Up in Smoke? Hot Spots for Cannabis Businesses

Thursday, October 18, 2018
9 a.m.–12:15 p.m.

3 General CLE credits
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### SCHEDULE

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FACULTY

Whitney Boise, Boise Matthews LLP, Portland. Mr. Boise has been serving individuals and corporations charged with crimes in state and federal court since 1987. He has been recognized by Best Lawyers in America for criminal defense in both white collar and non-white collar crimes and as Lawyer of the Year for White Collar Criminal Defense in 2017 and as Lawyer of the Year for General Practice Criminal Defense in 2018 and 2016. Mr. Boise has been inducted into the American College of Trial Lawyers.

Susan S. Ford, Sussman Shank LLP, Portland. Ms. Ford practices in the areas of business restructuring, bankruptcy, receiverships, and commercial litigation. She has over 30 years of experience resolving complex business problems for clients. Susan has been individually named to Oregon’s Top 50 Super Lawyers List since 2015 and to Oregon’s Top 25 Women Super Lawyers List since 2013. She also is recognized by Best Lawyers in America for her work in bankruptcy and creditor-debtor rights law/insolvency and reorganization law, bankruptcy litigation, and commercial litigation.

Matthew Parkin, Sussman Shank LLP, Portland. Mr. Parkin has a broad-based business and federal income tax practice focused primarily on business transactions involving taxable entities and individuals, tax litigation and controversy, and the taxation of nonprofit/exempt organizations. His practice relating to cannabis business transactions includes advising clients in the formation of business ventures, mergers and acquisitions, capital restructurings, and asset and stock dispositions. Mr. Parkin represents individuals, closely held businesses, and large corporate clients in audits, administrative appeals, and collection matters, as well as in litigation in the U.S. Tax Court, federal district court, and federal courts of appeal when the matter is not resolved at the administrative level.

Victor Roehm, Sussman Shank LLP, Portland. Mr. Roehm focuses his practice on corporate and real estate transactional matters, including commercial and public finance transactions. He has experience representing corporate and business clients, including those in the cannabis industry, in connection with a variety of transactional matters from entity formation and restructurings to complex mergers and acquisitions. He regularly represents clients in connection with the acquisition, sale, and leasing of real property. He is vice chair of the American Bar Association Business Law Section Commercial Finance Committee Real Estate Financing Subcommittee and a member of the Columbia Corridor Association board.

Billy Williams, U.S. Attorney, District of Oregon, Portland. Mr. Williams has been the U.S. Attorney and chief federal law enforcement official in Oregon since May 2015. He was reappointed by President Donald J. Trump on November 17, 2017, to serve a four-year term. He was confirmed by the Senate on March 7, 2018, and his presidential commission was signed on March 13, 2018. Mr. Williams has held multiple leadership positions in the Department of Justice, including First Assistant U.S. Attorney, Chief of the Criminal Division, Chief of the Violent Crimes Unit, and the district’s Indian Country Assistant U.S. Attorney and Tribal Liaison. He has served on a number of Attorney General Advisory Subcommittees; he currently is appointed to serve on the Native American Issues Subcommittee, Civil Rights Subcommittee, Border & Immigration Subcommittee, and Domestic Terrorism Executive Committee. He is also the Public Lands Focus Area Leader for the Marijuana Issues Working Group. Mr. Williams is a member of the Ninth Circuit Fairness Committee and the District of Oregon Implicit Bias Steering Committee.
Chapter 1
Presentation Slides: State and Federal Law Conflicts

Victor Roehm
Sussman Shank LLP
Portland, Oregon
Chapter 1—Presentation Slides: State and Federal Law Conflicts

State and Federal Law Conflicts
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- Victor focuses his practice on corporate and real estate transactional matters, including commercial and public finance transactions. Victor has experience representing corporate and business clients, including those in the cannabis industry, in connection with a variety of transactional matters from entity formation and restructuring to complex mergers and acquisitions. He regularly represents clients in connection with the acquisition, sale and leasing of real property. He is currently the Vice Chair of the Real Estate Financing Subcommittee of the Commercial Finance Committee of the American Bar Association's Business Law Section. He is a member of the Board of the Columbia Corridor Association.
Chapter 1—Presentation Slides: State and Federal Law Conflicts

+ Controlled Substances Act

- Signed into law in October 1970.
- Created five Schedules for drugs with Schedule 1 being most highly regulated.
- Categories are based on potential for abuse and medical usage.
- Schedule 1 includes marijuana, heroin, LSD, peyote, mescaline and pretty much anything else reference by Hunter S. Thompson in *Fear and Loathing in Las Vegas*.

+ But I’m Just a Landlord!

“[I]t shall be unlawful to… knowingly... lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance...” 21 USC 856

- Up to 20 years in prison and a $500,000 fine ($2,000,000 fine for legal entities).
Civil and Criminal Forfeiture

- Further expanded by Comprehensive Crime Control Act of 1984
- **Civil Forfeiture**
  - Government has to have probable cause.
  - Burden of proof is a preponderance of the evidence.
- **Criminal Forfeiture**
  - Brought as part of a criminal case.
  - Burden of proof is beyond a reasonable doubt.

Property Subject to Forfeiture

- **Real property used or intended to be used in violation of the Controlled Substances Act.**
- **Raw materials, products, and equipment of any kind which are used, or intended for use, in manufacture, processing or delivery of controlled substances.**
- **Moneys**, negotiable instruments, and securities used or intended to be used to facilitate any violation of this subchapter.
Adult Use Cannabis in Oregon

- Overseen by OLCC.
- Cities and Counties can prohibit producers, processors, wholesalers, and/or retailers. (Home Rule)
- Licenses are specific to a location.
  - Applications require a Land Use Compatibility Statement
  - Six types of licenses:
    - Producer, Processor, Wholesale, Laboratory, Retail and Research Certificate.
    - Can be vertically-integrated (ex. have licenses for producing, processing and retail)

The Dam Breaks. The Feds Respond.

Information is current as of March 16, 2018.

Marijuana Legalization Status

- Medical marijuana broadly legalized
- Marijuana legalized for recreational use
- No broad law legalizing marijuana

The Cole Memorandum (August 2013)

- Restated enforcement priorities for the Department of Justice with respect to cannabis.
- Preventing distribution to minors;
- Preventing revenue from going to criminal organizations;
- Preventing diversion of cannabis to other states;
- Preventing state-authorized activity from acting as a front;
- Preventing violence and use of firearms;
- Preventing drugged driving and adverse health consequences;
- Preventing growing of cannabis on public lands; and
- Preventing cannabis possession and use on federal property.

Cole Memorandum (Cont.)

- Put a burden on states to have a system of appropriate regulations and to enforce their regulations.
- Reduced the focus of prosecutors on large operations in states where cannabis was legal in some form.
- Did not have the force of law. (Foreshadowing)
**Sessions Memo—Where Does This Leave Us?**

- Attorney General Sessions rescinded the Cole Memorandum (and other subsequent and prior guidance with respect to cannabis enforcement).
- This leaves U.S. Attorneys to the general guidance on prosecutorial priorities.

**Murphy v. NCAA**

- Holdings regarding the 10th Amendment could impact enforcement of Controlled Substances Act.
- Federal government cannot require states to enforce Federal law. ("Anti-commandeering")
Trademark and Patent

- Some strains of cannabis have been patented. Cannabis-related tech is also patentable.
- Lanham Act prohibits a trademark for anything “immoral, deceptive or scandalous.”
- However, creative cannabis entrepreneurs are finding a way around this by using trademarks for branding (t-shirts and apparel).
- Additionally, common law and state trademark and trade name rights can be helpful at the local level.

The Cannabis Business at a Crossroads

- What changes to regulations will be necessary to address concerns of U.S. Attorney?
- How does Oregon address oversupply and related insolvencies?
- Does cannabis get rescheduled?
- Does Congress make other changes to banking, tax, bankruptcy or IP law?
- How does legalization in California effect everything.
- How does legalization of industrial hemp impact the market.
Chapter 2

Presentation Slides: Banking, Finance, and Debtor-Creditor Concerns

Susan Ford
Sussman Shank LLP
Portland, Oregon
Chapter 2—Presentation Slides: Banking, Finance, and Debtor-Creditor Concerns

Susan S. Ford, Sussman Shank LLP

Susan practices in the areas of business restructuring, bankruptcy, receiverships and commercial litigation. She has over 30 years of experience resolving complex business problems for clients. Susan has been individually named to Oregon’s Top 50 Super Lawyers List since 2015 and to Oregon’s Top 25 Women Super Lawyers List since 2013. She also has been recognized since 2011 by Best Lawyers in America, and is currently recognized for her work in Bankruptcy and Creditor-Debtor Rights Law/Insolvency and Reorganization Law, Bankruptcy Litigation, and Commercial Litigation.
Risky Business

- Reliance Effect of the Cole Memorandum: Cannabis businesses relied upon guidance of Cole Memorandum even though it was not law.
  - State-legal businesses would not be subject to
    - federal prosecution; or
    - forfeiture of revenue and property
  - Fueled investment in the industry locally and nationally.

Risky Business

- Cole Memorandum Had Relatively Little Effect on Banks
  - Majority of federally insured banks refused to serve the cannabis industry
  - Accounts opened by only a handful of state-chartered credit unions.

- Likely effects of Rescission of the Cole Memorandum:
  - Banks even more fearful
  - Chill new cannabis business and related industry investment?
  - Existing markets will continue, subject to increasing regulatory scrutiny
Cannabis is the New Frontier

- Legalization has Outpaced Projections for U.S. Cannabis Markets
  - 10 recreational markets
  - 30 medical/recreational markets combined
  - Canada recently legalized recreational marijuana nationwide
  - Investors anticipating global expansion

Cannabis is the New Frontier

- Horizontal Expansion – New Products and Uses
  - Health and Wellness
  - Non-prescription pharmaceuticals
  - Food & beverage
  - Pet products
  - Hemp
Cannabis is the New Frontier

- Market Projections – Long Term Outlook Appears Strong
  - Global cannabis market expected to grow to $200 billion in near future
  - U.S. Market – Exponential Growth
  - Canadian market currently estimated at $15 billion
  - California anticipated to be $3.1 billion per year for recreational and medical by 2020
  - Oregon is projected to $1.04 billion in recreational and medical sales by 2020
  - Washington will have $2.28 billion in projected sales by 2020

Finance: The Cost of Starting a Cannabis Business

- Start-up Cost Examples:
  - Dispensary: Typical total start-up cost for a retail store is in the hundreds of thousands to millions of dollars. Portland Oregon "Mom and Pop" bare bones small dispensary total minimum average start-up cost is $40,000-$50,000
  - Indoor 5,000 Sq. Ft Grow Facility (Assumes land is owned – not leased): $270,000 – including $20,000 per month in labor and operational costs.
Finance: Where the Money Comes From

- Where Do Cannabis Businesses Obtain Capital and Financing?
  - Not From a Bank.
  - Mom and Pop Growers use their own land and family farms.
  - Mom and Pop Retailers Use Life Savings and partner with other individuals

- Sophisticated Large Investors
  - Buying up failed Mom and Pops at low prices
- Private Equity Firms
- Deep-Pocketed Venture Capitalists
The Legal Marijuana Industry is severely under-served by the traditional banking and finance industries

- Legal Barriers to Banking Relationships:
  - The Controlled Substances Act: in addition to direct activities, the CSA makes it a crime to knowingly aid and abet the manufacturing, distribution or dispensing of marijuana.
  - Penalties include incarceration and forfeiture of proceeds and property related to the crime.
  - The Cole Memorandum (now rescinded) issued “guidance” on federal enforcement priorities under the CSA, which did not exempt the banking industry. Burden on states to:
    - Enact appropriate regulations to ensure transparent tracking and reporting of business activities of cannabis business; and
    - Enforce those regulations.
The Banking Problem

Legal Barriers to Banking Relationships:

- The Bank Secrecy Act ("BSA"). Requires all banks to report to the federal government any suspected illegal activity, including any transaction associated with a marijuana business.
- Suspected Activity Reports ("SARS") must be filed with respect to every transaction involving a state-authorized marijuana business.
- Federal bank regulators have not issued guidance regarding the BSA. However, the Financial Crimes Enforcement Network ("FinCEN") a division of the Department of the Treasury, which oversees the BSA issued guidance in 2014 which sets expectations for financial institutions serving marijuana businesses, including offering bank accounts.
- Requirements are extensive.
- However, in rescinding the Cole Memorandum’s guidance, Attorney General Jeff Sessions made it clear that financial transactions connected with marijuana businesses can still form the basis for prosecution.

Legal Barriers to Banking Relationships:

- Other Laws Impacting Banking Services to Marijuana Businesses.
  - USA Patriot Act
  - The Racketeer Influenced and Corrupt Organizations Act ("RICO").
The Banking Problem

The Impact of Federal Law
- Banks are subject to a level of scrutiny far in excess of what is expected in any other banking relationship.
- Relatively few are serving cannabis businesses. Those that are tend to be state-chartered credit unions, which are not supervised by the FDIC.
- Most cannabis businesses generate and maintain on premises large amounts of cash, creating a major security risk.

- Cannabis businesses must transact all their business in cash, including paying payroll, rent, and payment of taxes and fees to federal and state governments.
- Customers cannot use debit and credit cards at cannabis businesses.
- Banks that do offer services to cannabis businesses must expend tremendous resources to comply with due diligence requirements, and must pass the cost on to customers in the form of high fees.
- Services have not yet extended to commercial lending to cannabis businesses.
**Debtor-Creditor Concerns**

- Case Study: Oregon
  - Oregon is currently experiencing an over-production problem.
  - In 2017 – early 2018, Oregon marijuana farmers grew 3 times the amount of product that Oregon consumers can use in a year.
  - Prices are dropping to unprecedented lows at auction wholesalers and dispensaries throughout the state. The wholesale marijuana price dropped from $1500 per pound in summer 2017 to $700 per pound by mid-October.
  - Result: Cannabis businesses – mainly the Mom and Pops, are closing their doors, selling to out-of-state investors and big players.
  - Black market concerns.

**DEBTOR-CREDITOR CONCERNS**

- Bankruptcy Not Available:
  - In a number of decisions issued by United States Bankruptcy Courts, including Oregon, it is clear that both cannabis businesses, their landlords, and related businesses do not have access to relief under the federal bankruptcy laws.
Debtor-Creditor Concerns

- Bankruptcy Not Available:
  - In In re McGinnis, 453 BR 770 (Bankr. D. Or. 2011)
  - In In re Mother Earth’s Alternative Healing, Case No. 12-10223m Dkt.No. 54 (Bankr. S.D. Cal. 2012)

- Landlord Cases.
  - In In re Rent-Rite Super Kegs West, Ltd, 484 BR 799 (Bankr. D. Colo 2012)
  - In In re Arm Ventures, LLC, 564 BR 77 (Bankr. S.D. Fla. 2017)
Debtor-Creditor Concerns

- Other Related Businesses.
  - In re Medpoint Management, LLC, 528 BR 178 (Bankr. D. Ariz. 2015)

- State Court Receiverships.
  - Typically, a lender’s tool, it is also used for dissolving businesses with ownership disputes or a failure of management.
  - Receiver is similar to a bankruptcy trustee, and has powers granted under an order of the court to temporarily manage, sell or liquidate the assets of distressed cannabis businesses and related parties.
Debtor-Creditor Concerns

- State Court Receivership.
  - OLCC Regulation 845-026-1260
    - Sets forth the standards for authority to operate a licensed marijuana business as a trustee, Receiver, Personal Representative or Secured Party.
    - Under Subsection(1), the OLCC may issue temporary authority to operate a licensed business to a trustee, the receiver of an insolvent or bankrupt licensed business, the personal representative of a deceased licensee, or a person holding a security interest in the business for a reasonable period of time to allow orderly disposition of the business.

Debtor-Creditor Concerns

- State Court Receivership.
  - No Oregon receivership to date using the new law.
  - Receivers have expressed interest, but many will be reluctant due to obvious operational concerns: insurance, lack of access to banking, regulatory concerns, etc.
  - Both California and Washington have had receivership cases, but only a handful.
**Debtor-Creditor Concerns**

- **Self-Help**: Turnover to Secured Creditor, Sale, Dissolution.
  - Given the costs, and barriers to third-party assistance, most failing businesses seek to sell their business as a going concern, or failing that, sell the assets, pay creditor to the extent possible, shut down, and dissolve.

**Future Forecast:**

- With the economic changes in the industry, and bigger investors with significant stakes, creditors and stakeholders in financially challenged cannabis businesses will likely seek out receiverships, rather than leaving cannabis debtors a free hand in liquidation.
- Greater regulatory challenges are also likely to make cannabis businesses susceptible to intervention and control of a third party receiver.
Land Use and Licensing

- **Application requires Land Use Compatibility Statement (LUCS)**
  - From the city or county confirming proposed use is not prohibited
  - All retail establishments need to be at least 1,000 feet from schools or 500 if geographic or physical barrier

- **Water Law Compliance**
  - Need proof of legal access to water
  - Can contract to have water delivered if the property doesn’t otherwise have water source
Land Use and Licensing Continued

- Size of Production Canopy
  - Indoor (3-5 crops per year)
    - Micro Tier I (up to 625 square feet)
    - Micro Tier II (626-1,250 square feet)
    - Tier I (1,251-5,000 square feet)
    - Tier II (5,001-10,000 square feet)
  - Outdoor (1 crop per year...unless you use artificial light)
    - Micro Tier I (up to 2,500 square feet)
    - Micro Tier II (2,501-5,000 square feet)
    - Tier I (5,001-20,000 square feet)
    - Tier II (20,001-40,000 square feet)
  - Keep in mind that “indoor” production includes any use of artificial light

Medical Marijuana and Industrial Hemp

- Medical grow sites have much smaller grow sizes

- In city limits, in residential areas*:
  - 12 mature plants
  - 24 immature plants over 24 inches
  - Unlimited immature plants under 24 inches

- Outside city limits or in city limits but outside residential areas:
  - 48 mature plants
  - 96 immature plants over 24 inches
  - Unlimited immature plants under 24 inches

- Industrial hemp—site size is not limited
Local Option

- In counties where 55% or more of voters opposed Measure 91, local governments could ban cannabis businesses without voter approval.
- In other areas, ban could be put in place by referendum.

Local Zoning and Water Rights Issues

- Marijuana production is a “farm use” in Exclusive Farm Use zones. In other zones, counties have discretion.
- In Portland, we are seeing some areas opened to cannabis production (formerly retail areas) and others more restricted (industrial areas).
- Bureau of Reclamation (“BOR”) policy prohibits approving use of BOR water for cannabis production.
- Limits on existing water rights can be problematic—ex. a second harvest may not be possible despite artificial light.
**Oregon’s Right to Farm**

ORS 20.936

“(1) No farming or forest practice on lands zoned for farm or forest use shall give rise to any private right of action or claim for relief based on nuisance or trespass.

(2) Subsection (1) of this section shall not apply to a right of action or claim for relief for:

(a) Damage to commercial agricultural products; or

(b) Death or serious physical injury as defined in ORS 161.015.”

Note that this does not prevent claims from other agricultural producers—Ex. *Momtazi v. Wagner*

**What May Give Rise to a Neighbor Dispute**

- Odor
- Waste management
- Use of hazardous materials in processing (Key argument brought up with respect to oil/isolate processing facilities)
- Security
- Aesthetics and sensibilities
Civil RICO

- Disgruntled neighbors are starting to resort to claims based on RICO’s civil penalties, which include treble damages and attorneys fees.

- A Tenth Circuit case (*Safe Streets Alliance v. Hickenlooper*) found that the neighboring landowners could sue for alleged injuries to property related to a cannabis grow operation.

- These cases can include a number of parties as defendants with only a tangential connection to the business.
Chapter 4

U.S. Attorney’s Office for the District of Oregon
Priorities in Enforcement of Federal Laws
Involving Marijuana in the District of Oregon

Billy Williams
U.S. Attorney, District of Oregon
Portland, Oregon
FROM: THE UNITED STATES ATTORNEY FOR THE DISTRICT OF OREGON

SUBJECT: PRIORITIES IN ENFORCEMENT OF FEDERAL LAWS INVOLVING MARIJUANA IN THE DISTRICT OF OREGON

May 18, 2018

On January 4, 2018, Attorney General Jefferson Sessions, III, rescinded previous Justice Department guidance related to enforcement of federal marijuana laws. U.S. Attorneys around the country were instructed to determine marijuana enforcement policy in light of the specific circumstances in their individual districts. Because Oregon, under state law, previously legalized marijuana, this change raised questions regarding how our District intended to exercise its discretion in marijuana enforcement under the federal Controlled Substances Act. That act prohibits the cultivation, possession, and distribution of marijuana.

In response, and to provide an opportunity to hear and learn from the diverse range of Oregonian viewpoints, I convened a Marijuana Summit on February 2, 2018. The summit was attended by more than 130 people from nearly 70 organizations and represented a wide cross-section of interests and perspectives bearing on federal marijuana enforcement in our state. Among those in attendance were the Governor of Oregon, representatives from 14 U.S. Attorney’s Offices, and Oregon congressional delegation staff. The Summit featured presentations by State officials, including the Governor’s Marijuana Policy Advisor and Criminal Justice Commission, as well as representatives of the Association of Oregon Counties, Oregon-Idaho High-Intensity Drug Trafficking Area (HIDTA), Federal Bureau of Investigation, Drug Enforcement Administration, Oregon Cannabis Association, affected landowners, banking industry, medical community, and leadership from tribal nations.

Although the views expressed at the Summit were often divergent, the group found consensus in three principal areas. First, there is urgent need for more comprehensive and accurate data on the scope and effect of marijuana production and distribution in Oregon. Second, too few resources are devoted to enforcement and oversight of the State’s marijuana regulatory regime. Third, there can be no doubt that there is significant overproduction of marijuana in Oregon. As a result, a thriving black market is exporting marijuana across the country, including to states that have not legalized marijuana under their state laws.
Overarching Principles

As the primary federal law enforcement official in Oregon, I will not make broad proclamations of blanket immunity from prosecution to those who violate federal law. When I became the U.S. Attorney for this District, I swore to uphold the rule of law in this state, and I take that responsibility extremely seriously; indeed, all of my actions in this job derive from that solemn pledge. The U.S. Constitution is the source for the rule of law in our nation, and two of its bedrock principles direct my deliberations on this subject. The first is that federal law is the supreme law of the land. Second, Congress determines the content of that federal law. The fact that a State may pass a law that conflicts with, or reflects a different policy from federal law cannot nullify these principles or shield an activity from federal prosecution regardless of whether the substance of the law addresses marijuana, environmental protection, or any other subject.

At the same time, our office’s resources are finite. By necessity, we must use appropriate discretion before prosecuting any federal case. This has several implications for purposes of the present guidance. It means, for example, that we will strategically consider and use available civil law enforcement mechanisms in conjunction with or as an alternative to criminal prosecution in appropriate cases. Such options include asset forfeiture, civil litigation, and administrative enforcement. Next, we will continue to efficiently leverage federal resources by closely coordinating with our partners in state, tribal, and local governments around the state. As an example, our office is currently participating with the Oregon State Police’s Northwest and Southwest Regional Marijuana Teams and we regularly confer with local law enforcement agencies around the state to address and support their marijuana enforcement concerns. Lastly, it means we will focus our enforcement efforts on federal violations implicating one or more of the priority elements of this guidance.

Finally, consistent with the Attorney General’s direction, we will apply this guidance in a manner consistent with well-established principles the Justice Department and our office has employed for many years. As noted in the Attorney General’s memorandum, these principles include “federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community.” Such principles ensure that enforcement of federal law is fair, equally administered, and not influenced by any personal biases or feelings that any of our Assistant U.S. Attorneys or I may have about particular laws, including those involving marijuana.
PRIORITIES IN ENFORCEMENT OF FEDERAL LAWS INVOLVING MARIJUANA
IN THE DISTRICT OF OREGON
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Five Federal Enforcement Priorities

The Importance of Effective Partnerships

As a preliminary matter, I am fully committed to continuing the long tradition in Oregon of carrying out law enforcement in close coordination with our partners at the State, Tribal, and local levels, including all Oregon Sheriffs and municipal police departments. I am committed to working in coordination with Oregon officials to address the issues the state marijuana law has engendered. I am encouraged that the Oregon Legislature recently enacted SB1544. That legislation establishes an Illegal Marijuana Market Enforcement Grant Program to help local governments and their law enforcement agencies combat unlawful marijuana cultivation with $9 million in state funding over the next six years. We will also continue to leverage federal resources in conjunction with those of our state, tribal, and local law enforcement partners to achieve the most efficient results possible using the latest and best data. At the same time, however, and especially to the extent major enforcement or state regulatory oversight gaps persist, we will not hesitate to act as the law and facts warrant. In so doing, we will focus our resources primarily on situations involving one or more of the following priorities

Priority 1: Overproduction and Interstate Trafficking

We will prioritize enforcement of federal marijuana violations that have national or interstate implications, particularly when the Oregon-based criminal activity adversely affects states that have not legalized marijuana. This will be a top priority until overproduction that feeds exportation of marijuana across Oregon’s borders stops. Notably, since broader legalization took effect in 2015, large quantities of marijuana from Oregon have been seized in 30 states, most of which continue to prohibit marijuana.

Priority 2: Protecting Oregon’s Children

We will prioritize enforcement of federal marijuana violations that threaten public health, with particular emphasis on the access to marijuana by minors. This priority is consistent with state law, which strictly limits marijuana use to those 21 years of age and older. More can and must be done to ensure that both state and federal law are upheld in this regard, and I look forward to working with the Governor and our state law enforcement partners to ensure this occurs. The need to gather more data is particularly acute on this front, as numerous educational and social-services officials report significant increases in use by young people in their communities. We can, and must, do better by our youth.
Priority 3: Violence, Firearms, or other Public Safety Threats

We will prioritize enforcement of federal marijuana violations that involve or pose a substantial risk of violence or other threats to public safety in our communities, especially those involving firearms. During the Summit, I heard landowners describe feeling intimidated by marijuana producers, some of whom were armed. Federal marijuana violations associated with violence are of particular concern given that the protection of public safety is our paramount objective. Another public safety concern is the illegal manufacture of butane hash oil resulting in dangerous explosions and fires. Federal prosecutors throughout the district will continue to bring appropriate cases under federal law that fall within these public safety concerns.

Priority 4: Organized Crime

We will prioritize enforcement of federal marijuana violations that serve to fuel other criminal activity, especially through racketeering and the involvement of organized crime. Regardless of the underlying criminal offense involved, groups acting in concert to violate the law on an ongoing basis pose a particularly grave threat to the communities in which they operate. This includes not only violent crimes, but also non-violent criminal activity, such as federal income tax evasion or systematic money laundering to evade detection of illegal proceeds.

Priority 5: Protecting Federal Lands, Natural Resources, & Oregon’s Environment

We will prioritize enforcement of federal marijuana violations that have serious adverse effects on federal land or natural resources, including water, air, and listed species. The United States has a fundamental interest in protecting its property and natural resources. This priority also reflects the appreciation Oregonians share for our public lands, and our longstanding dedication to its appropriate conservation for current and future generations. Examples falling within this priority include cultivating marijuana on federally managed lands, using unlawful pesticides that pose a threat to human health, wildlife, and our environment, or using large amounts of water for grow operations without proper authorization. Oregon’s livability transcends the interests of any one industry.
Chapter 5

Presentation Slides: Criminal Defense Matters

W H I T N E Y  B O I S E
Boise Matthews LLP
Portland, Oregon
Chapter 5—Presentation Slides: Criminal Defense Matters

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- Whitney has been serving individuals and corporations charged with crimes instate and federal court since 1987. During this time, he has represented clients in some of the most high-profile cases in the state. Whitney has been recognized by Best Lawyers in America© for Criminal Defense in both White Collar and Non-White Collar Crimes since 2007. Through Best Lawyers®, his peers recognized him as Lawyer of the Year for White Collar Criminal Defense in 2017, and as Lawyer of the Year for General Practice Criminal Defense in 2018 and 2016. Whitney has also been included on Oregon's Super Lawyers lists, and been awarded the AV Preeminent rating for the highest level of professional excellence in the Martindale-Hubbell Law Directory. Whitney is a criminal defense lawyer because he believes he can make a positive difference in people's lives. He is also passionate about his work and is a highly-respected advocate for his clients. In September, Whitney was inducted into the American College of Trial Lawyers.
What is Money Laundering?

- Money laundering is any transaction that seeks to conceal or disguise proceeds of illegal activities.

Four Elements of Money Laundering Statute


- Financial Transaction
- Proceeds of Specific Unlawful Activity
- Knowledge that money is dirty
- Intending to:
  - Promote the SUA, § 1956(a)(1)(A)(i)
  - Evade Taxes, § 1956(a)(1)(A)(ii)
  - Conceal or Disguise, § 1956(a)(1)(B)(i)
  - Avoid Transaction Reporting Requirements, § 1956(a)(1)(B)(ii)
Element #1: Financial Transaction

- Examples of Financial Transactions:
  - Delivery of cash from drug dealer to money launderer
  - Wire transfer through Western Union
  - Transferring title to real property
  - Buying a vehicle

Element #2: Proceeds

- Property involved must, in fact, be proceeds of a Specified Unlawful Activity (SUA)
Element #3: Knowledge

- Knowledge that property represents proceeds of “some form of unlawful activity”

Element #4: Specific Intent

- Defendant acted with intent to:
  - Promote the SUA, § 1956(a)(1)(A)(i)
  - Evade Taxes, § 1956(a)(1)(A)(ii)
  - Conceal or disguise, § 1956(a)(1)(B)(i)
  - Avoid transaction reporting requirements, § 1956(a)(1)(B)(ii)
Forfeiture Statutes

- Criminal: 18 § 982
  &
- Civil: 18 § 981

Both statutes authorize civil and criminal forfeiture of all property involved in a violation of § 1956 or § 1957


- Defendant acted with intent to:
  - Promote the SUA, § 1956(a)(1)(A)(i)
  - Evade Taxes, § 1956(a)(1)(A)(ii)
  - Conceal or disguise, § 1956(a)(1)(B)(i)
  - Avoid transaction reporting requirements, § 1956(a)(1)(B)(ii)
Chapter 6

Presentation Slides: Taxation of Cannabis Businesses: The Perils and the Pitfalls

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Chapter 6—Presentation Slides: Taxation of Cannabis Businesses: The Perils and the Pitfalls

+ Taxation of Cannabis Businesses: The Perils and the Pitfalls

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Matt has a broad-based business and federal income tax practice focused primarily on business transactions involving taxable entities and individuals, tax litigation and controversy, as well as on the taxation of non-profit/exempt organizations. His practice relating to cannabis business transactions includes advising clients in the formation of business ventures; mergers and acquisitions; capital restructurings; and asset and stock dispositions. Matt represents individuals, closely held businesses and large corporate clients in audits, administrative appeals and collection matters, as well as in litigation in U.S. Tax Court, Federal District Court, and Federal Courts of Appeal when the matter is not resolved at the administrative level.
Federal Law

- IRC § 61(a):
  
  "General definition: Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items....."

- An activity which violates the law is subjected to tax on its income in the same manner as any legal business would be. Further it is entitled to the same business deductions as would be available to a legal business. *Commissioner v. Tellier*, 383 US 687, 691 (1966).

The rise of § 280E

  - Convicted drug trafficker argued successfully in the US Tax Court that he was entitled to claim 'ordinary and necessary expenses under IRC §162.
  - The taxpayer was able to produce records that substantiated expenses related to his sale of illegal drugs, including phone, auto, and cost of goods sold.
  - Taxpayer was denied deductions related to meals and entertainment as he did not meet the substantiation requirements of IRC § 274(b).

- Decision in 1981 – Reagan era war on drugs “Just Say No!”

- Congress responds by enacting IRC § 280E
Chapter 6—Presentation Slides: Taxation of Cannabis Businesses: The Perils and the Pitfalls

Enactment of § 280E

- Congress feels allowing deduction of business expenses bad public policy

“There is a sharply defined public policy against drug dealing. To allow drug dealers the benefit of business expense deductions at the same time that the U.S. and its citizens are losing billions of dollars per year to such persons is not compelled by the fact that such deductions are allowed to other, legal, enterprises. Such deductions must be disallowed on public policy grounds.”

1982 Senate Report 97-494(I)

26 U.S.C. § 280E

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.
Effect of § 280E

In its simplest form, a business calculates its taxable income as follows:

Total Revenue – Cost of Goods – Business Expenses = Taxable Income

- Total Revenue - § 61(a) includes income from all sources worldwide, including income from illegal activities.
- Cost of Goods Sold – Treas. Reg. §1-61.3(a) reduces total revenue by the cost of the goods sold. Cost of goods sold is not considered an expense, but rather an adjustment taken into account in arriving at gross income.
- Business Expenses - § 162 generally allows ordinary and necessary deductions related to the carrying on of a trade or business

Effect of § 280E (continued)

- IRC § 280E disallows any “deduction or credit” related to a business “trafficking in controlled substance.”
- Cannabis is listed as a Schedule I controlled substance under 21 USC § 812(c)(10).
- The § 280E denial of deductions includes the § 162 ordinary and necessary business expenses.
- Therefore, a taxpayer operating a cannabis business is subject to tax on its gross income rather than its net income. No deduction is allowed for what are clearly business expenses, such as rent, employee salaries, and utilities.
What is allowable under § 280E?

- Cannabis businesses are only allowed to reduce income by expenses related to the Cost of Goods Sold, which is largely governed by the inventory rules.
- Inventory must be determined under rules prescribed under § 471(a).
- As part of the 1986 Tax Reform, IRC § 263A was added, requiring that any indirect costs related to the “inventory” be included in cost of goods sold. These are referred to as the UNICAP Rules.
- Any and all costs that somehow relate to inventory should be treated as components of inventory….BUT…

IRS Chief Counsel Memo - 20150411

- In response to multiple audits, the IRS on January 23, 2015 issued CCM 20150411 seeking to clarify the IRS position on § 280E and the inventory cost rules.
- The IRS stated their position that businesses in the cannabis industry must compute Cost of Goods Sold under the inventory cost rules that existed when § 280E was enacted. This position eliminates the ability to claim indirect inventory costs under the UNICAP Rules.
- CCM 20150411 addresses inventory treatment for both producers and retailers.
- CCM 20150411 is the only substantive guidance on § 280E
Retailers: can only include in Cost of Goods Sold the invoice price of the cannabis, less trade or other discounts, plus transportation and other “necessary charges” incurred in acquiring the cannabis.

Growers: can include the direct material costs (i.e. seeds) and direct labor costs (i.e. labor to plant, harvest, sort). Also allowed indirect costs so long as “incidental and necessary for production” such as:
- Utilities
- Maintenance
- Repairs
- Excise Taxes

**Effect of § 280E**

IRC § 280E disallows a deduction for business expenses but permits the taxpayer to reduce its sales by the cost of goods sold. The inventory capitalization rules in effect draw the line between these two categories of costs; they define the cost of inventory and thus the cost of goods sold. Any cost included in inventory under these rules is not an otherwise deductible business expense and thus is not subject to disallowance under § 280E.
Limits of § 280E – Separate Businesses

- A taxpayer which sells cannabis and is also engaged in another business is not subject to § 280E with respect to the other business.  

- It is well established that a taxpayer can have more than one trade or business.  

- This principle is reflected in the regulations, which provide standards to determine whether a taxpayer’s activities constitute separate businesses. Treas. Reg. § 1.183–1(d)(1)

Separate Businesses (continued)

- Treas. Reg. § 1.183(d)(1) states, in relevant part:  
  [W]here the taxpayer is engaged in several undertakings, each of these may be a separate activity, or several undertakings may constitute one activity. In ascertaining the activity or activities of the taxpayer, all the facts and circumstances of the case must be taken into account.

- The most significant facts and circumstances in making this determination are the degree of organizational and economic interrelationship of various undertakings, the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting, and the similarity of various undertakings.

- Generally, the Commissioner will accept the characterization by the taxpayer of several undertakings either as a single activity or as separate activities ... BUT... the taxpayer’s characterization will not be accepted, however, when it appears that his characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.
Separate Businesses – (continued)


  1. Whether the undertakings are conducted at the same place;
  2. Whether the undertakings were part of a taxpayer’s efforts to find sources of revenue from his or her land;
  3. Whether the undertakings were formed as separate activities;
  4. Whether one undertaking benefited from the other;
  5. Whether the taxpayer used one undertaking to advertise the other;
  6. The degree to which the undertakings shared management;
  7. The degree to which one caretaker oversaw the assets of both undertakings;
  8. Whether the taxpayers used the same accountant for the undertakings, and
  9. The degree to which the undertakings shared books and records.

CHAMP v. Commissioner

- In *Californians Helping to Alleviate Med. Problems, Inc. v. Commissioner*, 128 T.C. 173, 183 (2007) (“CHAMP”), the Tax Court held that the taxpayer’s provision of caregiving services and its provision of medical marijuana were separate business activities because the taxpayer “was regularly and extensively involved in the provision of caregiving services, and those services are substantially different from the [taxpayer’s] provision of medical marijuana.”

- In CHAMP, the director of the dispensary was well experienced in health services, and he operated the dispensary with caregiving as the primary feature and the dispensing of medical marijuana as a secondary feature.
CHAMP – (continued)

- Sixty-eight percent of the CHAMP dispensary's employees—17 out of 25—worked exclusively in its caregiving business, and the dispensary provided its caregiving services regularly, extensively, and substantially independent of its providing of medical marijuana.

- It rented space at a church for peer group meetings and yoga classes, but the church did not allow marijuana on the church's premises.

- It provided its low-income members with daily lunches consisting of salads, fruit, water, soda, and hot food.

- Its members, approximately 47% of whom suffered from AIDS, paid a single membership fee “for the right to receive caregiving services and medical marijuana from” the taxpayer.

Olive v. Commissioner

- The Tax Court applied the separate business factors in *Olive v. Commissioner*, 139 T.C. No. 2 (2012), to deny the taxpayer's attempt to treat its medical marijuana dispensary, and its caregiving activity - the Vapor Room- as two activities under CHAMP.

- In Olive, the Vapor Room was established so that its patrons, including some suffering from AIDS and HIV, cancer, and other maladies, “could socialize and consume marijuana there.”

- The “Vapor Room” was designed with a comfortable lounge-like community center atmosphere, placing couches, chairs and tables throughout the premises along with vaporizers, games, books and art supplies on the premises for patrons to use at their desire.
Olive (continued)

- The taxpayer claimed that he trafficked marijuana only when actually selling it “and [that] the rest of the Vapor Room’s business was providing caregiving services” by providing the lounge and recreational supplies.

- The Ninth Circuit Court affirmed the Tax Court on Appeal:
  - Because selling medical marijuana was The Vapor Room’s only source of revenue, and it provided all its other services free of charge, the court concluded that its only trade or business was selling medical cannabis.
  - Olive’s only “business” was selling medical marijuana because its other services were free of charge. Therefore all of The Vapor Room’s relevant activities “consisted of” trafficking in controlled substances and Olive’s deductions must be disallowed. Olive v. C.I.R., 139 T.C. 19, 42 (2012), aff’d, 792 F.3d 1146 (9th Cir. 2015).

Canna Care, Inc. v. Commissioner

- IRS applied IRC §280E to deny the deduction of all operating expenses, including substantial officer’s salaries and automobile expenses.

- Taxpayer appealed the tax assessment to the U.S. Tax Court arguing:
  - That medical marijuana is not a Schedule I controlled substance;
  - That Canna Care was not “trafficking” for purposes of IRC §280E because its activities were not illegal under the California Compassionate Use Act of 1996;
  - That the Tax Court decision in CHAMP was incorrect.
Canna Care – (continued)

- Tax Court reiterated that medical marijuana is a Schedule I controlled substance.

- Second, the Tax Court held that the sale of medical marijuana is always considered trafficking under IRC §280E, even when permitted by state law. Thus, operating expenses associated with the sale, manufacturing or production of cannabis are always disallowed under IRC § 280E.

- The Tax Court held that the CHAMP had been correctly decided. The Tax Court held that because Canna Care’s only business was selling cannabis, none of its operating expenses could be deducted under IRC §280E.

- The Tax Court noted that Canna Care arguably had a second trade or business selling clothing and could have argued these expenses should be deducted. As that fact was not stipulated in its petition, the Tax Court could not consider that issue on the merits.

Canna Care – (continued)

- Taxpayer appealed to the Ninth Circuit raising a constitutional issue, rather than a direct appeal on the original 3 arguments, arguing that IRC § 280E violates the Excessive Fine Clause of the 8th Amendment of the United States Constitution.

- Taxpayer argued that IRC §280E was enacted by Congress to punish drug dealers, and as such, it illegally imposes a fine on cannabis dispensaries. Taxpayer as a non-profit noted that its income tax liability was 1000% of its net income and a 1000% tax rate for engaging in an activity allowed under California law constituted a grossly disproportionate fine on such activity. The tax rate impact under IRC § 280E is especially disproportionate when compared to the tax rate of other business – both legal and illegal. Accordingly, the income tax liability imposed under IRC §280E constitutes an excessive fine in violation of the 8th Amendment.

- The Circuit Court of Appeals dismissed Canna Care’s appeal and upheld the Tax Court’s holding because the arguments presented were not raised in the lower court, the Court did not address the merits of each argument.
**Alterman v. Commissioner**

- Taxpayer operated a Colorado medical marijuana grow and dispensary selling **both** cannabis products and paraphernalia, hats and shirts.
- The Court held that the sale of paraphernalia, hats and shirts was not a separate trade or business **primarily due to the lack of records**, therefore costs associated with these activities were not deductible under IRC §280E.
- The Court determined that certain costs were not allowable as COGS **because of insufficient records**.
- *Alterman v. Commissioner*, TC Memo 2018-83

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**Loughman v. Commissioner**

- A married couple owned and operated a Colorado corporation, taxed as an S Corporation, which grew and sold cannabis.
- The Court addressed the issue of double taxation of income because of IRC §280E, concluding that double taxation is allowed.
- An S corporation is not subject to tax; instead shareholders are taxed on S Corporation income at the individual level. Special rules treat S Corporation shareholder/officers as employees and require the S Corporation to pay them a reasonable wage. Under ordinary circumstances, an S Corporation deducts shareholder/officer wages; the shareholder/officer then pays income tax on the wages. The S Corporation's deduction of wages prevents double taxation.
Loughman – (continued)

- IRS applied IRC §280E and disallowed the S Corporation deduction for wages paid to the Owners.
- Consequently, the amount of S Corporation income passed through to the owners increased. The result is that the Owners wages are taxed twice — first as an employee and then as S Corporation shareholders.
- The Court rejected the argument that IRC§280E discriminates against S Corporation shareholders operating a cannabis business.
- The Court reasoned that wage payments to a third-party performing the same services as the Owners would not be deductible under IRC §280E. Accordingly, the amount of pass through income to the Owners would not change: IRC §280E applies equally to increase S Corporation income, regardless of who receives wages.
- Loughman v. Commissioner, TC Memo 2018-85

The STATES Act

- On June 7, 2018, the Strengthening the Tenth Amendment Through Entrusting States Act (The “STATES Act”) was introduced.
- The STATES Act exempts persons from the Controlled Substances Act, so long as they are acting in compliance with a state’s cannabis law.
- Under the STATES Act, the production or sale of cannabis in a cannabis legal state “shall not constitute trafficking”.
- If enacted, the STATES Act would eliminate, or substantially ameliorate, the impact of IRC § 280E - IRC § 280E only applies to activities of a trade or business that “constitute trafficking.”