



*Static Excise Tax and its Detrimental Impact
on MJ Businesses*

by

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Economical Impact of a marijuana business – why should you care if cannabusinesses tank?

- As the industry transforms into a legitimate and considerable economic force, it brings along with it an uptick in work for ancillary businesses:
 - Fire marshal reviews require stamped professional drawings – employing mechanical and electrical engineers, architects, structural engineers, project managers, and civil engineers.
 - CPAs, accountants, payroll companies, and payment processors, cash management and storage.
 - Equipment sales – lightening, flooring, and other equipment needed (trays, tables, tools, etc)
 - Lawyers
 - Construction crews of buildouts and building new structures.
- Based on sales marijuana at the retail level– including flower, infused products and concentrates – the estimates by Marijuana Business Factbook use an economic multiplier of four to quantify the industry’s overall contribution to the economy, showing how revenue generated by cannabis businesses percolates through communities, cities, states and the nation.
- **In other words, for each dollar spent by marijuana customers at the retail level, an additional \$3 in economic benefit is realized – much of it at the local level.**

Economical Impact of a marijuana business

- Following are examples of how marijuana businesses affect the economy:
 - Wages paid to employees of cannabis companies benefit many other local businesses, given that workers spend a portion of their earnings to buy food from a grocery store or dine at a restaurant.
 - Marijuana businesses collectively pay hundreds of millions of dollars in state and local taxes, which fund projects including roads and rural hospitals as well as government programs such as education.
 - The launch of a new cannabis business – cultivation facilities, in particular – generate real estate and construction activity, often in economically disadvantaged areas of a town or municipality.
- An average 7K square foot grow employs 8-15 people year round
- An average 15K square foot grow employs 14-25 people year round
- An average marijuana retailer employs 4-9 people year round
- Note – my Alaskan clients alone have generated at least 500 new jobs

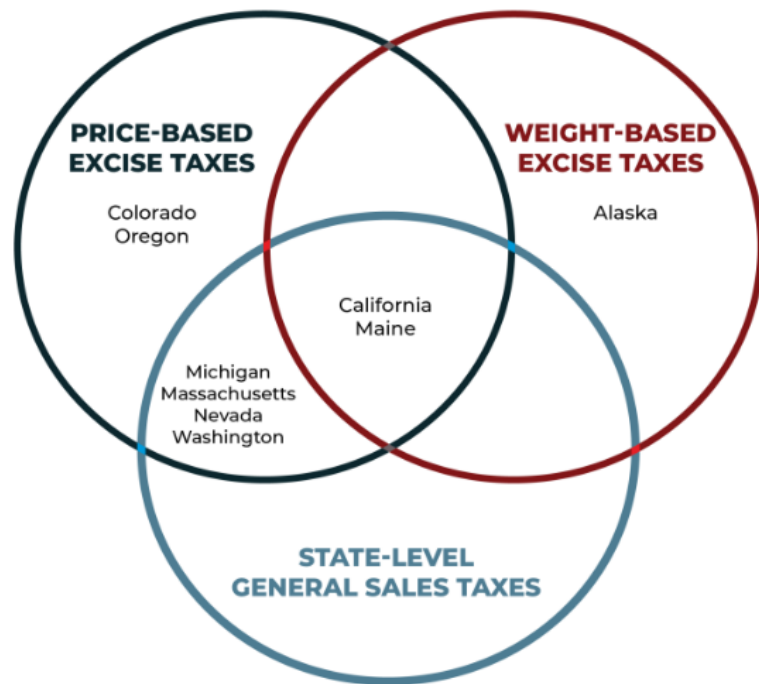
MCB Cannot Change the tax structure

- But – the MCB can be a vital tool in educating the legislature and other governmental agencies and departments on the basic economics imposed on cannabusinesses.
- And – MCB meetings are the best place to get the word out to licensees that they need to contact their legislators and representatives to support a bill that would restructure the State excise tax.
- We need the MCB to continue to weigh in on this matter (legislatively) because this Board and the AMCO office are the only governmental entities that truly understand that challenges, expenses, and unique issues that this industry had to grapple with.

So – if not a flat tax, then what?

- A mix of other state's approach would likely yield best tax approach for the State and for licensees:

State-Level Tax Structures Applying to Recreational Cannabis



- ✓ Alaska is currently the ONLY legal state that bases its State tax solely weight based only.
- ✓ All other states utilize some priced base taxation in their marijuana excise tax structure.
- ✓ Tax rates on cannabis flowers, or bud, are \$50 per ounce in Alaska, \$20.94 per ounce in Maine, and \$9.25 per ounce in California.
- ✓ Per-ounce tax rates on trim are \$15 in Alaska, \$5.88 in Maine, and \$2.75 in California. Each of these states also levies a tax on immature cannabis plants, and Maine levies a tax of 30 cents per seed.

Source: ITEP analysis of information reported by state revenue offices. Note that legal sales have yet to begin in Maine and Michigan. Note also that while Colorado and Nevada's excise taxes are based mostly on price, the administration of these taxes involves a weight-based component since the weight being sold is multiplied by a statewide average price to calculate the base against which the tax is applied.

States, image, and statics sourced from:
<https://itep.org/taxing-cannabis/>

Breaking Down the Cost of Production Per Pound

- Assumption – Price per pound in AK ranges from \$3800-\$1600 – average price hovers around \$2,800.00.
- Assumption – 5,000 sq. under cultivation
- Assumption – the facility should produce approx. **46 pounds** monthly from this facility
- **Medium Wholesale price \$2,800.00**

MONTHLY COSTS OF PRODUCTION

- Minus \$800 off the top per each pound – $46 \times \$800 = \underline{\$36,800}$ per month in SOA Excise tax liability
- Electric costs **\$20,000.00**
 - Assumption: Vegetative Stage 720 hours: 40 days of 18/6 schedule
 - Assumption Flowering Stage 720 hours: 60 days of 12/12 schedule
 - Results in approx monthly electric costs for 5000 foot grow = \$20,000.00
- Water & Gas – approx. **\$2,000.00**
- Trash – approx. **\$300.00**
- Metrc - **\$500.00**
- Security **\$400.00**
- G&L Insurance – **\$2,000.00**
- Workers Compensation Coverage - **\$600.00**
- Product Testing - **\$2,400.00**
- Employee Wages and Expenses - **\$28,000.00**
- Internet - **\$200.00**
- AMCO licensing fee **\$600.00** (for standard cultivation license)
- Grow mediums, growing amendments, nutrients, etc: **\$3500.00**
- TOTAL MONTHLY COSTS of PRODUCTION/Compliance: \$97,300.00**

Breaking Down the Cost of Production Per Pound

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- **Medium Wholesale price \$2,800.00**
 - TOTAL MONTHLY COSTS of PRODUCTION/Compliance: \$97,300.00
 - 46 pounds X median wholesale price \$2,800.00 = \$128,800.00
 - TOTAL Remaining: \$31,500.00.

COSTS not included in COST of Production Breakdown

- **TOTAL MONTHLY COSTS of PRODUCTION/Compliance: \$97,300.00**
- **46 pounds X median wholesale price \$2,800.00 = \$128,800.00**
- **TOTAL Remaining: \$31,500.00**
 - now subtract advertisement;
 - Rent (at least \$6,250.00)
 - Legal and accounting fees;
 - Cash management expenses (purchasing cashier checks, physically traveling across the state to pay vendors/partners);
 - MJ14/MJ15/MJ16 modifications
 - Local Taxes and Expenses;
 - Transporting product costs, etc.
- \$31,500.00 is insufficient to cover these expenses, and no traditional lines of credit or business loan infusion available to these businesses (except private lending at extremely high interest rates).

What would the numbers look like with a different tax structure?

- Lets try a percentage tax as an example:
 - 46 Pounds sold at the assumed average wholesales price of \$2800.00
 - Total monthly sales generated = \$128,800.00
 - Deduct Costs of Production (note no tax include) = \$60,500.00
 - Add a hypothetical 10% Excise tax based on Fair Market Value (FMV) $\$128,800 \times 0.10 = \$12,880$ for Percentage Based Excise Tax
 - Summary: $\$128,800$ (sales) - $\$60,500$ (Costs of Production) - $\$12,880 = \$55,420.00$
 - \$55,420 in monthly revenue is much healthier business margin and covers, with a modest profit, additional expenses.
 - Currently, as detailed before, the current excise tax alone is tantamount to over 24% tax rate (and that is assuming the price holds strong at \$2800, which it without question (due to no limit licensing) will not remain).

So – if not a flat tax, then what?

- A mix of other state's approach would likely yield best tax approach for the State and for licensees:
 - Draw (in part) from Nevada:
 - NV has a combo approach: 15 percent excise tax of FMV paid by cultivator on wholesale sales & 10 percent excise tax paid by retailer on retail sales.
 - NV is integrated like Alaska (meaning a licensee can hold all three levels of licensing, retail, manufacturing, & cultivation) how does NV protect the state from licensees undervaluing bud and flower at a lower than FMV wholesale price when selling to their own retail license?
 - FMV determination is set by the state of NV (*see attached* FMV Determination authored and issued by the state of NV).

How do we make up the gap the depart of revenue would see if we imposed a percentage cultivation tax? Lets split the difference.

- How do we offset the additional tax revenue the state would not be seeing?
 - We should look at manufacturing as a tax base.
- Currently, as detailed before, the current excise tax alone is tantamount to over 24% tax rate – one idea would be to spread the burden:
- Splitting the tax burden between cultivators and manufacturers could result in a more sustainable market:
 - Here is the basic idea:
 - Cultivation to Retailer event would be 10% of FMV
 - Cultivation to Manufacturing event – not a taxable event
 - Manufacturing to Retail – 10% of FMV of wholesale price.

A look at Manufacturing Costs of Production

- Costs per pound of trim: apprx. \$700-1,000.00
- On average that amount will produce 30-50 grams of concentrate (depending on the quality of trim used).
- The 30-50 grams of concentrate will produce apprx 500 units of edible packets that contain 50 mg of THC. Therefore, the average unit cost approx. \$1.75 to produce (for the THC portion of the edible product.)
- The edible ingredient portion of products CLEARLY depends on the type of edible, but for the purpose of this example, lets pretend we are talking about gummies or a similar small candy type of product. That edible ingredient ranges from \$2-5 per unit.
- Testing for batch lot of edibles is apprx \$750 – assuming each batch is 100 units, that is approx. \$7.50 a unit in testing costs.
- Packaging is not cheap and ranges, lets assume, with compliance costs, packaging is \$1.00 per unit.

A look at Manufacturing Costs of Production

- Recapping the expenses – on average to make one unit that contains 50mg of THC
 - \$1.75 for raw cannabis material expense
 - Median of edible ingredients apprx \$3.25
 - \$7.50 for testing
 - \$1.00 for packaging
- Cost of Production apprx \$13.50.
- Average Wholesale Price – assuming the expenses above – apprx. \$25.00 for wholesale price
- Concentrate only products: \$700-1000 (trim); produces apprx 30-50 grams of concentrate
 - Cannabis material for ½ gram cost: \$8.50 MJ material; packaging labor \$2 per unit; \$3.50 testing costs per unit; Vape Pen Hardware \$3.00
 - still comes out to almost same costs as edible products per unit (without any regard for variation in edible ingredient quality); totals: \$13.50 per half gram unit

Assumptions on Wholesales

- No public access to wholesale figure – assumptions are based on market history (drawn from other states) – we take the total retail sales, the percentage we think are from concentrate and edibles, divide that number in half (retailers usually mark up wholesale product 100%), in order to get an estimate on total concentrates and edibles sales.
- 2018 Total Alaska MJ sales \$130,475,707.00
- Assuming edibles make up 30% of retail sales; and assuming 35 percent of retail sales are generated from concentrate sales – 65%
 - \$84.809MM divided by 50% = \$42.404MM estimated 2018 wholesales generated in Alaska.
 - A 10% excise tax on the edible and concentrate wholesales figure would yield the SOA \$4.240MM in 2018.
 - A 10% excise tax on the cultivation wholesales (\$45,666,707) for 2018 would have yielded SOA \$4.47MM.

I know what you're thinking..

- \$4.240MM (hypothetical excise tax on manufacturing) + \$4.47MM (hypothetical excise tax on cultivation) = \$8.71MM which is LESS than the assessed taxes in 2018 of \$15,695,517.
- BUT keep in mind – the \$15MM assessed taxes are just that – ASSESSED – not collected.
- Currently 1/3 of all cultivators are either on payment plans OR in delinquent status – 1.3 of \$15MM is right around \$10MM, so for practical purposes, we get to a similar result for SOA tax revenue WITHOUT Alaskans losing their investments, people losing their jobs, and Alaska owned businesses failing. Win Win.

Why are we having this conversation today?

- Public Relation Issues – so far, the legalized commercial marijuana market has wide spread public support. Communities are seeing old buildings be remodeled and brought up to code; the legalized market has created jobs and ancillary business development; its diversified the economy in ways we haven't seen for many decades; and by and large, the positives of legalization outweigh any drawbacks.
- However, one of the main positives politicians and industry advocates point to as an undisputable benefit to the state and its citizens is tax revenue. If the industry and this board does not educate the state governmental departments and the public about the negative impact a static taxation method imposes on a developing business, the industry will lose public support, political support, and departmental support.
 - The industry is still developing and business owners are still recouping (in large part) their original investments - meaning these businesses are particularly vulnerable to failure. Failure for many will occur, not because of capitalism and letting the market flourish (resulting in winners and losers), capitalism and the market cannot truly yield results when the static taxation creates an artificial price floor – that interferes with the market.
- Failure will be caused by the taxation model currently in place. What other business can thrive and avoid failure when its riddled with regulatory expenses, a state imposed 25-40% excise tax right off the top of the price of the good, no licensing limits on the amount of the good produced, which drives the price down, but the tax expense stays the same, coupled with 280E implications, it's a recipe for disaster.
- **Lets learn from other states – lets make our local cultivators strong enough to have a chance to survive.**
- If the approach for tax reform in this presentation isn't the right approach, my hope is that at least this presentation will get the discuss going and better ideas flowing.

Fair Market Value at Wholesale of Marijuana

- NRS 453D requires the Department to determine the Fair Market Value at Wholesale of retail marijuana. Pursuant to NAC 453D.045, Fair Market Value is defined as the value established by the Nevada Department of Taxation (Department) based on the price that a buyer would pay to a seller in an arm's length transaction for marijuana in the wholesale market.
- NAC 453D.236(6) sets forth that the Department will calculate the Fair Market Value at Wholesale using reported sales or transfers of each category.
- The Fair Market Value at Wholesale rate will be posted to the Department's website and shall be used to calculate the tax on the Wholesale Marijuana Return.
- The Fair Market Value at Wholesale is utilized by the Department in levying the wholesale excise tax imposed pursuant to NRS 453D.500 on the sale of marijuana by a marijuana cultivation facility.
- The Fair Market Value at Wholesale was calculated based on marijuana cultivator transactions recorded from October 1, 2018 through March 31, 2019, as requested by the Department.
- The next determination of the Fair Market Value at Wholesale Rate will be published for January 1, 2020. Detailed transaction reports shall be submitted by each marijuana cultivation facility to the Department by November 30, 2019. The reports must include transactions from April 1 through October 31, 2019.

Beginning July 1, 2019, The Department will set the Fair Market Value at Wholesale to the following:

Fair Market Value at Wholesale

Flower (lb)	Trim (lb)	Small Bud (lb)	Wet Whole Plant (lb)	Immature Plant (ea)	Pre-Roll (ea)	Flower Approved for Extraction (lb)	Trim Approved for Extraction (lb)
\$2,300	\$599	\$2,000	\$145	\$50	\$5.00	\$552	\$510

Methodology

The Department determined that the excise tax upon wholesale sales of retail marijuana can effectively be levied upon eight product categories:

1. Flower
2. Small Bud
3. Trim
4. Wet Whole Plants
5. Immature Plants
6. Pre-Rolls
7. Flower Approved for Extraction
8. Trim Approved for Extraction

All of these categories are taxed by weight in pounds, except for pre-roll marijuana cigarettes/joints and immature plants which are taxed by individual unit.

The Department collected sales data for the period October 1, 2018 through March 31, 2019 from marijuana cultivators for each category to establish the Fair Market Value at Wholesale in order to comply with NRS 453D.

Summary Statistics (All Raw Data)

	Flower (lb)	Trim (lb)	Small Bud (lb)	Wet Whole Plant (lb)	Immature Plant (ea)	Pre-Roll (ea)	Flower Approved for Extraction (lb)	Trim Approved for Extraction(lb)
Max	\$45,359	\$6,804	\$18,144	\$425	\$50	\$35	\$5,756	\$800
Min	\$6	\$46	\$100	\$5	\$13	\$0.01	\$5	\$4.54
Median	\$2,304	\$603	\$2,000	\$145	\$50	\$5.00	\$568	\$510
Mean	\$2,467	\$681	\$1,955	\$185	\$45	\$5.15	\$615	\$494
Mode	\$1,352	\$299	\$2,500	\$5	\$50	\$5.00	\$798	\$299
Standard Deviation	\$1,455	\$626	\$844	\$157	\$9	\$2.43	\$455	\$171
Number of Observations	19,081	1,864	2,826	63	61	9,053	392	151

Summary Statistics (Excluding Outliers)

	Flower (lb)	Trim (lb)	Small Bud (lb)	Wet Whole Plant (lb)	Immature Plant (ea)	Pre-Roll (ea)	Flower Approved for Extraction (lb)	Trim Approved for Extraction(lb)
Max	\$4,344	\$1,311	\$3,846	\$425	\$50	\$9.01	\$1,102	\$800
Min	\$193	\$46	\$281	\$5	\$44	\$0.50	\$5	\$5
Median	\$2,300	\$599	\$2,000	\$145	\$50	\$5.00	\$552	\$510
Mean	\$2,269	\$555	\$1,923	\$185	\$48	\$4.80	\$536	\$494
Mode	\$1,352	\$299	\$2,500	\$5	\$50	\$5.00	\$798	\$299
Standard Deviation	\$679	\$234	\$675	\$157	\$3	\$1.26	\$248	\$171
Number of Observations	18,532	1,709	2,798	63	53	8,727	371	151

For each taxable category, the raw transaction data (including outliers) were analyzed and the maximum price, minimum price, median, mean, mode and the population standard deviation were calculated.

Outliers were determined by first finding the range between the 25th percentile and 75th percentile prices and multiplying that range by 1.5. Any reported values lower than the 25th percentile by this amount, or greater than the 75th percentile by this amount, were determined to be outliers and excluded from the subsequent analysis of the data. This method of finding outliers is commonly known as Tukey’s rule.

The Fair Market Value at Wholesale is determined to be the median price after outliers (if any) are removed from the data.

The Department has eliminated the wholesale category for seeds as of January 1, 2019 due to a lack of reported transactions.