



# MARIJUANA RELATED TAX EXPENDITURES

EVALUATION SUMMARY | SEPTEMBER 2022 | 2022-TE37

Expenditure	Medical Marijuana Sales Tax Exemption for Indigent Patients	Retail Marijuana Sales Tax Exemption	Marijuana Business Expense Deduction
TAX TYPE	Sales and Use	Sales and Use	Income
YEAR ENACTED	2010	2017	2013
REPEAL/EXPIRATION DATE	None	None	None
REVENUE IMPACT	\$10,133 (Tax Year 2021)	\$53 million (Tax Year 2021)	10.6 million (Tax Year 2018)
NUMBER OF TAXPAYERS	83	Could not determine	488

**KEY CONCLUSION:** The Medical Marijuana Sales Tax Exemption for Indigent Patients is underutilized and appears to benefit few indigent medical marijuana patients. The Retail Marijuana Sales Tax Exemption and Marijuana Business Expense Deduction are widely used and help define the tax base for taxing marijuana and marijuana businesses.

## WHAT DO THESE TAX EXPENDITURES DO?

**MEDICAL MARIJUANA SALES TAX EXEMPTION FOR INDIGENT PATIENTS (INDIGENT PATIENTS EXEMPTION)** [Section 39-26-726, C.R.S.]—Exempts purchases of medical marijuana by indigent patients from the state sales tax. Indigent patients are classified as individuals with income at or below 185 percent of the federal poverty level.

**RETAIL MARIJUANA SALES TAX EXEMPTION** [Section 39-26-729(1)(a), C.R.S.]—Exempts sales of retail marijuana from the state sales tax.

**MARIJUANA BUSINESS EXPENSE DEDUCTION** [SECTION 39-22-304(3)(m), C.R.S. AND SECTION 39-22-104(4)(r), C.R.S.]—Allows licensed marijuana businesses to deduct business expenses that are disallowed for federal tax purposes from their Colorado taxable income.

## WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

**INDIGENT PATIENTS EXEMPTION**—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.

**RETAIL MARIJUANA SALES TAX EXEMPTION**—To exempt purchases of retail marijuana from the state sales tax of 2.9 percent because they are instead subject to the special retail marijuana sales tax rate of 15 percent.

**MARIJUANA BUSINESS EXPENSE DEDUCTION**—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the Marijuana Related Tax Expenditures.
- Whether it should amend statute to address the limited use of the Indigent Patients Exemption. This could include allowing alternative documentation to establish qualifying income or expanding the exemption to include all medical marijuana sales.

# MARIJUANA RELATED TAX EXPENDITURES

## EVALUATION RESULTS

### WHAT ARE THE TAX EXPENDITURES?

This evaluation covers three tax expenditures that apply to the State's medical and retail marijuana industry, which we refer to as the Marijuana Related Tax Expenditures.

In Calendar Year 2000, Colorado voters approved Amendment 20, which created Article XVIII, Section 14 of the Colorado Constitution. This amendment legalized sales, possession, and cultivation of limited amounts of medical marijuana for patients with a debilitating medical condition. In order to qualify, patients must receive a certification from their health care provider indicating that they have a qualifying medical condition and apply for a medical marijuana card with the Colorado Department of Public Health and Environment (CDPHE). Generally, applicants for a medical marijuana card must submit a \$29.50 fee with their application; however, patients with household incomes at or below 185 percent of the federal poverty level can receive a fee waiver.

In Calendar Year 2012, voters passed Amendment 64, which created Article XVIII, Section 16 of the Colorado Constitution, which legalized the retail sale, purchase, and possession of retail marijuana for individuals aged 21 years and above, beginning January 1, 2014, and allowed local governments to prohibit retail marijuana sales. Retail marijuana is sometimes referred to as recreational marijuana and individuals are not required to meet any qualification standards, other than the age requirement, to purchase retail marijuana.

In addition to legalizing medical and retail marijuana, Article XVIII, Sections 14 and 16, of the Colorado Constitution requires the Department of Revenue (Department) to establish a state marijuana regulatory structure. As a result, the General Assembly passed several

bills to implement Amendment 64, including House Bill 13-1318, which referred Proposition AA to voters. Proposition AA authorized the Department to tax the cultivation, sale, and use of marijuana. Marijuana sales and businesses that sell marijuana can be subject to several types of taxes in Colorado, including regular sales tax, a special retail marijuana sales tax, and a retail marijuana excise tax, with businesses that sell marijuana also subject to the State's income tax. However, medical and retail marijuana sales are subject to separate taxing structures and statute establishes several tax expenditure provisions that define when the taxes apply. These taxes and the relevant tax expenditures are discussed below.

#### SALES TAX

Statute [Sections 39-26-104(1)(a) and 105(1)(a)(I)(A), C.R.S.] provides that sales of tangible personal property are subject to the state sales tax rate of 2.9 percent unless specifically exempted by statute. Since marijuana is considered tangible personal property, sales of both medical and retail marijuana are subject to state sales tax unless a specific exemption applies. However, unlike most sales tax revenue, which supports the State's General Fund, the sales tax collected from medical marijuana is distributed to the Marijuana Tax Cash Fund. There are two sales tax exemptions related to marijuana:

- **MEDICAL MARIJUANA SALES TAX EXEMPTION FOR INDIGENT PATIENTS (INDIGENT PATIENTS EXEMPTION)**—Section 39-26-726, C.R.S., exempts purchases of medical marijuana by indigent patients from the state sales tax. Indigent patients are classified as individuals with income at or below 185 percent of the federal poverty level [Section 25-1.5-106(16)(a), C.R.S.]. The exemption was enacted in 2010 by House Bill 10-1284. In order for qualifying patients to claim the exemption, they must obtain a medical marijuana card and also submit a copy of their Colorado tax return from the most recent tax year along with their application for the indigent patient designation to the Medical Marijuana Registry, a division within CDPHE, showing that they meet the income requirement. A patient's medical

marijuana card is then updated to show that they qualify for the exemption and patients must present their card to retailers when making qualifying purchases. Retailers then apply the exemption at the point of sale and report the exempt sales on Schedule A, Line 12, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100). There have been no legislative changes to the exemption since its enactment. Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that statutory cities and counties that have their sales taxes collected by the State apply most of the State’s sales tax exemptions, including the Indigent Patients Exemption.

- **RETAIL MARIJUANA SALES TAX EXEMPTION**—Section 39-26-729(1)(a), C.R.S., exempts all sales of retail marijuana from the state sales tax. This exemption was created by Senate Bill 17-267 in 2017 and there have been no substantive legislative changes since its enactment. Additionally, under Section 29-2-105(1)(d)(I)(O), C.R.S., local governments that have their sales taxes collected by the State may choose whether to apply the exemption to their local sales taxes. Retail sales exempt from the State’s 2.9 percent sales tax are reported on Schedule B, Line 10, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100).

#### SPECIAL RETAIL MARIJUANA SALES TAX

Section 39-28.8-202(1)(a)(I), C.R.S., levies a special, 15 percent retail marijuana sales tax on retail marijuana in lieu of the state sales tax that is typically applied to sales of tangible personal property. The special sales tax collected on retail marijuana is distributed between the General Fund, the State Public School Fund, and the Marijuana Tax Cash Fund [Section 39-28.8-203(1)(b)(I.5), C.R.S.]. Because the authorizing statute for the special retail marijuana sales tax does not include medical marijuana, we did not consider the exclusion of medical marijuana from this tax base as a separate tax expenditure for the purposes of our evaluation. We did not identify any tax expenditures that apply to the special retail marijuana sales tax.

#### RETAIL MARIJUANA EXCISE TAX

Section 39-28.8-302(1)(a)(I), C.R.S., levies an excise tax at a rate of 15 percent on the first transfer of retail marijuana between unaffiliated retail marijuana business licensees or retail marijuana cultivation facilities. Although cultivators or manufacturers are responsible for paying the excise tax, excise taxes are typically passed on to consumers in the form of higher prices. Excise tax revenue collected from retail marijuana is transferred into the Building Excellent Schools Today (BEST) fund for public school capital reconstruction [Section 39-28.8-305(1)(a)(III), C.R.S.]. The retail marijuana excise tax does not apply to the transfer of medical marijuana. However, we did not consider the exclusion of medical marijuana from the retail marijuana excise tax to be a tax expenditure for the purposes of this evaluation because it is prescribed by a constitutional provision approved by voters in Colorado that appears to establish retail marijuana as its own tax base for the purposes of the excise tax. We did not identify any tax expenditures that apply to the retail marijuana excise tax.

#### FEDERAL AND STATE INCOME TAX

Marijuana businesses are subject to federal and state income taxes. Both federal and state income taxes are based on a percentage of businesses' taxable income, which is generally equivalent to businesses' total proceeds for the year, less deductible expenses, such as the cost of goods sold and necessary business expenses. Because Colorado uses federal taxable income as the starting point for calculating taxable income for state tax purposes, most deductions that taxpayers claim at the federal level automatically apply to their Colorado taxable income. However, Section 280E of the Internal Revenue Code (IRC) disallows deductions or credits for amounts paid or incurred if "such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances..." This prevents marijuana businesses from deducting many business expenses at the federal level since marijuana is listed as a Schedule I substance under the federal Controlled Substance Act. The following income tax expenditure applies to marijuana businesses' Colorado income tax:

- MARIJUANA BUSINESS EXPENSE DEDUCTION [SECTION 39-22-304(3)(m), C.R.S. AND SECTION 39-22-104(4)(r), C.R.S.]—This deduction allows licensed marijuana businesses to deduct business expenses that are disallowed for federal tax purposes under Section 280E of the IRC from their Colorado taxable income. House Bill 13-1042 and Senate Bill 13-283, together, enacted the Marijuana Business Expense Deduction. House Bill 13-1042 created the deduction for medical marijuana and Senate Bill 13-283 created the deduction for retail marijuana, both effective for Tax Year 2014. Legislative changes in Calendar Year 2019 re-codified separate sections of statute concerning the regulation of retail and medical marijuana into the Colorado Marijuana Code.

Individuals claim the deduction on Line 14 of the 2021 Subtractions from Income Schedule (Form DR 0104AD), which is included in the total subtractions they report on Line 6 of the 2021 Colorado Individual Income Tax Return (Form DR 0104). Fiduciaries report the deduction on Line 3 of the 2021 Colorado Fiduciary Income Tax Return (Form DR 0105), while partnerships and S corporations report the deduction on Line 6 of the 2021 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Lastly, C-corporations claim the deduction on Line 11 of the 2021 Colorado C Corporation Income Tax Return (Form DR 0112).

Exhibit 1 summarizes the taxation of medical and retail marijuana in the state.

EXHIBIT 1. TAXATION OF COLORADO'S MARIJUANA INDUSTRY		
Taxes	Medical Marijuana	Retail Marijuana
State Sales Tax (2.9 percent)	Taxed, unless the Indigent Patients Exemption applies	Exempt under the Retail Marijuana Sales Tax Exemption
Special Retail Marijuana Sales Tax (15 percent)	Not subject to tax	Taxed
Retail Marijuana Excise Tax (15 percent)	Not subject to tax	Taxed
Federal Income Tax (rate varies)	Taxed, with no deduction allowed for business expenses	Taxed, with no deduction allowed for business expenses
State Income Tax (4.55 percent)	Taxed, after deducting business expenses under the Marijuana Business Expense Deduction	Taxed, after deducting business expenses under the Marijuana Business Expense Deduction

SOURCE: Office of the State Auditor analysis of taxes that apply to marijuana.

## WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statutes do not directly state the intended beneficiaries of the Marijuana Related Tax Expenditures. Based on our review of statutory language, we inferred that the provisions were intended to benefit the following:

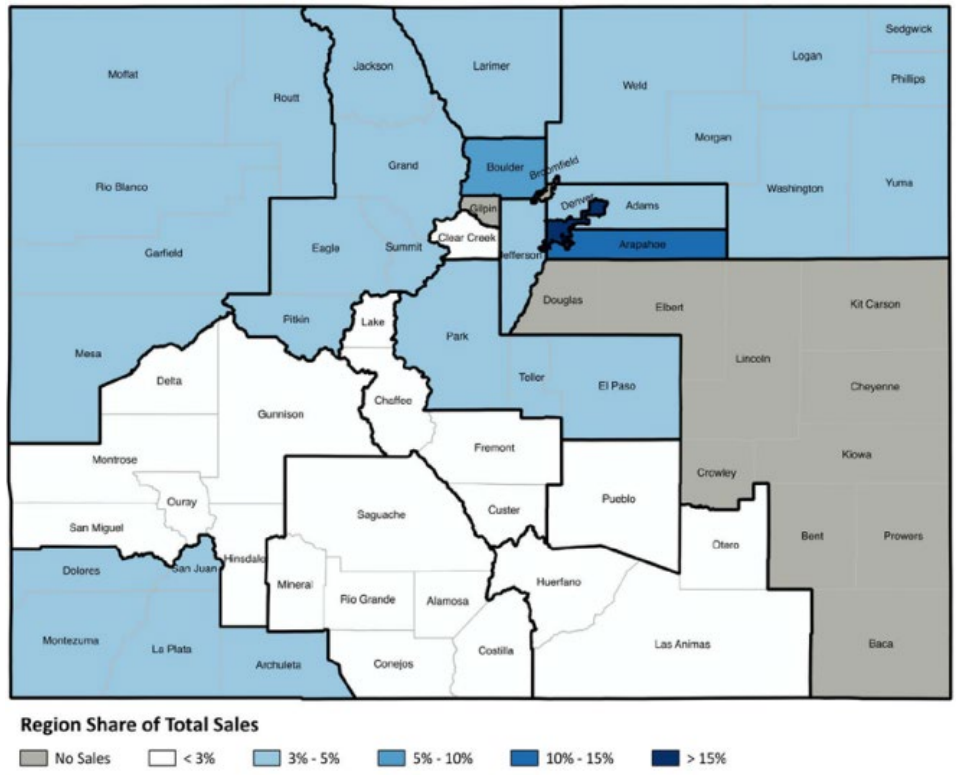
- **INDIGENT PATIENTS EXEMPTION**—Low-income individuals treating medical conditions with medical marijuana. According to Medical Marijuana Registry data, the most commonly reported conditions among medical marijuana patients include severe pain or nausea, muscle spasms, opioid addiction, and post-traumatic stress disorder.
- **RETAIL SALES TAX EXEMPTION**—Consumers of retail marijuana, who would otherwise be subject to the State's 2.9 percent sales tax, in addition to the special marijuana retail sales tax, which was increased from 10 percent to 15 percent at the time the exemption was established. Marijuana businesses may also benefit indirectly to the

extent that consumers purchase more marijuana due to the exemption.

- **MARIJUANA BUSINESS EXPENSE DEDUCTION**—Marijuana businesses including stores, manufacturers, transporters, and cultivators with operations in Colorado. Marijuana consumers may also benefit indirectly to the extent that the deduction allows businesses to sell marijuana at lower prices.

Because the concentration of marijuana businesses varies across the State’s regions, with some counties prohibiting the sale of marijuana altogether, the expenditures provide a more significant benefit in areas with more marijuana sales. Exhibit 2 shows the share of total retail marijuana sales in the state, by region, in Calendar Year 2017.

**EXHIBIT 2. COLORADO RETAIL MARIJUANA SALES DISTRIBUTION BY REGION, CALENDAR YEAR 2017**



SOURCE: Evaluation of the Colorado Department of Revenue’s Use of Marijuana Inventory Tracking Data, Office of the State Auditor, August 2019.



## WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statutes do not directly state a purpose for any of the Marijuana Related Tax Expenditures; therefore, we were unable to definitively determine their intended purposes. However, based on our review of statutory language, legislative audio, and discussions with stakeholders, we considered the following potential purposes:

**INDIGENT PATIENTS EXEMPTION**—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.

**RETAIL MARIJUANA SALES TAX EXEMPTION**—To exempt purchases of retail marijuana from the state sales tax of 2.9 percent because they are instead subject to the special retail marijuana sales tax rate of 15 percent. Senate Bill 17-267, which enacted the exemption, also increased the special retail marijuana sales tax rate from 10 percent to 15 percent, indicating that the purpose of the exemption was to define the tax base for taxing retail marijuana sales and not to reduce the overall rate consumers pay on their marijuana purchases.

**MARIJUANA BUSINESS EXPENSE DEDUCTION**—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income. As discussed, marijuana businesses are not allowed to claim ordinary and necessary business expenses as a deduction at the federal level due to Section 280E of the IRC, which disallows this type of deduction for businesses that make sales of controlled substances that are illegal under federal law. As a result, based on legislative audio, we determined that the General Assembly intended to tax marijuana businesses the same as other businesses that operate legally under state law by calculating Colorado taxable income after the deduction of business expenses.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSES AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We could not definitively determine whether the Marijuana Related Tax Expenditures are meeting their purposes because no purposes are provided for them in statute or their enacting legislation.

Based on the potential purpose we considered in order to conduct the evaluation of the Indigent Patients Exemption, we found that the exemption is likely not meeting its purpose, because few eligible indigent medical patients use it.

Based on the purposes we considered for the Retail Sales Tax Exemption and the Marijuana Business Expense Deduction, we determined that they are meeting their purposes because eligible marijuana businesses are aware of and apply the exemption to eligible sales and regularly claim the deduction.

Statute does not provide quantifiable performance measures for these tax expenditures. Therefore, we created and applied the following performance measures to determine the extent to which the tax expenditures are meeting their potential purposes:

PERFORMANCE MEASURE #1: *To what extent are sales of medical marijuana to indigent patients being exempted from Colorado's state sales tax?*

RESULT: It appears that most indigent medical marijuana patients are not receiving the benefit of the exemption when they purchase medical marijuana. Based on feedback from stakeholders, we found that the dispensaries are generally applying the exemption to sales of medical marijuana to indigent patients that present a medical marijuana card with indigent tax-exempt status. However, it appears that few eligible patients have applied to use the exemption.

To determine the extent to which the exemption is being applied to eligible purchases, we spoke to a Certified Public Accountant (CPA)

who confirmed that their clients, which are marijuana businesses in Colorado, are aware of the Indigent Patients Exemption and they see the exemption on their companies' records of financial transactions. However, we could not quantify the extent to which the exemption is being applied because the Department requires exempt sales to indigent patients to be reported on Schedule A, Line 12, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100), which includes other exempt sales and cannot be disaggregated for analysis. Therefore, we analyzed Medical Marijuana Registry data to estimate the extent to which the exemption is being sought and used among potentially eligible low-income individuals that purchase medical marijuana in the state.

Based on Medical Marijuana Registry data from Calendar Years 2018 through 2020, there were an average of 84,688 certified medical marijuana card holders in Colorado during this period. Of those, an average of only 98, or 0.12 percent, were certified as indigent patients that qualified for the Indigent Patients Exemption. In comparison, according to the U.S. Census Bureau, the State's share of individuals with household incomes below 150 percent of the poverty level was about 17 percent of the total population from Calendar Year 2018 through Calendar Year 2020. Assuming that the proportion of individuals in or near poverty within Colorado's total population is consistent with that among medical marijuana card holders, we estimate that there were between about 14,000 and 16,000 total patients eligible for the Indigent Patients Exemption in the state. Therefore, it appears that less than 1 percent of eligible indigent patients applied for and received indigent tax-exempt status from Tax Year 2018 through Tax Year 2020.

We identified certain barriers for low income applicants that may have reduced the number of patients filing for tax exempt status. For example, Medical Marijuana Registry staff indicated that applicants must submit a certified copy of their Colorado income tax return from the most recent tax year to apply for a fee waiver or tax exempt status. However, individuals with gross incomes below the standard deduction, which was \$12,550 for single filers and \$25,100 for married joint filers

in Tax Year 2021, typically do not owe taxes and are not required to file a tax return. Therefore, many individuals who qualify for the exemption may not otherwise file tax returns, but they would need to do so to register as an indigent patient with the Medical Marijuana Registry. Additionally, Medical Marijuana Registry staff indicated that some applicants expressed concerns with having to obtain the documentation from the Department to meet the requirements. The low number of patients with tax exempt status may also be due to a lack of awareness, administrative requirements, and the potential stigma associated with acquiring and presenting a medical card that designates an individual as low income.

*PURPOSE MEASURE #2: To what extent are retail marijuana businesses exempting sales of retail marijuana from Colorado's state sales tax?*

RESULT: Our discussions with two CPAs who specialize in accounting for marijuana businesses in Colorado and a marijuana business with a dispensary and a grow operation indicated that the Retail Marijuana Sales Tax Exemption is widely known and applied to sales of retail marijuana by retail marijuana dispensaries. Additionally, marijuana retail stores typically use point-of-sale software that automatically applies local and state taxes and exemptions to their sales of marijuana, making the exemption relatively easy to administer. However, we were not able to quantify the extent to which the exemption is being applied because, prior to October 2019, the retailers reported their exempt sales under Exemptions Schedule - Part B, Line 10, titled "Other Exemptions," of the Colorado Retail Sales Tax Return with Deductions & Exemptions Schedule (Form DR 0100), which includes several other exemptions. At the time of our review, the Department had also not compiled data on the exemption's use since Tax Year 2019.

*PURPOSE MEASURE #3: To what extent do retail and medical marijuana businesses use the Marijuana Business Expense Deduction to deduct eligible business expenses for Colorado income tax purposes?*

RESULT: Department data indicate that marijuana businesses deducted a total of about \$228 million in federally non-deductible operating expenses from their Colorado taxable income in Tax Year 2018, the

most recent year with data available. Further, stakeholders we contacted indicated that the Marijuana Business Expense Deduction is widely known and utilized by Colorado marijuana businesses and tax professionals that work with marijuana businesses.

## WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

### INDIGENT PATIENTS EXEMPTION

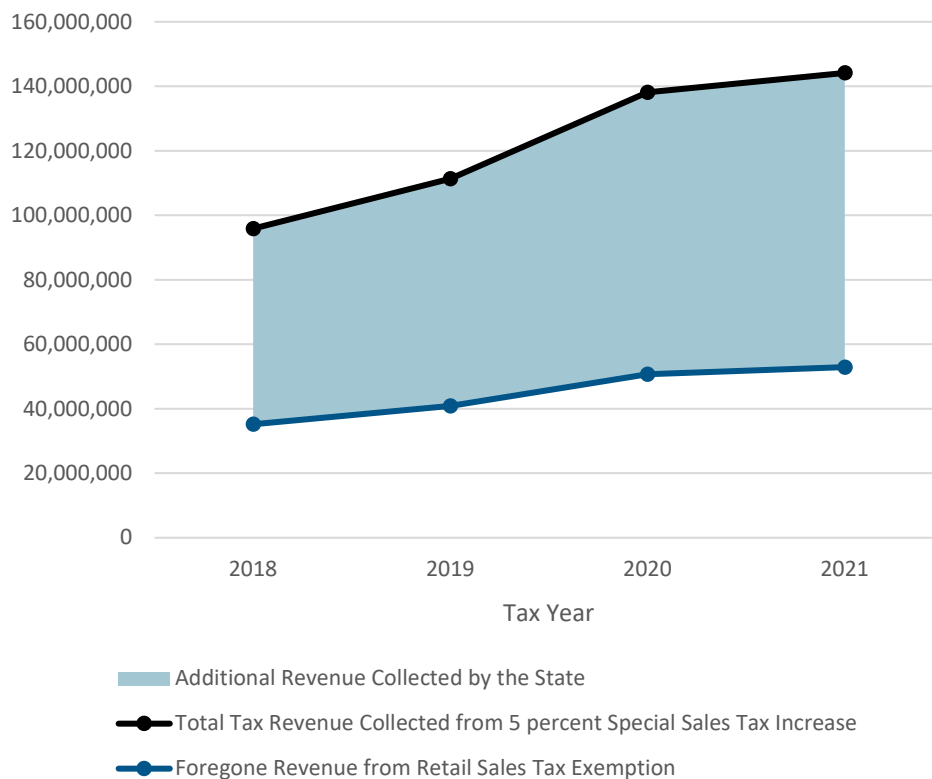
Based on data provided by CDPHE and the Department, we estimate that the Indigent Patients Exemption resulted in an average annual revenue impact to the State of about \$11,000 from Tax Year 2018 through Tax Year 2021, with a revenue impact of \$10,133 for Tax Year 2021.

Because the Department was not able to provide data on the use of the exemption, we estimated its revenue impact to the State using Department data on medical marijuana sales from Tax Year 2018 through Tax Year 2021 and Medical Marijuana Registry data on the number of individuals with medical marijuana registration cards at the end of each year. Based on Department data, there was an average of \$379 million in annual sales of medical marijuana and accessories that do not contain marijuana during Calendar Years 2018 through 2021. Because accessories that do not contain marijuana are not covered by the exemption and make up about 10 percent of these sales, based on data from the Colorado Office of the State Controller, we adjusted this figure accordingly to estimate that there was an average of about \$341 million in annual medical marijuana sales from Calendar Year 2018 through Calendar Year 2021. Assuming indigent patients who were certified to claim the exemption—which made up 0.12 percent of all medical marijuana card holders during this period—purchased an equivalent amount of medical marijuana as the average Medical Marijuana Registry patient, the indigent patients would have purchased roughly \$380,000 in medical marijuana annually during Tax Years 2018 through 2021, resulting in an average annual revenue impact to the State of about \$11,000 (calculated as \$380,431 multiplied by the State sales tax rate of 2.9 percent).

### RETAIL MARIJUANA SALES TAX EXEMPTION

According to Department data on the total sales of retail marijuana, we found that the exemption had a revenue impact to the State of about \$53 million in Tax Year 2021. However, at the time the exemption was enacted, Senate Bill 17-267 also increased the special retail sales tax imposed on sales of retail marijuana from 10 percent to 15 percent. We estimated that this increase in sales tax resulted in about \$91.2 million in additional sales tax revenue collected by the State in Tax Year 2021, resulting in a \$38.3 million net increase in revenue from the bill, factoring in the exemption. Exhibit 3 shows the revenue impact of Senate Bill 17-267 from Tax Year 2018 through Tax Year 2021.

**EXHIBIT 3. SENATE BILL 17-267 HAD A NET POSITIVE REVENUE IMPACT TO THE STATE**



SOURCE: Office of the State Auditor analysis of Department Marijuana Retail Sales Revenue Data.

According to Department data, the Marijuana Business Expense Deduction resulted in about \$10.6 million in foregone revenue for the State and a corresponding benefit to taxpayers in Tax Year 2018, which was the most recent year that the Department had data. Specifically, 399 individuals and three fiduciaries claimed the deduction in Tax Year 2018, resulting in a revenue impact of \$5.5 million, while 86 corporations claimed the deduction in Tax Year 2018, resulting in a revenue impact of about \$5.1 million.

Furthermore, we determined that the benefit of the deduction for companies varies among different businesses within the industry, with retail dispensary stores likely realizing the greatest benefit. While federal law prohibits marijuana businesses from deducting business expenses, which include salaries for retail staff, wages, rent, and insurance, they are allowed to deduct the cost of goods sold, which includes direct costs they incur, such as materials, products purchased for resale, packaging, or direct labor costs associated with the production of marijuana. According to stakeholders, marijuana dispensaries typically have a greater amount of federally non-deductible expenses that are eligible for the Marijuana Business Expense Deduction, while cultivators' typically have a larger proportion of expenses that qualify as federally deductible costs of goods sold. For example, one stakeholder reported that operating expenses, which are eligible for the deduction, can range from between 10 to 40 percent of total expenses, depending on the type of business.

Although the deduction's benefit can vary, we found that it generally has a modest impact on the profitability of marijuana businesses. Stakeholders indicated that industry gross profit margins—total revenue minus costs of goods sold—ranged from 50 to 60 percent of total revenue for dispensaries and 20 to 40 percent of total revenue for cultivators. Based on the gross profit margins and standard operating expense ranges provided by stakeholders, we estimated that, on average, marijuana businesses' net profits after Colorado income tax increased by approximately 5 percent due to the deduction. In other words, the deduction increases marijuana companies' profits after

Colorado income tax by roughly \$0.05 for every dollar of profit earned. This indicates that the exemption is likely to have the most significant benefit to marijuana companies operating closer to the margins and not necessarily the most profitable marijuana companies in the state.

Additionally, the deduction may provide a modest economic benefit by fostering economic development within the marijuana industry. Specifically, according to stakeholders, the tax benefit provided by the deduction reduces industry barriers to entry for new marijuana businesses and indicates to beneficiaries that the State supports the industry by providing equal tax treatment to marijuana businesses.

#### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

INDIGENT PATIENTS EXEMPTION. Eliminating the exemption would increase the cost of medical marijuana for the roughly 100 indigent patients who use the exemption by at least 2.9 percent, due to the sales no longer being exempt from state sales tax. Additionally, their purchases would be subject to additional local city, county, and special district sales taxes in jurisdictions that have their sales tax collected by the State, since those local governments are generally required to apply the State's sales tax exemptions, including the Indigent Patients Exemption. We estimate that this would have resulted in indigent patients paying, on average, \$122 more per year, per person in state sales taxes on medical marijuana in Tax Year 2021 (we lacked sufficient data to estimate the additional local taxes they would pay). We estimated the cost to indigent patients of eliminating the exemption by dividing the \$10,133 estimated annual amount claimed by the 83 registered indigent patients for Tax Year 2021. As discussed, our estimate assumes that indigent patients purchase equivalent amounts of medical marijuana as other non-indigent medical marijuana patients. Additionally, to the extent that the price increase of medical marijuana due to eliminating the exemption curbs low-income marijuana patients' consumption by making it less affordable, low-income patients may not be able to treat medical conditions with medical marijuana as



effectively. However, we lacked data to quantify the types of medical conditions that were reported by indigent patients who used the exemption.

**RETAIL MARIJUANA SALES TAX EXEMPTION.** If the Retail Marijuana Exemption was eliminated, individuals purchasing retail marijuana would see a 2.9 percent increase in their cost of retail marijuana purchases due to the state sales tax, plus any additional local sales taxes that applied. Stakeholders reported that the additional price increases associated with eliminating the exemption may also have a modest negative impact on the marijuana industry in Colorado by potentially decreasing demand and consumption of retail marijuana.

**COLORADO MARIJUANA BUSINESS EXPENSE DEDUCTION.** Eliminating the deduction would reduce the after-tax income of marijuana companies filing as individuals on average by \$13,660 per taxpayer and \$59,151 per business for marijuana companies filing as C-corporations, based on Department data from Tax Year 2018. As discussed, because dispensaries have a greater proportion of operating expenses that are federally-nondeductible, dispensaries would experience the most significant impact in nominal terms if the deduction were eliminated. In addition to the negative income effects of reducing monetary relief, eliminating the deduction might signal a lack of state support for marijuana businesses and the marijuana industry.

#### ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Based on our review of other states' tax expenditures and marijuana tax policies, we identified the following similar tax expenditures:

**INDIGENT PATIENTS EXEMPTION—**We did not identify any other states that provide an explicit sales tax exemption from medical marijuana purchases for indigent patients. However, we found that of the 27 other states that have legalized medical marijuana and have a state sales tax, 14 states exempt all medical marijuana sales from state sales tax, while 13 states levy a state sales tax on medical marijuana similar to Colorado. Additionally, while six of the states that exempt medical

marijuana from state sales tax levy an excise tax on medical marijuana, the other eight fully exempt medical marijuana sales from tax.

**RETAIL MARIJUANA SALES TAX EXEMPTION.** We did not identify any states with a similar tax expenditure.

**COLORADO MARIJUANA BUSINESS EXPENSE DEDUCTION**—Based on our review of states that levy an income tax on marijuana businesses, we identified six other states—Arkansas, Hawaii, Michigan, Minnesota, New Mexico, and Oregon—that, similar to Colorado, do not conform to Section 280E of the IRC and allow all marijuana businesses to deduct business expenses for state tax purposes. Eight other states treat individuals and businesses differently with respect to conforming to Section 280E of the IRC. For example, California and Vermont do not conform to Section 280E of the IRC for the purpose of taxing C-corporations that sell marijuana, but do for tax treatment of individuals. On the other hand, New Jersey and Pennsylvania conform to Section 280E for the tax treatment of C-corporations, but do not for individuals.

**ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?**

Similar to the Indigent Patients Exemption, the Sales Tax Exemption for Prescription Drugs [Section 39-26-717(2)(a), C.R.S.] reduces the financial burden on patients purchasing drugs used to treat a medical condition. However, the exemption is broader than the Indigent Patients Exemption and exempts all purchases of medically necessary prescription drugs regardless of the purchasers' income.

We did not identify any tax expenditures or programs in the state similar to the Retail Marijuana Sales Tax Exemption or the Marijuana Business Expense Deduction.

## WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

The Department could not provide data showing the revenue impact for the Indigent Patients Exemption because this exemption is claimed on Schedule A, Line 12, titled “Other exempt sales” of the 2021 Colorado Retail Sales Tax Return (Form DR 0100), which taxpayers use to report several unrelated exemptions. For this reason, we estimated the exemption’s revenue impact using Medical Marijuana Registry cardholder data and Department data on overall medical marijuana sales. If the General Assembly wants complete information, it could consider instructing the Department to add a reporting line for sales to indigent patients to the Sales Tax Return form. GenTax, the Department’s tax processing and information system, would also have to be reconfigured to collect and extract this data. However, according to the Department, this type of change would require additional resources to develop the form and complete the necessary programming in GenTax (see the Tax Expenditures Overview Section of the *Office of the State Auditor’s Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations). Further, this type of change may not be cost-effective, since it appears that the exemption is used infrequently and has a minimal revenue impact to the State.

Additionally, the Department could not provide data showing the revenue impact of the Retail Marijuana Sales Tax Exemption. Until Tax Year 2019, retailers reported their exempt sales under Exemptions Schedule - Part B, Line 10, titled “Other Exemptions,” of the Colorado Retail Sales Tax Return (Form DR 0100), which includes several other exemptions. Beginning in October 2019, the Department added a reporting line for exempt retail sales of marijuana; however, at the time of our review, the Department had not compiled data on this exemption and could not provide data for our analysis. According to Department staff, this information will likely be available in future years.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH STATUTORY PURPOSES AND PERFORMANCE MEASURES FOR THE MARIJUANA RELATED TAX EXPENDITURES. Statutes and the enacting legislation for the Marijuana Related Tax Expenditures do not state their purposes or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of our evaluation, we considered the following potential purposes for the Marijuana Related Tax Expenditures:

- **INDIGENT PATIENTS EXEMPTION**—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.
- **RETAIL MARIJUANA SALES TAX EXEMPTION**—To exempt retail marijuana sales from the state sales tax of 2.9 percent because they, instead, are subject to a special retail marijuana sales tax at a rate of 15 percent.
- **MARIJUANA BUSINESS EXPENSE DEDUCTION**—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income.

We identified these purposes based on the operation of the tax expenditures, conversations with stakeholders, and recordings of legislative hearings. We also developed performance measures to assess the extent to which the tax expenditures are meeting these potential purposes. However, the General Assembly may want to clarify its intent for the tax expenditures by providing purpose statements and corresponding performance measures in statute. This would eliminate potential uncertainty regarding the expenditures' purposes and allow our office to more definitively assess the extent to which they are accomplishing their intended goals.

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER WHETHER THE INDIGENT PATIENTS EXEMPTION SHOULD BE AMENDED TO ADDRESS ITS LIMITED USE. As discussed, we found that the exemption appears to be underutilized, with an average of only about 100 medical marijuana patients certified to use the Indigent Patients Exemption from Calendar Year 2018 through 2020. This represents about one-tenth of 1 percent of all medical marijuana cardholders in the state. In comparison, U.S. Census Bureau data indicate that more than 17 percent of the population in the state meets the exemption's income restrictions. Therefore, the General Assembly could consider making changes to the exemption to address its limited use. As discussed, we identified barriers for low income applicants that may have reduced the number of patients filing for tax exempt status. For example, Medical Marijuana Registry staff indicated that applicants must submit a certified copy of their Colorado tax return from the most recent tax year to apply for a fee waiver or tax exempt status. However, individuals with income below the federal standard deduction, which was \$12,550 for single filers and \$25,100 for married joint filers in Tax Year 2021, likely do not owe income taxes and are generally not required to file a tax return. Therefore, many individuals that qualify for the Indigent Patients Exemption may not otherwise file tax returns and would need to do so in order to register as an indigent patient with the Medical Marijuana Registry. Additionally, Medical Marijuana Registry staff indicated that some applicants express concerns about obtaining the documentation from the Department to meet the requirements. Furthermore, the small number of patients with tax exempt status may be due to a lack of awareness, burdensome administrative requirements, and the potential stigma associated with acquiring and presenting a medical card that designates an individual as having a low income. Therefore, the General Assembly could consider:

- ALLOWING ALTERNATIVE DOCUMENTATION FOR INDIGENT PATIENTS TO ESTABLISH THAT THEY MEET THE EXEMPTION'S INCOME REQUIREMENTS. For example, other income-restricted state programs, such as the Supplemental Nutrition Assistance Program (SNAP), allow participants to establish eligibility by providing proof

of earned income (pay stubs, employer statement that includes pay per hour and hours per week, etc.), self-employment bookkeeping records (if self-employed), or an agency letter showing unearned income (Social Security Retirement or Disability income, Supplemental Security Income, Veterans Affairs pension or disability benefits, Unemployment, child support, alimony, private retirement, pension, etc.). Identity can be proven with a driver's license or state-issued identification card, birth certificate, Social Security card, work or school identification card, or voter registration card. Alternatively, some programs' eligibility is based on eligibility for another income-restricted program. For example, families are automatically eligible for the Women Infant Children Program (WIC) if they are receiving benefits from Temporary Assistance for Needy Families (TANF), Health First Colorado (Colorado's Medicaid), SNAP, or Food Distribution Program on Indian Reservations (FDPIR).

- **EXEMPTING ALL MEDICAL MARIJUANA SALES FROM SALES TAX.** This change would ensure that indigent patients do not pay sales taxes on their medical marijuana purchases and would provide medical marijuana purchases the same tax treatment as prescription drugs, which are exempt from sales tax. As discussed, we found that eight states exempt medical marijuana sales from tax (both sales and excise). We also identified at least one other state, Vermont, which exempts medical marijuana from the state sales tax under its prescription drug exemption. However, exempting all medical marijuana sales from sales tax would increase the revenue impact of the exemption to a total of about \$10.6 million from the current impact of \$10,133 in Tax Year 2021 due to the Indigent Patients Exemption, and reduce the total Marijuana Cash Fund revenue by a similar amount, assuming sales of medical marijuana are equivalent in future years to Tax Year 2021. Because Marijuana Cash Fund revenue is distributed to fund programs, services, and for the general purpose of regulating medical marijuana, it may reduce revenue for programs and departments that implement programs funded by the Marijuana Cash Fund.