal year spending without the increase.

Table 2 shows the dollar amount of state spending under the constitutional spending limit.

**Table 2. State Spending**

	<b>Actual FY 2009-10*</b>	<b>Actual FY 2010-11</b>	<b>Actual FY 2011-12</b>	<b>Estimated FY 2012-13</b>	<b>Estimated FY 2013-14</b>
State Spending	\$8.57 billion	\$9.43 billion	\$10.27 billion	\$11.12 billion	\$11.50 billion
Four-Year Dollar Change in State Spending: <b>\$2.93 billion</b>					
Four-Year Percent Change in State Spending: <b>34.2 percent</b>					

\*FY = fiscal year. The state's fiscal (or budget) year runs from July through June.

The numbers in Table 2 show state spending from 2010 through 2014 for programs that were subject to the constitutional spending limit during those years. However, the constitution allows a program that operates similarly to a private business to be exempt from the limit if it meets certain conditions. Because the exempt status of some programs has changed during the last five years, the numbers in Table 2 are not directly comparable to each other.



Table 3 shows the revenue expected from the two new taxes for FY 2014-15, the first full fiscal year for which the taxes would be in place; state fiscal year spending without these taxes; and the sum of the two.

**Table 3. Estimated State Fiscal Year Spending and the Proposed New Taxes**

	<b>FY 2014-15 Estimate</b>
State Spending Without the New Taxes	\$12.08 billion
State Revenue from the New Excise and Sales Taxes	\$67 million
State Spending Plus the New Taxes	\$12.15 billion

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