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LESSONS FROM WASHINGTON AND COLORADO: THE POTENTIAL FINANCIAL GAINS OF RECREATIONAL MARIJUANA TO CANADA

By Nachshon Goltz¹ and Ekaterina Bogdanov²

ABSTRACT

While Colorado and Washington are among the jurisdictions spearheading the global trend towards legalization of recreational Cannabis (marijuana), Canada lags behind in the regulatory process - but not in Cannabis consumption. An empirical study conducted in downtown Toronto, as well as studies done by Statistics Canada, reveal that Cannabis use is widespread among Canadians, which indicates that the current regulatory regime is not effective as a deterrent.

This paper details the results of the above-mentioned empirical study, reviews the regulatory framework of recreational Cannabis use in Colorado, Washington and Canada, and uses taxation data from Colorado to estimate the potential financial gain of cannabis legalization in Canada. The paper concludes with a brief discussion of the non-financial benefits of legalization.

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If you would like to smoke a joint, it will cost you about \$10 in Denver. If it is your first time, you will also need to purchase a small reusable white bag for another \$2. In Seattle, you don't need the bag, though the joint will cost you twice as much.

In Toronto, Ontario, a joint will cost you a \$1000 fine and 3 years in jail.

MARIJUANA SMOKING PATTERNS IN CANADA

Smoking marijuana is not a rare activity in Canada. According to Statistics Canada, in 2012, 43% of Canadians reported that they used marijuana at least once in their life, while 12% used it in the past year.³ Of those who used marijuana in the past year, 94% had used it more than once.⁴ According to a study that the authors conducted in Toronto, the average smoker is 18-30 of age, with a slight positive bias to males, people of color and/or those originating from countries where Cannabis smoking is seen as a natural part of life (the Caribbean, Philippines, etc). Males and cigarette smokers are more likely to be cannabis smokers, as well. Smoking Cannabis is less common in more upscale neighborhoods, within mature populations and among young families.

An empirical study of Torontonians' cannabis smoking habits conducted by the authors indicates that cannabis smoking is especially widespread in Toronto. A survey of discarded joint and cigarette butts in Downtown Toronto reveals that the estimated ratio of cannabis joints to cigarettes smoked in the City is 1:25. More significantly, this reveals public attitudes to cannabis smoking: people are comfortable smoking in public at any time of day and discarding their butts on the street, without facing a sanction from law enforcement or a measurably negative reaction from the general public.

Cannabis use is widespread, but in Canada, it is also illegal. Cannabis is included in Schedule II to the *Controlled Drugs and Substances Act*⁵ ("CDS"). Accordingly, its possession, obtaining and trafficking constitutes an offence under the CDS, with punishments of up to five years' imprisonment if indicted for possession or obtaining of

³ Statistics Canada. *Prevalence and correlates of marijuana use in Canada, 2012*, online: Statistics Canada <<http://www.statcan.gc.ca/pub/82-003-x/2015004/article/14158-eng.htm>>.

⁴ *Ibid*

⁵ *Controlled Drugs and Substances Act*, SC 1996, c 19.

the substance,⁶ and up to a life sentence if indicted for trafficking (lesser penalties are applicable to charges pertaining to smaller amounts of the substance and subject to summary conviction).⁷ The only exception is medical marijuana, the growth, sale and use of which is governed by *Narcotic Control Regulations*⁸ and *Marihuana for Medical Purposes Regulations*.⁹

Although the existing regulatory regime was fairly recently endorsed by the Supreme Court of Canada (see *R v Malmo-Levine*; *R v Caine*¹⁰) and despite the resources devoted to prosecution by law enforcement, the frequency with which marijuana provisions are violated indicates that they fail as a deterrent, serving only to increase the cost and risk of the activity. This failure is increasingly recognized by other federal jurisdictions, including the countries of Bangladesh, the Czech Republic, the Netherlands, Portugal, Spain, Switzerland, Uruguay, as well as the American states of Colorado, Washington, Oregon and Alaska. In the cases of the District of Columbia and Maine's Portland and South Portland, it was *municipalities* which legalized use in their jurisdictions.

As these jurisdictions make the shift from criminalization to legalization and regulation, in recognition of the need to conserve law enforcement resources, enhance revenue and promote individual freedom, the question of potential reform in Canada still looms large. Questions of the morality of decriminalizing marijuana use set aside, this paper outlines the regimes which legalize and regulate recreational marijuana use and retail in the American states of Colorado and Washington, and explores the practical benefits that Canadians may derive from legalization, with a special emphasis on tax revenues.

⁶ *Supra* note 5, s 4.

⁷ *Supra* note 5, s 5.

⁸ *Narcotic Control Regulations*, CRC, c. 1041.

⁹ *Marihuana for Medical Purposes Regulations*, SOR/2013-119.

¹⁰ *R. v Malmo-Levine*; *R. v Caine*, [2003] 2003 SCC 74, 3 SCR 571.

REGULATORY REGIMES

Colorado

Legalization History

Colorado legalized marijuana use in 2012, through Amendment 64 to section 16 of Article XVIII of the state's constitution.¹¹ The Amendment was passed subsequent to a referendum, "in the interest of the efficient use of law enforcement resources, enhancing revenue for public purposes, and individual freedom."¹² It prescribed that Cannabis is to be regulated "in a manner similar to alcohol,"¹³ with a resulting emphasis on (1) permitting use by persons aged 21 years or over, (2) implementing restrictions on driving while under the influence of THC,¹⁴ (3) the need for sales to occur through "legitimate, taxpaying business people, and not criminal actors," and (4) the need for further regulation to ensure that consumers are "informed and protected."¹⁵ The section further permitted personal use of marijuana, including its possession, use, display, purchase, gift-giving and transport in the amount of one ounce or less, and simultaneous growth of up to six plants, with three flowering at any given time.¹⁶ It further allowed for marijuana cultivation, harvesting, processing, packaging and sales by operators licensed under regulations to be adopted by July 1, 2013.¹⁷ The *Colorado Retail Marijuana Code*¹⁸ ("CRMC") became the governing statute.

Regulatory Framework

A comprehensive set of regulations under the CRMC, which established a licensing scheme for retail marijuana growers and retailers, as well as a set of controls for retail marijuana sales and cultivation, was made available on September 9, 2013 by the

¹¹ Colo. Const. art. XVIII, § 16.

¹² *Supra* note 11, § 16(1)(a).

¹³ *Supra* note 11, § 16(1)(b).

¹⁴ Tetrahydrocannabinol, physiologically active compound of cannabis preparations.

¹⁵ *Supra* note 13.

¹⁶ *Supra* note 11, § 16(3)

¹⁷ *Supra* note 11, § 16(4)

¹⁸ 12 Colo. Rev. Stat. § 12-43.4

Marijuana Enforcement Division (“MED”) of the Colorado Department of Revenue.¹⁹ The MED set out licensing procedures, security requirements, regulations of the retail process, as well as health and safety regulations, standards for cultivation and processing, and restrictions on advertising and display. The MED’s evident regulatory priorities include:

- (1) *Maintaining business legitimacy* through criminal background checks for all owners, management and staff, as well as denial of licenses to persons convicted of drug-related felonies within ten years (or any felony within five years) prior to the license application, or to persons with a criminal history indicating poor character;
- (2) *Preventing unregulated sales* in Colorado and diversion of marijuana to states where its sale is illegal, by requiring that retail marijuana be obtained from licensed cultivation facilities, instituting protocols for storage, security (including locks and video-monitoring) and inventory tracking, prohibiting online sales, limiting the amount of marijuana that can be sold in one transaction and requiring proof of Colorado residency before purchase;
- (3) *Protection of consumers*, by providing for the licensing and operation of Marijuana Testing Facilities to (optionally) test the product for contamination and potency, as well as requiring retail establishments to submit samples for testing by the MED on demand, instituting protocols for quality and potency testing, prescribing the content of product labels, which are to include information about the cultivation process, licenses, test results, health and use warning statements and more, and prohibiting the sale of nicotine or alcohol products at retail marijuana establishments;
- (4) *Prevention of diversion of marijuana to minors* through requiring proof of age, prohibiting outdoor advertising, prohibiting marketing to an audience comprised of 30% or more minors, and requiring child-resistant packaging;
- (5) *Facilitation of a tax collection scheme*, by requiring the maintenance of business records, and providing for the reporting and transmittal of taxes, as well as independent audit procedures.

¹⁹ 1 CCR 212-2

Taxation

Recreational retail marijuana in Colorado is subject to four separate taxes, instituted by various legal measures.

First is a 15% *excise tax* on wholesale marijuana, collected by the State. The possibility of an excise tax was allowed for by Amendment 64 itself, which allowed a tax of up to 15%.²⁰ The 15% tax rate, together with the above-described allocation to school construction, was approved by 65.27% of Colorado voters in a vote on “Proposition AA” under bill HB13-1318, which added Article 28.8 (“Taxes on Marijuana and Marijuana Products”) to Title 39 of the *Colorado Revised Statutes*.²¹ The tax went into effect in January 2014. The first \$40 million of annual revenues collected from the excise tax is allocated to the Public School Capital Construction Assistance Fund, and the rest is transferred to the Marijuana Cash Fund (MCF), used for purposes approved by the General Assembly.²² Approved purposes include funding the MED, expanding drug education and prevention efforts, and improving law enforcement.

Second, sales are subject to a 10% state marijuana retail tax, also approved by Proposition AA under HB13-138²³ (this tax is to be decreased to 8% as of July 1, 2017²⁴). 15% of the revenues is allocated to local governments, in proportion to the sales generated within their jurisdiction (in order to encourage the implementation of local zoning laws to allow for marijuana operations), and the rest is allocated to the Marijuana Cash Fund.²⁵

²⁰ *Supra* note 11, § 16(5)(d).

²¹ 39 Colo. Rev. Stat. § 39-28.8.

²² *Ibid*, § 39-28.8-401

²³ *Ibid*

²⁴ Robert Wood, *Colorado Cuts Marijuana Tax, Targets Black Market, While Oregon Eyes 20% Tax*, (2015), online: Forbes <<http://www.forbes.com/sites/robertwood/2015/06/10/colorado-cuts-marijuana-tax-targets-black-market-while-oregon-eyes-20-tax/>>.

²⁵ Colorado Department of Revenue, *Colorado Marijuana Tax Data* (2015), online: <<https://www.colorado.gov/pacific/revenue/colorado-marijuana-tax-data>>.

Third is a state retail sales tax of general application, at the rate of 2.9%. This tax is allocated to the general state cash fund.²⁶

Fourth, retail marijuana sales are subject to all other generally applicable local taxes, allocated to local governments. As an example, Denver, via the *Denver Revised Municipal Code*, subjects retail marijuana sales to the general 3.65% sales tax which it imposes on all retail sales, as well as a special retail marijuana tax of 3.5%,²⁷ bringing the total taxation level in Denver to 35.05% (including the state excise and retail taxes).

Washington

Legalization History

Recreational cannabis use became legal in Washington State upon passage of “Initiative Measure No. 502” which amended various sections of Title 69 (“Food, Drugs, Cosmetics and Poisons”²⁸) and Title 46 (“Motor Vehicles”²⁹) of the *Revised Code of Washington* (“RCW”). The stated purpose of the Initiative is substantially similar to the stated purpose of Colorado constitutional amendments, and is to allow law enforcement to focus on violent and property crimes, to generate tax revenue, and to put marijuana sales in the hands of legitimate businesses instead of criminal organizations.³⁰ The Initiative authorized the Washington State Liquor Board (now known as the Washington State Liquor and Cannabis Board, “WSLCB”) “to regulate and tax marijuana for persons twenty-one years of age and older, and add a new threshold for driving under the influence of marijuana.”³¹ The WSLCB’s regulations are contained in Chapter 55 of Title 314 of the *Washington Administrative Code*.³²

Regulatory Framework

²⁶ *Ibid*

²⁷ D.R.M.C. §§ 53-25(1), 53-85(a).

²⁸ 69 R.C.W. §§ 69.50-325 – 69.50-369.

²⁹ 46 R.C.W. §§ 46.61.503 – 46.61.50571

³⁰ Bill I-2465.1/11: Initiative No. 502 (2011), § 1.

³¹ *Ibid*

³² 314 WAC § 55.

Washington regulations evidence substantially the same priorities as those of Colorado, although its regime is more restrictive. Regulatory differences include, for example:

- Cultivation of marijuana for personal use and gift-giving is prohibited, in any volume: marijuana may only be obtained from a licensed retailer, whereas Colorado permits small amounts of marijuana to be grown, used and given away by an individual;
- No marijuana producer or processor may also be a marijuana retailer, whereas a Colorado retailer may cultivate his/her own marijuana, provided the cultivation facility is also duly licensed;
- Retailers are unable to open stores or advertise within 1,000 feet of schools, and 100 feet of public parks, libraries arcades or other places frequented by minors, where no such restriction exists in Colorado;
- Marijuana products must be tested by a state-accredited independent facility prior to sale, whereas Colorado products can be tested by independent facilities at the option of the retailer, or by the MED on occasional demand;
- There are much more detailed regulations about the size and location of signage, whereas Colorado retailers need only to comply with local ordinances.

Taxation

Washington's marijuana taxation scheme was recently reformed through Bill 2136, passed on June 26, 2015.³³ Even with the passage of this bill, which dramatically decreased taxation levels, Washington has a more onerous taxation scheme than Colorado. Further to Bill 2136, Washington imposes a 37% excise tax on marijuana at the point of sale,³⁴ with revenues allocated between a number of specific programs, including youth drug use prevention, healthcare, marijuana public health education, and program administration, evaluation and research.³⁵ The retail sale of recreational marijuana is also subject to general state and local sales taxes. In Seattle, for example, these general taxes

³³ Bill 2136: AN ACT Relating to comprehensive marijuana market reforms to 2 ensure a well-regulated and taxed marijuana market in Washington 3 state. 64th Legislature, 2nd sess. 2015.

³⁴ *Ibid* s 205(1)(a).

³⁵ American Civil Liberties Union of Washington, *Estimated Annual Tax Distributions from I-502*, online: <https://aclu-wa.org/sites/default/files/pie_graph/502_tax_revenue_chart.pdf>.

come to 9.5%, of which 6.5% goes to the State of Washington, 2.6% to the City of Seattle, and 0.4% to the Regional Transit Authority.³⁶

LESSONS LEARNED

The Possibility of Legalization

Public support for decriminalization of marijuana use is strong, with 53% of the population favouring decriminalization, 35% favouring legalization and taxation, and 68% indicating that marijuana regulations ought to be relaxed in at least some form.³⁷ Only about one tenth of Canadians think that the current state of regulation is appropriate.³⁸ Nonetheless, multiple bills calling for legalization have died over the years.

Politically, only the Conservative party officially supports criminalization at the federal level. Liberal leader Justin Trudeau has made legalization a part of the Liberal party's platform. Similarly, NDP leader Tom Mulcair has, in advance of the upcoming federal election, promised to decriminalize marijuana "the minute we form government."³⁹ It would appear that decriminalization at the federal level is now more likely than ever. Even if yet another decriminalization bill dies in the federal government, the American example suggests that provinces may opt to institute *provincial* regulatory regimes despite federal criminalization (although a discussion of the legality and manner of such measures is beyond the scope of this paper).

In any event, the provinces are well placed to enforce a new regime based on legalization and regulation of marijuana, whether it is federal or provincial in scope. Each of the Canadian provinces has a liquor board or commission, such as Ontario's LCBO (Liquor Control Board of Ontario), which oversees alcohol sales in its jurisdiction. The Washington model of control, i.e. expansion of the liquor boards' existing powers, is a feasible option for all Canadian jurisdictions. As discussed below, legalization and

³⁶ Department of Revenue: Washington State, *State and Local Retail Sales Tax*, online: <http://dor.wa.gov/content/fileandpaytaxes/fileoramendmyreturn/retailing/retailingact_statesalestax.aspx>.

³⁷ Lorne Bozinoff, 'Support for marijuana legalization steady at more than half', (2015), online: *The Forum Poll* <<http://poll.forumresearch.com/post/1362/just-one-tenth-think-current-laws-are-appropriate>>.

³⁸ *Ibid*

³⁹ Michael Bolen, 'Mulcair pledges NDP will decriminalize pot 'the minute we form government'', (2015), online: *CBC* <<http://www.cbc.ca/news/politics/ndp-mulcair-marijuana-decriminalization-1.3199532>>.

regulation is an attractive alternative to the current state of affairs, especially financially.

The Financial Cost of Marijuana Criminalization

There is no denying that marijuana sales bring millions of dollars into the coffers of states and municipalities in which recreational use of the substance is legalized. So how much potential tax revenue is Canada, Ontario and Toronto missing out on?

Consider: in 2014, the first year of legalized sales, Colorado retailers sold \$213,414,440⁴⁰ worth of recreational marijuana, before all taxes.⁴¹ According to the Substance Abuse and Mental Health Services Administration, Approximately 15.09% of Colorado residents,⁴² or 808,220 people, smoke some amount of pot, resulting in average annual retail marijuana spending of \$264 per user. Extrapolated to Ontario, which, according to Statistics Canada is home to 1,331,299 marijuana smokers (12.1% of the population),⁴³ the first year of legalization could generate \$351,462,936 in marijuana sales province-wide, with 19% of this amount generated in Toronto (which comprises ~19% of the province's population).⁴⁴ Assuming taxation and tax revenue allocation at the level of Denver, Colorado and a simplified allocation of the Harmonized Sales Tax (HST), Figure 1 describes what Canada, Ontario and Toronto stand to lose on \$351,462,936 of annual marijuana sales.⁴⁵

⁴⁰ Calculated by dividing amount collected in 10% retail tax in 2014 by 10, multiplying by 100.

⁴¹ Colorado Department of Revenue, *State of Colorado Marijuana Taxes, Licenses and Fees, Transfers and Distribution, December 2014 Sales Reported in January 2015*, (2015), online: <<https://www.colorado.gov/pacific/sites/default/files/1214%20Marijuana%20Tax%2C%20License%2C%20and%20Fees%20Report.pdf>>.

⁴² CBS News, *17 stoner states: Where's marijuana use highest?* online: <<http://www.cbsnews.com/pictures/17-stoner-states-wheres-marijuana-use-highest/16/>>.

⁴³ Michael Bolen, *Which Province Takes The Most?*, online: The Huffington Post <http://www.huffingtonpost.ca/2013/09/20/marijuana-use-canada-stats-per-cent_n_3962841.html>.

⁴⁴ Please refer to Appendix A for details on calculations.

⁴⁵ Please refer to Appendix B for details on calculations.

Fig. 1

| Jurisdiction | Estimated Revenues in First Year of Legal Sales |
|----------------|---|
| Toronto | \$13.3 Million |
| Ontario | \$110.7 Million |
| Canada | \$17.6 Million |

The figures above would represent almost 5% of the 2014 contribution of the City of Toronto to the budget of the Toronto District School Board,⁴⁶ and almost 0.25% of Ontario's 10-year transportation infrastructure investment.⁴⁷ Although these amounts would not be decisive, these would be real funds, extracted from the underground economy and reaching cash-strapped schools and transportation authorities at a recessionary time. Moreover, sales and, therefore, tax revenues, increase as legalization becomes established. As an example, Colorado saw a 66.5% increase in marijuana taxes collected in December-June 2015, as compared to December-June 2014.⁴⁸ This figure also does not include revenues from licensing fees, tourism from jurisdictions where marijuana is illegal, economic benefits in terms of employment in marijuana and marijuana-related industries, and cost savings to be generated by freeing up law enforcement resources, reduction in crime, and more.⁴⁹ Finally, it must be noted that the administration of the regulatory regime is not costly relative to the revenues it generates, especially considering that administrative costs are relatively fixed even as sales increase. Washington, for example, allocates \$5.0 million to the WSLCB to administer the framework,⁵⁰ which relative to Canadian estimates above, would represent only about

⁴⁶ Toronto District School Board. *Financial Statements*, 2014. Web.

⁴⁷ The Province of Ontario. *Building Ontario Up: Ontario Budget 2015*, 2015. Web.

⁴⁸ Colorado Department of Revenue, *State of Colorado Marijuana Taxes, Licenses and Fees, Transfers and Distribution, June 2015 Sales Reported in July 2015*, (2015), online <<https://www.colorado.gov/pacific/sites/default/files/0615%20Marijuana%20Tax%2C%20License%2C%20and%20Fees%20Report.pdf>>

⁴⁹ For simplification, the impact of the USD/CAD exchange rate is also omitted.

⁵⁰ *Supra* note 35.

3.5% of all tax revenues. Higher taxation levels are also possible, though the optimal tax rate must be one which would not increase costs of legal marijuana to the point where users are driven to the black market for cheaper product.

Other Costs of Marijuana Criminalization

Although data on the impact of legalization is still scarce given the extreme recency of the regulatory change, the authors expect that the following additional benefits will also materialize:

- *Reduction in crime* (including violent and property crimes) associated with the trade in illicit drugs;
- *Diversion of revenue* from criminal to legitimate organizations, which serves to financially cripple criminal organizations and reduce their capabilities across a range of activities;
- *Improved protection of marijuana users*, as jurisdictions develop and perfect oversight, quality testing and consumer information mechanisms which are entirely non-existent when the substance is sold illegally;
- *Improved protection of minors*, as the consumer base is tightly controlled through proof of age as well as retail location and advertising requirements of the kind already established in Washington and Colorado;
- *Promotion of healthier forms of consumption*, such as edibles, which can replace the relatively more harmful joint – the predominant illegal form of consumption.
- *Greater social satisfaction with the state of regulation*, which is less restrictive of personal autonomy when sales are legal and regulated, rather than criminalized.

Each of the above factors represents an avenue of future research, as empirical and other research data becomes available that would allow for tracing the impact of legalization and regulation on each area. As various regulatory regimes emerge, an analysis of best practices will also become possible.

CONCLUSION

It appears that marijuana use is here to stay, whether or not it is criminalized. Faced with this state of affairs, a legalization/regulation regime modeled on the Colorado and Washington experiences is neither unreasonable nor far-fetched. Tightly regulated but legal sales of marijuana could bring in millions of dollars into municipal, provincial and federal treasuries. A host of other benefits, still to be explored, will most likely emerge.

APPENDIX A

| Line | Line Description Calculation Instructions | Number |
|-------------|---|---------------|
| 1 | 2014, 10% Retail Marijuana Tax Collected, Colorado From Colorado Marijuana Tax Data | \$21,341,444 |
| 2 | 2014 Retail Marijuana Before-Tax Revenues, Colorado (1 / 10)*100 | \$213,414,440 |
| 3 | Number of Colorado Marijuana Users State population * % of Users; 5,356,000 * 15.09% | 808,220 |
| 4 | Annual Expense on Marijuana, per user Line 2 / Line 3 | \$264 |
| 5 | Number of Ontario Users Province population * % of Users; 13,600,000 * 12.01% | 1,331,299 |
| 6 | Torontonians as % of Ontario Population City Population/Province Population; 2.615 Million / 13.6 Million | 19.2% |
| 7 | Estimated Ontario Retail Marijuana Sales (in 1st year of legalization) Line 5 * Line 4 | 351,462,936 |

APPENDIX B

| Line | Tax Type, % (Calculation Instructions) Tax Allocation (%) (Calculation Instructions) | Annual Revenue (\$) |
|-------------|--|----------------------------|
| 1 | Total Retail Revenues Before Tax | 351,462,936 |
| 2 | Retail Marijuana Excise Tax, 15% (1 * 0.15) To Ontario, 100% | 52,719,440 |
| 3 | Retail Marijuana Sales Tax, 10% (1 * 0.1) | 35,146,294 |
| 4 | To Ontario, 85% (3 * 0.85) | 29,874,350 |
| 5 | To Municipalities, 15% (3 * 0.15) | 5,271,944 |
| 6 | To Toronto, 19% (5 * 0.19) | 1,001,669 |
| 7 | To other municipalities, 81% (5 * 0.81) | 4,270,275 |
| 8 | Harmonized Sales Tax, 13% (1 * 0.13) | 45,690,182 |
| 9 | To Canada, 5% (1 * 0.05) | 17,573,146.80 |
| 10 | To Ontario, 8% (1 * 0.08) | 28,117,035 |
| 11 | Toronto Retail Marijuana Sales Tax, 3.5% (1 * 0.035) | 12,301,203 |
| 12 | Total to Toronto (6+12) | 13,302,872 |
| 13 | Total to Ontario (2+4+8+11) | 110,710,825 |
| 14 | Total to Canada (10) | 17,573,146 |
| 15 | Total to All Jurisdictions (13+14+15) | 141,586,843 |

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