

Taxing Legalized Marijuana: Equitable Options for a Marijuana Tax Scheme

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ABSTRACT

The legal marijuana industry in the United States is rapidly developing, but there is little consensus or uniformity among state tax structures for marijuana. This Essay argues that states should adopt a weight and potency hybrid system for taxing recreational marijuana. It provides background into “vice taxes” and the unique considerations and potential goals of a marijuana tax. It then outlines the various forms excise taxes on recreational marijuana could take, the various recreational marijuana tax schemes, and the benefits of each system, as discussed by scholars. This Essay concludes with a discussion of the taxes states have already implemented on recreational marijuana and an explanation for why a weight and potency hybrid system would be a more equitable option until there are further developments in the field.

Keywords: marijuana law tax, recreational marijuana, equitable considerations

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INTRODUCTION

The legal marijuana industry in the United States is rapidly developing. As of October 2022, thirty-seven states and four U.S. territories have legalized marijuana for medical usage.¹ Furthermore, nineteen states (as well as Guam and D.C.) have legalized the recreational use of marijuana.² States have the power to decide if and how to tax marijuana at both the medicinal and recreational levels. This Essay argues for a weight and potency hybrid system for taxing recreational marijuana as the most equitable option based on the current technology and knowledge available.

The issue at hand is incredibly complex, with a variety of factors for determining which system is the “best.” The nuances of and various angles from which to examine the question make it near impossible to determine one correct solution. This Essay offers a small glimpse into the vast field of taxation and other possibilities for taxing marijuana, such as wholesale versus resale taxes. It aims to analyze potential tax schemes based on how equitably and feasibly they can be implemented by states given the current state of technology and the market.

Because the topic of taxing marijuana is so broad and complex, the scope of this Essay is limited in several ways. For instance, it does not contemplate the effect of federal legalization or the possibility of federal taxes on marijuana. Additionally, it does not examine the supplemental, local taxes localities and municipalities are often allowed to levy by their respective states.³ Another limitation of this Essay is its focus on scholarly research and theories in place of considering more practical influences like the grey market of home growing or marijuana tourism. Lastly, the legal marijuana industry is in its infancy and rapidly developing. As a result, much of this Essay is based on educated speculation and predictions. There is little insight into how taxation will affect externalities and revenue in the long term since marijuana was only legalized recreationally in the past six years.⁴

The Essay begins by outlining the types of taxes typically levied on vices, the particular set of issues implicated in taxing marijuana specifically, and the potential goals of a marijuana tax. It then gives an overview of the various forms excise taxes on

¹ *State Medical Cannabis Laws*, NAT'L CONF. OF STATE LEGISLATURES (Sept. 12, 2022), <https://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>.

² Claire Hansen, Horus Alas, & Elliott Davis Jr., *Where Is Marijuana Legal? A Guide to Marijuana Legalization*, U.S. NEWS & WORLD REP. (Oct. 14, 2021, 2:24 PM), <https://www.usnews.com/news/best-states/articles/where-is-marijuana-legal-a-guide-to-marijuana-legalization>.

³ Benjamin Hansen, Keaton Miller, Boyoung Seo, & Caroline Weber, *Taxing the Potency of Sin Goods: Evidence from Recreational Cannabis and Liquor Markets*, 73 NAT'L TAX J. 511, 516 (2020).

⁴ Ulrik Boesen, *A Road Map to Recreational Marijuana Taxation*, TAX FOUND. 1, 2 (June 2020) [hereinafter *A Road Map*]. Colorado was the first state to legalize the sale of recreational marijuana in 2014. *Id.* The author speculates that the market will continue to expand in the years following the writing of this Essay.

recreational marijuana could take and the various recreational marijuana tax schemes and considerations scholars have proposed. Lastly, it discusses what taxes states have implemented on recreational marijuana before explaining why a weight and potency hybrid system is the current ideal.

I. TYPES OF TAXES: SALES AND EXCISE TAXES

In taxing a product such as marijuana, there are mainly two types of tax options: sales taxes and excise taxes. Sales taxes are the typical taxes applied to everyday purchases and services.⁵ The tax is calculated by multiplying the cost of the good or service by the stipulated tax rate.⁶ Theoretically, sales taxes apply to all retail transactions, but in practice, they are more complex with exemptions for specific items and different rates for different types of purchases.⁷

Excise taxes are levied on the manufacturing, sale, and/or consumption of a few specific products.⁸ The most common examples of excise taxes are those on tobacco and alcoholic products.⁹ Usually, excise taxes are used as “sin” (aka Pigouvian) taxes meant to offset the negative externalities associated with consuming these products;¹⁰ mainly by disincentivizing consumption. These taxes factor the “external cost”—what a private person using the “sinful” product costs (economically speaking) the public—into the product’s internal price for the consumer.¹¹ By increasing the price of marijuana, the excise tax is theoretically decreasing demand, thereby lowering marijuana usage and the associated externalities.¹² Excise taxes do not work well as tools solely intended for revenue production because they are typically focused on a narrow product or industry and thus are unstable sources of revenue. Additionally, they usually have regressive tax burdens.¹³ Therefore, excise taxes should mainly be used to capture a negative externality—not to raise revenue.¹⁴

The question then becomes whether either or both of these taxes are appropriate for purchases of marijuana. Most policy and tax experts agree that sales taxes are appropriate for recreational marijuana. Because sale taxes are meant to be applied to most, if not all, retail transactions, logically it follows that most marijuana purchases should have a sales

⁵ INST. ON TAX’N & ECON. POL’Y, HOW SALES AND EXCISE TAXES WORK 1 (Aug. 2011), <https://leg.mt.gov/content/Committees/Interim/2019-2020/Revenue/Meetings/July-2020/HJ-35/ITEP-How-Sales-and-Excise-Taxes-Work.pdf>.

⁶ *Id.*

⁷ *Id.*

⁸ *What Is an Excise Tax?*, TAX FOUND., <https://taxfoundation.org/tax-basics/excise-tax/> (last visited Nov. 18, 2021).

⁹ INST. ON TAX’N & ECON. POL’Y, *supra* note 5, at 2.

¹⁰ *What Is an Excise Tax?*, *supra* note 8 (“Excise taxes can be employed as Pigouvian taxes, or sin taxes, to price in externalities. An externality, in economics terms, is the side effect or consequence of an activity that is not reflected in the cost of said activity.”).

¹¹ Benjamin M. Leff, *Marijuana Taxation: Theory and Practice*, 101 B.U. L. REV. 915, 920–21 (2021).

¹² *Id.* at 919.

¹³ Ulrik Boesen, *Excise Tax Application and Trends*, TAX FOUND. 1, 2 (Mar. 2021).

¹⁴ *A Road Map*, *supra* note 4, at 2, 22.

tax applied.¹⁵ In fact, in 2020, only one recreationally legal state with a sales tax did not levy its general sales tax on recreational marijuana.¹⁶

The greater question is whether and how to apply an excise tax to recreational marijuana; that is, whether marijuana has a societal cost that justifies an extra tax. Like alcohol and tobacco, marijuana is a vice and regulated substance the government has an interest in decreasing; therefore, the purchase of marijuana should warrant an excise tax. Since most states already have an infrastructure for general sales tax, which they apply to marijuana, this Essay focuses on the different forms of excise taxes and the potential ways they could be implemented by states.

II. ISSUES WITH TAXING MARIJUANA

Marijuana's unique characteristics make it hard to create an appropriate and effective tax scheme. First, marijuana comes in many different forms: it can be smoked or vaporized in its flower form, "dabbed" as an oil or wax, infused into edibles, or taken orally as a tincture or capsule—just to name a few of the most popular delivery methods.¹⁷ Because of this variety, applying one uniform rule can be difficult.

Second, the external social costs of marijuana consumption are difficult to identify and even more difficult to quantify.¹⁸ Every excise tax requires consideration of the cost of externalities. However, marijuana's externalities are especially challenging to calculate because there have been no studies on them (as of 2020), and they can be impacted by substitution.¹⁹ This is likely to remain true as long as the federal government continues to classify marijuana as a Schedule I drug, strongly limiting research on the drug.²⁰ The limited research that does exist provides only speculative information regarding the drug's negative externalities. For instance, health concerns are often cited as a key risk of marijuana usage, yet scientists are still unclear on the associated health risks of marijuana usage.²¹ Experts have suggested other externalities that are more clearly societal, such as

¹⁵ For a discussion of sales tax and medical marijuana, see *infra* subpart II.A.

¹⁶ *A Road Map*, *supra* note 4, at 7 (The one state with a general sales tax is not levied on marijuana is Colorado).

¹⁷ DOUGLAS A. BERMAN & ALEX KREIT, MARIJUANA LAW AND POLICY 9–11 (2020).

¹⁸ *A Road Map*, *supra* note 4, at 22.

¹⁹ *Id.*

²⁰ The Schedule I classification "functionally serves to preclude large-scale scientific research in the United States." Researchers wishing to study marijuana must apply to the DEA and FDA, and if approved, they can only conduct research on marijuana grown in the singular federal facility created for this purpose. BERMAN & KREIT, *supra* note 17, at 422.

²¹ Hansen, Miller, Seo, & Weber, *supra* note 3, at 518 (stating that while long-term marijuana consumption has been linked to "liver, lung, and cardiovascular disease and . . . an increased risk of mental illnesses," scientists have not been able to find a causal relationship between marijuana usage and these health conditions.) Studies also conflict about what harm marijuana use causes while pregnant. See Chia-Shan Wu, Christopher P. Jew, & Hui-Chen Lu, *Lasting Impacts of Prenatal Cannabis Exposure and the Role of Endogenous Cannabinoids in the Developing Brain*, 6 FUTURE NEUROLOGY 459, 461 (2011) (claiming that the two foundational studies on prenatal exposure did not find a correlation between marijuana exposure and miscarriages and finding that the data and studies linking some other reported harms to prenatal

adolescent marijuana usage,²² secondhand smoke, and driving impairment.²³ However, there is still not enough research to show proof of or the extent of these social costs.²⁴

Ultimately, it is still unclear how the various elements of marijuana interact with the human body and to what capacity marijuana usage harms the public. Until the negative externalities can be reliably determined, it will be difficult to appropriately set excise tax rates on recreational marijuana. As a result, some experts recommend using Tetrahydrocannabinol (THC) content as a proxy for the external costs of marijuana consumption until more research can be done.

Third, illicit marijuana is more accessible than illicit tobacco or alcohol.²⁵ As a result, a tax scheme would need to factor in the black market and make sure prices are low enough to minimize illegal purchases.²⁶ Fourth, and finally, the marijuana industry is incredibly new and bound to evolve.²⁷ Any tax scheme implemented now needs to be adaptable to future changes and developments in the industry, and the industry should be monitored for significant changes that warrant a change in tax law.

In addition to marijuana-specific challenges, there are problems that any new tax law will inevitably face. As Pat Oglesby, former chief tax counsel of the U.S. Senate Finance Committee, stated: “The amount of tax to levy is a value judgment—there is no clear ‘right’ tax burden.”²⁸ He cautioned that “[t]echnical errors and drafting blunders will complicate the work.”²⁹ When creating tax schemes for recreational marijuana, legislators should take extra caution given the contention and demand around the product—both of which exacerbate the need for care and increase the magnitude of potential grievances.

III. GOALS OF TAXING MARIJUANA

Any marijuana tax scheme must also be evaluated, at least in part, by its goals. The most apparent purpose for an excise tax would be to discourage use and offset associated negative externalities and social costs.³⁰ Other potential goals include decreasing black market purchases and raising revenue for the government.³¹ Additionally, an excise tax on marijuana needs to straddle the line between being high enough to offset social costs

marijuana exposure were “weak” or irreproducible), and Hansen, Miller, Seo, & Weber, *supra* note 3, at 518 (citing a study that claims fetal marijuana exposure is correlated to miscarriages).

²² Leff, *supra* note 11, at 925–26.

²³ *A Road Map*, *supra* note 4, at 2.

²⁴ See Hansen, Miller, Seo, & Weber, *supra* note 3, at 517 (explaining that one study found marijuana impaired driving performance, but researchers from another study could not show that marijuana usage actually caused more traffic fatalities when analyzing data from two legal states).

²⁵ Pat Oglesby, *States May Be Stuck with Second-Best Marijuana Taxes*, 72 STATE TAX NOTES 539, 539 (2014) [hereinafter *States May Be Stuck*].

²⁶ *Id.*

²⁷ Pat Oglesby, *Marijuana Taxes — Present and Future Traps*, 83 TAX NOTES 391, 392 (2017) [hereinafter *Marijuana Taxes*].

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*; RICHARD PHILLIPS, INST. ON TAX’N & ECON. POL’Y, ISSUES WITH TAXING MARIJUANA AT THE STATE LEVEL 1 (May 2015).

³¹ *Marijuana Taxes*, *supra* note 27, at 392.

while not driving people to a black market.³² These goals can conflict as decreasing consumption also decreases the revenue that a state can obtain through the tax.

States may weigh these goals differently and prioritize the objectives each feels are most salient. “Sin taxes” are used to encourage a reduction in consumption to lower societal costs, like gasoline taxes; encourage consumption in moderation, such as with alcohol; or discourage consumption completely, as with cigarettes. Most states will likely take the first or third approach, depending on their views on marijuana. States that reluctantly legalized marijuana will likely want to reduce consumption, while states seeking to raise revenue from this specific market will encourage consumption tempered with caution. It is unlikely that any state which has legalized recreational marijuana will want to completely discourage consumption unless legalization happens against the legislature’s will;³³ and even then, pushing consumers to the black market is a risk the legislators are not likely to take. Ultimately, the objectives behind a marijuana tax will be individual and subjective based on state goals.

IV. TAXING MEDICAL MARIJUANA

Taxing medical marijuana raises a separate question: mainly, whether it should be subject to tax at all because it is a medicine. Currently, there is a broad range in how states tax medical marijuana from no taxes at all to different combinations of sales and excise taxes.³⁴

A. Sales Tax

Generally, prescription drugs are exempted from sales tax, while non-prescription drugs are not.³⁵ Therefore, whether medical marijuana should be subject to sales tax turns on whether it is better classified as a prescription or non-prescription drug. Richard Phillips, a senior tax analyst for the Senate Budget Committee, suggests that medical marijuana is best considered a non-prescription drug since it lacks Food and Drug Administration (FDA) approval, and thus, doctors cannot formally prescribe it.³⁶ According to Phillips, regular sales tax should apply to medical marijuana until the FDA approves it.³⁷

The key reason the FDA cannot or will not approve medical marijuana—thus prohibiting doctors from prescribing it—is that marijuana is still classified as a Schedule

³² PHILLIPS, *supra* note 30, at 2.

³³ One example of a state legalizing marijuana against the legislature’s will was Colorado, where voters legalized recreational marijuana in direct opposition of the then Governor, who at the time strongly opposed legalization. Dan Kedmey, *Colorado Governor: Legalizing Marijuana Was ‘Reckless’ Decision*, TIME (Oct. 7, 2014, 8:54 AM), <https://time.com/3478057/colorado-john-hickenlooper-reckless/>.

³⁴ *Breakdown of Taxes in Adult-Use States*, MARIJUANA POL’Y PROJECT (May 26, 2021), <https://www.mpp.org/issues/legalization/breakdown-taxes-adult-use-states/>.

³⁵ PHILLIPS, *supra* note 30, at 5.

³⁶ *Id.*

³⁷ *Id.*

1 drug under the Controlled Substance Act.³⁸ The Drug Enforcement Administration (DEA) and other federal agencies have consistently refused to recategorize marijuana to a lower schedule arguing there is insufficient evidence to show a potential medical benefit.³⁹ Ironically, this lack of evidence is likely because marijuana's Schedule 1 classification heavily limits the research that could legally be conducted on potential medical benefits of marijuana.⁴⁰ There are also political and racial motivations for marijuana's categorization which could explain why the government refuses to reschedule the drug despite the solid scientific evidence in favor of the medical benefits of marijuana.⁴¹ About these motivations, John Ehrlichman, Assistant for Domestic Affairs to President Richard Nixon, the President who declared the "war on drugs", stated:

You want to know what this was really all about. . . . The Nixon campaign in 1968, and the Nixon White House after that, had two enemies: the antiwar left and black people.... We knew we couldn't make it illegal to be either against the war or black, but by getting the public to associate the hippies with marijuana and blacks with heroin, and then criminalizing both heavily, we could disrupt those communities. We could arrest their leaders, raid their homes, break up their meetings, and vilify them night after night on the evening news. Did we know we were lying about the drugs? Of course we did.⁴²

While this campaign started nearly 60 years ago, the ACLU has found that "[t]he [wa]r on [m]arijuana [r]ages on" with over 6.1 million arrests for marijuana occurring between 2010 and 2018—making up more than 43% of all drug arrests.⁴³ More importantly, "a Black person is 3.64 times more likely to be arrested for marijuana possession than a white person, even though Black and white people use marijuana at similar rates" regardless of state, socioeconomic class, size of county, and size of Black population.⁴⁴

Although doctors cannot formally prescribe medical marijuana, patients also cannot simply purchase it as an over-the-counter drug. A patient in a recreationally legal state could indeed go to a recreational dispensary to purchase marijuana; however, they would not be able to get medical-grade products or any medical tax benefits without proof of their medical status. In every state that legalizes medical marijuana, a patient cannot

³⁸ Joseph Gregorio, *Physicians, Medical Marijuana, and the Law*, 16 AMA J. ETHICS 732, 733 (2014).

³⁹ German Lopez, *The Federal Drug Scheduling System, Explained.*, VOX (Aug. 11, 2016, 9:05 AM), <https://www.vox.com/2014/9/25/6842187/drug-schedule-list-marijuana>.

⁴⁰ *Id.*

⁴¹ David Downs, *The Science Behind the DEA's Long War on Marijuana*, SCI. AM. (Apr. 19, 2016), <https://www.scientificamerican.com/article/the-science-behind-the-dea-s-long-war-on-marijuana/>.

⁴² Dan Baum, *Legalize It All: How to Win the War on Drugs*, HARPER'S MAG. (Apr. 2016), <https://harpers.org/archive/2016/04/legalize-it-all/>.

⁴³ EZEKIEL EDWARDS, EMILY GREYTAK, BROOKE MADUBUONWU, THANIA SANCHEZ, SOPHIE BEIERS, CHARLOTTE RESING, PAIGE FERNANDEZ, & SAGIV GALAI, ACLU, A TALE OF TWO COUNTRIES: RACIALLY TARGETED ARRESTS IN THE ERA OF MARIJUANA REFORM 5, 7 (2020), https://www.aclu.org/sites/default/files/field_document/marijuanareport_03232021.pdf.

⁴⁴ *Id.*

obtain medical marijuana without a recommendation or certification from a medical professional.⁴⁵ The patient must register with the state, submit the physician's certification, and confirm they have a qualifying medical condition before receiving an ID card asserting their status as a medical patient entitled to the accompanying benefits.⁴⁶ The entire system in place is akin to—if not more rigorous than—attaining a typical medicinal prescription from a doctor.

Therefore, it makes sense to exempt medical marijuana from sales tax even though the FDA has yet to approve it. Most states that have legalized recreational marijuana do not subject medical marijuana to the sales tax levied on recreational marijuana. Eight out of the eighteen states do not tax medical marijuana in any capacity, sales tax or otherwise.⁴⁷

B. Excise Tax

In contrast, excise taxes are not applied to every transaction and are intended to discourage use and offset negative societal costs.⁴⁸ With medical marijuana, there is a health benefit to patients, so there is not a societal interest in discouraging use.⁴⁹ Moreover, “[w]hile recreational marijuana shares negative externalities (secondhand smoke, driving under the influence, health impacts) with other ‘sinful’ products like tobacco and alcohol, medical marijuana would, by definition, not be viewed the same way when recommended as a treatment for medical conditions.”⁵⁰ These other products do not have the same medicinal benefits that possibly negate the need to capture externalities.

On the other hand, there is a substantial concern that people will turn to medical marijuana and seek doctors' notes as a means to escape the excise taxes on recreational marijuana.⁵¹ As Oglesby contends, “[n]o tax would be evaded by a claim of bodily pain that, as a practical matter, is both unprovable and irrefutable.”⁵² Those with this opinion look at Colorado as an example of this same worry coming to life.⁵³ Two months after Colorado legalized marijuana, 70% of sales were by medical patients who did not pay excise taxes.⁵⁴ Oglesby's commentary on this occurrence highlights the skepticism medical marijuana faces: “That's a lot of sick people.”⁵⁵

Two tax policy experts have proposed solutions for handling the potential abuse of medical marijuana. First, Phillips suggests that states with more restrictive requirements

⁴⁵ MARIJUANA POL'Y PROJECT, SUMMARY OF STATE MEDICAL MARIJUANA LAWS 1 (Dec. 17, 2018), <https://www.mpp.org/issues/medical-marijuana/summary-of-state-medical-marijuana-laws/>.

⁴⁶ *Id.*

⁴⁷ *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

⁴⁸ PHILLIPS, *supra* note 30, at 5; *see supra* subpart I.A.

⁴⁹ PHILLIPS, *supra* note 30, at 5.

⁵⁰ *A Road Map*, *supra* note 4, at 2.

⁵¹ PHILLIPS, *supra* note 30, at 5.

⁵² *Marijuana Taxes*, *supra* note 27, at 394.

⁵³ PHILLIPS, *supra* note 30, at 5; *States May Be Stuck*, *supra* note 25, at 543.

⁵⁴ *States May Be Stuck*, *supra* note 25, at 543.

⁵⁵ *Id.*

for a doctor's note would have a better chance at limiting the number of people that do not need medical marijuana taking advantage of it.⁵⁶ Some states have imposed restrictions such as limiting the conditions that qualify for a doctor's note or the quantities or forms of marijuana that can be dispensed to medical patients.⁵⁷

Alternatively, Oglesby recommends taxing everyone equally regardless of whether they are medical marijuana patients or recreational users.⁵⁸ He believes that simplicity should be favored over fairness.⁵⁹ However, Oglesby acquiesces that if the medical components of marijuana could eventually be isolated and prescribed separately, reevaluating the tax scheme would make sense.⁶⁰

While these concerns over abuse of medical status are valid, applying the total excise tax to medical marijuana would negate the purpose of an excise tax to offset negative externalities. Better systems for qualifying for medical marijuana should be further researched, but a tax scheme needs to be in place until then. Because of the strong potential for abuse, medical marijuana should still be subject to some type of tax, but at a lower rate than that at which recreational marijuana is taxed. It is important to ensure that patients have access to medicine without the high barrier an excise tax can create—especially since the purpose of an excise tax is not fulfilled in taxing medical marijuana. There are already several states implementing some form of this suggestion that can serve as models.⁶¹

V. AN ANALYSIS OF THE POTENTIAL FORMS OF EXCISE TAXES

Applying an excise tax to marijuana is not as simple as it might seem. There are several types of taxes that states can theoretically implement at various stages of the retail process, from manufacturing to distribution to consumer sales. This Essay will primarily focus on consumer-level taxes since they are the most visible and widely discussed but will briefly touch on taxes higher up on the distribution chain. Specifically, this Essay will discuss price-based taxes, weight-based taxes, potency-based taxes, and manufacturer-directed taxes.

A. Price-Based Taxes

Price-based taxes, also known as *ad valorem* taxes, are the most common form of marijuana excise taxes.⁶² A price-based tax is calculated as a percentage of the sales

⁵⁶ PHILLIPS, *supra* note 30, at 5.

⁵⁷ *State Medical Cannabis Laws*, *supra* note 1.

⁵⁸ *Marijuana Taxes*, *supra* note 27, at 394.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Breakdown of Taxes in Adult-Use States*, *supra* note 34 (Arizona, Colorado, Illinois, Maine, Michigan, New Jersey, New York, and Rhode Island are examples of states where medical marijuana is exempt from excise taxes altogether or has a lower excise tax while not being completely tax-free.).

⁶² *A Road Map*, *supra* note 4, at 26.

price.⁶³ Consequently, a price-based tax is the simplest way to tax marijuana.⁶⁴ This simplicity likely explains the popularity of *ad valorem* taxes.

In addition to simplicity, there are other benefits to using a price-based tax. First, the tax will capture the same share of spending on marijuana even as the price changes.⁶⁵ Second, the tax will likely be correlated to potency because higher potency items are theoretically more expensive than lower potency items.⁶⁶

Nevertheless, there are also several disadvantages to using a price-based excise tax. First, a “drop in marijuana prices would dramatically erode the revenue that a value-based tax can raise.”⁶⁷ As the marijuana industry becomes more efficient, it is predicted that the price will level out, as most markets do.⁶⁸ Colorado is a prime example of a state where this price drop is already occurring, so the concern is genuine and imminent.⁶⁹ While revenue-raising is not a central goal excise taxes, it is interconnected to the goals of keeping the price high enough to discourage and compensate for the social cost of marijuana use. Second, the *ad valorem* model does not account for the tax principle that “[a] product with similar qualities and in similar quantities should have equal tax liability regardless of design or price.”⁷⁰ Meaning, the THC level in a product should be the focus of the tax, regardless of whether it comes in a fancier form or a more expensive brand.

Third, consumers are potentially harmed by this system because a price-based tax incentivizes consumers to choose cheaper alternatives, which, in turn, encourages manufacturers to lower costs, oftentimes by sacrificing product quality.⁷¹ Moreover, this “downdrading,” or consumers choosing cheaper products, trend does not relate to any externality the tax is trying to capture, so the excise tax is not most directly related to its purpose.⁷² Fourth, price-based taxes often result in tax pyramiding where a “wholesale tax is built into the retail selling price on which the retail tax is based, resulting in a tax on a tax.”⁷³ Essentially, manufacturers and retailers factor the costs of the taxes directed at them into the consumers’ retail price. This tax pyramiding leads to consumers bearing the brunt of the taxes despite not being the intended target. All of these disadvantages raise concerns over the equity of an *ad valorem* tax.

⁶³ *Marijuana Taxes*, *supra* note 27, at 393.

⁶⁴ *Id.*

⁶⁵ PHILLIPS, *supra* note 30, at 4.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ CARL DAVIS, MISHA E. HILL, & RICHARD PHILLIPS, INST. ON TAX’N & ECON. POL’Y, TAXING CANNABIS 12 (Jan. 2019), https://itep.sfo2.digitaloceanspaces.com/012319-TaxingCannabis ITEP_DavisHillPhillips.pdf.

⁶⁹ *Id.*

⁷⁰ *A Road Map*, *supra* note 4, at 26–27.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

B. Weight-Based Taxes

An alternative to a price-based tax is a weight-based tax. This tax is also known as specific taxation,⁷⁴ or per-unit taxation.⁷⁵ As the name implies, this tax is levied at a specific cost per item or unit⁷⁶ or calculated by volume.⁷⁷ A per-unit tax is generally the most common excise tax type.⁷⁸ For example, cigarettes are taxed at a flat rate per pack,⁷⁹ and gasoline is taxed in cents per gallon.⁸⁰ In taxing marijuana, the per-unit or specific tax would most logically be weight-based.⁸¹

There are a few key benefits of a weight-based system for taxing marijuana. To start, the tax is relatively stable and not likely to be affected if the predicted price drop of marijuana occurs.⁸² The amount collected remains the same per product (of the same weight and category) without regard to brand or price.⁸³ This blindness to cost might make the excise tax, whose purpose is to capture the externalities of consumption, more equitable. Moreover, a weight-based tax may counterbalance any price drop by establishing a minimum selling price at the retail level.⁸⁴ Lastly, an artificial market valuation of marijuana—such as retail price—would not be required to implement this form of taxation.⁸⁵

Despite the advantages of a weight-based tax system, there are still significant drawbacks to consider. Namely, “[a] flat, weight-based marijuana tax may inadvertently incentivize producers to cultivate stronger marijuana because it would have a higher sale price, yet still only be subject to the same per-unit tax as lower potency marijuana.”⁸⁶ Similarly, a weight-based tax can end up being regressive since consumers pay the same taxes regardless of the quality and cost of the product.⁸⁷ Furthermore, because marijuana comes in many forms that are not analogous by weight (for instance one gram of flower is very different than a gram of concentrated THC oil), it is “untenable” to have a flat, weight-based tax.⁸⁸ Consequently, a more complex system would be needed with multiple weight categories similar to what legislatures already use for taxing alcohol and tobacco.⁸⁹ Other considerations also need to be factored in, such as the weight discrepancies between fresh and dried flowers and effects of new preservation and

⁷⁴ *Id.*

⁷⁵ PHILLIPS, *supra* note 30, at 3.

⁷⁶ INST. ON TAX’N & ECON. POL’Y, *supra* note 5, at 2; PHILLIPS, *supra* note 30, at 3.

⁷⁷ *A Road Map*, *supra* note 4, at 27.

⁷⁸ INST. ON TAX’N & ECON. POL’Y, *supra* note 5, at 2.

⁷⁹ *Id.*; PHILLIPS, *supra* note 30, at 3.

⁸⁰ INST. ON TAX’N & ECON. POL’Y, *supra* note 5, at 2.

⁸¹ *A Road Map*, *supra* note 4, at 27.

⁸² Leff, *supra* note 11, at 929; PHILLIPS, *supra* note 30, at 3.

⁸³ *A Road Map*, *supra* note 4, at 27.

⁸⁴ *Id.* at 28.

⁸⁵ *Id.*

⁸⁶ PHILLIPS, *supra* note 30, at 3.

⁸⁷ INST. ON TAX’N & ECON. POL’Y, *supra* note 5, at 2.

⁸⁸ JOSEPH HENCHMAN, TAX FOUND., TAXING MARIJUANA: THE WASHINGTON AND COLORADO EXPERIENCE 2 (Aug. 2014), <https://files.taxfoundation.org/legacy/docs/FF437.pdf>.

⁸⁹ *A Road Map*, *supra* note 4, at 28.

extraction techniques such as flash freezing,⁹⁰ which removes water weight from flower and significantly increases the volume to weight ratio.⁹¹

As a result, most weight-based taxes are levied on the plant material and not the final product, which excludes externalities associated with the product's final form.⁹² Specific forms of marijuana might have higher externalities that legislators (or society) would want to capture. For example, edibles are more easily consumed and take longer to metabolize, which can lead to consumers taking higher doses of THC than they anticipated or desired. Journalist Maureen Dowd famously highlighted this issue in her *New York Times* article discussing her distressing experience with THC-infused chocolate.⁹³ A weight-based tax system would not account for this externality without extreme difficulty because it would need to be a complex system with different classes that would each be taxed differently to incorporate the many end forms of marijuana. Lastly, a weight-based tax is not dynamic, so while it will not decrease as price drops, it likely will not increase continuously either.⁹⁴

C. Potency-Based Taxes

The last type of consumer-directed excise taxes is a potency-based tax. Under this kind of system, the excise tax would be directly related to the THC levels in the product, with higher levels of THC taxed at a higher rate.⁹⁵ As of 2020, Illinois was the only state to incorporate potency in its marijuana tax scheme.⁹⁶ Since then, Connecticut and New York have legalized recreational marijuana and enacted potency-based excise taxes on the consumer and wholesale levels respectively.⁹⁷

The key benefit of a potency-based tax is that THC consumption is likely the best way to account for the negative externalities the excise tax aims to capture.⁹⁸ Additionally, a potency-based tax encourages consumers to purchase and consume less-potent products.⁹⁹ This incentive may decrease societal costs of THC consumption and discourages heavy use. Finally, because a potency-based tax more completely captures negative externalities in comparison to the other methods of taxation, it is the most equitable solution.¹⁰⁰

⁹⁰ *Id.*

⁹¹ *What is Flash Frozen Cured?*, SPACE WEED USA, <https://www.spaceweedusa.com/learn> (last visited Dec. 28, 2022) (A manufacturer of flash frozen marijuana flower claims its product has double the volume of “normal weed.”).

⁹² *A Road Map*, *supra* note 4, at 28–29.

⁹³ Maureen Dowd, Opinion, *Don't Harsh Our Mellow, Dude*, N.Y. TIMES (June 3, 2014), <https://www.nytimes.com/2014/06/04/opinion/dowd-dont-harsh-our-mellow-dude.html>.

⁹⁴ Leff, *supra* note 11, at 929.

⁹⁵ *A Road Map*, *supra* note 4, at 29.

⁹⁶ *Id.* at 13.

⁹⁷ *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

⁹⁸ *A Road Map*, *supra* note 4, at 23, 29.

⁹⁹ *Id.* at 31.

¹⁰⁰ *Id.* at 29.

As with all tax options, there are downsides to a potency-based tax system as well. A potency-based tax would likely be the most complex system to implement.¹⁰¹ For example, reliably testing the product's potency is a significant issue. Currently, the results of potency tests are heavily dependent on which lab conducts the test.¹⁰² Also, there is the difficulty of measuring marijuana potency in its various forms. The most straightforward way to test potency might be measuring concentrates or other derivatives of marijuana, but marijuana is not only sold in this form.¹⁰³ However, measuring the THC in dried plants is more complicated than measuring it in derivative forms and unprecedented in tax schemes for nicotine and tobacco.¹⁰⁴ Additionally, which cannabinoids should be measured is unclear because cannabinoids besides THC may play a role in potency and inhibition.¹⁰⁵ Lastly, while revenue from a potency-based tax will remain stable if there is a price drop, it will not increase either to counterbalance the price drop and is therefore not dynamic.¹⁰⁶

D. Manufacturer-Directed Tax

The last option this Essay discusses is taxing manufacturers instead of consumers. Oglesby suggests this tax base is one of the most feasible options in addition to weight, potency, and price schemes.¹⁰⁷ Specifically, he suggests that manufacturers could be taxed by square footage of their operations or by the number of cultivated plants.¹⁰⁸ One benefit of this tax is that there is little risk of pretax leakage, (i.e. taxes being evaded or uncollected) because the tax is implemented at the head of the supply chain.¹⁰⁹ Additionally, this tax structure is much simpler and “requires little lead time to implement” in contrast to weight or potency-based tax.¹¹⁰ However, manufacturer-directed taxes have drawbacks as illustrated by California’s implementation of a cultivation tax per square foot of cultivation.¹¹¹ California localities levy the tax through gross tax receipts, which results in tax pyramiding as the tax cost is continuously passed on to each stage of the retail process.¹¹² While this tax might be more logically straightforward than some other forms, it must be implemented carefully to avoid tax pyramiding.

¹⁰¹ *Id.*

¹⁰² *Id.* at 29–30 (“This is no small issue as there may be significant problems developing tests that reliably measure the THC level consistently. The marijuana industry is a young industry and currently test results depend on which lab tests the product.”).

¹⁰³ *Marijuana Taxes*, *supra* note 27, at 394.

¹⁰⁴ *Id.*

¹⁰⁵ *A Road Map*, *supra* note 4, at 29.

¹⁰⁶ Leff, *supra* note 11, at 929.

¹⁰⁷ *States May Be Stuck*, *supra* note 25, at 541. Oglesby specifically outlines these bases saying that “[p]ossible bases for marijuana taxes include weight, potency, percentage of sale price, number of plants, production area square footage, or abnormally high electricity use.” *Id.* He then rejects electricity as not being a feasible long-term solution. *Id.* at n. 12.

¹⁰⁸ *States May Be Stuck*, *supra* note 25, at 543.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *A Road Map*, *supra* note 4, at 9.

¹¹² *Id.*

VI. POTENTIAL SOLUTIONS AND CONSIDERATIONS

There are three chief solutions scholars endorse as effective tax systems for recreational marijuana: a potency-based system, a weight-based system, and a combination of the two. Scholars also offer considerations states should take into account when devising their tax systems on marijuana.

A. Proposed Solutions

The first solution is a potency-only test. Ulrik Boesen, a senior policy analyst at The Tax Foundation, suggests this system is the best short-term solution.¹¹³ His recommendation explicitly “[d]isregard[es] the issues surrounding testing”¹¹⁴—a fairly large oversight given the current technological limitations.¹¹⁵ Boesen recommends a potency system based on THC content alone until further research is done.¹¹⁶ He posits that a potency-based system is the best way to capture the negative externalities of recreational marijuana usage.¹¹⁷ To best implement this tax scheme, Boesen offers three pieces of guidance: 1) reconsider the taxation categories as the market develops and new research emerges on how to best capture the externalities, 2) factor into the tax code the harm caused by the delivery method of marijuana consumption, and 3) consider levying the tax on the wholesale level to avoid tax pyramiding while also decreasing the number of taxpayers the government has to deal with.¹¹⁸

Nonetheless, some scholars deem a potency-based tax system impractical because of the current technological limitations on testing the potency of marijuana products.¹¹⁹ Unprocessed marijuana may never have a reliable test for potency, similar to the issue of measuring nicotine in cigarettes.¹²⁰ If testing cannot be done reliably and in a manner accessible to manufacturers, a solely potency-based tax system is unrealistic. Such a tax would be inequitable and would not correctly capture the externalities an excise tax aims to collect.

Alternatively, a tax system based primarily on weight is proposed in a report from the Institute on Taxation and Economic Policy (ITEP) written by Carl Davis, Misha Hill, and Richard Phillips. ITEP concludes that a weight-based excise tax on recreational marijuana makes the most sense for the long-term because of its purported stability.¹²¹ They believe *ad valorem* taxes are too unstable because of the projected price drop,¹²² and a potency-based tax is problematic because testing is currently too unreliable.¹²³ In

¹¹³ *Id.* at 31.

¹¹⁴ *Id.*

¹¹⁵ See *supra* subpart III.C.

¹¹⁶ *A Road Map*, *supra* note 4, at 31.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ DAVIS, HILL, & PHILLIPS, *supra* note 68, at 10–11.

¹²⁰ *Id.*; *States May Be Stuck*, *supra* note 25, at 541.

¹²¹ DAVIS, HILL, & PHILLIPS, *supra* note 68, at 5.

¹²² *Id.*

¹²³ *Id.* at 11.

order to obtain the most revenue, ITEP suggests indexing the tax to grow alongside inflation each year to maintain the tax's value over time.¹²⁴ ITEP acknowledges that their favored system would not account for potency, but suggests that states may account for potency by setting different tax rates for the various categories of products and potencies.¹²⁵

ITEP's proposal leads to scholars' third tax scheme suggestion—a hybrid of potency and weight-bases. The simplest way to implement this system could be to model it after the way legislatures currently tax alcohol, where liquor is taxed at a higher rate per gallon than wine and beer, which have lower alcohol content.¹²⁶ Boesen posits that “[b]y introducing THC intervals in a similar style to alcohol intervals, testing may be easier as the acceptable margin of error is larger. This could be done by taxing the plant materials according to weight, but at different rates according to THC content.”¹²⁷ He acquiesces such a system has the potential to distort the market due to resulting tax cliffs but still believes factoring in potency is “the most equitable and realistic option at this point.”¹²⁸ Eventually, each category's tax brackets could become more linear as the reliability of potency tests improve.¹²⁹

Importantly, most scholars heavily discourage a solely *ad valorem* excise tax.¹³⁰ Boesen cautions explicitly that “[t]o best tax marijuana products equitably and stably, policymakers should stay away from ad valorem taxes despite their simplicity.”¹³¹ Because legalized recreational marijuana is still fairly new in the United States, the accuracy of Boesen's prediction remains unknown. While states that have implemented *ad valorem* excise taxes on recreational marijuana have seen an increase in revenue each year, the rate of revenue growth for the more senior states seems to be slowing down.¹³² If a state insists on a price-based tax, ITEP suggests implementing it alongside a weight-based tax to increase the tax's stability for the long run.¹³³ ITEP highlights Maine's system¹³⁴ where consumers pay a price-based excise tax while manufacturers pay a weight-based tax as an example of this model.¹³⁵

B. Considerations

Scholars also offer a few essential considerations for designing a tax scheme for recreational marijuana. First, states should contemplate slowly implementing the tax as

¹²⁴ *Id.* at 5.

¹²⁵ *Id.* at 9.

¹²⁶ *Id.*

¹²⁷ *A Road Map*, *supra* note 4, at 30.

¹²⁸ *Id.*

¹²⁹ *Id.* at 32.

¹³⁰ DAVIS, HILL, & PHILLIPS, *supra* note 68, at 11; *A Road Map*, *supra* note 4, at 31.

¹³¹ *A Road Map*, *supra* note 4, at 31.

¹³² *Cannabis Tax Revenue in States that Regulate Cannabis for Adult Use*, MARIJUANA POL'Y PROJECT (Apr. 5, 2022), <https://www.mpp.org/issues/legalization/cannabis-tax-revenue-states-regulate-cannabis-adult-use/>.

¹³³ DAVIS, HILL, & PHILLIPS, *supra* note 68, at 11.

¹³⁴ *Id.* at 9.

¹³⁵ *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

the marijuana market grows.¹³⁶ Doing so will help the legal market compete with the black market and acclimate consumers to shopping legally so they will not be deterred by the taxes as they eventually increase.¹³⁷ States should balance this interest with the fact that lower prices can lead to more consumption, which will increase societal costs. Additionally, states need to balance fighting the black market with constituent satisfaction since constituents tend to be unhappy with tax increases.¹³⁸ Second, states might consider using the excise tax as a means to create a price floor.¹³⁹ Phillips illustrates what this may look like: “For example, if the pretax price of retail marijuana falls to \$60 per ounce, but state lawmakers want to ensure that marijuana is never cheaper than \$100 an ounce, the state could require that the total tax collected at the cash register be the greater of the statutory tax rate, or the tax rate needed to raise the final price to \$100 (\$40 in this case).”¹⁴⁰ Third, state constitution construction may make amending a tax law once it is on the books difficult; therefore, states should give much thought and deliberation to the long-term ramifications of their tax design for recreational marijuana.¹⁴¹ While choosing the most straightforward scheme (likely *ad valorem*) as a placeholder until the industry develops may be tempting, states could get stuck with their chosen tax model for longer than they anticipate.

VII. CURRENT STATE MODELS

While theoretical conjectures and proposals are helpful, analyzing what is really happening in the world is critical. Currently, only two recreationally legal states do not have an excise tax for recreational marijuana at the retail level—Alaska and New Jersey.¹⁴² Both opted only to have an excise tax at the wholesale level.¹⁴³ Of the remaining seventeen¹⁴⁴ states, fifteen implemented a solely *ad valorem* tax at the retail level with rates ranging from 8-37%.¹⁴⁵ Interestingly, New Mexico chose to phase in its tax rate with gradual, annual increases until 2030.¹⁴⁶ New Mexico’s policy will serve as an exciting case study in the future to see if scholars were correct in suggesting states implement such an approach.

¹³⁶ *Id.* at 9.

¹³⁷ PHILLIPS, *supra* note 30, at 5; DAVIS, HILL, AND PHILLIPS, *supra* note 68, at 5.

¹³⁸ *Marijuana Taxes*, *supra* note 27, at 394.

¹³⁹ PHILLIPS, *supra* note 30, at 5.

¹⁴⁰ *Id.*

¹⁴¹ *Marijuana Taxes*, *supra* note 27, at 394.

¹⁴² *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

¹⁴³ *Id.*

¹⁴⁴ While South Dakota has passed an amendment which would legalize recreational marijuana, its Supreme Court is still deciding the constitutionality of the amendment. The proposed amendment did levy a tax which was solely based on price and would be 15% of the sales price at the retail level.

¹⁴⁵ *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

¹⁴⁶ *Id.*

Illinois and Connecticut both employ systems more aligned with scholarly proposals. Illinois has a tax scheme for recreational marijuana based on both potency and sales price.¹⁴⁷ Taxes on recreational marijuana in Illinois are as follows:

Any cannabis, other than a cannabis-infused product, with an adjusted delta-9-tetrahydrocannabinol level at or below 35% shall be taxed at a rate of 10% of the purchase price;

Any cannabis, other than a cannabis-infused product, with an adjusted delta-9-tetrahydrocannabinol level above 35% shall be taxed at a rate of 25% of the purchase price; and

A cannabis-infused product shall be taxed at a rate of 20% of the purchase price.¹⁴⁸

These tax rates are among the highest in any state. A reasonable inference is that Illinois might be trying to disincentive citizens from purchasing high-potency marijuana products.

Comparatively, Connecticut's tax system for recreational marijuana combines both weight and potency.¹⁴⁹ In Connecticut, recreational marijuana is taxed at a rate of \$0.00625/mg THC for flower; \$0.0275/mg THC for edibles; and \$0.009/mg THC for other products.¹⁵⁰

This data shows most states choose to implement *ad valorem* systems despite the concerns tax and policy analysts have regarding those schemes. While the reasons why states are so drawn to this model is unclear without further research, one can presume scholars are likely correct in saying states would be attracted to the simplicity of *ad valorem* taxes and the ease of implementation. Time will tell whether scholars are correct about the long-term instability of *ad valorem* taxes on recreational marijuana. The different models each state has chosen should be studied as the legal marijuana industry levels out, to see which system(s) captures the most negative externalities and produces the most revenue in the long term.

VIII. POLICY RECOMMENDATIONS

A. The Ideal Excise Tax

Out of the three proposed options for an excise tax on marijuana, a weight and potency hybrid system is currently the ideal choice. This system captures externalities more equitably than a solely potency-based tax. Processed products, such as extracts and edibles, could be taxed in brackets by potency, while unprocessed marijuana, which cannot currently be reliably tested for potency, could be taxed by weight. This way, the

¹⁴⁷ *Id.*

¹⁴⁸ *Resource Page for Taxes on Cannabis Sales - UPDATED*, ILL. REVENUE (June 27, 2021), <https://www2.illinois.gov/rev/research/taxinformation/other/Pages/Cannabis-Taxes.aspx>.

¹⁴⁹ *Breakdown of Taxes in Adult-Use States*, *supra* note 34.

¹⁵⁰ *Id.*

different types of marijuana would be taxed based on their characteristics and the current testing limitations.

Additionally, by not relying solely on weight and incorporating potency, this system discourages heavy consumption and discourages consumers from purchasing products with higher THC concentrations. Third, this tax scheme would remain stable throughout the marijuana market's leveling out process and subsequent price drop. If a state government is concerned about raising revenue, it will not want tax revenue to decrease drastically over time. While this system might be more difficult for states to set up, the complexity will ensure longevity and satisfied objectives. Since amending tax laws once they are on the books is hard, states should invest time and thought now into implementing the most ideal system possible the first time around.

B. Recommendations for Future Research

The most obvious place to continue research on effective recreationally marijuana tax schemes is to conduct case studies on each state's tax system in upcoming years. This research should look beyond revenue and measure the societal costs and negative externalities accounted for by the tax to quantify each system's true success.

Additionally, research in this field will benefit from controlling for factors not directly related to the marijuana tax that may affect an individual state's results. New Mexico, in particular, should be studied as an example of how phasing in the total tax rate actually affects marijuana sales in the black market.

Another critical area of research is each state's objective(s) in choosing and levying its tax system. States need to weigh revenue-raising, reduction of marijuana consumption, and elimination of the black market, among other considerations, when designing their system. States are likely to prioritize these considerations differently based on their unique needs and concerns. States' legislative intent can provide insight into which considerations were factored into their decisions. Ideally this will provide a greater understanding as to the practicalities of devising a tax system for recreational marijuana. Lastly, analyzing how a federal tax or legalization might affect the discussion of the ideal tax model would be prudent as well.

Pat Oglesby suggests a government monopoly might be the best method for the distribution of marijuana.¹⁵¹ If the federal government ever implemented such a system, states would need to reconsider their entire tax models for marijuana. Ultimately, there are still many gaps in the research on taxing legalized marijuana, and hopefully, researchers and scholars to come will continue the conversation.

¹⁵¹ *States May Be Stuck*, *supra* note 25, at 539.