Get ’em High: False Claims Act Implications of Legal Recreational Marijuana Market in New York

As more states legalize recreational use of marijuana, the tax revenue some states are starting to collect from their legal marijuana sales are growing to jaw-dropping totals. But wherever there are high taxes, there is often fraud to avoid paying those taxes. The increasingly legalized business of supplying the high will be no exception. But in New York in particular, individuals with knowledge about tax dodgers in the upcoming legal marijuana market will be able to blow the whistle on this wrongdoing.

Since legal marijuana sales first started in 2014, a recent report showed that states that have legalized marijuana—now up to fifteen states with recreational marijuana and eighteen states with medical marijuana—have collected $10 billion in cannabis tax revenue.

As the number of states legalizing marijuana continues to grow, so will the tax revenue. New York—which legalized marijuana in 2021 but has not yet put all the pieces in place for sales to begin—has projected that legal recreational marijuana will generate more than $1.25 billion in revenue over the next six years.

Other states have collected enormous quantities of tax revenue too, but for people considering whether to blow the whistle on state tax fraud by cannabis companies, New York is the most important state to know about. That is for two reasons. First, the New York False Claims Act is one of only two state false claims laws that clearly allow a whistleblower to file a *qui tam* complaint based on state tax fraud. (The other, Illinois, also has legal recreational marijuana and recently reported collecting more revenue from marijuana than alcohol, a whopping $387 million dollars from January-November 2021.)

In particular in New York, the potential for tax fraud in the legal marijuana market will be substantial. New York’s new tax regime is complex and multi-faceted, which always creates opportunities for shenanigans. Like other states, New York’s Marihuana Regulation & Taxation Act (MRTA) will tax retail sales, but will also impose a related wholesale tax. The wholesale tax is where things get sticky icky icky.

The wholesale tax, unlike the retail sales tax, has a combination of features. First, there is a 9% “transfer tax” for wholesalers on sales to retailers. However, the MRTA simultaneously imposes a “THC tax,” measured based on concentration of THC in marijuana products. The MRTA taxes wholesales per milligram of THC at different rates depending on whether the wholesale product is marijuana flower, concentrated cannabis, or edible products. (Illinois, in contrast, has a 7% transfer tax and a product-specific flat tax: 10% for cannabis flower, 20% for edibles, and 25% for THC concentrates).

How will the concentrations of cannabis products in New York be measured for tax purposes? By whom? Will there be any compliance requirements? All of these questions are up in the air right now. But one thing is clear: once the legal marijuana market goes live in New York, some unscrupulous wholesalers will be tempted to cut corners to reduce their tax liability. It will be important for people with knowledge of this fraud to come forward and report that information to the Attorney General to ensure that New York State can fund all the important programs that will depend on legal recreational marijuana revenue.