MICHIGAN'S WHOLESALE MARIJUANA TAX

Preliminary Thoughts and Observations

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They say the only certainties in life are "death and taxes." And life, as they say, comes at you fast. It stands to reason then, that sometimes death and taxes come at you fast, and that may now be the case for many of Michigan's recreational marijuana businesses. At daybreak on October 3rd, the Michigan legislature passed the "Comprehensive Road Funding Act" (HB 4951, hereafter the "*CRFA*") imposing a new wholesale tax on marijuana transactions and flipping Michigan from one of the most tax-friendly marijuana markets in the country to one of the least.

Supporters of the industry came out in droves to contest the new legislation, but the CRFA nonetheless passed the Senate, albeit at a razor-thin margin (19-17).

Michigan's marijuana industry is now in shock, and the short- and long term implications of the CRFA will dominate industry-specific discussions for the weeks and months to come. With an effective date of January 1, 2026, however, commentators, licensees and consumers won't have to wait long to witness the initial impacts of this sudden effort to "fix the damn roads." Constitutional challenges, modified business strategies and third-party funding options are all actively being explored. To help stimulate discussions among various interest holders, below we share our preliminary thoughts, observations and questions.

Tax On Tax On Tax

First, the CRFA is represented as a "24%" tax on wholesale transactions of adult-use marijuana. But, as already pointed out by several industry commentators (Link), "Wholesale price" is defined to include "**any tax, fee, or other charge** reflected on the invoice, bill of sale, purchase order, or other document evidencing the sale or transfer of the mari[j]uana." (Sec. 3(m)(i)) (emphasis added). Interpreted literally, the 24% tax is imposed on the dollars charged by the seller including the tax itself, recursively, until the total rounds to the nearest penny. Per the running math, that results in an effective wholesale tax rate of approximately 32%, not 24%.

Add the 10% retail excise tax and 6% sales taxes already in place (which also apply to price increases caused by the CRFA) and the total estimated tax burden is 51% — none of which will go to the already cash-starved operators struggling to survive in Michigan's oversaturated market.

Back to the Grey Market

One of the most common statements made by industry interest groups is that the CRFA will result in sharp declines in legal sales and a re-proliferation of the grey market. Time will tell, and the concern certainly calls into question the stability of the 40,000+ jobs currently supported by Michigan's cannabis industry.

But to us, this is not the most interesting or novel concern. The more critical issue may be how this new tax reshapes the licensee-to-licensee competitive landscape, particularly in terms of credit, liquidity, and integration, as discussed below.

De-facto COD in 2026

As noted above, the "Wholesale price" subject to the new tax includes all figures listed in the sales documentation. (Sec. 3(m)(i)). Stated otherwise, the seller owes the tax to the Treasury whether or not the buyer actually pays. And per current regulations, an operator that is more than one year late on any tax will be ineligible for license renewal. Given that many upstream producers are already burdened with aging accounts receivable from non-paying retailers, it's hard to see how the CRFA doesn't immediately shift the market to a cash-on-delivery model.

Growers and processors will be far less likely to extend terms when doing so risks tax liability on uncollected revenue, or worse, loss of licensure. Retailers who have historically stocked inventory on credit will now need to tie-up hundreds of thousands of dollars just to keep shelves filled

How many independent retailers can do that given the already fragile economics of the market? That remains to be seen, but non-vertically integrated retailers should begin planning immediately, because the switch gets flipped in less than 90 days.

Shifts in the Competitive Landscape

This is where things get especially consequential. As noted above, independent retailers lacking (i) sufficient cash reserves, or (ii) enough purchasing power to negotiate terms, will struggle to keep their shelves stocked. That leads to lower inventory quality and variety, further depressing sales.

Who doesn't have that problem? Vertically integrated businesses, who can offer themselves credit between their cultivation/processing arms and their retail outlets. This internal flexibility could become a massive competitive advantage, allowing integrated businesses to maintain full, fresh shelves without having to tie-up massive amounts of cash. Prior to the CRFA, many considered the independent retailer model ideal in Michigan. That assumption may no longer hold...

280E and the Disincentive to Increase Efficiency

There's a pendulum swing here. While vertical integration may offer a short-term advantage, the CRFA attempts to curb abuse by introducing the concept of an "average Wholesale price," defined as "the price of mari[j]uana that is calculated and published by the [Treasury] **based on the best available information.**" (Sec. 3(b)) (emphasis added).

For wholesale transactions between "affiliated persons" – a term defined broadly – the tax is calculated using this Treasury-set figure instead of the invoice price. (*See Sec.* 5(a)). This doesn't negate the competitive advantages outlined above, but it does introduce two new burdens for vertically integrated operators:

1. <u>Loss of 280E tax strategy flexibility</u>. Many operators structure internal sales at the highest price possible to push revenue into grow operations, where it can offset cost-of-goods-sold and reduce federal tax exposure under 280E. That strategy is now out the window, because:
   a. Charging a higher price increases the CRFA tax burden, and
   b. The state may ignore internal pricing in favor of the Treasury-determined average.
2. <u>Disincentive to pursue production efficiency.</u> If the state imposes a fixed "average" price on affiliated transactions, even if an operator could profitably produce for less and pass savings to its own storefront, that pricing flexibility disappears.

The extent to which these, and the other points discussed immediately above, will ultimately come to pass is presently unknown. But, what is clear is that the CRFA is going to change things – a lot – and operators need to start thinking about how to adapt immediately.

Time to Renew Med-Cards

Finally, it's worth noting that the CRFA does not apply to Michigan's medical marijuana market. While the number of medical cardholders has fallen from a high of 240,000 down to roughly 80,000 in recent years, side-stepping a 45% tax (51%, less the 6% sales tax) may be enough incentive for patients to return to the medical market. Additionally, for transfers of inventory from a medical provisioning center to an equivalent retailer, the CRFA states that the tax accrues at the time of transfer. Could daily, or concurrent-with-consumer-sale flips of inventory from med to rec shelves offer a workaround for independent operators? Will we see an increase in dual provisioning center licenses in 2026?

At this point, it's anyone's guess. One thing is clear though: life, taxes, and for some businesses, death – are all going to come fast in 2026.

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