

**HF600 - 4E - Legalize Cannabis**

Chief Author: **Ryan Winkler**  
 Committee: **Agriculture Finance and Policy**  
 Date Completed: **4/15/2021 9:31:02 AM**  
 Agency: **Revenue Dept**

State Fiscal Impact	Yes	No
Expenditures	X	
Fee/Departmental Earnings		X
Tax Revenue	X	
Information Technology	X	
Local Fiscal Impact	X	

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions shown in the parentheses.

State Cost (Savings)	Biennium			Biennium		
	Dollars in Thousands	FY2021	FY2022	FY2023	FY2024	FY2025
General Fund	-	4,393	4,093	4,113	4,009	
<b>Total</b>	<b>-</b>	<b>4,393</b>	<b>4,093</b>	<b>4,113</b>	<b>4,009</b>	<b>4,009</b>
<b>Biennial Total</b>			<b>8,486</b>			<b>8,122</b>

Full Time Equivalent Positions (FTE)	Biennium			Biennium	
	FY2021	FY2022	FY2023	FY2024	FY2025
General Fund	-	25.03	29.59	29.76	28.89
<b>Total</b>	<b>-</b>	<b>25.03</b>	<b>29.59</b>	<b>29.76</b>	<b>28.89</b>

**LBO Analyst's Comment**

I have reviewed this fiscal note for reasonableness of content and consistency with the LBO's Uniform Standards and Procedures.

This bill will impact state tax revenues. An estimate of revenue impact is not included in this fiscal note. The Department of Revenue prioritizes revenue estimate requests for bills before Tax Committee and will provide one for this bill when it is before Tax Committee.

**LBO Signature:** Joe Harney      **Date:** 4/6/2021 10:41:54 AM  
**Phone:** 651-284-6438      **Email:** joe.harney@lbo.leg.mn

**State Cost (Savings) Calculation Details**

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions are shown in parentheses.

\*Transfers In/Out and Absorbed Costs are only displayed when reported.

<b>State Cost (Savings) = 1-2</b>		<b>Biennium</b>			<b>Biennium</b>	
<b>Dollars in Thousands</b>		<b>FY2021</b>	<b>FY2022</b>	<b>FY2023</b>	<b>FY2024</b>	<b>FY2025</b>
General Fund	-	4,393	4,093	4,113	4,009	
<b>Total</b>	<b>-</b>	<b>4,393</b>	<b>4,093</b>	<b>4,113</b>	<b>4,009</b>	<b>4,009</b>
	<b>Biennial Total</b>		<b>8,486</b>			<b>8,122</b>
<b>1 - Expenditures, Absorbed Costs*, Transfers Out*</b>						
General Fund	-	4,393	4,093	4,113	4,009	
<b>Total</b>	<b>-</b>	<b>4,393</b>	<b>4,093</b>	<b>4,113</b>	<b>4,009</b>	<b>4,009</b>
	<b>Biennial Total</b>		<b>8,486</b>			<b>8,122</b>
<b>2 - Revenues, Transfers In*</b>						
General Fund	-	-	-	-	-	-
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
	<b>Biennial Total</b>		<b>-</b>			<b>-</b>

**Bill Description**

The bill legalizes cannabis for adult use. It establishes a Cannabis Management Board to oversee all agency activity related to the legalization and regulation of cannabis.

This summary covers the provisions in the bill that impact the Department of Revenue (DOR), primarily in Article 2, Taxes.

Cannabis manufacturer’s expenses, whether medical or licensed under 342 (new legislation), are not allowed as a subtraction for federal income tax purposes under section 280E of the IRS Code.

The retail sale of cannabis would be taxed at the general sales tax rate.

Cannabis would be subject to a 10% gross receipts tax on the retail level as a result of this bill and a use tax will be imposed. The gross receipts tax will be collected by cannabis retailers and microbusinesses with nexus in Minnesota. Medical cannabis and adult use cannabis brought into the state valued at \$100 dollars or less will be exempt.

The Cannabis Products Gross Receipts Tax will be effective for gross receipts received after December 31, 2022.

**Assumptions**

DOR will need to update the Integrated Tax System (GenTax) and other computer systems, which includes analysis, gathering requirements, and system testing. A new Account type will be established for the 10% gross receipts tax. This includes creating registration, eServices return filing and payment system, audit, billing, financials, letters, interfaces, data capture, etc. Additional staff would be needed beginning in FY22 for systems analysis and testing for the new account type. See the **FTE impact** table below for the FTE impact needed each year. Staff will be needed on an ongoing basis.

DOR assumes this bill will require an offsite facility to collect cash payments. The offsite option was discussed at length and determined to be the best solution for the following reasons: cost and disruption to renovate a location at DOR’s main office (Stassen); renovation of existing space in Stassen was more expensive; better security and safety for Revenue staff and customers; perception of the public stemming from association with cannabis; one location for all payments to be received; less traffic for customers to location potentially not located downtown; and reduction of internal risk involving potential disclosure and personal association. This facility will need to be secure, accessible, and able to handle large cash payments. There will be additional staff needed in the Tax Operations Division to schedule and collect the payments. DOR will incur expenses for the rent and renovation of an offsite location requiring set up of software/system, safe, and staff to handle payment of returns. This potentially includes armored transport.

The model for an offsite facility was based off conversation and review of other states, mainly Oregon. Federally backed banks cannot take money from the sale of cannabis so reliance was put on state backed banks. In the state of Oregon, the state banks also did not want to accept the funds, which is a potential in MN as well. This requires large amounts of cash to be paid for Cannabis returns. In Oregon the paying parties regularly showed up fully armed; this would cause numerous potential issues in Revenue. In order to process the cash, additional security and equipment such as counting machines are required. If cannabis is legalized at a Federal level, an offsite location could continue operation. 4 AFSCME and 1 MMA FTE's are needed to staff this outside location for scheduling, collecting, and processing of payments. 1 MAPE FTE is needed for system upgrades including the creation of the new tax type and setup of computers and GenTax cashiering system at an offsite location. This additional staff is needed on an ongoing basis.

DOR will need additional taxpayer assistance, enforcement, compliance and appeals staff.

The Special Taxes Division assumes 12 FTE's at MAPE level, 1 Supervisor and 1 Managerial level FTE will be needed on an ongoing basis beginning in FY22. A new unit will be needed to administer the new tax. The Special Tax Division currently oversees over 150 specialty taxes and fees and the addition of an Assistant Director will give the division the support it needs to manage the addition of a new, complex tax type, especially on a product that will have just been made legal. The unit size was determined based on other unit sizes for similar tax types and tax needs. We will need employees for auditing, taxpayer education, compliance, policy work, systems, legal review, etc. For reference, when the MinnesotaCare tax became law an entire division was created to set up and administer the tax.

The new FTE's for the Special Taxes Division would be needed in FY22. Processes and procedures for a new unit will need to be established before the tax begins. It takes time to create new accounts within GenTax, test them, and bring them into production for taxpayers to start using. We also need to create, review, and publish letters, returns, education material and employee information, and all documents need to go through our communications procedures which also takes time. Auditing processes and procedures and compliance process and procedures need to be created as well.

The Corporate Franchise Tax Division (CFT) assumes additional staff will be needed. Since the subtractions in the bill are effective for tax years beginning after 12/31/21, returns with non-medical subtraction will first be received for calendar year filers for tax year 2022, with the possibility of short-year 2021 returns. CFT assumes we will audit returns immediately, in 2023, in order to encourage compliance with the recently created subtraction for a new set of taxpayers. We assume that all returns received in early years will be reviewed at a high level via a pre-audit, since the subtraction is new and cannot be checked against values on the federal return. CFT assumes 190 business returns will be filed as a result of the changes in this bill. See the **FTE Impact** table below for details.

The bill subjects cannabis and cannabis products to sales tax as well as the gross receipts tax. The Sales Tax Division assumes 2 additional FTE will be needed due to the language in this bill. These employees will specialize in the industry, be granted appropriate security permissions to access specific software databases, be the primary auditors for sales and use tax audits of businesses within the industry, assist in the development of training material (internal and external), and assist other divisions during potential joint audit ventures. One FTE is assumed to be needed in FY22 as the language of the bill is effective for only half of the fiscal year. We anticipate that for a full fiscal year, 2 FTEs will be required to perform the duties as described above. See the **FTE Impact** table below.

DOR will need additional legal staff to respond to requests for legal advice, analysis, and opinions. One FTE in FY22-FY25 and ongoing will be needed for this work. Since this is a new tax type, it is assumed there will be front-end work that could include issuing revenue notices, administrative rules, fact sheets, research, memos and other related work for the legal staff.

DOR will need 0.25 FTE beginning in FY23 and ongoing for sales tax appeals. This impact is determined by a formula that takes into account the number of auditors the Sales Tax Division assumes is needed, the number of appeals that tend to be generated by one auditor in one year, and the number of appeals that can be completed per appeals officer in one year.

The Criminal Investigations Division (CID) assumes a significant increase in cases as a result of this bill and will need 2 Criminal Investigators and 1 Supervisor, beginning FY23 for that work. CID also assumes specialized equipment and supplies, including one vehicle, will be needed. These costs include a 5-year lease on a Toyota Highlander Hybrid (\$676.02/month) and fuel. Additional subpoena costs are estimated at \$1,500/year, beginning in FY23.

CID believes that enactment of any legislation legalizing and taxing cannabis at the retail level will increase the number of criminal referrals to CID. Additional staff and resources will be necessary to deal with the increase in criminal referrals. Based on conversations with other states, criminal investigation referrals increased as a result of their cannabis legislation.

Our estimate is based on the number of tobacco investigations that CID conducts on an annual basis, as discussed below.

Under this bill, the retail sale of cannabis would be taxed at the general sales tax rate and a 10% gross receipts tax would be added. The criminal tax provisions of M.S. 289A.63 would apply, and CID would have jurisdiction over investigation of failure to file and/or pay these taxes as well as filing of false returns. CID would treat these criminal tax investigations as we would a general rate sales tax criminal tax investigation.

We anticipate that these businesses will be heavily cash intensive, due to federal banking issues and other factors. We further anticipate that pursuing these cash intensive cases may require additional investigative efforts. Identifying, investigating, and prosecuting under-reporting of sales will require extensive surveillance at suspect sites. This will require multiple unmarked vehicles.

Due to the nature of the investigation being a criminal investigation, CID conducts surveillance using unmarked state vehicles for surveillance activities and search warrants. These efforts typically also include search warrants and would be more labor intensive than tobacco investigations. CID currently operates with one vehicle per three investigators.

The CID FTE assumption is based on an estimate of a closely related activity we currently investigate tobacco investigations. CID sees approximately 25-30 tobacco investigations per year. We anticipate that cannabis will involve many of the same players from tobacco using similar operations. Both types of cases require research, training, surveillance, electronic tracking, search warrants, subpoenas, financial analysis, witness interviews, collaboration with other law enforcement agencies, report write-ups, submittal to prosecutor, and any prosecutor follow-up and trial. We conservatively assume an average of 150 hours per case. This translates into 3,750 4,500 new FTE hours to work the new cases we anticipate as a result of this bill.

Increasing CID FTE's by two investigators to handle an increase in cases will require the addition of one more vehicle to the CID fleet. CID conducts investigations statewide and year-round, necessitating the need for an all-wheel drive vehicle. CID vehicles are used to conduct surveillance, travel to conduct in-person interviews, for search warrants, and transporting evidence from the search warrant location to the CID evidence room in the Stassen Building to address chain of custody concerns. Vehicles are also used to transport evidence from the Stassen Building evidence room to the Department of Human Services, Computer Forensic Lab who processes electronic evidence for CID.

DOR will engage in outreach and communication to inform taxpayers, businesses, tax preparers, tax software companies and DOR employees about the changes in this bill. For example, DOR may issue email and social media bulletins, and include information about the changes in press releases, conference calls, and other materials about new tax law changes. DOR will update employee instructional and training materials.

DOR will mail letters to taxpayers affected by the law change. The letters will notify them of the change and provide related information about what the change means for them. DOR will mail approximately 25 letters the first year, 50 letters the second year, and 75 letters the third year to taxpayers required to pay the gross receipts tax.

DOR will create/update tax forms, instructions, and schedules to reflect the changes in this bill. DOR will create/update fact sheets, web content and outreach materials to reflect the changes in this bill.

DOR assumes systems costs would be incurred if a unique tax line to track recreational cannabis subject to the general sales tax rate would be required to be added to the sales and use tax return. These numbers are assumed to be reported on normal existing tax lines on the sales and use tax return. The bill is not clear as to whether the Gross Receipts Tax will be filed on the sales tax return, but if it is then DOR may incur costs for adding an additional "Goods and Services" indicator under registration to allow businesses to add the Gross Receipts Tax to their sales tax return.

DOR assumes no additional costs will be incurred for funds transfers and distributions, unless a new account code and revenue budget in SWIFT need to be set up and monthly distributions processed.

The language in the A13 amendment references the powers of the Cannabis Management Board (CMB). DOR assumes that under the A13 amendment the CMB has the sole power of inspection and investigation. The language that the A13 replaces allowed the CMB to delegate licensing, inspection, reporting, and enforcement duties to a community health board, city or county but that language is not stricken under the A13 amendment. So, it returns to sole jurisdiction for licensing and enforcement is with the CMB. Revenue and specifically CID has no jurisdiction and no part to play under this bill, including with the A13 amendment.

DOR also notes the bill does not give the CMB the same seizure powers that DOR's Special Taxes Division or law

enforcement have with contraband tobacco. The amendment gives the CMB the power, if they have probable cause that any cannabis product is being distributed in violation of the chapter or rules adopted under the chapter, to tag or in some other way order its withdrawal from distribution or other appropriate marking notice thereby embargoing the cannabis. The only way that embargo can be lifted is by order of the board or of the district court. If the CMB finds that the cannabis that was embargoed is then found to be in violation of the chapter or rules, it can petition the district court for an order and decree for the condemnation of the product. DOR has no involvement in this area under this bill.

**FTE Impact**

FTE's	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Systems Analysis & Testing Staff		2.97	2.19	2.19	1.19
Legal staff		1.00	1.25	1.25	1.25
Communications staff		0.04			
Tax Operations / Processing staff		6.00	6.00	6.00	6.00
Special Taxes staff		14.00	14.00	14.00	14.00
Corporate Franchise Tax staff		0.02	1.15	1.32	1.45
Sales and Use Tax staff		1.00	2.00	2.00	2.00
Criminal Investigations staff			3.00	3.00	3.00
<b>TOTAL FTE IMPACT</b>		<b>25.03</b>	<b>29.59</b>	<b>29.76</b>	<b>28.89</b>

**Expenditure and/or Revenue Formula**

This bill will impact state tax revenues. An estimate of revenue impact is not included in this fiscal note. The Department of Revenue prioritizes revenue estimate requests for bills before Tax Committee and will provide one for this bill when it is before Tax Committee.

**Administrative Impact**

Administrative Costs (Savings)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Employees		2,709,335	3,392,664	3,412,862	3,428,313
Systems Analysis & Testing		354,834	261,782	261,782	142,382
Systems Development		200,000			
Systems Support			20,000	20,000	20,000
Forms/Media/Communications		14,733	1,806	1,806	1,806
Mailing		16	32	48	
Offsite Location Renovation/Rental		1,114,563	404,373	404,373	404,373
CID Equipment, Supplies, Vehicle & Fuel			11,113	11,113	11,113

<b>Subpoena costs</b>			1,500	1,500	1,500
<b>Total Administrative Costs (Savings)</b>		<b>4,393,482</b>	<b>4,093,269</b>	<b>4,113,483</b>	<b>4,009,487</b>

**Long-Term Fiscal Considerations**

Ongoing and annual system support is necessary to accommodate future maintenance of new code, storage, and support. System support is calculated at up to 20% of original development costs.

Staff will be needed on an ongoing basis to handle outreach and education, return processing, compliance and enforcement activities, taxpayer appeals and for legal support. Supporting equipment, supplies, and offsite rental costs will be needed on an ongoing basis.

**Local Fiscal Impact**

Local governments are expected to see increased tax revenues due to the expansion of the sales tax base.

**References/Sources**

Agency staff provided information for this fiscal note.

**Agency Contact:** Penny Demko (651-566-4025)

**Agency Fiscal Note Coordinator Signature:** Lisa Knops

**Phone:** 651-556-6754

**Date:** 3/29/2021 3:29:07 PM

**Email:** Lisa.Knops@state.mn.us