New York’s THC-Potency Excise Tax Analysis and Recommendations

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I. Executive Summary

This paper analyzes the current tax structure in the New York State Cannabis Law ("Cannabis Law") and its impact on the burgeoning cannabis industry in the state.

We conclude:

The THC tax, untried by any other state, is excessively complex, costly to cannabis enterprises and costly to collect, and will lead to shopping for the best lab results.

These essential attributes of the THC tax result in burdens that fall disproportionately on small business and social equity applicants, burdens that can more easily be borne by large cannabis businesses.

The amount of the THC tax does not vary with changing market conditions and therefore exacerbates the boom-and-bust cycle that has been experienced by other states with fixed tax burdens.

The large amount of data now available from other cannabis-legal states strongly suggests that lower overall rates and simpler tax structures facilitate higher tax revenues and create an environment in which smaller businesses can thrive.

Proponents of the current tax regime point to all the good things they can do with the tax revenue, but that is irrelevant to the structure of the tax. Further, if the tax burden is too high, as it seems to be, that will only result in lesser tax revenues and greater illicit market activity.

New York State already has a massive and well-established illicit market that has flourished after cannabis was "legalized" under MRTA, and the THC tax and total tax burden will make this problem far worse.

We advocate a single tax at the final point of cannabis sale as it is easier to administer and less burdensome for cannabis operators.

II. New York Cannabis Tax Structure

Two separate taxes are imposed on cannabis in New York — a potency tax and a special cannabis sales tax.

a. Potency Tax

The THC potency tax varies by product category as follows:

Product Category	Tax Rate
Flower	$0.005 per milligram of Total THC
Concentrates	$0.008 per milligram of Total THC

Edibles	$0.03 per milligram of Total THC

These taxes are paid by the retail license holder to the licensed distributor.

b. Sales Tax

In addition to the THC potency tax, there is a 13% retail tax accruing at the point of sale. This retail tax replaces (and is not in addition to) the sales tax under New York Tax Law § 1105.

III. Examples of Retail Prices in the New York Adult-Use Market

Applying the New York THC potency tax to costs and using industry standard markups[1], the final retail price of 3.5 grams of flower will come out to $75.53, over twice the cost of the competing legacy market. Here is a breakdown of how the costs of the taxes will be dispersed throughout the supply chain.

	THC %	MG of THC	THC Tax Rate	THC Tax	Wholesale Cost	Wholesale Cost with Tax	Retailer Cost with Markup	13% Retail Tax	Tax in $	Cost at Retail per gram	Tax in %
Flower	30%	300	0.005	$1.00	$8.05[2]	$9.55	$19.09	$2.48	$5.49	$21.58	34%
Cartridge	80%	800	0.008	$6.40	$19.60[3]	$26.00	$52.00	$6.76	$19.56	$58.76	50%
Edible	-	100	0.03	$3.00	$8.00[4]	$11.00	$22.00	$2.86	$8.86	$24.86	55%

IV. Problems Caused by the Structure of the THC Potency Tax

The high tax rates will make it difficult for small businesses to compete and may incentivize consumers to continue shopping on the illicit market. Small businesses will not only have to worry about illicit dealers undercutting them, but also well-capitalized cannabis firms that have the funding and the production technology to absorb the cost of the taxes while still offering a lower price to consumers. In either scenario, small cannabis operations end up getting pushed out of the market in favor of illicit dealers and large corporations, and local economies end up missing out on the opportunity to gain from cannabis legalization.[5]

a. Increased Expense

Under the regulations promulgated by the Office of Cannabis Management ("OCM"), a cannabis grower or producer is required to contract with an independent sampling firm that comes to a production site, collects samples, transports the samples back to the lab, and tests the potency of the product.[6] Not only is this procedure expensive, it doesn't even produce consistent results.

[1] Whitney, Beau, Whitney Economics, An Economic Analysis of CAOA, 2021.
[2] The average wholesale cost per gram in Massachusetts and Illinois.
[3] The average whole cost of one gram cartridge in California, Colorado, Nevada, Oregon and Washington.
[4] The average whole cost of one gram cartridge in California, Colorado, Nevada, Oregon and Washington.
[5] See Whitney, 2021 and Whitney 2022.
[6] No other state requires the lab to transport the samples, an additional expense without justification.

In the states that require THC testing for labeling (not tax) purposes, "lab shopping" (as it's known in the industry) for high THC results is a constant. In New York, the lab shopping will be for lower content and thus lower tax — one law firm has already publicly recommended lab shopping as a New York tax planning technique.

Because this is a novel tax and no other independent sampling firm criteria have been established in other adult-use states, the costs of the THC testing are unknown, but will certainly be an added burden on cultivators who already face 50-70% effective federal tax rates.

To quote a recent book on cannabis economics, "Call it the economics of common sense: Lower-priced sellers will win out unless the more expensive seller brings something special to the market. This rule tends to hold especially when the lower-priced option has been satisfying customers for decades."[7]

b. Burden on Small Business

The expensive and complicated THC tax will further burder small businesses that must compete on two fronts already, against large multi-state operators with access to massive capital and an entrenched illicit market.

As seen in New York's medical cannabis space, well capitalized license holders can wait out anemic sales for better market conditions; adult-use in New York will be no different. As illustrated above, it is likely that prices of adult-use cannabis in New York will be, at minimum, twice the price of illicit cannabis.

This will lead to a consolidation in the industry, either through acquisition or the failure of small companies to compete and outlast larger operators. The proliferation of smaller businesses leads to more robust local economies. According to a study regarding interstate commerce of cannabis under federal legalization,

> economic research in other industries shows that small, independent businesses strengthen local economies in ways that large businesses do not, like spending more on local professional services. There's a positive association between the concentration of small businesses and per capita income on the county level, while the density of large firms negatively impacted per capital income growth.[8]

New York must lower the barriers to entry for small businesses so that they may meaningfully compete against larger market entrants as well as the illicit market.

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[7] Goldstein, Robin, and Daniel Sumner. *Can Legal Weed Win? The Blunt Realities of Cannabis Economics*, 2022.

[8] Politico – Congress should pause interstate commerce under federal legalization, July 14, 2022, citing Economic and Social Consequences of Interstate Commerce in Recreational-Use Cannabis, July 2022. Michele Mattingly and James Parrott.

c. Barrier to Entry for Social Equity Applicants

While the burden of the THC tax clearly creates obstacles to small business, it may fall even more heavily on social equity applicants. According to Whitney Economics' latest report, in response to the question whether the respondent's cannabis business is recognizing a profit, only 42.4% stated they were profitable, 20.3% stated they were breaking even, and 37.4% stated they were losing money.[9] Further breaking down the data, women and minority owned businesses were less likely to report they were profitable.

The responses indicated that, only 37.5% of women-owned businesses were profitable (45.6% for male-owned businesses), 43% of women-owned businesses broke even (20.7% of male-owned businesses), and 19.5% of women-owned businesses were losing money (33.8% male-owned businesses).[10]

On the basis of race (broken down to non-white and white, due to limitations of the data), 45.7% of white owned businesses reported being profitable, compared to 32.2% of non-white owned businesses. Nineteen percent of white-owned businesses reported breaking even, compared to 24.1% of non-white-owned businesses. Lastly, 35.3% of white-owned businesses reported not making a profit, while 43.7% of non-white-owned businesses reported not making a profit.[11]

Whitney Economics concluded its analysis of profitability broken down by race and gender stating, "the data show that the further an operator is from being white and male, the less likely they are to be turning a profit in the U.S. cannabis market. The implication of this observation… is that current business conditions, including regulations and policies, are disproportionately impacting women-owned and minority-owned businesses."[12]

One of the issues in a potency-based tax is the arbitrary nature of the various tax rates by product. Unlike alcohol, where lower proof products require substantially more volumetric consumption, e.g., 1.5 ounces of 80 proof liquor contain 0.6 ounces of alcohol, the same as. 12 ounces of 5% alcohol beer, cannabis does not have the same type of relationship. An 80% 1-gram THC vaporizer cartridge contains 800 milligrams of THC per gram and 3.5 grams of 30% THC flower contains 300 milligrams of THC per gram. Therefore, while an alcohol consumer may be inclined to drink liquor to feel a given effect instead of drinking 800% more beer to feel the same effect, thereby incentivizing a higher tax rate to reduce consumption, the same is not true for cannabis. Inhalation of a single vaporizer dose versus 2.5 doses from smoking flower is not subject to the same volumetric restriction as with alcohol that may favor consuming higher concentrated products where increased tax rates have an effect on consumption amounts.

d. Alternate Forms of THC Circumvent the THC Tax

Delta-9 THC, the most common form of active THC, has various isomers, such as Delta-8 and Delta-10. However, minor cannabinoids like Tetrahydrocannabiphorol (THCP) and

[9] Whitney Economics U.S. Cannabis Business Conditions Survey Report Q4 2021
[10] *Id.*
[11] *Id.*
[12] *Id.*

Tetrahydrocannabivarin (THCV) are homologs of Delta-9 THC; the difference being the number of repeating units in the alkyl side chain of the molecules. THCP has been reported to be up to 33 times stronger than Delta-9 THC.

Assuming THCP falls under the definition of THC[13] and is not a controlled substance under the Public Health Law[14], and therefore can be legally produced and sold by New York licensees, this provides a mechanism to mitigate the effects of the THC tax and circumvent the rationale discussed above. THCP is commonly sold in vaporizer cartridges, which is subject to the middle tier tax of $0.008 per milligram of THC. Assuming the potency of THCP is accurate, a THCP cartridge that is equivalent of a one gram 90% Delta-9 THC cartridge, containing 900 milligrams of Delta-9 THC, would only need to contain 27.3 milligrams of THCP. That would result in a 97% reduction in the amount of taxes generated by the THC potency tax.

Because the THC potency tax will cause prices to far exceed the illicit market prices, particularly in the adult-use cannabis products space, it would be expected that as the market and our understanding of cannabinoids continues to develop, this and other similar actions would result in New York receiving far less tax than it estimates.

e. A THC Tax Unrelated to Cannabis Market Price is Disastrous

Having a tax rate disconnected from the market price will make the boom and bust agricultural cycle worse. In other words, as the price of cannabis declines, the tax becomes a higher percentage of the sale price and exacerbates the difference with the illicit market and other states.

For example, prior to the repeal of its cultivation tax, California saw prices drop as low as $300 per pound of cannabis. The cultivation tax in California was $10.08 per ounce, resulting in a $161.28 per pound tax. When prices fell, the effective cultivation tax rate was nearly 54%, resulting a wholesale cost of over $460 per pound. Ignoring additional taxes and margins, which compound the effective rate at retail, if illicit market sellers were matching the price, without tax, of the legal market, they were able to undercut the legal wholesale market by 35%.

A percentage based tax that fluctuates with the market price allows cultivators and retailers to better compete with the illicit market as there is no longer a price floor for cannabis due to taxes, which do not exist in the illicit market.

f. Measurements of Uncertainty

The THC Potency tax requires New York authorized laboratories to perform analyses to determine the amount of THC in a product and report the results to OCM. Despite careful measurement and the latest instrumentation used, all results will include a measure of uncertainty, similar to a margin of error. This is standard practice and even required by the USDA for hemp production. Because the product is taxed by the milligram, requiring an accurate report of total THC to the tenths of a percent, the Measure of Uncertainty ("MU") could cause differing or inaccurate calculation of tax due. These inaccuracies could easily lead to millions of dollars of underpaid or overpaid tax and

[13] Cannabis Law Sec. 3(52).
[14] Public Health Law Sec. 3306(d)(20).

disputes over the final tax, depending on the testing lab used. Each lab reports its own MU based on its equipment and process.

For example, a lab may have an MU of 3% with a confidence interval of 95%, meaning that there is a 95% chance the true value will be within ± 3% of the stated value. Under these hypothetical facts, a farmer that produces 1,000 pounds of cannabis that tests at 20% total THC has a product that may actually range from 17% to 23%. In terms of taxes owed, the difference would be a range of $385,560 to $521,640. Presumably, the farmer would be taxed at whatever percentage is reported on the label, but would be able to choose the percentage on the label, so long as it fell within the MU.

This results in at least two problems. The first problem is that the government may be shortchanged in its tax collection. Second, there is a public health concern resulting from underreporting. With a typical dosage of THC of 5 milligrams, an eighth of reportedly 20% total THC with an MU of 3%, could contain anywhere between 595 milligrams and 805 milligrams of total THC. If a farmer is incentivized to report the lower percentage, that could result in a consumer consuming approximately 35% more THC than expected.

V. New York Cannabis Taxes are Too High

a. Tax Rates Increase Prices in Relation to Illicit Market

Recently, it was estimated that New York's illicit market would generate sales of $1.95 billion in 2022.[15] But according to New York's own budget estimates, the regulated and taxed adult-use market in New York is projected to have sales of somewhere between $616 million and $1.13 billion.[16]

The demand in the cannabis market is subject to demand elasticity, i.e., a price increase will result in demand decrease. Because of the demand elasticity, "the price increases will be borne mostly by operators and less so by the consumer, further eroding margins and driving out small businesses."[17]

Consumers are very price sensitive in the cannabis space, and will abandon the legal market in favor of the illicit market (or neighboring state markets) if the legal market cannot compete on price. In particular, collected data suggests that consumers are willing to pay no more than a 10-15% premium over the illicit market (or neighboring state markets) to access state-legal cannabis. For example, when Oregon's adult-use program came online with tax rates around 20% versus

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15 https://www.bloomberglaw.com/bloomberglawnews/cannabis/BNA%200000018211d2d86aa9d713f3c2690003?bna_news_filter=cannabis.

16 https://www.budget.ny.gov/pubs/archive/fy23/ex/fp/fy23fp-ex-amend.pdf. This budget projects $339 million in cannabis tax revenue in fiscal year 2027, so an effective tax rate estimates of 30% and 55% equates to $1.13 billion and $616 million respectively.

17 Whitney, 2021.

Washington's 37% plus local taxes, Washington saw a steep decline in demand as Washington consumers crossed the border to access Oregon's lower prices.[18]

New York's tax rates, which put it far above the illicit market and many, if not all, adult-use states, will cause a significant disparity between legal and illicit prices, resulting in a failure to convert consumers from the illicit market to the regulated market.

b. Lessons from Other States

With adult-use programs in 18 states, all with varying tax regimes, information can be gleaned from the plethora of data from states with mature programs and high taxation, mature states with low taxation, and states recently legalizing with both high and low taxation. However, it is likely that, for New York's emerging adult-use market, placing more weight on the data from states such as Michigan, Massachusetts and Illinois, each of whom have similar comparative economics to New York in both cost to do business and the cost of cannabis, will yield data that will be much more applicable to New York than data from the west coast where legalization has been around longer, there was not initial social equity considerations, and cannabis prices are significantly lower, even after markets mature on the east coast.

A detailed discussion of each state's cannabis tax experience is found in Appendix A, but several themes are extremely clear:

1. States with high cannabis taxes (which also tend to have high regulatory compliance burdens) don't reduce illicit market share.

2. States with high cannabis taxes that reduce those taxes get increased cannabis tax revenue.

3. States with cannabis sales taxes get more cannabis tax revenue than states with more complex cannabis tax structues.

VI. Proposed Reforms

a. 20% Sales Tax at Retail - No Other Taxes

According to economist Beau Whitney, of Whitney Economics, for every 1% reduction in price, there is a corresponding 2% increase in sales. Under current cannabis taxes, one gram of cannabis would cost the consumer $21.58 and would generate $3.98 to New York State. By enacting a 20% sales tax and removing all other taxes, one gram of cannabis would cost the consumer $19.32 and net New York State $3.22.

Although the State collects slightly less revenue off of each gram, the advantage of this policy is that the lower prices offered to the customer would incentivize consumers to shop legally by enabling small businesses to sell their product at a reasonable price, and therefore ultimately may lead to increased tax revenue.

[18] Whitney, Beau, Whitney Economics, Cross-Border Effect, 2022.

Using industry standard mark-ups, here is how this tax plan would affect the retail price 3.5 grams of flower, and how the costs are distributed among different levels of the cannabis supply chain.

Wholesale Cost of a Gram of Cannabis	Retailer Cost (100% Markup)	20% Sales Tax	Consumer Cost + Sales Tax (20%)	Retail Price of 3.5 grams
$8.05[19]	$16.10	$3.22	$19.32	$67.62

Compare the above to the Cannabis Law taxes and retail price, assuming 30% THC flower:

Wholesale Cost of a Gram of Cannabis	THC Tax	Retailer Cost (100% Markup)	13% Sales Tax	Consumer Cost + Taxes	Retail Price of 3.5 grams
$8.05[20]	$1.50	$19.10	$2.48	$21.58	$75.53

The difference between the 20% suggested tax and the Cannabis Law's current tax regime, from a tax revenue perspective, is of just $0.76 per eighth, but results in a 10% price reduction at retail. Therefore, it could be reasonably estimated that the reduction in taxes would end up revenue neutral but allow businesses to more readily compete with the illicit market.

b. Proposed Statutory Language.

To effectuate the above, Article 20-c of the Tax Law should be amended to remove the THC potency excise tax and increase the flat tax at retail to a total of 20%. See Appendix B for proposed statutory language.

[19] Average of Massachusetts and Illinois pricing.

[20] Average of Massachusetts and Illinois pricing.

APPENDIX A – STATE CANNABIS TAX EXPERIENCES

Summary of the Repeal of THC Potency Excise Tax

- Every 1% reduction in price increases sales by 2%
- In every adult-use state analyzed below, both sales revenue and tax revenue have increased year over year, regardless of how long the legal market has been established
- Women-owned and minority-owned businesses are less likely to be profitable due to regulatory and tax requirements
- Consumers are extremely price sensitive and will only pay 10-15% above illicit market prices – in order to pull consumers and operators from legacy markets, legal prices must be competitive
- Tax rates in NY would be 50% to 100% higher than Massachusetts and Connecticut, exacerbating the cross-border effect (i.e., consumers will travel long distances to obtain cheaper products)
- Michigan, with a population of 9.9 million, has generated nearly $300 million in tax revenue in its two full years of operations
- Massachusetts, with a population of 6.9 million, has generated nearly $500 million in tax revenue in its three full years of operations
- New York's latest projections estimate, according the NYS FY 2023 Executive Budget Briefing, cannabis tax revenues of $56 million in FY 2023 (including $40 million in licensing fees), $95 million in FY 2024, $158 million in FY 2025, $245 million in FY 2026, $339 million in FY 2027 and $363 million in FY 2028
    - Either NY recognizes that its immense tax rates will suppress legal cannabis sales or NY is substantially underestimating revenues based on all available data
    - In either case, a reduction of NY's cannabis excise taxes would likely be revenue neutral based on the Governor's projections
- As seen in states with tax revenues based on a percentage of sales such as Washington, Oregon, Massachusetts, Michigan and Nevada, a reduction in the price of cannabis has resulted in the government collecting more tax revenue:
    - Michigan[21]
        - Average retail ounce price January 2020: $512.05
        - Average retail ounce price December 2021: $184.90
        - Tax Revenue January 2020: $1.6 million
        - Tax Revenue December 2021: $21.6 million
        - Average Monthly Tax Revenue Growth Rate: 13%
        - Average Monthly Cannabis Price Change: -4.21%
    - Massachusetts[22]
        - Average retail ounce price December 2018: $389
        - Average retail ounce price December 2021: $317.66
        - Tax Revenue December 2018: $4 million
        - Tax Revenue December 2021: $25.4 million
        - Average Monthly Tax Revenue Growth Rate: 20.14%

[21] Monthly data available at https://www.michigan.gov/mra/0,9306,7-386-93032-497635--,00.html
[22] Monthly data available at https://public.tableau.com/app/profile/ma.cannabis.control.commission/viz/AU-Sales-Total-YTD-Gross/SalesDashboard

    - Average Monthly Cannabis Price Change: -0.42%
  - Colorado[23]
    - Average Market Rate per pound July 2014: $1,876
    - Average Market Rate per pound January 2022: $948
    - Tax Revenue July 2014: $5 million
    - Tax Revenue December 2021: $29 million
    - Average Monthly Tax Revenue Growth Rate: 2.99%
    - Average Market Rate per pound change: -1.45%

State Tax Statutes

Michigan

Tax Rates		**Year**	**Est. Revenue Per Year[24]**	**Total Revenue**
Excise	*10%*	*2020*	$81.7 million	---
Sales	*6%*	*2021*	$209.9 million	$291.6 million

When Michigan legalized adult-use cannabis in 2018, it implemented one of the lowest cannabis taxes in the nation. The tax rate is composed of a 10% excise tax and a 6% sales tax. Michigan was also one of the first states to initiate a robust social equity program as part of itslegalization bill that now has an operational market.

Massachusetts

Tax Rates		**Year**	**Est. Revenue Per Year[25]**	**Total Revenue**
Excise	*10.75%*	*2019*	$86 million	---
Sales	*6.25%*	*2020*	$140 million	$226 million
Local	*Up to 3%*	*2021*	$266.8 million	$492.9 million

Massachusetts legalized adult-use cannabis in 2016 but sales didn't begin until late 2018. Despite the slow roll out and high wholesale costs, over $4,000 per pound, Massachusetts has been able to continue to grow its revenue on average 20% per month from 2019 through 2021. The approximate total tax rate in Massachusetts is 20%. Despite its high wholesale costs, the lower tax rate makes retail products more competitive with the illicit market.

[23] Data available at https://tax.colorado.gov/sites/tax/files/AMR_PriorRates_Jan2022.pdf and https://docs.google.com/spreadsheets/d/11d0K4KpnZBT2l19FPgvvZ04pzklfi_M_/edit#gid=2009424505

[24] https://www.michigan.gov/mra/0,9306,7-386-93032-497635--,00.html

[25] https://public.tableau.com/app/profile/ma.cannabis.control.commission/viz/AU-Sales-Total-YTD-Gross/SalesDashboard

Washington

Tax Rates		Year	Revenue Per Year[26]	Total Revenue
Cultivation	*N/A*	*2015*	$65.71 million	---
Excise	*37%*	*2016*	$189 million	$254.71 million
		2017	$319 million	$573.71 million
Sales	*Varies by locality*	*2018*	$367.4 million	$941.11 million
		2019	$395.5 million	$1.33 billion
		2020	$473.9 million	$1.8 billion

When Washington State legalized adult-use cannabis in 2014 it imposed taxes at a 25% rate on producers, 25% rate on processors, and a 25% rate on retailers, resulting in higher retail prices and lower revenues than expected.

In 2015 Washington combined these taxes into a single 37% excise retail tax and ended up outperforming its expected revenues by over 200%. Since consolidating its tax structure and retiring the weight-based cultivation tax, the cannabis industry in Washington has continued to grow steadily, and is expected to surpass $2 billion in total tax revenue once the 2021 data is finalized.

Colorado

Tax Rates		Year	Revenue per Year[27]	Total Revenue
Cultivation	N/A	2015	$130.4 million	$198.0 million
Excise	15%	2016	$193.6 million	$391.6 million
		2017	$247.4 million	$638.9 million
Sales	15%	2018	$266.5 million	$905.5 million
		2019	$302.5 million	$1.3 billion
		2020	$387.5 million	$1.6 billion
		2021	$423.5 million	$2 billion

Colorado is home to the most mature cannabis market in the United States and has served as a regulatory and legislative model for states like Washington and Nevada. Colorado imposes a 15% state tax on retailers and a 15% excise tax on wholesalers, adding up to a 30% effective tax rate, one of the lowest in the country.

Since the legalization of adult-use cannabis in Colorado in 2014, it has experienced monumental growth in cannabis tax revenues, and in 2019 surpassed $1 billion in total revenues collected from cannabis. Companies have made more than $6.5 billion in sales since 2015.

[26] https://lcb.wa.gov/sites/default/files/publications/annual_report/2020%20annual-report-final-opt.pdf
[27] https://cdor.colorado.gov/data-and-reports/marijuana-data/marijuana-tax-reports

Nevada

Tax Rates		***Year***	***Revenue Per Year***[28]	***Total Revenue***
Cultivation	N/A	*2019*	*$99.2 million*	---
Excise (Wholesalers)	15%	*2020*	*$105.2 million*	*$204.4 million*
Excise (Retailers)	10%	*2021*	*$157.8 million*	*$362.1 million*

Nevada imposes a 15% excise tax on wholesalers and a 10% excise tax on retailers. Depending on the sales tax of the locality in which the cannabis is being sold, these taxes add up to around a 30% effective tax rate.

Given Nevada's relatively high tax rates and supply chain restraints, Nevada has not grown its program as quickly as other recently legalized states like Michigan and Massachusetts.

California

Tax Rates		**Year**	**Revenue Per Year**	**Total Tax Revenue**
Cultivation	$10.08/ounce of flower $3.00/ounce of leaves	2018	$397.7 million	---
Excise	15%	2019	$638.6 million	$1.036 billion
Sales	9.25%	2020	$1.1 billion	$2.136 billion

California recently repealed its cultivation tax, discussed more fully below. However, prior to the repeal California imposed a 9.25% sales tax, 15% excise tax, up to a 10% local tax, and a cultivation tax of $9.25 per ounce of flowers and $2.75 per ounce of leaves, adding up to an effective tax rate of around 45%. California has one of the largest markets for cannabis in the country, and if taxed and regulated correctly could become a cannabis powerhouse in the US.

Although California reached $1 billion dollars more quickly than Colorado or Washington, legal cannabis has underperformed in every fiscal quarter since legalization, and in 2018 cannabis tax revenue in California was actually 50% lower than originally projected.

As a result of high tax rates, dispensaries within the state are struggling to offer a price that can compete with illicit market dealers and many consumers in California have chosen to buy from illicit dealers. Since the tax rates force dispensaries to dramatically raise their prices, many businesses are choosing to ignore state regulations and have taken to selling cannabis without the

[28] https://tax.nv.gov/Publications/Cannabis_Statistics_and_Reports/

proper licensing. The United Cannabis Business Association found that of the 3,708 cannabis businesses operating in California, only 873 of them are actually licensed. With over three times as many illegal operations as legal ones, it's no surprise that California consumers are continuing to shop in the unregulated markets.

The combination of high taxes, illicit market activity, and overregulation has effectively stifled the cannabis industry in California, and its regulatory structure is need of a serious overhaul in order to create an industry that can compete with Washington or Colorado.

Illinois

Tax Rates		**Year**	**Revenue Per Year**	**Total Revenue**
Cultivation	7%	2020	$174.9 million	--
Excise	• 10% on non-cannabis infused products with 35% THC or less • 25% on non-cannabis infused products with greater than 35% THC • 20% on cannabis infused products	2021	$423.2 million	$598.1 million
Sales Tax	Up to 10%			

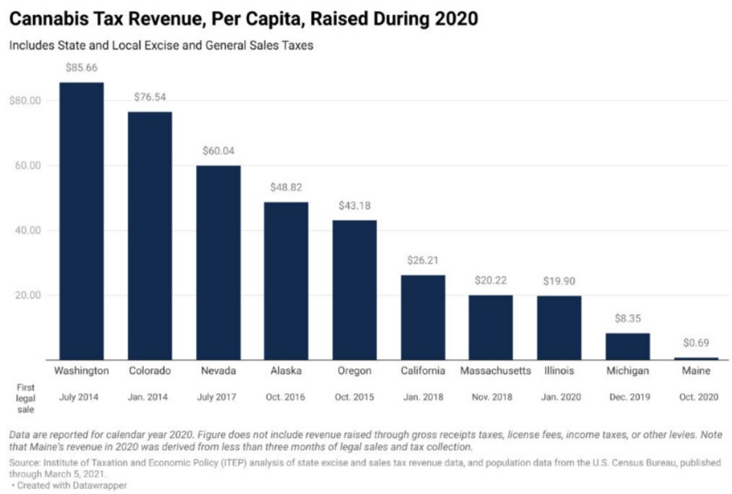
The Cannabis Cultivation Privilege Tax is a tax imposed on cultivators at the rate of 7%. The tax is paid by the cultivator.

The Cannabis Purchaser Excise Tax is a tax imposed on purchases of cannabis products. The tax is paid by the retail customer.

- 10% of taxable receipts from the sale of adult use cannabis, other than cannabis-infused products, sold with 35% THC or less
- 25% of taxable receipts from the sale of adult use cannabis, other than cannabis-infused products, sold with greater than 35% THC, and
- 20% of taxable receipts from the sale of adult use cannabis-infused products

In addition to the THC tax, cannabis is also subject to the Illinois 6.25% State Retailers' Occupation Tax, as well as the local retailers' occupational tax, which may not exceed 3.75%.

Analysis of Differences Among State Tax Structures



[29]

Washington, Colorado, and Nevada, states that have embraced excise and sales taxes, yield the highest revenues per capita, while states that rely on weight-based taxes on cultivators like California and Alaska trail behind.

Washington's high tax rate, totaling out to about 46% of the price of cannabis sold, and high per capita tax revenue is a bit of an outlier due to several factors.[30] Washington has one of the most mature cannabis markets in the country, which launched in July 2014. According to the ITEP report, "States with older, more established markets that feature many retailers tend to raise significantly more revenue than states with newer markets that are still in the process of growing to meet consumers' demand."[31] However, as indicated above, when Oregon's program came online with significantly lower taxes and retail prices, demand in Washington significantly dropped due to the cross-border effect, i.e., people will cross a state border to get lower prices on cannabis owing to the price sensitivity of cannabis consumers.

While there are many other issues that impact the profitability and health of a given state's cannabis industry, the data above supports the claim that states with percentage-based cannabis taxes tend to have overall healthier industries. New York policymakers should take notice of this trend and adjust the tax structure to reduce the burden on the nascent market.

One of the major advantages of the excise and sales taxes that states like Colorado and Washington have adopted is that they do not impact the source of the cannabis supply – the cultivators. Although they may force wholesalers and retailers to raise prices, they protect the integrity of the cannabis supply chain as a whole by ensuring that cultivators are able to produce the amount of cannabis that meets the demands of consumers.

[29] https://itep.org/state-and-local-cannabis-tax-revenue-jumps-58-surpassing-3-billion-in-2020/
[30] *Id.*
[31] *Id.*

a. Rate of tax results in shortfall from predicted revenue

By New York's estimates, after roughly 5 years of legal adult-use sales, the State's tax revenue would only be approximately $17.40 per capita, among the lowest of any mature market in the United States, and the lowest of every state analyzed in this paper.

b. Some states reduce tax rates

As discussed above, Washington initially had a total of a 75% tax rate. A year after sales began, Washington collapsed its tax rate to a single 37% rate and saw revenue double.

California provides an insight into New York's future under the THC potency tax. California recently removed its cultivation tax and froze its excise tax at 15% for at least three years.

> Frustrations have been building steadily since voters legalized recreational cannabis in 2016, with [Governor] Newsom's backing. Rather than watching businesses rush to enter the market, the nascent legal industry has languished behind an expansive network of off-the-book- pot shops and tucked-away farms that fuel a multi-billion-dollar enterprise. For licensed operations trying to survive, the reason is simple: The taxes are too high.[32]

California's stated reasoning for the reduction is to "reduce[ ] barriers to entry to the legal, regulated cannabis market and combat[ ] the illicit market, Department of Finance Chief Deputy Director Erika Li told the [California] Assembly Budget Committee…."[33]

New York and California share similar problems, insofar as high taxes, extensive regulatory compliance, partially necessitated by the complexity of the THC potency tax, as well as a lack of enforcement against illicit operators. Unlike California, however, New York's market has not begun. New York has the ability to draw on data from all adult-use states and lower the taxation to help ensure small and social equity businesses have the ability to compete with the illicit market.

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[32] https://subscriber.politicopro.com/article/2022/07/tax-cuts-leave-california-pot-businesses-wanting-much-more-00044612

[33] https://www.bloomberglaw.com/product/blaw/bloomberglawnews/cannabis/XA2QAPU8000000?bc=W1siU2VhcmNoICYgQnJvd3NlIiwiaHR0cHM6Ly93d3cuYmxvb21iZXJnbGF3LmNvbS9wcm9kdWN0L2JsYXcvc2VhcmNoL3Jlc3VsdHMvNDM0NjI5ZWQxZTY5NDlhNTIwZmY5YzY1ODAwM2Y4NzciXV0--545d7221d15f7552d188cd1fa918ae5c0c4bafb2&bna_news_filter=cannabis&criteria_id=434629ed1e6949a520ff9c658003f877

APPENDIX B – PROPOSED STATUTORY LANGUAGE

Bill Draft

STATE OF NEW YORK

2022-2023 Regular Sessions

SENATE - ASSEMBLY

AN ACT to amend the tax law, in relation to taxes on adult use cannabis products

Section 1. Subdivision (k) of Section 492 of the tax law is hereby REPEALED.

§2. Section 493 of the tax law is amended to read as follows:

493. Imposition of tax. ~~**(a) There is hereby imposed a tax on adult-use cannabis products sold by a distributor to a person who sells adult-use cannabis products at retail at the following rates:**~~

~~**(1) cannabis flower at the rate of five-tenths of one cent per milligram of the amount of total THC, as reflected on the product label;**~~

~~**(2) concentrated cannabis at the rate of eight-tenths of one cent per milligram of the amount of total THC, as reflected on the product label; and**~~

~~**(3) cannabis edible product at the rate of three cents per milligram of the amount of total THC, as reflected on the product label. This tax shall accrue at the time of such sale or transfer. Where a person who distributes adult-use cannabis is licensed under the cannabis law as a microbusiness or registered organization, such person shall be liable for the tax, and such tax shall accrue at the time of the retail sale.**~~

~~(b)~~ **(a)** In addition to any other tax imposed by this chapter or other law, there is hereby imposed a tax of ~~**nine**~~ **sixteen** percent of the amount charged for the sale or transfer of adult-use cannabis products to a retail customer by a person who sells adult-use cannabis products at retail. This tax is imposed on the person who sells adult-use cannabis at retail and shall accrue at the time of such sale or transfer.

~~**(c)**~~ **(b)** In addition to the taxes imposed by subdivision~~**s**~~ (a) ~~**and (b)**~~ of this section, there is hereby imposed a tax on the sale or transfer of adult-use cannabis products to a retail customer by a person who sells adult-use cannabis products at retail at the rate of four percent of the amount charged by such person for such adult-use cannabis product, which tax shall accrue at the time of such sale or transfer. The tax imposed by this subdivision is imposed on a person who sells adult-use cannabis products at retail, and shall be paid to the commissioner in trust for and on account of a city having a population of a million or more, and counties (other than counties wholly within such a city), towns, villages, and cities with a population of less than a million in which a retail dispensary is located.

~~(d)~~ **(c)** The taxes imposed by this section shall not apply to sales of adult-use cannabis to a person holding a cannabis research license under section thirty-nine of the cannabis law.

§3. Paragraph (i) of subdivision (a) of section 494 of the tax law is amended to read as follows:

(i) **~~Every distributor on whom tax is imposed under this article and~~** ~~e~~**E**very person who sells adult-use cannabis products at retail must file with the commissioner a properly completed application for a certificate of registration before engaging in business. An application for a certificate of registration must be submitted electronically, on a form prescribed by the commissioner, and must be accompanied by a non-refundable application fee of six hundred dollars. A certificate of registration shall not be assignable or transferable and shall be destroyed immediately upon such person ceasing to do business as specified in such certificate, or in the event that such business never commenced.

§4. Section 496 of the tax law is amended to read as follows:

§ 496. Records to be kept; penalties. (a) Records to be kept. **~~Every distributor on whom tax is imposed under this article and~~** ~~e~~**E**very person who sells adult-use cannabis products at retail shall maintain complete and accurate records in such form as the commissioner may require including, but not limited to, such items as **~~the total THC content of the adult-use cannabis products sold to or produced by such person;~~** complete records of every retail sale of adult-use cannabis, and any other record or information required by the commissioner. Such records must be preserved for a period of three years after the filing of the return to which such records relate and must be provided to the commissioner upon request.

(b) Penalties. In addition to any other penalty provided in this article or otherwise imposed by law, **~~Every distributor on whom tax is imposed under this article and~~** every who sells adult-use cannabis products at retail who fails to maintain or make available to the commissioner the records required by this section is subject to a penalty not to exceed five hundred dollars for each month or part thereof for which the failure occurs. This penalty may not be imposed more than once for failures for the same monthly period or part thereof. If the commissioner determines that a failure to maintain or make available records in any month was entirely due to reasonable cause and not to willful neglect, the commissioner must remit the penalty for that month.

§5. The act shall take effect immediately.