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Crafting a Constitutional Marijuana Tax

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ABSTRACT

Marijuana legalization and decriminalization have become important policy issues. Twenty-three states have partially legalized marijuana (generally for medicinal purposes), and four – Alaska, Colorado, Oregon, and Washington – have legalized it for general adult recreational use. Given the likely hyper-growth of the cannabis market due to widespread legalization, states might enjoy budgetary windfalls from collecting marijuana taxes.

Marijuana, however, remains a federally controlled substance, the sale or use of which is subject to substantial penalties. For the states, this presents a potential problem in collecting marijuana excise taxes. If an individual user in a state where marijuana is legal pays an accompanying excise tax, the payment could be construed as admission of federal criminal possession of a controlled substance. Similarly, the seller, in collecting the tax, could face federal criminal distribution penalties merely for complying with state collection procedures.

This article presents (i) the current constitutional status of marijuana excise taxes and the concomitant Fifth Amendment jurisprudence, and (ii) a mechanism to construct an aggregate tax encompassing marijuana, which we believe overcomes any constitutional problems for both buyers and retailers.
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I. INTRODUCTION

Marijuana legalisation and decriminalisation have become important policy issues.\footnote{We will use the term “marijuana” to describe a derivative of the cannabis plant – “a tall plant with a stiff upright stem, divided serrated leaves, and glandular hairs” – used primarily as a psychotropic drug. See The New Oxford American Dictionary 251 (2001).} Twenty-three U.S. states have partially legalized marijuana (generally for medicinal purposes), and four – Alaska, Colorado, Oregon, and Washington – have legalized it in small quantities for adult recreational use.\footnote{See, e.g., Carly Schwartz, Marijuana Market Poised to Grow Faster Than Smartphones, The Huffington Post (Nov. 4, 2013) (discussing the states that currently legalize marijuana, and the possibilities for expansion of the market and alleviation of governmental enforcement burdens legalization would bring); see also Editorial Board, Real Prohibition, Again, NY Times (July 27, 2014) (calling for Congress to repeal the ban on marijuana).} Given the anticipated growth of the cannabis market owing to the possible broader decriminalization of marijuana, states might enjoy a substantial rise in revenues from marijuana excise taxes.\footnote{See Nat’l Conference of State Legislatures, State Medical Marijuana Laws, Nov. 13, 2014, http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx (last visited Jan. 9, 2015); NORML, Legalization, http://norml.org/legalization (last visited Jan. 9, 2015).}

An excise tax is “[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax).”\footnote{See supra note 2.} In most cases, an excise tax is generally imposed as an \textit{ad valorem} tax (i.e., a percentage tax) or a unit tax. Thus, a marijuana excise tax could take the form of a percentage tax (e.g., 15% of the sales price) or a unit tax (e.g., $100 per ounce). Colorado, for example, has approved a 25% tax on all individual purchases of commercial marijuana.\footnote{Black’s Law Dictionary 605 (8th ed. 2004).} The state projected resulting tax revenue of $33.5 million its first year and $67 million its second year.\footnote{Elizabeth Chuck, Colorado weighs how much to tax legal marijuana, NBC News, available at http://usnews.nbcnews.com/_news/2013/11/05/21319011-colorado-weighs-how-much-to-tax-legal-marijuana.} Indeed, the potential for significant tax revenues is very real (perhaps similar to the wave of gambling legalization and subsequent taxation that occurred across the United States during the 1990s and
Marijuana, however, remains a federally controlled substance, the sale or use of which is subject to substantial penalties. This presents a dilemma of state legalization vis-à-vis federal law. Although a user may legally consume marijuana within, say, Colorado, federal authorities in Colorado could punish the user under federal law. For the states, this presents a conundrum in collecting any excise taxes on marijuana. If an individual purchaser in a state where marijuana is legal pays an excise tax, then it could be construed as an admission of federal criminal possession of a controlled substance. Similarly, the seller, in collecting the tax, could face federal criminal distribution penalties merely by complying with state collection procedures.

For this reason, state marijuana tax schemes, at least as currently structured, may be unconstitutional. The Fifth Amendment prohibits compulsory self-incrimination. But if the federal government can use the fact of payment or collection of a state tax on a controlled substance as evidence in a criminal matter, then state laws requiring users and retailers to report and pay the tax may amount to compelled admission of a federal crime. Indeed, a pending Colorado lawsuit contends just that.

We attempt to craft a usable formula for the taxation of marijuana that avoids this constitutional issue. In this article, we first set forth, as background and example, the process of

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8 See Melissa Schettini Kearney, The Economic Winners and Losers of Legalized Gambling, Brookings Institution 3 (2005) (“Gross casino revenue in 2003 totaled $28.7 [billion], excluding Native American tribal casinos. This represents a more than three-fold increase since 1990, when casino revenue totaled $8.7 billion.”).
9 See infra notes 18-20, and accompanying text.
10 See Amended Complaint ¶ 51, No Over Taxation v. Hickenlooper, No. 2014CV32249 (Denver Cnty. Dist. Ct.) (contending that because “[m]arijuana is illegal under federal law . . . [a] Plaintiffs are forced to incriminate themselves . . . by payment of Marijuana Taxes”); cf. People v. Duleff, 515 P.2d 1239, 1240 (Colo. 1973) (holding that Colorado’s marijuana licensing requirements violated defendant’s Fifth Amendment right against self-incrimination because “in order to fully comply with the [Colorado] requirements . . . [defendant] would have been forced to reveal information which would have tended to incriminate him of violating the federal marijuana tax laws”).
decriminalization/legalization of marijuana. We use Colorado as an example of a state where general recreational marijuana is legal, but where the state is in the early stages of dealing with the policy of how to structure a marijuana tax. Next, we present the current constitutional status of marijuana excise taxes and related Fifth Amendment jurisprudence. Finally, we describe a mechanism to construct an aggregate excise tax encompassing marijuana, which we believe would overcome constitutional hurdles for both buyers and retailers.

II. HISTORY, LEGALIZATION EFFORTS, AND COLORADO

The use of cannabis – the derivative source plant of marijuana – as an intoxicant traces back millennia.11 Cannabis was also considered biologically versatile and economically useful.12 It had a wide variety of industrial and personal uses in the early United States.13 Early laws encouraged the domestic growth and production of the plant and, indeed, marijuana even became a common ingredient in medicinal products sold openly in public pharmacies.14

By the early 1900s, the federal government began regulating marijuana.15 The Pure Food and Drug Act of 1906 required manufacturers of medicines containing marijuana to specify the ingredients of the previously unregulated products, marking the first major entry of the federal government into the field of drug regulation.16 From there, individual states began imposing restrictions on the sale and use of cannabis until, by the mid-1930s, cannabis use was regulated

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11 Islamic chronicler al-Maqrizi provided one description of the origin of cannabis use in 1155 A.D. See Martin Booth, Cannabis 15 (Random House 2003). According to al-Maqrizi, the founder of the Persian Sufi Hyderi sect, Haydar, discovered an unweathered plant in the heavy heat in the mountains near his monastery near Neyshar, in (now presently) northeast Iran. See id. Perplexed by the plant’s ability to withstand heat, he took a few leaves and chewed them, returning to his sect “in a fickle frame of mind, with a smile on his face.” Id. Cannabis is also described in the Vedas, books of the Hindu faith dating back to 1100 B.C. See id. at 40.

12 See id. For more on the history and uses of the cultivation of cannabis, see generally id. at 18-25.

13 See id. at 62-63 (describing the cultivation of hemp for heavy rope and hessian, storage, clothing, and housing in the early 1800’s). The complete history of cannabis cultivation and use is beyond the scope of this article, but the its brief genesis provides context for its legalization status in the United States.


15 See id.

16 Glen R. Hanson, et al., Drugs and Society 94 (11th Ed. 2012).
in every state, including 35 states that adopted the Uniform State Narcotic Drug Act, a uniform code established by the National Conference of Commissioners on Uniform State Laws to control the sale, distribution, and possession of drugs like marijuana.\textsuperscript{17}

By the 1970s, there was a limited legalization effort, leading to the abolition of state regulations on cannabis.\textsuperscript{18} Around the same time, however, Congress passed the Controlled Substances Act of 1970 (“CSA”), “which classified cannabis as having high potential for abuse, no medical use, and not safe to use without medical supervision.”\textsuperscript{19} The legislation, which remains in full force today, categorically regulates the use of scheduled narcotics and provides substantial resources for federal law enforcement personnel to enforce its provisions.\textsuperscript{20} Since then, as part of the so-called “War on Drugs,” Congress has continuously amended the CSA to increase the potentially extreme penalties for trafficking and possession of narcotics, including marijuana.\textsuperscript{21} In addition to incarceration, commentators have noted in some detail the extensive collateral consequences associated with marijuana-related convictions.\textsuperscript{22}

In the past decade, legalization efforts for marijuana have gained increasing momentum. Indeed, Proposition 215 in California – a ballot measure for the personal use of marijuana and


\textsuperscript{20} See Gonzales v. Raich, 545 U.S. 1, 10-11 (2006) (discussing origination of U.S. marijuana laws and the “War on Drugs”).

\textsuperscript{21} See Richard Glen Boire, J.D., The Collateral Consequences of Cannabis Convictions in The Pot Book 219-21 (2010) (noting that in most states, “a person who commits a marijuana offense and fully serves his or her sentence . . . is nonetheless subject to continuing and long-lasting professional debilitation, barriers to family life, and limits on civic participation”).
cultivation upon a doctor’s prescription – was among the first strides in the wave of legalization efforts.\textsuperscript{23} Today, 23 U.S. states and the District of Columbia have legalized marijuana in some form; four of those states – Alaska, Colorado, Oregon, and Washington – have legalized marijuana for recreational use.\textsuperscript{24} Nevertheless, efforts to reduce penalties for marijuana use under federal law have been largely ineffective, and the Supreme Court has continued to hold that the federal government’s regulatory rights are unaffected by conflicting state laws.\textsuperscript{25}

In 2012, Colorado voters approved Amendment 64, which legalized marijuana for full recreational use.\textsuperscript{26} The state now stands to raise hundreds of millions of dollars in excise taxes over the next decade.\textsuperscript{27} The potential boon to the Colorado fisc is obvious, and many across the United States are watching closely to see how Colorado develops and implements a workable tax scheme for the use and sale of cannabis derivatives.\textsuperscript{28}

Of course, there remains a conflict between state and federal law on marijuana.\textsuperscript{29} Thus, even though Colorado legalized marijuana for recreational use, its users and sellers face the real

\textsuperscript{23} California NORML Patient’s Guide to Medical Marijuana, available at http://www.canorml.org/medical-marijuana/patients-guide-to-california-law. A comprehensive state-by-state analysis is beyond the scope of this article, but it suffices to note that there has been increasing state-by-state receptiveness to the idea of marijuana legalization.


\textsuperscript{25} See, e.g., Raich, 545 U.S. at 27 (finding Congress could regulate the use of marijuana notwithstanding conflicting state law).

\textsuperscript{26} See Amendment 64, Use and Regulation of Marijuana (2013) (amending Art. XVIII of the Colorado Constitution).


\textsuperscript{29} To be sure, there is reason to believe that the federal government – even if informally – has begun to take a more relaxed approach on the enforcement of federal marijuana laws. On October 19, 2009, the Obama Administration’s Justice Department circulated a memo to its district U.S. Attorneys “advis[ing] federal prosecutors
prospect of federal prosecution under the CSA. This poses a constitutional dilemma, too, because, by paying a mandatory marijuana tax, the user or seller will have admitted to violating federal law.

III. DISCUSSION

Requiring the payment of a state tax on marijuana (for recreational use or otherwise) implicates the Fifth Amendment right against self-incrimination, insofar as a tax based on a sales transaction of the substance would imply its distribution or use – both of which are prohibited under federal law. Marijuana is a Schedule I controlled substance under the CSA. Distribution and possession can carry substantial penalties under the federal regulatory framework.

A. Basic Overview of the Fifth Amendment Right Against Self-Incrimination

At its core, the Fifth Amendment’s privilege against self-incrimination “is an exception to the general principle that the Government has the right to everyone’s testimony.” The amendment provides that “no person ‘shall be compelled in any criminal case to be a witness against himself.’” In other words, it permits a person to refuse to respond to questions or inquiries that have the capacity to put the person at risk of criminal prosecution.

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31 See, e.g., 21 U.S.C. §§ 841(a), 844.
33 See infra note 49, and accompanying text.
36 See United States v. Stein, 233 F.3d 6, 14 (1st Cir. 2000) (explaining the scope of the rule); see also United States v. Gordon, 710 F.3d 1124, 1153 (10th Cir. 2013) (explicating the rule in multiple contexts).
Generally, the privilege must be invoked affirmatively, but the Supreme Court has found exceptions to that requirement. For example, the privilege need not be invoked where doing so could itself lead to incrimination. And it is well-established that a “witness need not expressly invoke the privilege where some form of official compulsion denies him a free choice to admit, to deny, or to refuse to answer.”

B. *Leary v. United States* and the Marihuana Tax Act of 1937

Marijuana was not “significantly” regulated by the federal government until 1937 when “accounts of [its] addictive qualities and physiological effects, paired with dissatisfaction with enforcement efforts at state and local levels, prompted Congress to pass the Marihuana Tax Act.” The Marihuana Tax Act imposed certain registration and reporting requirements on individuals dealing in marijuana, and it imposed concomitant federal taxes on both an annual basis and a per-transaction basis when the drug was transferred in commerce. For instance, the Act provided that “all persons who ‘deal in’ marihuana shall be subject to an annual occupational tax.” The persons subject to the tax were required to register with the Internal Revenue Service, and transferees and transferors in particular had to specify covered orders on

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37 *Salinas*, 133 S. Ct. at 2179-80 (noting that the affirmative invocation requirement “ensures that the Government is put on notice when a witness intends to rely on the privilege”). For instance, the Court has adopted a *per se* rule that a defendant need not take the stand at his own criminal trial, *see id.* at 2179 (referencing *Griffin v. California*, 380 U.S. 609, 613-15 (1965)), and it has held that custodial interrogation requires the government to put a defendant on notice of his right against self-incrimination to avoid the inevitable circumstance “where governmental coercion make his forfeiture of the privilege involuntary,” *id.* (discussing the *Miranda* rule).

38 *Albertson v. Subversive Activities Control Bd.*, 382 U.S. 70, 77-78 (1965) (government could not compel members of Communist Party to fill out form where responses could involve admission of a crime).

39 *Salinas*, 133 S. Ct. at 2180.


41 *See id.* (explaining background of the Marihuana Tax Act, and specific provisions). The Act’s stated purpose was “[to] impose an occupational excise tax upon certain dealers in marihuana, to impose a transfer tax upon certain dealings in marihuana, and to safeguard the revenue therefrom by registry and recording.” Pub. L. 75-238, 50 Stat. 551, 551 (1937).

government-approved forms, which were available to law enforcement.43

In 1969, in Leary v. United States, the Supreme Court held the Marihuana Tax Act unconstitutional with respect to its requirements that covered persons under the statute (i.e., dealers) register and pay a transfer tax because such a requirement would result in compulsion and exposure to “a real and appreciable risk of self-incrimination” under local law.44 Because the Act required registration and payment of taxes upon a transfer of quantities of marijuana, the defendant – who was prosecuted for, among other things, failing to pay the tax as a transferee – could not be forced to comply with the Act’s provisions insofar as doing so “would surely prove a significant link in a chain of evidence tending to establish his guilt under the state marihuana laws then in effect.”45

C. State Taxes and Leary

How states will tax marijuana has been subject to considerable debate.46 “[E]stimates of the revenues likely to flow into state and local government coffers because of legalization of marijuana vary widely.”47 But there is little disagreement that states stand to reap a substantial untapped source of revenue from taxing marijuana – particularly for recreational uses.48

43 Id. at 14-15 (discussing 26 U.S.C. §§ 4751-53). Attendant regulations required that any applicable order form “show the name and address of the transferor and transferee.” Id. at 15 (citing 26 C.F.R. § 152.69 (repealed)).
44 Id. at 15-16. Indeed, at the time, marijuana was illegal under most state laws.
45 Id. at 16.
47 Id.
48 See id. The revenue-raising implications appear stronger for recreational marijuana than in those states that have already legalized and taxed marijuana used for medicinal purposes. See id. (citing authority); see also Divya Raghavan, supra, note 27; Lauren Lyster, Denver Post Marijuana Editor: Pot to Generate $40 Million in Tax Revenue, Yahoo Finance (Dec. 13, 2013), available at http://finance.yahoo.com/blogs/daily-ticker/denver-post-marijuana-editor-this-job-has--been-a-trip-172605621.html (discussing the substantial revenue estimates of Colorado’s legalization efforts). To be sure, some commentators have pointed out high marginal rates on recreational marijuana could have backlash effects on legalization efforts. See, e.g., Jacob Sullum, High Marijuana Taxes Could Derail Legalization Plans, Forbes (Oct. 17, 2013), available at http://www.forbes.com/sites/jacobsullum/2013/10/17/high-marijuana-taxes-could-derail-legalization-legislation/ (suggesting the “after-tax price for marijuana sold by state-licensed outlets will be something like two to three times as high as prices charged by black-market dealers or dispensaries,” potentially causing circumvention of applicable state law). The reason for
However, the constitutional analysis articulated in *Leary* should force states to take a second look at prospective tax structures given the status of marijuana under federal law. The state taxation of marijuana is the inverse of the facts under *Leary* – today, requiring a tax to be paid under state law could present “real and appreciable” risk to the payor or payee of incurring federal criminal liability.

Under the CSA, marijuana remains a Schedule I controlled substance. Congress has specified stringent penalties for its possession and distribution. Indeed, statutory penalties for possession with the intent to distribute quantities of marijuana can carry prison sentences of up to twenty years and fines of $1 million, as well as numerous post-conviction supervision restraints on liberty. While efforts have been made to reduce the harsh effects of marijuana penalties under the CSA, marijuana remains criminally regulated.

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50. 21 U.S.C. § 812(c).

51. See, e.g., 21 U.S.C. § 844(a) (“Any person who violates this subsection may be sentenced to a term of imprisonment of not more than 1 year, and shall be fined a minimum of $1,000, or both.”); see id. § 841(a) (“[I]t shall be unlawful for any person knowingly or intentionally . . . to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance[.]”).

52. *Id.* § 841(c). Statutory penalties for distribution of marijuana are further graded by the amount possessed. For instance, possession with intent to distribute of less than 50 kilograms of marijuana can range up to five years in prison and fines of $250,000. *Id.* § 841(b)(D); see also NORML, *Federal Laws & Penalties*, available at [http://norml.org/laws/item/federal-penalties-2](http://norml.org/laws/item/federal-penalties-2) (describing the federal penalties for marijuana possession, distribution and cultivation). The U.S. Sentencing Guidelines (the “Guidelines”) further delineate the case-specific penalties for narcotic possession/distribution after application of the statutory minimum sentences. See, e.g., U.S. Sentencing Guidelines Manual § 2D1.1 (2013). Distribution of even small amounts of marijuana can subject one to strong penalties under the Guidelines. See, e.g., *id.* § 2D1.1(c), ch. 5, pt. A, sentencing table. The individual penalties for marijuana possession or distribution are not material to the ideas in this article, however. The key is that dealing or possessing marijuana can lead to significant *criminal* penalties under federal law.

53. See Moberly & Hartsig, *supra* note 38, at 425, n. 65 (citing 21 U.S.C. § 812(c)). As commentators have pointed out, the federal government has recently rejected petitions to remove marijuana from Schedule I of the CSA. *See id.* (noting that, “[a]s recently as July 8, 2011, the [DEA] rejected a petition filed in 2002 by medical marijuana
The question is whether a formulaic state excise tax on marijuana sales would put the buyer and/or the seller at risk of federal prosecution under the CSA. Looking past the nuances, in *Leary*, the Supreme Court was clear that government schemes that require registration (for identification and/or taxation purposes) in a manner that would tend to imply criminal conduct on behalf of the registrant are unconstitutional because they present a “real and appreciable” risk of self-incrimination. Requiring relevant state actors (i.e., users and sellers of marijuana) to register and pay state taxes on marijuana poses a very strong risk that state-required registration will be used as evidence in a federal criminal proceeding.

The regulatory scheme for recreational marijuana in Colorado provides a good example. The Colorado Retail Marijuana Code requires individuals and entities involved in the cultivation, manufacture, distribution, sale, and testing of retail marijuana and retail marijuana products to register their businesses with the state and obtain a license from the Marijuana Enforcement Division (“MED”). The MED must maintain a “seed-to-sale tracking system that tracks retail marijuana from either seed or immature plant stage until the marijuana or retail marijuana product is sold to a customer at a retail marijuana store.” The MED is also required to issue rules related to the “[i]dentification of state licensees and their owners, officers, managers, and

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54 395 U.S. at 16 (noting that this was the case under the Marihuana Tax Act because “[s]ections 4741-4742 required [the defendant], in the course of obtaining an order form, to identify himself not only as a transferee of marihuana but as a transferee who had not registered and paid the occupational tax under §§ 4751-4753”).


57 Colo. Rev. Stat. § 12-43.4-202(1).
employees”\(^{58}\), the “reporting and transmittal of monthly sales tax payments . . . and any applicable excise tax payments”;\(^{59}\) “[r]ecords to be kept by licensees and the required availability of the records”;\(^{60}\) and “inspections, investigations, searches, seizures, [and] forfeitures.”\(^{61}\) Although the Retail Marijuana Code has a provision related to the confidentiality of business records (including “customer information”) of licensed marijuana establishments,\(^{62}\) the statute further provides, “Nothing in this article shall be construed to limit a law enforcement agency’s ability to investigate unlawful activity in relation to a retail marijuana establishment.”\(^{63}\) The term “law enforcement agency” is not defined and probably includes federal as well as state authorities.\(^{64}\)

Regulatory requirements like these present a “real and appreciable” risk of self-incrimination under Leary. Like the defendant in Leary, manufacturers, distributors, retailers, and even users of retail marijuana have “ample reason to fear that transmittal [of registration and taxation information] could prove a significant link in a chain of evidence tending to establish . . . guilt” under federal law.\(^{65}\)

**IV. OVERCOMING LEARY**

States implementing marijuana tax regimes should consider, other things being equal, designing such regimes to avoid the Leary issue. Doing so will ensure that (i) participants in the marijuana distribution and sales system will remain in voluntary compliance with the tax regime

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58 Id. § 12-43.4-202(3)(b)(V), (VI).
59 Id. § 12-43.4-202(3)(a)(XIII).
60 Id. § 12-43.4-202(3)(a)(XII).
61 Id. § 12-43.4-202(a.5)(III).
62 Id. § 12-43.4-202(2)(d).
63 Id. § 12-43.4-202(3)(e).
65 Leary, 395 U.S. at 16.
rather than opting out on the basis of advice from attorneys and (ii) the entire tax regime is not subject to attack on federal constitutional grounds. By avoiding the potential unconstitutionality of tax schemes, states can foster voluntary compliance, avoid challenges by special interest groups, and ensure that their tax revenues are not disrupted.

Avoiding the *Leary* issue requires that the risk of self-incrimination from participating in the marijuana tax system is not “real and appreciable.” In other words, a law enforcement officer examining any submissions by a taxpayer to a local tax authority with respect to marijuana taxes should be unable to associate such submissions with transactions in marijuana. Such an association could imply the fact of marijuana possession or distribution and therefore lead back to the *Leary* problem.

Certain types of taxes already avoid association problems. For example, typical sales taxes are levied at the final point of sale based on the retail price of the product. Retailers simply report their gross sales on a periodic basis to the relevant tax authority on a sales tax return and remit the appropriate amount of tax. Such tax regimes are indifferent as to the source of the sale proceeds as most items are subject to the same rate of tax. Consequently, the typical sales tax system avoids the problem since a federal agent examining such a sales tax return would not be able to associate the proceeds reported on the return with the possession of any particular good. A taxpayer could be selling bicycles or marijuana, but an examination of the applicable sales tax

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66 While ultimately these entities would likely come into compliance when pressured by the state (such as threats to strip recalcitrant distributors and sellers of their state business licenses), such enforcement efforts require expenditure of funds. Eliminating reasons for non-compliance should reduce enforcement costs and help maximize revenue from the marijuana tax system.

67 If states are unable effectively to collect revenue from their marijuana tax systems, then they may be more inclined to reintroduce prohibition policies until the federal government revises marijuana’s status under the CSA.

68 We assume if one transacts in a good, one must possess such good. Also, the fact that a person is reporting sales of marijuana likely suggests that such a person is “distributing” marijuana within the meaning of the CSA. *See, e.g.*, 21 U.S.C. § 841(a).
return would simply show a gross amount of “goods” sold. Thus, the imposition of typical sales taxes on marijuana does not raise any association problems.

Recognizing the inelasticity of demand and negative externalities associated with psychoactive substances, however, states generally have imposed (or will want to impose) excise taxes on the marijuana supply chain in addition to the typical sales tax. These excise taxes will generally require that the taxpayer file a special tax return with the local tax authority showing either the quantity of marijuana sold (in the case of per-unit type excise taxes) (“Marijuana Unit Tax”) or the dollar amount of marijuana sold (in the case of ad valorem excise taxes) (“Marijuana Sales Tax,” and together with Marijuana Unit Tax, the “Specific Marijuana Taxes”). The Specific Marijuana Taxes require the taxpayer to specifically detail its dealings in marijuana, thus implicating criminal association problems.

We believe the association problems arising from Specific Marijuana Taxes can be overcome by slightly generalizing the taxes. By applying uniform special excise taxes across a basket of goods that includes both marijuana and other (fully) legal goods, a federal agent

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70 Laura Wilson & Alex Stevens, Understanding Drug Markets And How to Influence Them, The Beckley Foundation Drug Policy Programme 1-2 (Report 14) (discussing issues concerning regulations and narcotics’ elasticities).


72 Colorado’s 15 percent excise tax is imposed in this manner. Twice a year, the Colorado Department of Revenue determines the average market rate for various parts of a marijuana plant (“Flower,” “Trim,” and “Immature Plant”). Certain sellers of marijuana are then required to report the quantity of marijuana sold and the tax due (quantity sold multiplied by the average market rate and 15%). Colo. Dep’t of Rev., Excise 23: Excise Tax on Retail Marijuana (Jan. 2014), available at https://www.colorado.gov/pacific/sites/default/files/Excise23.pdf (last visited Jan. 13, 2015).

73 Colorado requires retailers to complete a “Retail Marijuana Sales Return” showing the dollar amount of marijuana sold. http://www.colorado.gov/cms/forms/dor-tax/MarijuanaSalesTaxInstructionsJan2014.pdf
examining the tax documentation could not reliably associate the taxes with the possession or distribution of marijuana. Our specific proposals for generalizing each of the Specific Marijuana Taxes are discussed below.

A. Marijuana Unit Taxes

Our generalized Marijuana Unit Tax would work as follows. First, a basket of legal goods (under federal law) would be selected for taxation in a similar manner as the desired Marijuana Unit Tax. We would propose including salvia divinorum (“salvia”), a hallucinogenic herb in the mint family, because it is not regulated under federal law and is generally untaxed. In addition to serving as the legal good in the basket, including salvia has the added benefit of generating revenue from a product not previously taxed. We would also propose including snuff, a form of smokeless tobacco legal under federal law. While cigarette excise taxes have continued to rise, snuff taxes have generally not followed the same trajectory. Further, by focusing on snuff rather than cigarettes, states can add a legal item to the basket while ensuring that they do not tinker with their existing (and substantial) cigarette excise tax revenues.

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74 Salvia is legal in certain states, illegal in others, but most importantly, it is legal federally. See Nat’l Inst. on Drug Abuse, Drug Facts: Salvia (Apr. 2013), available at http://www.drugabuse.gov/publications/drugfacts/salvia (“Salvia currently is not a drug regulated by the Controlled Substances Act, but several States and countries have passed legislation to regulate its use.”). For more information on the drug see id.


76 Most tobacco products, including smokeless tobacco, are unscheduled under the CSA. See 21 U.S.C. § 841(a); see also United States v. Gaertner, 583 F.2d 308, 312 (7th Cir. 1978) (discussing legal status of tobacco vis-à-vis the CSA).

77 See, e.g., Jonathan Gruber, The Economics of Tobacco Regulation, Health Affairs (2002) (“In addition, the average state and federal excise tax on cigarettes has risen by a third in real terms since 1995, to seventy-six cents per pack.”), available at http://content.healthaffairs.org/content/21/2/146.full.

78 See AAFP, Excise Taxes on Other Tobacco Products (OTP) (Position Paper) (“[S]mokeless tobacco is greatly more affordable than cigarettes because the tax on smokeless products is proportionately much lower than the tax on cigarettes.”), available at http://www.aafp.org/about/policies/all/tobacco-taxes.html.

After selecting a basket of goods consisting of salvia, snuff, and marijuana (the “Basket”), the incidence of the generalized Marijuana Unit Tax on each item in the Basket must be established. We believe there are two possible approaches to this issue. One possibility is a simple uniform per-ounce tax on each item in the Basket. For example, a uniform tax of $10 per ounce of each good in the Basket sold in the chain of distribution could be imposed. This approach offers simplicity (the only input needed to calculate the tax is the weight of the items sold) but also brings the downside of a one-size-fits-all approach. For instance, legislators could determine that a $50 per ounce tax is appropriate for marijuana while a $2.50 per ounce tax is appropriate for snuff. The uniform per ounce tax would force legislators to give up one of these desired rates of tax in order to implement our proposal.

Another possibility is a unit rate tax where a single arbitrary tax rate is established and a unit value is assigned to each item in the Basket to determine how much tax should be imposed. First, the legislature would pick an arbitrary “per unit” tax, such as $25 per unit. Second, the legislature would assign a unit value per ounce of each item in the Basket. For example, if the legislature wanted excise taxes of $50 per ounce of marijuana, $25 per ounce of salvia, and $2.50 per ounce of snuff, it would decree that the sale of one ounce of marijuana would be 2 units ($50/$25), one ounce of salvia would be 1 unit ($25/$25), and one ounce of snuff would be 0.1 unit ($2.50/$25). Sellers would simply report the amount of “units” sold rather than the volume of each specific product sold. Thus, a sale of an ounce of marijuana, an ounce of salvia, and an ounce of loose leaf tobacco would be reported by a seller as a sale of 3.1 units with a tax of

Consequently, the per gram tobacco tax on cigarettes in New York City is approximately $0.29 (20 cigarettes in a pack = 20 grams; $5.85/20 grams = ~$0.29 $/gram) versus $0.07 for snuff (1 ounce = 28 grams; $2/28 grams = ~$0.07 per gram).
$77.50 due.\footnote{80}

Under the foregoing system, a proprietor would specify only the amount of “units” sold and remit the appropriate amount of tax to the state or local tax authority. This system should avoid Fifth Amendment association problems. A federal agent examining such a proprietor’s return would be unable to tell whether the “units” reported sold were for legal or illegal goods. Further, the unit rate tax overcomes the downside of the uniform per ounce tax by allowing legislators to set different rates of tax for different items in the Basket by simply assigning them a multiple of the arbitrary defined unit tax.\footnote{81}

B. Marijuana Sales Taxes

A similar system can be used to implement a generalized, and potentially constitutionally sound, Marijuana Sales Tax. Like the generalized Marijuana Unit Tax described above, we outline two possible approaches to crafting a generalized Marijuana Sales Tax that may overcome the Fifth Amendment criminal activity association problems.

First, legislators could choose a uniform percentage to apply to each dollar of items sold in the Basket. For example, a 15% sales tax would apply to the retail price of any of the items in the Basket. Thus, the $100 sale of marijuana, salvia, or snuff would yield a $15 tax. Retailers would report the tax as the percentage of the dollar value of Basket items sold – thus preventing any federal agent from clearly associating the tax reporting with the sale of the illegal good in the Basket (i.e., marijuana). Like the uniform per ounce excise tax, however, this type of tax structure has the downside of a “one-size-fits-all” approach. Legislators may be hesitant to implement such a sales tax if they cannot craft a specific rate to apply to each item in the Basket.

\footnote{80}{The math: one ounce of marijuana is 2 units at $25 per unit = $50, one ounce of salvia is 1 unit at $25 per unit = $25, and one ounce of loose leaf tobacco is 0.1 units = $2.50, for a total of 3.1 units and $77.50 in taxes.}
\footnote{81}{For example, using the facts from our example, if a legislature wanted to double the marijuana excise tax to $100 per ounce, it would simply decree that an ounce of marijuana was equal to four units (4 * $25 = $100).}
While slightly more complex than the generalized Marijuana Unit Tax described above, we believe we have a workable proposal to avoid such a drawback with respect to a generalized Marijuana Sales Tax. First, the legislature would determine its desired sales tax rates for each item in the Basket: for example, 20% on the dollar value of marijuana sold, 10% on the dollar value of salvia sold, and 5% on the dollar value of snuff sold. The legislature would then establish an arbitrary sales tax rate (say, 10%) on the dollar value of all goods sold, but further decree that dollar sales of marijuana would be reported at double their value (i.e., $2 reported for every actual $1 in sales), dollar sales of salvia would be reported dollar for dollar (i.e., $1 reported for every actual $1 in sales), and dollar sales of snuff would be reported at half their value (i.e., $0.50 reported for every actual $1 in sales). Thus, for instance, a retailer who sold $100 of marijuana, $100 of salvia, and $100 of snuff would report $350 of “deemed” sales on its sales tax return ($200 for marijuana, $100 for salvia, and $50 for tobacco) and remit $35 ($350 in deemed sales * 10% sales tax) in tax to the relevant state or local tax authority. Such a system would ensure that the legislature’s desired rate of sales tax has been imposed on each item in the Basket while avoiding criminal association issues under the Fifth Amendment (because a federal agent would be able to see only the dollar amount of “deemed sales” reported that could potentially relate to any item in the Basket).

C. Drawbacks

We recognize that our proposals are not without policy pitfalls. We illustrate a few of them here and offer potential solutions. This list is not intended to be exhaustive, as there could very likely be other potential issues raised by our alternative tax structure.

1. De Facto Marijuana Only Tax

If in application it turns out that virtually all of the revenues from the generalized Marijuana Unit Taxes and generalized Marijuana Sales Taxes (collectively, the “Generalized
Marijuana Taxes”) are from sales of marijuana, constitutional problems could again arise. This is because a federal agent examining any particular tax could have some confidence that the figures reported therein – if indeed they were mostly for marijuana – were for the sale of an illegal good.

However, we do not see this as a deal breaker. In the first place, it is unclear how states would propose to record revenues from the Generalized Marijuana Taxes. Potentially, record-keeping initiatives could be legislatively walled off from law enforcement.

More importantly, however, the Fifth Amendment association problems would not likely arise under our proposed scheme because any link to criminal activity would be significantly attenuated, particularly where more goods are added to the Basket. In other words, unlike in Leary, it is far less likely that law enforcement could show “a significant link in a chain of evidence” that could establish guilt under federal law on behalf of a state actor participating in legal marijuana commerce under state law.82

2. Audit Issues

Auditing tax returns presents another tricky issue. Audits would likely require state or local tax authorities to review the books and records of a particular seller. Such review may reveal clear sales of marijuana, thus implicating the Leary problem. But this should not affect the imposition of the Generalized Marijuana Taxes in the first place. States should consider auditing methods that are flexible and sensitive to association problems, just as they would use our method to craft the tax itself efficiently and constitutionally. In other words, if states take on

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82 Leary, 395 U.S. at 16 (emphasis added).
the burden of crafting Generalized Marijuana Taxes to avoid Fifth Amendment problems, then they should consider auditing methods that do the same.83

V. CONCLUSION

Marijuana legislation efforts have reached a fevered pitch over the past five years. Two states have fully legalized marijuana for recreational use. The legal status of marijuana under federal law, however, poses a potential conundrum for state policy actors in crafting revenue-raising provisions to capitalize on the sale of marijuana. In many instances, the sale or purchase of marijuana (and the payment of a tax) could implicate Fifth Amendment self-incrimination issues. This article proposes methods of crafting excise and sales taxes to help states avoid those problems and realize the substantial fiscal benefits of taxing marijuana in an efficient, constitutional manner.

83 What those methods could entail is not explored in this article. We flag the issue only for policy consideration.