Research Brief # 4-16

Updated Marijuana Tax Revenue Estimates
Based on Actions Taken in the 2015 and 2016 Sessions

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Inside this Brief

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Summary

Legislative actions in the 2015 and 2016 sessions modified Measure-91 that was approved by voters in 2014. The culmination of these actions results in a new estimate of $43 million for distribution in the 2015-17 biennium.

There were several bills that interacted to produce that outcome. HB 2041 of the 2015 session changed to a rate of 17% on sales at commercial shops starting January 2017. As a result, annual revenue was estimated to be $31 million in the subsequent years. As for the early start period (January to December 2016) mandated by SB 460 and SB 1511, the revenue expected for distributions was estimated during the session to be $4 million. Total revenue for distribution in the 2015-17 biennium was expected to be $8.4 million (early start and 6 months of regular commercial program). The startup cost for marijuana programs during the early-start from different agencies was assumed to reach $27 million. However, the updated admin/regulation costs show smaller startup costs that are more dependent on fees than tax revenue, and more evenly distributed throughout the biennium. Moreover, actual revenue (3 months) is coming in at about $3.5 million a month and expected to strengthen. This is estimated now to leave about $43 million for distribution in 2015-17 (early start and the beginning of the commercial program). The 17-19 biennium is still expected to produce $60 million for distributions.

Background

In November 2014, Oregon voters approved Ballot Measure-91 which legalized marijuana. The legalization was primarily through allowing the production, sale and possession of recreational marijuana by persons over 21 years of age. Oregon recreational marijuana under Measure-91 would have been taxed at the rate of $35 per ounce of flowers and $10 for leaves. The tax would have been imposed on the producer and collected and regulated by the Oregon Liquor Control Commission (OLCC). The measure provided that net recreational marijuana tax revenue (after costs of administration and regulation are paid) would be distributed, 40% to the Common School Fund, 20% to the Mental Health Alcoholism and Drug Services, 15% to State Police, 20% to local (equally divided between cities and counties) law enforcement agencies, and 5% to the Oregon Health Authority. None of the revenue was designated to the General Fund nor can it be directly used in the education budget because the Common School Fund works more like an endowment than an expenditure resource.

Estimated tax revenue from Measure-91, was estimated and documented in Research Report # 3-14 dated September 2014[i]. That report delineated the methodology and data sources for the estimate of market demand, user acceptance of the legalized product, price structure and elasticity that begins to restrict and limit the gray markets. That report predicted an average of $23 million in gross revenue in an average year for the ensuing two biennia. Startup costs would be higher in the first year, but they were all incurred by the OLCC and paid for by loans from the liquor fund.

Ballot Measure-91 was a statutory measure, which allowed the Legislature to make changes, introduce fixes and improvements to the language of the Measure, and to restructure of the tax regime. Such changes varied from clarifying language, changes in other connecting and corresponding laws (such as criminal fines and penalties), to dealing with edibles and extracts as well as modifying the structure of the marijuana tax, imposition of fees, requiring licenses, and using some of the revenue to pay for administration and regulation programs. The 2015 legislative assembly dealt with the issues through a house and senate joint committee on the implementation of Measure-91.

2015 Legislative Session Actions

The 2015 Legislative Assembly through the joint marijuana policy committee passed implementing legislation that formalized the roles of state agencies and local governments in the regulation of recreational marijuana. Moreover, changes were also made to laws governing medical marijuana. In general, the Legislature made significant and comprehensive changes to most of the elements of the recreational program as specified in Measure-91. More importantly, the 2015 session provided more clarity and specificity to program operations and regulations. These changes amounted to more than one hundred pages of statutory language. The significant bills that passed the 2015 session dealing with the M-91 implementation issues were:

- **HB 3400**[ii]: Outlined the responsibilities and authorities for Oregon's recreational and medical marijuana programs.
  - The bill specified that the Oregon Health Authority (OHA) is responsible for regulating medical marijuana and OLCC for the regulation of recreational marijuana.
  - OLCC was made responsible for packaging, OHA for labeling, and OHA, with the Department of Agriculture, for testing of marijuana items.
  - The bill established peace officer authority to aid in the regulation function of OLCC.
  - Specifying the types of licenses to be issued, the amount and circumstances under which marijuana and related products could be grown, processed, delivered, sold and stored.
  - Specified canopy (indoor and outdoor) size as limits on production capacity.
  - Fees for licensure enforcement and inspection provisions.
  - Allowed local governments to adopt regulations pertaining to marijuana, including the allowance for local tax on retail marijuana sales, and for locals to opt-out from allowing marijuana business to operate within the local jurisdiction.
  - The bill also changed the fines and penalties for several related violations, infractions and other acts.

- **HB 2041**[iii]
  - Changed the privilege tax established by Measure-91 to a 17% tax on the retail sale of the different categories of marijuana items beginning January 1, 2017.
  - Retailers are required to submit quarterly returns and monthly tax payments to the Department of Revenue (DOR), and are allowed to retain 2% of the tax collected to cover their costs, as well as a percentage for DOR (collection allowance).

- Describes process of collection for delinquent taxes and defines penalties.
- Changed the distribution method by which local governments' share is divided starting the second year of the biennium, and prohibits the cities and counties that prohibit marijuana facilities from getting any marijuana tax funds.
- The first year will have distributions based on population, after that the new distribution method will be proportioned to the number of marijuana businesses (of different types) within the jurisdiction.
- The bill also allowed medical marijuana dispensaries (upon passage of SB 460 "early start") to sell limited recreational marijuana products at a point of sale tax rate of 25%.

The revenue impact[iv] for HB 2041A was estimated for half of 2017 and the subsequent biennium as shown in the following table:

HB 2041 (2015)							
		FY 2016	**FY 2017**	**FY 2018**	**FY 2019**	**BN 15-17**	**BN 17-19**
Revenue			$10.75	$30.37	$32.04	$10.75	$62.42
collection costs			($11.56)	($6.84)	($6.94)	($11.56)	($13.78)
Fee & License revenue			$5.17	$5.24	$5.30	$5.17	$10.54
Net Revenue			**$4.36**	**$28.77**	**$30.40**	**$4.36**	**$59.17**
Revenue Distribution							
Common School Fund	40%		$1.74	$11.51	$12.16	$1.74	$23.67
Mental Health	20%		$0.87	$5.75	$6.08	$0.87	$11.83
State Police Account	15%		$0.65	$4.31	$4.56	$0.65	$8.88
Cities	10%		$0.44	$2.88	$3.04	$0.44	$5.92
Counties	10%		$0.44	$2.88	$3.04	$0.44	$5.92
Oregon Health Authority	5%		$0.22	$1.44	$1.52	$0.22	$2.96

The revenue estimates in FY 2017 is $10.75 million, which is the result of 5 months of commercial sales (considering delayed receipts and end of month reporting). This translates to $2.15 million in revenue per month for the few months of the commercial sales left in FY 2017. The 2017-19 biennium is expected to average $31.2 million a year in gross revenue. Revenue amount is higher than Measure-91 estimates due to the change in the nature of the tax and the point of taxation, which results in a lower final price. Moving the tax to the end point of production chain results in lower markup and price escalation in the business process. The resulting lower final price allows an increase in market share for the legal product over the gray market.

SB 460 [v](**Early Start Program**)

- Authorized medical marijuana dispensaries to sell limited recreational marijuana retail product October 1, 2015 through December 2016.
- The tax on these sales does not occur until January of the calendar year 2016 (CY 2016). At that time early-start sales are taxed at the rate of 25% of retail price.
- OHA was tasked with developing and implementing rules, and procuring compliance staff to enforce the law.

		CY 2016
		early start
Revenue		
collection costs		
Fee & License revenue		
Net Revenue		**$3.00**
Revenue Distribution		
Common School Fund	40%	$1.20
Mental Health	20%	$0.60
State Police Account	15%	$0.45
Cities	10%	$0.30
Counties	10%	$0.30
Oregon Health Authority	5%	$0.15

- o DOR was still tasked to collect the tax occurring in the early start period, however, other responsibilities were not clear.

The implementation of the bill was thought to be highly dependent on the administration and enforcement of the program[vi]. However, these costs of the new and unpresented program were complex, occurring in multiple agencies, and not readily delineated. However, costs were assumed by the estimate to be significant, especially when coupled with the startup costs for both (early-start and commercial) programs. These costs were assumed to consume most of the revenue (as shown in the table) netting only **$2 to $3** million for distributions in the 2016 calendar year[vii].

To show the gross amount assumed in the early start, we adjusted the $2.15 monthly revenue expected from the commercial phase in 2017 (HB 2041 estimate) for the 25% tax rate in the early-start period which is 8 percentage points higher than the 17% (2017) commercial rate. The resulting adjusted monthly revenue climbs to $3.16 million a month. However, using the assumed -0.66 elasticity for each percentage change in rate, brings revenue expected for this (early start) phase to $2.49 million per month. Therefore, the calendar year 2016 was expected to witness[1] about $29.91 million in gross revenue. The calendar year revenue is split between the fiscal years 2016 and 2017. However, payments to DOR start in February and FY 2016 (ending June-30-2016) will have 5 months of the collection amount while FY 2017 includes 7 collection months (and analogues collection/program costs). The collection costs were assumed at the elevated level of $26.9 million. This will leave the amount predicted to be available for distribution at $3 million. The lower range ($2 million) would have been the result of a system with higher degree of difficulty and more than usual glitches in implementation.

early start		CY 2016		FY 2016	FY 2017
Assumed Gross Revenue		$29.91		$12.46	$17.45
Assumed collection costs		($26.91)		($11.21)	($15.70)
Fee & License revenue					
Net Revenue		**$3.00**		**$1.25**	**$1.75**

2016 Legislative Session Actions

The 2016 Legislative Assembly enacted further changes to marijuana legalization and taxation. Some of the most important ones were

- **HB 4014**
  - o Removed a two-year residency requirement for recreational marijuana producer, processor, wholesaler, and retail licensees.
  - o Change canopy size and requirements (supply determination).
  - o Medical marijuana businesses are allowed to transfer their inventory into the OLCC system if they become OLCC licensees (Inventory Transfer).
  - o Establish a youth marijuana-use prevention pilot program funded with a loan from the Liquor Fund.
  - o Criminal penalties and certain fines are also amended and changed by the bill.

While the revenue impact for the bill was indeterminate[viii], the fiscal impacts[ix] for this complicated new program residing in multiple agencies added to the detail and intricacy of the total costs of marijuana programs in the various agencies.

[1] By December-2016 there will be 11 months of revenue on cash bases with reports starting on the second month (February), however, the 12th month is collected on January 2017, which is still within the 2017 fiscal Year and the Biennium.

- **SB 1511**
  - o Requires OLCC to register recreational licensees who produce, process, transfer, or sell marijuana products for medical purposes, subject to certain conditions.
  - o It requires Oregon Health Authority (OHA) to adopt rules allowing for the provision, transfer, and sale of usable marijuana (Medical allowance and Transfer).
  - o The measure prohibits taxation of retail sales made to a medical registry cardholder (Medical Exemption in commercial shops).
  - o The bill also expands the base of the tax, subject to the early star tax rate of 25%, to some edibles and extracts during the year 2016.

The impact for the bill was to generate added tax revenue to the early start program through medical dispensaries as defined in the 2015 session. This increase was estimated to be equivalent to about 10 % to 15% of the volume of total sales, netting **$1 million**[x] in new revenue. The fiscal impacts [xi] depicted the complexity and the need for all marijuana-related legislation to be reviewed in order to determine the overall startup costs of the marijuana programs residing in the different agencies. The simplifying assumption (of the revenue estimate) was that the increase in net revenue will be mainly reflected in a lower impact of the collection costs. The edibles were assumed in the commercial sales and that was counted in the base of the early start estimate.

To sum up the total net revenue for distribution after the 2016 session, we add $4.36 million in FY 2017 (from HB 2041 of 2015 session), $3 million from early start program, and $1 million form the expansion of the early start (SB 1511). That totaled to $8.36 million for distribution in the 2015-17 biennium. However, the revenue occurs in different fiscal years and tabulates in the following way:

Assumed Gross revenue		FY 2016	FY 2017				BN 15-17	BN 17-19
Tax Revenue @ 25%		$12.46	$17.45				$40.66	$62.42
Tax Revenue @ 17%			$10.75					
Assumed expenditure		($10.81)	($21.49)				($32.30)	($3.25)
Net revenue		**$1.65**	**$6.71**				**$8.36**	**$59.17**

The estimates for the 2017-19 biennium did not change from the original estimate since the collection and program costs are expected to stabilize by then and become ongoing program costs ($3.25 million). This assumption about the collection costs of the 2017-19 biennium is subject to (and likely) to change. Thus the distribution amounts for the 2017-19 biennium are assumed to remain around $60 million.

- **SB 1601:** Used to resolve conflicts and allow for the taxation pieces to implement in the appropriate time[xii].

Revenue Changes Based on Updates of Budget and Collection Expenditures:

In April 2016, The Legislative Fiscal Office (LFO) was able to identify and connect all the programs[xiii] and the budget segments that draw on marijuana revenue. These expenditure limitations amount to about $25 million. The updated budget numbers found that about $13 million of the costs are funded through licenses and fees[2] rather than being dependent on the tax revenue. Thus, the impact of all the marijuana program

[2] Fees are considered to be set at a level that covers the cost of the function that it charges for and a license fee covers the costs of issuing that particular licenses.

expenditures were much lower on the tax segment of revenue than originally anticipated (by the revenue estimate). Nevertheless, the startup costs are still assumed to be more skewed towards the first year (65%) of the biennium. That assumption is made and based on observations of requirements and not on exact budget allocations.

This preceding discussion leaves the revenue estimates for 2015-17changed (2017-19 expectations don't change) in the following way.

Assumed Gross revenue		**FY 2016**	**FY 2017**			**BN 15-17**	**BN 17-19**
Tax Revenue @ 25%		$12.46	$17.45			$40.66	$62.42
Tax Revenue @ 17%			$10.75				
Licenses and Fees		$6.51	$6.51			$13.02	$13.67
Updated budget numbers	Taxes	($7.75)	($4.17)	(65,35% split budget)		($11.93)	($3.25)
	Fees	($6.51)	($6.51)	(50,50% split budget)		($13.02)	($13.67)
Net Tax revenue		**$4.71**	**$13.28**			**$28.73**	**$59.17**

Thus the net revenue available for distribution increased by $20 million as a result of updated budget amounts for 2015-17.

Actual Revenue Collections and Updated Revenue Estimates:

As of May-2016, the tax payments have been coming on a rate of $3.5 million a month. This is a stronger revenue stream than anticipated. This result may indicate more acceptance of the legalized products and higher rate of movement away from the illicit product market. The edibles will come into the system in June, and that will push the volume up by about 10%. Over all, the monthly rate for the whole year is likely to end up at $3.7 million. The estimate for 2017-19 doesn't change from the original estimate[3].

If the early-start period reach the rate of $3.7 million a month as discussed before, then the revenue available for distribution is likely to be:

If early start continue at $3.7 million monthly rate							
		FY 2016	**FY 2017**			**BN 15-17**	**BN 17-19**
		$22.20	$32.95			$55.15	$62.42
Updated budget numbers	*Taxes*	($7.75)	($4.17)			($11.93)	($3.25)
Net revenue		**$14.45**	**$28.77**			**$43.22**	**$59.17**

The distribution percentages based on those net amounts are shown in the following table.

Revenue Distribution							
		FY 2016	**FY 2017**			**BN 15-17**	**BN 17-19**
Common School Fund	40%	$5.78	$11.51			$17.29	$23.67
Mental Health	20%	$2.89	$5.75			$8.64	$11.83
State Police Account	15%	$2.17	$4.32			$6.48	$8.88
Cities	10%	$1.44	$2.88			$4.32	$5.92
Counties	10%	$1.44	$2.88			$4.32	$5.92
Oregon Health Authority	5%	$0.72	$1.44			$2.16	$2.96

[3] Note that the collection costs for 2017-19 is only a simplifying assumption and doesn't reflect an actual budget amounts.

Conclusion:

Marijuana gross tax revenue is expected to average $3.7 million a month during the 2016 calendar year. The amounts available for distribution (after costs) in the 2015-17 biennium is expected to be $43 million, while the 2017-19 biennium estimate remains at $60 million. The estimate for the current biennium has changed from the session estimates by about $35 million. Of that change, $20 million as a result of reduced expectations of costs, and $15 million from stronger sales and a robust revenue stream. The commercial program revenue is not expected to stray much from the amounts previously predicted as the tax goes down to 17%, the regulation regime becomes clearer and more defined, and collection costs stabilize.

Finally, the revenue numbers could see a different pattern as we move from one regime and structure of taxation to another. Similarly, the final costs of programs are also susceptible to change as they strain to adapt to the changing and complex challenges of starting a new program. Regardless to what transpires, the revenue stream and cost related expenditures are likely to stabilize and become more predictable during the 2017-19 biennium and the succeeding four biennia. This will happen as the legal markets gradually become the preferred choice of the consumer who is more likely to choose safer and higher quality products over the less expensive illicit product which remains unregulated and a riskier option.

Sources and References:

[i] The Revenue Impact of Marijuana Legalization Under Measure 91, Research Report # 3-14, September 2014
[ii] Staff Measure Summary for HB 3400A of the 2015 session SMS
[iii] Staff Measure Summary for HB 2041A of the 2015 session SMS
[iv] Revenue Impact Statement for HB 2041A of the 2015 session RIS
[v] Staff Measure Summary for SB 460A of the 2015 session SMS
[vi] Fiscal Impact Statement for SB 460A of the 2015 session FIS
[vii] Revenue Impact Statement for SB 460A of the 2015 session RIS
[viii] Revenue Impact Statement for HB 4014A of the 2016 session RIS
[ix] Fiscal Impact Statement for HB 4014A of the 2016 session FIS
[x] Revenue Impact Statement for SB 1511A of the 2016 session RIS
[xi] Fiscal Impact Statement for SB 1511A of the 2016 session FIS
[xii] Staff Measure Summary for SB 1601 of the 2016 session SMS
[xiii] Status of Oregon Marijuana Programs (April 2016) LFO.