Professional Perspective

Navigating State & Federal Marijuana Law

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Marijuana-related businesses are increasing in size, scope, and sophistication across the US, but they must still navigate a conflicting state-federal regime that has created confusion and uncertainty regarding their basic legal obligations.

Slightly more than three-quarters of US states permit the use and distribution of marijuana for medicinal purposes, and many states and the District of Columbia permit the possession and distribution of marijuana for recreational purposes. Yet possessing and distributing the drug—regardless of its intended use—remains a criminal offense under federal law. Adding to this muddle, the federal government has offered conflicting signals on its attitude toward marijuana use and distribution.

The disconnect between state and federal law means that US businesses must necessarily tread carefully before directly operating in the cannabis space and seeking out or maintaining commercial relationships with those that are engaged in marijuana-related business activities.

In fact, even companies with no direct interest in or connection to marijuana production—from local dentists' offices to international banking conglomerates—are forced to navigate not only the conflicting state-federal regime, but also the federal government's inconsistent policies and messaging.

Evolving State-Federal Regime

Thirty-seven states, four territories, and the District of Columbia allow marijuana use and distribution for medicinal purposes, and 19 of those states, along with two territories and the District of Columbia, permit marijuana use and distribution for recreational purposes. Under federal law, however, marijuana is a Schedule I controlled substance pursuant to the Controlled Substances Act, meaning that marijuana presents a "high potential for abuse," and has "no currently accepted medical use in the United States." 21 U.S.C. § 812(b)(1)(A)-(C). Aiding and abetting a violation of the CSA and conspiring to further the manufacture or distribution of marijuana in violation of the CSA are also federal crimes. See 21 U.S.C. § 846; 18 U.S.C. § 2(a).

As a wave of marijuana legalization has swept across the country at the state level, the federal government has gravitated toward a more permissive, but still erratic, approach. In the late 1990s, President Bill Clinton and Congress directly opposed state laws permitting medical marijuana usage, a trend that continued into the George W. Bush administration. Under President Barack Obama, however, the government's attitude shifted. In 2009, the Department of Justice issued a memorandum explaining that it would not use its resources to prosecute individuals whose actions were in compliance with state medical marijuana laws.

DOJ followed up with the so-called Cole Memorandum in 2013, stating that, with respect to recreational marijuana, it would focus its enforcement efforts on eight enumerated enforcement priorities, including "[p]reventing the distribution of marijuana to minors" and "[p]reventing violence and the use of firearms" in the distribution of marijuana—with the implication being that DOJ would not enforce the CSA against marijuana users or businesses that operated in compliance with state law and did not implicate one of the eight priorities.

But DOJ has never taken steps to remove marijuana from the list of controlled substances, and under Attorney General Jeff Sessions, it rescinded the non-enforcement memoranda in 2018. During his confirmation hearing, Bill Barr expressed disagreement with Sessions' decision to rescind the memoranda and explained that he would not "go after" companies that had relied on DOJ's prior non-enforcement policy but also stated that he did not support federal legalization and upon becoming Attorney General, Barr did launch several antitrust investigations into marijuana-related enterprises. With respect to the current administration, Attorney General Merrick Garland recently reiterated that he believes it is "not an efficient use" of federal resources to prosecute marijuana possession, but he refused to say whether DOJ would reinstate the non-enforcement guidance.

Congress has offered inconsistent signals as well. In 2009, Congress permitted the District of Columbia to decriminalize medical marijuana, and since 2015, Congress has prohibited DOJ from spending money to prevent states from implementing their respective medical marijuana laws. Consolidated Appropriations Act of 2021, H.R. 133, 116th Cong.

(2019-2020). Yet Congress has failed to pass any of the proposed bills that would decriminalize marijuana. For example, the House of Representatives recently passed the Marijuana, Opportunity, Reinvestment and Expungement (MORE) Act, which would remove marijuana from the list of controlled substances in the CSA, among other things, but President Joe Biden has not weighed in on whether he supports the bill and it has not been taken up by the Senate

Biden's view on marijuana regulation overall remains murky. On the campaign trail, Biden promised to decriminalize marijuana, but his administration has not taken any action on that front. Furthermore, in March 2021, five White House staffers were fired and dozens were suspended, asked to resign, or placed in a remote work program after they admitted to past marijuana use.

All this means that despite some signs of a more permissive attitude emerging in Congress and the executive branch, as a legal matter very little has changed at the federal level in the wake of the push for legalization at the state level. Businesses, including those with ostensibly no relationship to the marijuana space, are increasingly finding themselves between a rock and a hard place as they try to navigate this jumbled landscape.

Before the U.S. Supreme Court

The disjointed legal picture that businesses and individuals alike confront on the subject of marijuana was on full display in a case disposed of June 21, 2022, by the U.S. Supreme Court.

Susan Musta, an employee at a dentist's office was injured at work and was eventually certified to participate in Minnesota's medical marijuana program. *See Musta v. Mendota Heights Dental Center*, 965 N.W.2d 312, 315 (Minn. 2021), *petition for cert. filed* (U.S. Nov. 4, 2021) (No. 21-676). But when Musta sought reimbursement from her employer for the treatment pursuant to Minnesota's Workers' Compensation Act, the dentist's office denied the request, arguing that the federal ban on possession of marijuana trumped the requirements of the state act.

A federal court agreed with Musta's employer, and Musta asked the high court to take up her case. But DOJ filed a brief in Musta's case—along with a separate case concerning the same issue—urging the court not to take it on the ground that the law in this area is "inconsistent" and "evolving." Brief for the United States as Amicus Curiae, *Musta v. Mendota Heights Dental Center* (No. 21–676). The court released an order June 21 denying the petition for review. But at some point it may be forced to grapple with this evident conflict between state and federal requirements.

Taxation

Workers' compensation is not the only area where the law is "inconsistent" and "evolving" on marijuana. Both state and federal law also offer competing tax treatment of marijuana-related businesses with implications for marijuana and non-marijuana businesses alike. Several states levy taxes on marijuana dispensation—taxes that can reach upwards of 25%. Based on current projections, tax revenue from marijuana is expected to grow to around $11 billion per year by 2030.

The federal tax code, however, has significant negative economic implications for those in marijuana-related businesses. For example, the US tax code generally permits businesses to subtract from their taxable income "ordinary and necessary" business expenses, including salaries and rental payments. 26 U.S.C. § 162(a). But under a federal provision, Section 280E, businesses that "consist of trafficking in controlled substances," which include those that sell marijuana products, cannot make such deductions. 26 U.S.C. § 280(E).

Tax courts have also interpreted Section 280E to prevent marijuana businesses from deducting even their charitable contributions, on the ground that those contributions are part of their "trafficking." *San Jose Wellness v. IRS*, 156 T.C. 4 (2021). This all adds up to a big difference when calculating a business's taxable income. For example, a company that is losing money could be taxed as if it is making millions of dollars in revenue, driving it further into debt. This tax treatment also impacts charitable donations more broadly because the IRS has that organizations that "promote" marijuana use, thereby encouraging illegal activity, cannot be tax exempt.

Bankruptcy

A number of courts have ruled that businesses whose operations constitute federal crimes cannot take advantage of the federal bankruptcy system. *In re United Cannabis Corp.*, No. 20-12692 (Bankr. D. Col. Jan. 12, 2020); *In re Basrah Custom Design, Inc.*, 600 B.R. 368 (Bankr. E.D. Mich. 2019); *In re Johnson*, 532 B.R. 53 (Bankr. W.D. Mich. 2015).

Again, this issue has implications for all sorts of businesses, even those that are tangentially related to marijuana: bankruptcy courts have dismissed cases where the debtors did not operate a marijuana business, but rather operated ancillary businesses that manufactured or sold equipment that could be used to cultivate marijuana, or leased real estate to marijuana growers, for example. In re Way to Grow, Inc., 597 B.R. 111, 132 (Bankr. D. Colo. 2018).

Thus, marijuana-related businesses may have helped ease budgetary constraints in their home states by paying steep tax bills but cannot avail themselves of the protections of the US bankruptcy regime, greatly increasing the risks faced by those enterprises, their creditors, and their employees.

Financial Products & Services

Perhaps nowhere is the conflict between state and federal law more evident than in the realm of banking and financial services. A few states, including California and Colorado, have either passed legislation or issued administrative guidance to protect those who provide banking services to marijuana businesses from state enforcement actions. Yet many banks operate across numerous states, some of which have not enacted any such protections.

Even financial institutions that exclusively operate in protected states still face legal risks in working with marijuana-related businesses. For example, a financial institution that provides a checking account to a state-licensed marijuana dispensary faces the risk of violating the CSA by aiding and abetting federally illegal sales of marijuana.

Additionally, financial institutions face the risk of violating the federal money laundering laws, which make it a crime to knowingly conduct a transaction that involves the proceeds of "specified unlawful activity," including the "receiving, concealment, buying, selling, or otherwise dealing in a controlled substance." 18 U.S.C. §§ 1956(c)(7), 1961(1)(D). And under the Bank Secrecy Act (BSA), financial institutions must monitor and report on any "suspicious activity," meaning instances where the bank suspects that it is being used as a conduit for funds resulting from illegal activity—including marijuana distribution. 12 U.S.C. § 21.11; 12 C.F.R. § 353.1.

Despite the federal prohibition on money laundering, the Financial Crimes Enforcement Network issued guidance in February 2014 explaining how banks should meet their obligations under the BSA when providing services to state-licensed marijuana businesses.

According to FinCEN, Banks with state-licensed marijuana-related businesses as clients only need to file a "marijuana limited" SAR. If the relevant activity potentially touches upon one of the eight Cole memorandum priorities, banks must file a "marijuana priority SAR." Finally, in situations where the relevant activity requires terminating the client relationship in order to maintain an effective anti-money laundering program, banks must file a "marijuana termination SAR." While the Cole memorandum has since been rescinded, the FinCEN guidance remains in place.

Again, Congress has offered inconsistent signals in this area. The House of Representatives has passed the Secure and Fair Enforcement Banking Act of 2021 (SAFE Banking Act) six times, which would, among other things, provide a safe harbor for depository institutions that provide banking services to state-licensed marijuana businesses. But the bill has died in the Senate each time.

In practice, the unclear legal consequences of acting in the space mean that banks err on the side of caution, often refusing to provide their services to marijuana businesses. Similarly, credit card companies often refuse to process transactions for marijuana businesses. Those businesses, in turn, frequently operate with huge volumes of cash because they cannot rely on established banking services. Those that attempt to disguise the true nature of their businesses face steep consequences. Last year, for example, two consultants for a marijuana e-marketplace were convicted by a federal jury of bank fraud for tricking banks and credit unions into processing more than $150 million of credit and debit card purchases of marijuana by disguising those transactions as purchases of other kinds of goods, such as face creams and dog products. But recently, smaller entities, such as credit unions and state-chartered banks, have started to fill the banking gap, beginning significant undertakings in the marijuana banking industry.

Additionally, marijuana-related securities are traded over the counter and on securities exchanges, but again the federal ban creates obstacles and has limited returns on those investments. Major US exchanges, such as NYSE and NASDAQ, as well as certain Canadian exchanges, such as the TSX, do not generally list companies acting in violation of US law or require that the company be in compliance with Securities and Exchange Commission rules and regulations. Accordingly, these

exchanges do not list US "plant touching businesses" and only allow certain foreign marijuana companies that are acting in compliance with federal law—e.g., Canadian marijuana companies that only do business in Canada—to list their shares.

On the other hand, some smaller, non-US securities exchanges—e.g., the Canadian Securities Exchange—do not require compliance with applicable law, and many over-the-counter exchanges do not either. Marijuana-related securities that are traded on these exchanges pose a greater potential risk. As a result, while a vibrant secondary market has emerged, several financial institutions have informed their clients that they will not let them purchase certain US marijuana-related securities.

Ancillary Businesses

Indirect or ancillary businesses, including, for example, fertilizer suppliers, armored car companies, consultants, and accountants, also face enhanced risk when dealing with marijuana-related businesses. Different service providers have taken different approaches to this issue, with some embracing "plant touching" clients and others eschewing those clients altogether. Into this void have stepped marijuana-specialized service providers, such as "marijuana consultants" who tout their knowledge of the particulars of the marijuana industry, as well as their willingness to wade into this murky legal terrain.

Depending on the nature of the services, as well as the percentage of the customer base that consists of marijuana-related businesses, such businesses could be viewed as "aiding and abetting" a violation of the CSA by materially supporting a US marijuana-related business. Such businesses may also receive payments consisting of proceeds of US marijuana sales in violation of federal money laundering laws.

As a general matter, advertising and real estate companies that provide services to marijuana-related businesses face a greater legal risk because both activities are direct violations of the CSA. 21 U.S.C. §§ 843(c), 856. That being said, proceeds derived from violations of those CSA provisions are not considered proceeds of specified unlawful activity under the money laundering laws.

Legal Industry

Even lawyers advising companies navigating these issues have to navigate competing rules governing their own conduct. The American Bar Association's (ABA) Model Rules of Professional Conduct are ethical rules for lawyers, which a majority of jurisdictions have adopted. Model Rule 1.2(d) states that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent."

On its face, this rule seems to prohibit the provision of legal services to US marijuana companies. Lawyers who provide legal services to marijuana businesses could even be perceived as aiding and abetting their clients' violations of the CSA. As is the case for other ancillary businesses, payments from clients that operate in the marijuana industry could also expose a lawyer to potential violations of the federal money laundering laws, if the payments are traceable to federally illegal marijuana sales.

In February 2020, the ABA moved for a more nationwide approach, adopting a resolution urging Congress to enact legislation clarifying that it does not violate federal law for lawyers to "provide legal advice and services to clients regarding matters involving marijuana-related activities that are in compliance with state, territorial, and tribal law."

But in this area as well no decisive congressional action has been taken. Several state bar associations, however, have attempted to clear the way for more legal work in the marijuana industry. For example, the New York and California bar associations have both issued ethics opinions stating that lawyers may assist clients in complying with those states' marijuana laws, consistent with their ethical obligations. Other states, such as Colorado and Connecticut, have explicitly amended their rules to permit attorneys to advise and assist clients in the marijuana business. Colo. R. Pro. Conduct r. 1.2 cmt. 14; Conn. R. Pro. Conduct r. 1.2(d) cmt.

Conclusion

As the marijuana industry continues to grow and permeate a large number of obvious and not-so-obvious segments of the US economy, individuals, small businesses, and complex multinational corporations will sooner or later be forced to navigate the conflicting state-federal legal regimes. Until Congress takes clear action, those navigating this hazy state of affairs will need to rely on carefully considered legal advice.