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The High Cost of Federal Cannabis Prohibition

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I. Introduction

Imagine a budding entrepreneur, Norville Rogers, who lives in a state that recently legalized recreational cannabis. Mr. Rogers wants to start a dispensary and meets all of his state's requirements for a new dispensary. He just needs enough startup capital.

Mr. Rogers knows it can cost between $250,000 and $750,000 just to get a new dispensary off the ground, and that he needs more cash on hand to keep up inventory.[1] This task should be easy. He will just go to the bank he uses for his other ventures, obtain a loan, and set up a business account from which to run the business. When Mr. Rogers meets with the bank, however, he learns it will not deal with him because of the risks associated with instigating a federal money laundering indictment by choosing to deal with cannabis-related businesses ("Cannabusinesses"). Mr. Rogers must either abandon his dreams of becoming a dispensary owner or find a way to procure almost three quarters of a million dollars and run a business without using banks.

Social equity is an oft-cited justification for cannabis legalization in states like New Jersey. Such legalization states have specific departments within their respective regulatory bodies aimed at furthering social equity goals by "establishing practices and procedures for promoting inclusion of diverse populations" in the cannabis industry.[2] These social equity goals, however, are all for naught when federal prohibition renders running a legitimate cannabis-related business ("Cannabusiness") incredibly difficult, if not nearly impossible, without independent wealth. While there is no federal law that explicitly forbids banks from doing

[1] *See* Gary Cohen, *Member Blog: How Much Does it Actually Cost to Open a Dispensary*, NAT'L CANNABIS INDUS. ASS'N (Sept. 25, 2018), https://thecannabisindustry.org/member-blog-how-much-does-it-actually-cost-to-open-a-dispensary/#:~:text=And%20while%20there%20are%20many,in%20the%20most%20saturated%20markets.

[2] *See What is the role of the Minority, Disabled Veteran, and Women Cannabis Development Office?*„ N.J. Cannabis Reg. Comm'n, https://www.nj.gov/cannabis/resources/faqs/social-equity/ (last visited Apr. 25, 2022).

business with Cannabusinesses, most banks avoid Cannabusinesses because of the unique risk the pose due to federal prohibition.[3] As a result, Cannabusinesses generally operate unbanked and cash-only.

Businesses operating cash-only have unique problems. Cash-only businesses are robbery targets. It is well-known that Cannabusinesses operate only in cash.[4] Cannabusinesses like BASA in San Francisco report repeated robberies, sometimes even multiple nights in a row, because they are "high-risk" businesses with ample cash on hand.[5] Crime is just one example of "shrinkage" wherein cash becomes unusable over time due to theft: mold, pests, misplacement, and other ill effects brought on by storing large volumes of cash for extended periods all serve to add extra expense to cash-only businesses. Budding Cannabusiness owners and operators must handle these large volumes of cash and account for shrinkage to operate successfully.

Federal prohibition presents additional tax barriers to operating Cannabusinesses. Cannabusinesses must pay taxes and fees in cash every month, so if the payment offices are closed – maybe due to a public health emergency – Cannabusinesses cannot pay their taxes and fees and may end up losing their licenses.[6] These barriers all prevent those without the financial means from opening and operating Cannabusinesses and introduce unnecessary risk to those with the financial means to operate them, ultimately stifling industry growth and preventing social equity programs through Cannabusiness.

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[3] Eric Kaufman, *The Challenges of Running a Legitimate Cannabis Business out of a Duffel Bag Filled With Cash*, Forbes Business Development Counsel (October 19, 2020), ¶2 https://www.forbes.com/sites/forbesbusinessdevelopmentcouncil/2020/10/19/the-challenges-of-running-a-legitimate-cannabis-business-out-of-a-duffel-bag-filled-with-cash/?sh=59317f9512b4,at ¶2.

[4] *Id*. ¶ 3.

[5] Chris Roberts, *Legal Cannabis Businesses are Preparing to get Robbed Again. Will Police Protect Marijuana Legalization?* FORBES (Jul. 2, 2020), https://www.forbes.com/sites/chrisroberts/2020/07/02/legal-cannabis-businesses-are-preparing-to-get-robbed-again-will-police-protect-marijuana-legalization/?sh=67bf59d81009.

[6] Kaufman, *supra* note 3, at ¶ 5.

Part II of this paper provides a brief overview of federal cannabis policy since the enactment of the Controlled Substances Act ("CSA"). In recent decades, states have begun legalizing cannabis to different degrees, despite federal prohibition. Since 2009, federal regulators have issued memoranda regarding federal enforcement of cannabis prohibition in legalization states. Part II briefly outlines those memoranda and their effects on Cannabusinesses and the cannabis market.

Part III examines the negative effects of federal regulation on Cannabusinesses, including increased risk of victimization, chilled investment, and lack of banking options. Part III also examines the burdens on Cannabusinesses caused by their largely cash-only status.

Part IV explores possible remedies to cannabis prohibition and its ill-effects. First, it explores the possibility of a new Department of Justice ("DOJ") memorandum that halts federal prohibition enforcement and grants amnesty to banking institutions. It then examines pending federal legislation aimed at remedy prohibition-related harms, including the Secure and Fair Enforcement Banking Act of 2021 ("SAFE Banking Act"), the Strengthening the Tenth Amendment Through Entrusting States Act, and the Marijuana Opportunity Reinvestment and Expungement Act ("MORE Act"). The MORE Act has gained the most traction, passing the United States House of Representatives ("House") on April 1, 2022, but it does not adequately address the concerns expressed in this paper because it fails to offer proper federal oversight.

Part V offers two policy recommendations aimed at enabling the federal government to better address state legalization and the risks associated with legalizing cannabis without adopting a more robust federal regulatory scheme. The first solution consists of amendments to proposed federal legislation that would reduce or eliminate the ill-effects of the CSA on Cannabusinesses and personal users in the United States. It also includes recommendations for

how federal regulators should approach standardizing the cannabis industry to ensure consistency across the market. The second solution proposes enactment of the MORE Act with amendments or, in the event the MORE Act passes unaltered, subsequent federal legislation to supplement the MORE Act's provisions.

II. Federal Cannabis Policy Post-CSA

The Controlled Substances Act

Before the Nixon administration initiated the "War on Drugs," there existed no official federal prohibition on cannabis use.[7] Prior administrations attempted to curb drug distribution and use through taxation and labeling regulations enforced by the Department of the Treasury.[8] Cannabis first became the target of federal regulation in 1937 with the passage of the Marihuana Tax Act which did not outlaw the possession, sale, or use of cannabis. Instead, it imposed registration, reporting, and taxation requirements on individuals who imported, produced, or sold cannabis.[9] Noncompliance with those requirements exposed those parties to severe federal penalties, while compliance often subjected them to prosecution under state law.[10]

In response to the "War on Drugs," Congress enacted Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, otherwise known as the Controlled Substances Act ("CSA").[11] The CSA radically changed the federal drug regulatory scheme by establishing five

[7] Gonzales v. Raich, 545 U.S. 1 (2005).
[8] *See, e.g.*, The Harrison Narcotics Tax Act of 1914, 38 Stat. 785 (repealed 1970) (requiring producers, distributors, and purchasers of narcotics to register with the Federal Government, assessing taxes against registered parties, and regulating issuances of prescriptions).
[9] Marihuana Tax Act of 1937, ch. 553, Pub. L. No. 75-238, 50 Stat. 551 (1937)(repealed 1970).
[10] Leary v. United States, 395 U.S. 6, 16, (1969) (stating that, if read according to its terms, the Marihuana Tax Act forced the petitioner to expose himself to self-incrimination by requiring him to identify himself as a transferee of marijuana with the Federal Government thus subjecting himself to state action for failure to pay state occupational tax; thus holding the Marihuana Tax Act was unconstitutional on self-incrimination grounds).
[11] 21 U.S.C. § 801 et seq.

"schedules" of controlled substances. These schedules vary in how strictly the government regulates their respective controlled substances, with schedule I ranked most strictly and Schedule V least strictly[12] Congress delegated to the United States Attorney General the authority to add or remove controlled substances to or from the schedules, though Congress may still add or remove drugs from the schedule by legislation.[13] Furthermore, the CSA explicitly classified "marihuana" and "Tetrahydrocannabinols, except for tetrahydrocannabinols in hemp" by name as Schedule I controlled substances, where they remain today.[14] A Schedule I controlled substance is one which (1) has a high potential for abuse, (2) has no currently accepted medical use in in treatment in the United States, and (3) lacks accepted safety for use under medical supervision.[15]

The Ogden Memo

In response to states' growing medical marijuana programs, then-Deputy Attorney General David Ogden issued a policy memorandum ("Ogden Memo") on October 19, 2009 to resolve tensions between state legalization and ongoing federal prohibition.[16]

The Ogden Memo, which was directed at federal prosecutors in states that had legalized medical cannabis, provided uniform guidance on how to focus federal cannabis investigations and prosecutions in those states.[17] The Memo stated that, as a general matter, disruption of illegal drug manufacturing and trafficking networks should not be a federal priority with regard to

[12] *Id.* § 812.
[13] *Id.* § 811.
[14] *Id.* § 812(c)(I)(c)(10) & (17) (listing "Marihuana" as a Schedule I controlled substance with "no currently accepted medical use and a high potential for abuse").
[15] *Id.*
[16] Joëlle Anne Moreno, *Half-Baked: The Science and Politics of Legal Pot*, 123 PENN ST. L. REV. 401, 453 (2019).
[17] Memorandum from Deputy Attorney Gen. David W. Ogden, to Selected U.S. Attorneys (Oct. 19, 2009), https://www.justice.gov/archives/opa/blog/memorandum-selected-united-state-attorneys-investigations-and-prosecutions-states [hereinafter *Ogden Memo*].

individuals whose actions are in "clear and unambiguous compliance with existing state laws providing for the medical use of marijuana."[18] It made clear that the federal government would not waste resources on individuals using cannabis as medicine so long as that use was compliant with applicable state law.[19] Individuals were not deemed in "clear and unambiguous compliance with state laws" if certain characteristics accompanied cannabis use including unlawful possession of firearms; violence; sale to minors; illegal possession of other controlled substances; or ties to other criminal enterprises.[20] The Ogden Memo was extremely limited in its scope, explicitly stating that the slightest deviation from state medical cannabis policy was grounds to initiate a federal investigation and that the memo was not intended to either "legalize" marijuana or provide a legal defense to any violation of federal law.[21]

The Cole Memo

On August 29, 2013, then-Deputy Attorney General James M. Cole issued an internal DOJ memorandum ("Cole Memo"), which provided updated guidance to federal prosecutors concerning "marijuana enforcement under the Controlled Substances Act."[22] The Cole Memo outlined eight priorities, commonly referred to as the "Eight Deadly Sins," to guide federal prosecutors' CSA enforcement of cannabis-related conduct.[23] The "Eight Deadly Sins" include, (1) preventing distribution of marijuana to minors; (2) preventing revenue from the sale of marijuana from going to criminal enterprises; (3) preventing diversion of marijuana from states

[18] *Ogden Memo, supra* note 17, at 1-2.
[19] *Id.* at 2.
[20] *Id.*
[21] *Id.*
[22] *See* Memorandum from Deputy Attorney Gen. James M. Cole, to U.S. Attorneys (Aug. 29, 2013), https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf [hereinafter *Cole Memo*].
[23] *Id.*

where it is legal under state law in some form; and (4) preventing marijuana possession on federal property, among others.[24]

The Cole Memo further noted that the federal government traditionally relied on state and local law enforcement to address marijuana activity by enforcing their own cannabis laws.[25] Such enforcement includes "[t]he enactment of state laws that endeavor to authorize marijuana production, distribution, and possession by establishing a regulatory scheme for these purposes."[26] The Cole Memo makes the point that legalization states that enact strong and effective enforcement mechanisms to ensure compliance with state law are unlikely to run afoul of any of the "Eight Deadly Sins."[27]

The Cole Memo directed federal prosecutors to "weigh all available information and evidence, including . . . whether the operation is demonstrably in compliance with a strong and effective state regulatory system" when determining if a cannabis operation implicated one of the "Eight Deadly Sins."[28] In other words, the Cole Memo did not alter the federal government's authority to enforce federal law, but announced that federal prosecutors should not waste valuable law enforcement resources enforcing federal cannabis laws against actors compliant with state law.[29]

The Financial Crimes Enforcement Network Memo

[24] *Id*.
[25] *Id*.
[26] *Id*.
[27] *Id*.
[28] *Id*.
[29] Steven Mare, *He Who Comes Into Court Must Not Come With Green Hands: The Marijuana Industry's Ongoing Struggle With The Illegality And Unclean Hands Doctrines*, 44 HOFSTRA L. REV. 1351, 1357 (2016) (stating that the Cole Memo "stressed state regulation of the marijuana industry instead of federal government interference").

Federal law expects financial institutions to discover and report illegal activity and prevent wrongdoers from accessing the banking system.[30] The Money Laundering Control Act,[31] for example, subjects individuals and entities to criminal liability for money laundering. With regard to cannabusiness banking, a banking institution may commit money laundering by conducting a financial transaction involving the proceeds of a known unlawful activity while knowing the transaction is "designed in whole or in part to conceal or disguise the nature, the location, the source, the ownership or the control of the proceeds of specified unlawful activity or to avoid a transaction reporting requirement under state law."[32] A financial institution may also commit money laundering where the institution "knowingly engages or attempts to engage in a monetary transaction in criminally derived property of a value greater than $10,000."[33] The "manufacture, importation, sale, or distribution of a controlled substance," including cannabis, is a "specified unlawful activity" under the Money Laundering Control Act.[34]

Additionally, federal statutes such as the Bank Secrecy Act [35] require financial institutions to maintain programs designed to prevent money laundering.[36] The Bank Secrecy Act broadly defines "financial institutions" to apply to all insured banks; private bankers; all credit unions; loan or finance companies; and other entities that may facilitate money laundering.[37] These financial institutions must make reasonable efforts to verify the identity of those seeking to open an account, regardless of if that entity is a person or business.[38]

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[30] Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 Case W. Res. L. Rev. 597, 610 (2015).
[31] 18 U.S.C. §§ 1956-57 (2012).
[32] *Id.* § 1956(a)(1)(B).
[33] *Id.* § 1957(a).
[34] *Id.* §§ 1956(c)(7), 1957(f)(3);
[35] Pub. L. No. 91-508, 84 Stat. 1114 (1970).
[36] 31 U.S.C.A. § 5318(h) (2012).
[37] *See Id.* § 5312.
[38] *Id.* § 5318(l)

On February 14, 2014, nearly six months after issuance of the Cole Memo, the Department of the Treasury Financial Crimes Enforcement Network ("FinCEN") released its own memo ("FinCEN Memo") to provide additional guidance to financial institutions regarding Cannabusinesses.[39] The FinCEN Memo clarified how financial institutions could provide services to Cannabusinesses consistent with their Bank Secrecy Act ("BSA") obligations.[40] In general, the FinCEN Memo advised financial institutions to consider whether the Cannabusinesses with which they conducted business implicated one of the "Eight Deadly Sins" or violated state law.[41] FinCEN explicitly stated that it agreed with the Cole Memo guidance and that it encouraged financial institutions to perform "customer due diligence" based on a series of factors to assess the risks of providing financial services to Cannabusinesses.[42] To perform their "due diligence," under the Bank Secrecy Act and the FinCEN Memo, institutions must file currency transaction reports for any transaction involving more than $10,000 in cash.[43]

The FinCEN Memo also reminded institutions that provide services to Cannabusinesses of their obligation to file a suspicious activity report ("SAR") to the federal government given that the business activities at issue were illegal under federal law.[44] There are three categories of

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[39] Brad Scheick, *Do You Feel Lucky, Banker? The Shaky Prospects for Financial Transactions with Marijuana-Related Businesses*, Miller & Starr, Real Estate News Alert, 459, 464 May 2018.

[40] Fin. Crimes Enf't Network, Fin-2014-G001, BSA Expectations Regarding Marijuana-Related Business (2014), https://www.fincen.gov/sites/default/files/shared/FIN-2014-G001.pdf (Financial institutions that conduct transactions with money generated by Cannabusinesses could face liability under the BSA for failing to identify or report financial transactions involving proceeds generated by cannabis-related violations of the CSA. For these purposes, prosecution of these offenses does not require an underlying cannabis-related conviction).

[41] *FinCEN Memo*, *supra* note 40, at 1-2.

[42] *Id.* at 2-3 (explain that the factors include (1) verifying with state authorities whether the business is duly licensed and registered; (2) reviewing the license application submitted by the business for obtaining a state license to operate; (3) requesting from state licensing and enforcement authorities available information about the business and related parties; (4) developing an understanding of the normal and expected activity for the business; (5) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (6) ongoing monitoring for suspicious activity, including any red flags described in this guidance; and (7) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with risk).

[43] 31 U.S.C. § 5313(a) (2012); 31 C.F.R. § 1010.311 (2014).

[44] *Id.* Because Cannabusinesses are federally illegal, funds from those businesses are derived from activity that is illegal under federal law. Therefore, any funds from Cannabusinesses must be reported in a SAR by financial institutions which choose to transact with a cannabusiness.

SAR depending on the nature of the "suspicious activity": (1) "Marijuana Limited" for businesses which do not implicate the "Eight Deadly Sins" or violate state law; (2) "Marijuana Priority" for businesses reasonably believed to implicate one of the "Eight Deadly Sins" or violate state law; and (3) "Marijuana Termination" for instances where a financial institution deems it necessary to terminate a relationship with a business to maintain an effective anti-money laundering compliance program.[45]The FinCEN Memo guidance created a narrow window for banking institutions to transact with Cannabusinesses without exposing themselves to federal enforcement of money laundering statutes. There is little financial incentive, however, for banking institutions to try to navigate the strict provisions laid out in the FinCEN memo. Any accidental lapse or deviation from that guidance could result in harsh federal criminal penalties and could cause the financial institution to lose its federal charter. As a result, virtually all large national banks have opted not to offer their services to the cannabis industry.[46]

The Sessions Recission

Then-Attorney General Jeff Sessions rescinded the Ogden Memo, Cole Memo, and other Department of Justice ("DOJ") memos regarding loosening of cannabis-related prosecution on January 4, 2018, three days after California became the eighth state to legalize recreational cannabis use, via a one-page "Memorandum for All United States Attorneys" ("Sessions Memo").[47] The Sessions Memo reminded United States attorneys that the CSA generally prohibits the cultivation, distribution, and possession of cannabis and that those activities may serve as the basis for prosecution of other crimes such as those prohibited by money laundering

[45] *Id.* at 3-4.
[46] Scheick, *supra* note 39, at 465.
[47] *See* Laura Jarrett, *Sessions nixes Obama-era rules leaving states alone that legalize pot*, CNN (Jan. 4, 2018), https://bit.ly/2lv5Ton.; Memorandum from Attorney Gen. Jefferson B. Sessions, to U.S. Attorneys (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196/download [hereinafter *Sessions Memo*].

statutes and the BSA.[48] While the Sessions Memo suggested that state cannabis legislation would no longer be permitted, prosecution of state-compliant cannabis activity has remained uncommon, inconsistent, and unclear.[49] The Sessions Memo did not rescind the FinCEN Memo, which remains in effect.

III. Effects of Deficient Federal Guidance on Cannabusiness and Crime

Cannabusinesses are at Higher Risk of Victimization

Federal prohibition prompts most banks to refuse to transact with cannabis growers, extractors, distributors, and sellers – even those that operate legally in their own states.[50] As a result, Cannabusinesses must operate on a cash-only basis with large volumes of currency, rendering them easy targets for robberies, kidnappings, and extortion.[51]

Even prior to the release of the Sessions Memo, banking institutions were hesitant to deal with Cannabusinesses given the tentative legal landscape, lack of federal legalization, and roadblocks posed by the FinCEN Memo. Following the Sessions Memo, which indicated that the Department of Justice might prosecute even actors in compliance with state law, the banking landscape is only more uncertain. The cumulative effect of this uncertainty is that Cannabusinesses must continue to operate cash-only and assume the risks. [52]

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[48] *Sessions Memo*, *supra* note 47.
[49] Adam R. Scott, *The Governing Dynamics of State Marijuana Legislation: Game Theory and the Need for Interstate Cooperation*, 124 Penn St. L. Rev. 769, 788 (2020).
[50] Aaron Klein, *Banking Regulations Create Mess for Marijuana Industry, Banks, and Law Enforcement*, Brookings Institution (Apr. 23, 2018), https://www.brookings.edu/research/banking-regulations-create-mess-for-marijuana-industry-banks-and-law-enforcement/.
[51] *See, e.g.* Kate Briquelet, *Escaped California Inmate Cut Off Pot Dealer's Penis*, The Daily Beast (Jan. 25, 2016), https://www.thedailybeast.com/escaped-california-inmate-cut-off-pot-dealers-penis. (Kidnappers robbed and abducted the owner of a legal dispensary in California, cutting off his penis when he refused to reveal the location of the cash used to run his business).
[52] Richard P. Ormond, *Cannabis, Cash, and Crime Banking, Lending, and Insolvency Restrictions Relegate the Legitimate Cannabis Industry in California to an All-Cash Business, Vulnerable to Crime*, L.A. Law., July/August 2018, at 22, 23 (2018).

Like bars, jewelry stores, and convenience stores, Cannabusinesses are "high-risk" businesses that hold highly valuable products and a lot of cash, which may tempt criminals or promote crime.[53] The risk and prevalence of crime against Cannabusiness, however, is incredibly difficult to quantify. There is little data on the prevalence of robberies and burglaries at Cannabusinesses, and many are dubious.[54] What is not in dispute is that Cannabusinesses and their owners are at high risk of such crimes as a direct result of their cash-only status and large stores of valuable inventory.[55] Storing cash on location is "like placing a giant target on your storefront" and storing large amounts of money on site creates a safety risk for those in and around those locations.[56] These businesses, their clientele, and states seeking valuable tax revenue will continue to suffer from these risks so long as banks are dissuaded from transacting with Cannabusinesses.

Operating cash-only places a target on the backs of cannabusinesses and their owners. It is common knowledge that those organizations rarely transact with banking institutions, meaning the flow of currency in or out of the business must be in cash.[57] Forcing cannabusiness operators to risk losing thousands of dollars and their lives by placing that target on their backs dissuades prospective owners from opening businesses. Less business development means fewer alternatives to the black market, which defeats the purpose of legalizing cannabis.

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[53] Tony Gallo, *Cannabis, Communities, and Crime: Recent Statistics for Lingering Fears*, Hoban Law Group, (October 11, 2019), https://hoban.law/2019/10/cannabis-communities-crime-stats/ (last visited Apr. 28, 2022).
[54] *One in Two Cannabis Dispensaries is Robbed or Burglarized? Perhaps Not…* RegTech Consulting LLC, (July 23, 2019), https://regtechconsulting.net/cannabis-marijuana/one-in-two-cannabis-dispensaries-is-robbed-or-burglarized-perhaps-not/ (last visited Apr. 28, 2022).
[55] *Id.* at ¶ 18.
[56] Anh Hatzopolous, *The Cost Of Cash For Unbanked Cananbis Businesses*, Forbes (Jul. 13, 2020, 8:20 AM), https://www.forbes.com/sites/forbesfinancecouncil/2020/07/13/the-cost-of-cash-for-unbanked-cannabis-businesses/?sh=289790e7f4dd.
[57] *Id.* (An estimated 70% of cannabusinesses operate cash-only. The decision to do so is often based on the conception that cash-only is a cheaper or safer alternative to banking, but cash-only businesses incur many safety and financial liabilities).

Cannabusinesses Must Still Pay Taxes but are not Eligible for Deductions

As a general rule, income from any source is taxable by the federal government, even if it is generated from illegal activity.[58] Thus, like any business, Cannabusinesses must pay taxes. Internal Revenue Code Section 280E ("Section 280E") calls for companies within the cannabis industry to report gross income from the sale of cannabis and cannabis products, less the cost of goods sold as taxable income. Section 280E, therefore, requires Cannabusinesses to pay taxes on their income without receiving any deductions because the goods sold include scheduled controlled substances and ineligible for deductions.[59] Section 280E is not limited to necessary business expenses ordinary to a Cannabusiness; it also disallows deductions related to the business, including deductions for depreciation, charitable contributions, and state and local taxes.[60] Section 280E, therefore, has the effect of drastically increasing the effective tax rate of Cannabusinesses and slashing their profit margins, often forcing Cannabusinesses to pay taxes despite net negative cash flow.[61]

Section 280E creates a significant financial challenge for any would-be cannabusiness startup: ensuring solvency while subject to an extraordinary federal tax relative to other businesses. One such method for ensuring solvency is to solicit investors and obtain ample startup capital. Soliciting investors is difficult, however, because the crushing tax bills which result from disqualified business-expense deductions may, depending on how the business is

[58] 26 U.S.C. § 61(a); James v. United States, 366 U.S. 213, 218 (1961) (stating that "the net income of a taxable person shall include gains, profits, and income from the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever").
[59] 26 U.S.C. § 280E (stating that no deduction or credit shall be allowed for any amount incurred during the taxable year in the course of business if such business consists of trafficking in controlled substances which is prohibited by federal law or the law of any state in which that business is conducted).
[60] Fed. Tax Coordinator ¶ L-2632 (2d.), *Disallowance of Expenses of Trafficking in Illegal Drugs; Trafficking in Marijuana; Cost of Goods Sold; Failed Constitutional Arguments*.
[61] Massachusetts Cannabis Law Manual, Chapter 5, *Business and Taxation of Cannabis*, 1st Edition 2019.

organized, flow through to the investors and require them to cover any deficiencies.[62] This risk has great potential to chill investment in cannabusiness and dissuade investors from providing much-needed startup capital to cannabis ventures, thus stifling the market.[63]

In addition to the financial burden Section 280E places on prospective and current Cannabusinesses, a second issue arises regarding the actual payment of income taxes: businesses operating cash-only must pay their taxes in cash.[64] Cannabusiness owners must travel to the Internal Revenue Service and applicable state Department of Revenue to pay their taxes with duffel bags full of cash.[65] These trips present their own obvious risks: carrying large sums of cash on-hand puts one at significant risk of being robbed, losing a significant portion of income, or simply being unable to pay taxes on time if the offices are closed or unavailable (say, in the event of a nation-wide quarantine).

Collecting cash payments from Cannabusinesses is similarly difficult for states in which those businesses operate. In Oregon, for example, adult-use cannabis sales are centralized around Portland, but the Oregon Department of Revenue is located in in Salem, roughly 50 miles away.[66] Washington adds an extra step to their tax collection process for Cannabusinesses: retailers must make non-cash payments despite their limited access to banking services.[67] If a business cannot pay via a cash alternative, it may petition for a waiver which allows that

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[62] Jeremy Vaida, *Tax Traps and Tips for Cannabusinesses*, 50 MD. B. J., November/December 2017, 30, 33 (2017).
[63] *See, e.g.*, Hillary Bricken, *Breaking News: Bye, Bye Cole Memo, Hello Uncertainty for Marijuana*, Canna L. Blog (Jan. 4, 2018), https://www.cannalawblog.com/breaking-news-bye-bye-cole-memo-hello-uncertainty-for-marijuana/ ("Banks are incredibly conservative and taking down the Cole Memo will almost certainly lead some banks to stop providing banking services to cannabis businesses") (last visited Apr. 25, 2022).
[64] Mark Snider and Victoria K. Hanohano-Hong, Cannabis Law, *High Taxes—Section 280E's Effect on Marijuana Businesses*, , Porter, Wright, Morris & Arthur LLP, at 2 (April 2, 2021).
[65] Mia Getlin, *Cannabis Clients Lack Banking Options Amid Onerous Federal Requirements Navigating Today's Wild West*, Or. St. B. Bull., April 2019, at 34 (2019).
[66] Justin E. Hobson, *Please Take My Money—Taxing Cannabis*, J. of Multistate Tax'n and Incentives, 1, 3 (August 27, 2017).
[67] Washington State Liquor and Cannabis Board, *Excise Tax Payment*, https://lcb.wa.gov/marj/excise-tax-payment (last visited Apr. 28, 2022).

business to pay in cash for six months with a 10% fee, adding even more costs to an already prohibitively expensive venture.[68]

The federal government and the states impose great barriers on Cannabusinesses and their owners, which collectively render tax payment near impossible. These hurdles stem entirely from cannabis' status as a Schedule I controlled substance and the federal government's decision to dissuade financial institutions from doing business with Cannabusinesses. Such challenges could be avoided by allowing Cannabusinesses to move away from a cash-only model and engage in traditional banking practices.

Cannabusinesses Have Limited Access to Federal Courts

Another glaring issue caused by prohibition presents itself in the form of the "Unclean Hands" doctrine. The "Unclean Hands" doctrine states that a contract that violates the law will not be recognized as valid by the courts and neither party to the contract will be entitled to a legal remedy in the event of breach, especially if public policy weighs against enforcement of the contract.[69]

Some states have allowed for contractual remedies relating to the sale of cannabis.[70] On the federal level, however, the "Unclean Hands" doctrine applies to all cannabis-related contracts because they concern business dealings with federally illicit substances and state law cannot guarantee protection to litigants engaging in those activities.[71] Potential litigants, then, must pray

[68] *See Id*.
[69] *See* Restatement (Second) of Contracts § 178(1) (Am. Law Inst. 1981) (A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms).
[70] *See, e.g.*, Colo. Rev. Stat. § 13-22-601. Colorado codified into state law that a contract is not void or voidable as against state policy if it pertains to lawful cannabis-related activities as stated in the Colorado State Constitution. COLO. CONST. art. XVIII, § 16.
[71] Candace C. Carlyon & Matthew R. Carlyon, *Bankruptcy Courts Deny Relief to Marijuana Businesses*, Am. Bankr. Inst. J., 42, 42-43 (2014).

their remedies are limited to the purview of state courts wherein the "Unclean Hands" doctrine is not used to void cannabusiness contracts, or risk their business dealings amounting to little more than handshake agreements in the view of the federal courts.

The "Unclean Hands" doctrine is not limited restricting access to courts for contractual remedies. Cannabusinesses also cannot file for bankruptcy because bankruptcy courts "wash their hands clean" of Cannabusinesses.[72] State law may apply in some instances, but bankruptcy courts are federal courts because bankruptcy law is federal law.[73] Cannabusinesses are, therefore, left without remedy when faced with bankruptcy.[74]

The inability to seek bankruptcy protection is especially harmful to Cannabusinesses because, as explained earlier, Cannabusinesses incur extra expenses compared to non-cannabis ventures. These expenses, especially when coupled with difficulties in procuring investment capital, put Cannabusinesses at an increased risk of bankruptcy and, therefore, create an increased need for bankruptcy protection. By precluding Cannabusinesses from accessing bankruptcy remedies, federal policy generates undue hardship for those businesses, their employees, and the businesses with which they transact.

IV. Suggestions for New Federal Cannabis Policy

A New "Cole Memo"

To lessen the considerable dissonance between federal and state cannabis law and policy, federal departments could issue new memoranda like the Cole Memo and FinCEN Memo to

[72] Steven Mare, *He Who Comes into Court Must Not Come with Green Hands: The Marijuana Industry's Ongoing Struggle with the Illegality and Unclean Hands Doctrines*, 44 HOFSTRA L. REV. 1351, 1363 (2016).
[73] Carlyon & Carlyon, *supra* note 71, at 42.
[74] Vivian Cheng, Comment, *Medical Marijuana Dispensaries in Chapter 11 Bankruptcy*, 30 EMORY BANKR. DEV. J. 105, 106 (2013)

further guide cannabis enforcement and banking policy. Issuance of new memoranda could open the door for better collaboration between the federal government and legalization states by ensuring that the federal government would only enforce the CSA against those not acting in compliance with state law. These memoranda must come from multiple sources, as guidance from just FinCEN or the DOJ alone in inadequate to address the problems caused by existing federal guidance.

The federal government and state governments are necessarily linked, and cooperation is sensible for those entities to ensure the best possible outcomes. The Cole Memo outlined a change in federal enforcement policy, encouraging federal actors to leave enforcement of state-legalized cannabis to the states unless an actor encroached upon one of "Eight Deadly Sins."[75] This policy shift allowed states to grow and police their respective cannabis industries without unnecessary federal oversight and allowed federal prosecutors to focus their resources on more serious enforcement matters.

New federal memoranda would similarly allow the states and federal government to collaborate on cannabis enforcement. By loosening their hold on enforcement and explicitly granting amnesty to financial institutions that choose to transact with Cannabusinesses, the federal institutions could facilitate a more just landscape for Cannabusinesses. State-compliant Cannabusinesses would no longer fear federal prosecution and banking institutions would be less wary of dealing with those businesses. Allowing banks to provide services to Cannabusinesses without significant federal retribution would give Cannabusinesses better access to capital, options other operating cash-only, and the ability to pay taxes with electronic transfers. These changes could lead to a more stable cannabusiness market, improved access to cannabis for

[75] *See Cole Memo supra* note 20 at 1-2.

recreational and medical users in legalization states, and, ultimately, more tax revenue for the federal and state governments.

Issuing new federal memoranda is not without issues. Its biggest strength, that memoranda can easily be altered and rescinded, is also its greatest weakness. There is no permanence to federal memoranda and, like the Ogden and Cole Memos of years past, later memoranda from unfriendly administrations could undo their guidance with ease. Such risk means banks are unlikely to change their policy regarding transactions with Cannabusinesses until more explicit legislation passes. To truly solve the cannabusiness banking issue, there must be a more permanent solution in the form of federal legislation.

The SAFE Banking Act

The Secure and Fair Enforcement Banking Act of 2021, which was originally proposed in 2017 and passed by the U.S. House of Representatives on April 19, 2021, aims to eliminate the cannabusiness banking issue.[76] The SAFE Banking Act includes provides a safe harbor for banking institutions that provide financial services to Cannabusinesses by prohibiting federal banking regulators from taking adverse action against those such institutions.[77] The Act also prohibits federal banking regulators from penalizing or discouraging financial institutions from providing financial services to Cannabusinesses.[78] In addition, the Act excludes proceeds from legitimate cannabis-related ventures from the definition of "proceeds from an unlawful activity."[79] The Act is currently pending in the United States Senate.

[76] Secure And Fair Enforcement Banking Act, H.R. 1996, 117th Cong. (2021).
[77] *Id.* at § 2(a).
[78] *Id.*
[79] *Id.* at § 3

The SAFE Banking Act includes multiple provisions that address the harms of federal cannabis prohibition.[80] While it does not deschedule or legalize cannabis, it specifically addresses the financial symptoms of prohibition.[81] By effectively granting amnesty to banking institutions that transact with Cannabusinesses, cannabusiness owners could begin to move away from a cash-only model without fear of repercussion or unavailable services. By excluding legitimate cannabusiness proceeds from the definition of "proceeds from an unlawful activity," the "Unclean Hands" doctrine would no longer apply to Cannabusinesses, thereby allowing easier access to federal courts. Finally, because the Act would become law unlike a DOJ memo or executive order, it would be significantly more difficult to overturn than a unilateral executive action.

The SAFE Banking Act is not without its drawbacks. While it reforms federal banking law, the SAFE Banking Act does not legalize cannabis. Because it does not remove cannabis from the federal schedule, the SAFE Banking Act continues federal prohibition and the categorization of Cannabusinesses as criminal enterprise under federal law.[82] The SAFE Banking Act also does not provide amnesty for state compliant Cannabusinesses other than no longer considering their proceeds "from unlawful activity" solely because the transactions involve Cannabusiness proceeds.[83] The SAFE Banking Act only grants amnesty to financial institutions that transact with those businesses and proceeds from those businesses, not the operations

[80] *See e.g. id.* at §2 (providing safe harbor for depository institutions by preventing federal banking regulators from terminating or limiting deposit insurance; from penalizing or discouraging depository institutions from dealing with cannabusinesses; and from encouraging depository institutions to not offer financial services to an account holder involved in cannabusiness).
[81] *Id.* at §1 ("The purpose of this Act is to increase public safety by ensuring access to financial services to cannabis-related legitimate businesses and service providers and reducing the amount of cash at such businesses).
[82] *Id.* at § 4 (the SAFE Banking Act only offers protection to those institutions operating within a state, political subdivision of a state, or Indian country that allows cultivation, sale, production, manufacture, and distribution of cannabis pursuant to that jurisdiction's laws or regulations).
[83] *Id.* at § 3.

themselves.[84] This deliberate omission leaves open the possibility of federal enforcement against legitimate Cannabusinesses during later, more cannabis-averse administrations and fails to protect those most vulnerable to cannabis prohibition: Cannabusinesses and their employees.

The SAFE Banking Act also fails to account for situations where a Cannabusiness accidentally falls out of compliance with state law. In those instances, the banking institution would no longer receive amnesty because the Cannabusiness is no longer a state-compliant actor. This possibility introduces too much risk for financial institutions, which will likely choose to avoid that risk until a more concrete regulatory landscape is established. As a result, the symptoms treated by the SAFE Banking Act will continue to be a problem until cannabis is federally legalized.

The STATES Act

The Strengthening the Tenth Amendment Through Entrusting States Act ("STATES Act") was introduced in the U.S. House of Representatives on April 4, 2019. If enacted, it would amend the CSA to provide for a new rule limiting the application of the CSA as to cannabis.[85] This Act adds language to Part G of the CSA thereby exempting its cannabis provisions as applied to "any person acting in compliance with state law relating to manufacture, production, possession, distribution, dispensation, or delivery" of cannabis.[86] The Act also includes provisions regarding transportation safety offenses[87] and distribution of cannabis to persons under the age of twenty-one.[88] The STATES Act has not seen any action in Congress since its

[84] *See id.*
[85] Strengthening the Tenth Amendment Through Entrusting States Act, H.R. 2093, 116th Cong. (2019).
[86] *Id.* at § 2(a).
[87] *Id.* at § 3.
[88] *Id.* at § 4 (noting that the exemptions named in section two of the STATES Act do not apply to conduct involving distribution of cannabis to those under the age of 21).

referral to the House Subcommittee on Crime, Terrorism, and Homeland Security on May 15, 2019.

If the STATES Act becomes law, the federal government must defer to state law regarding cannabis enforcement.[89] The Act, therefore, protects individuals and businesses compliant with the applicable state's cannabis policy.[90] This deference will have similar effects to the SAFE Banking Act by allowing banks to transact with Cannabusinesses without fear of retaliation from the federal government and allow Cannabusinesses to then transition away from the cash-only model.. Individuals and Cannabusinesses would be able to use and distribute cannabis without fear of federal prosecution and would have easier access to the courts for cannabis-related claims without fear of disqualification due to the "Unclean Hands" doctrine.

The biggest drawback of the STATES Act is that it does not deschedule cannabis. By not descheduling cannabis, it only takes a half-step toward legalization. Conditioning federal non-enforcement on Cannabusinesses remaining compliant with the very letter of state law means federal enforcement remains a viable threat. If a Cannabusiness violates even a minor and obscure aspect of state law unintentionally, it exposes itself to federal prosecution under the STATES Act. For example, if a cultivator owns a license to grow 1,000 plants but accidentally owns 1,001 plants, the cultivator is no longer in compliance with state law. The state may deem this a minor, fineable offense but federal law would punish cultivation of over 1,000 cannabis plants criminally and could do so consistent with the STATES Act.[91]

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[89] *Id.* at § 2(a) (amending Section 710 of the CSA to read: "(a) Notwithstanding any other provision of law, the provisions of this title as applied to marihuana, other than the provisions described in subsection (c) and other than as provided in subsection (d), shall not apply to any person acting in compliance with State law relating to the manufacture, production, possession, distribution, dispensation, administration, or delivery of marihuana").
[90] *Id.*
[91] Robert Mikos, *Analysis of the Warren-Gardner STATES Act*, Marijuana Law, Policy, and Authority, https://my.vanderbilt.edu/marijuanalaw/2018/06/analysis-of-the-warren-gardner-states-act/ (June 7, 2018).

The potential for criminal prosecution also includes the possibility that banking institutions will continue to refuse to transact with Cannabusinesses.[92] If there is any risk that financial institutions will be subject to criminal penalties for dealing with Cannabusinesses, there is a likelihood that they will avoid, or at least heavily scrutinize, dealing with those businesses. This leaves open the possibility that, despite the goals of the STATES Act, Cannabusinesses will be left without viable banking options. The only way to ensure banks will transact with Cannabusinesses and that Cannabusinesses will not be subject to federal penalties is to deschedule cannabis at the federal level.

The MORE Act

The Marijuana Opportunity Reinvestment and Expungement Act ("MORE Act") was introduced in the U.S. House of Representatives on May 28, 2021, which passed the legislation on April 1, 2022.[93] The Act removes cannabis from the list of federally scheduled controlled substances and eliminates federal criminal penalties for individuals who manufacture, distribute, or possess cannabis.[94] The MORE Act also directs the Bureau of Labor Statistics to compile, maintain, and make public data on Cannabusinesses, their owners, and their employees.[95] In addition, it creates an opportunity trust fund and sets forth a plan for federal taxation of cannabis for the purposes of aiding individuals adversely impacted by the war on drugs.[96]

The MORE Act is the most comprehensive of the three pending federal cannabis reform bills. By removing cannabis from the CSA schedule, the MORE Act repeals federal prohibition. The Act's focus on demographic research and creation of an opportunity trust fund ensures

[92] *See*
[93] Marijuana Opportunity Reinvestment and Expungement Act, H.R. 3617, 117th Cong. (2021).
[94] *Id.* at § 3.
[95] *Id.* at § 4.
[96] *Id.* at § 5.

greater long-term support for Cannabusinesses and the public than the STATES Act or SAFE Banking Act. By putting the repeal of federal prohibition first, the MORE Act directly targets the source of the problem and avoids the pitfalls common to the other bills; that is, treat the symptoms rather than the underlying disease.

The biggest drawback of the MORE Act is its limited prescriptive capacity. The MORE Act does not create a federal regulatory scheme for cannabis or provide any roadmap for federal regulation. It also fails to explicitly address any banking concerns. While descheduling cannabis would solve numerous cannabusiness banking issues, the Act does address SAR requirements nor clarify federal penalties for Cannabusinesses which fall out of compliance with state law. It also does not address any of the "Eight Deadly Sins" from the Cole Memo other than a small point about distribution to minors.[97] The MORE Act also does not speak to whether cannabis regulation will be left entirely up to the states, or the federal government will continue to play a role. These omissions would rend the regulatory landscape uncertain.

V. My Recommendation Moving Forward

To ensure effective regulation, Congress must repeal federal prohibition . The three pending federal bills addressed earlier are deficient insofar as they leave in place numerous cannabis-related legal issues. The STATES Act and SAFE Banking Act do not end the federal cannabis prohibition and therefore do not take adequate steps to encourage banking institutions to do businesses with cannabis ventures because they do not guarantee federal protection for Cannabusinesses. The MORE Act is deficient because it does not address the banking issue at all

[97] *Cole Memo, supra* note 20 (The "Eight Deadly Sins" outlined in the Cole Memo include preventing distribution to minors, preventing drugged driving, preventing revenue from sale of cannabis from going to gangs or cartels, and others).

and fails to account for the current regulatory landscape. While a good start, the MORE Act, addresses the problem by removing the federal schedule in hopes that the finer details will be worked out by the states and that there will be no regulatory vacuum. These are all incomplete solutions.

The ideal solution would be for the federal government to enact the MORE Act with several amendments. Those include guaranteed amnesty for banking institutions and a better framework for federal-state cooperation. This revised bill would remove reporting requirements for suspicious activity and only require banking institutions to report egregious violations via SARs. Descheduling cannabis would resolve many of the underlying issues presented to Cannabusinesses: the taxation and banking issues stem from cannabis' classification as a scheduled controlled substance.

A revised version of the MORE Act also ought to specifically address each of the "Eight Deadly Sins" not resolved by legalization. Preventing use of cannabis on federal lands, for example, is a moot point if cannabis is federally legal. This act should address age restrictions similarly to the legal drinking age. Because the federal government cannot compel state action, Congress must use its commerce power to influence state policy on the matter.[98] If Congress conditions disbursement of highway funding on a state's limitation of cannabis sales to individuals who are at least twenty-one, the "distribution to minors" concern would be resolved.

A revised MORE Act should also create a new Federal Bureau of Cannabis ("FBC") to promulgate a federal regulatory scheme or, in the alternative, delegate the creation of such a scheme to another federal regulatory body. The newly formed FBC should have the authority to

[98] *See generally* South Dakota v. Dole, 483 U.S. 203 (1987) (holding that federal statutes can condition states' receipt of federal funds on adoption of a minimum drinking age of 21 as a valid use of the spending power, provided the amount in question is not enough to turn "pressure into compulsion").

regulate and set standards for cannabis and cannabusinesses nationwide. The FBC must decide how to police the actual product and set standards for purity, potency, quantity per package, and safety. These regulations should be pursued similarly to how the FDA currently regulates vaccines and other biologics. For example, the FDA has authority to immediately suspend a biological product's license; set additional standards for certain product types; and test individual lots before manufacturers can distribute them.[99] Additionally, the FDA does not license any biologic absent clinical studies showing the product is safe, potent, and pure "in one or more appropriate conditions of use for which the reference product is licensed and intended to be used and for which licensure is sought for the biological product."[100] The agency tasked with regulating cannabis should adopt a similar "safe, potent, and pure" standard for all cannabis produced, marketed, and sold in the United States and apply that standard across the country.

An alternative, less optimal solution would be to pass the MORE Act as is and address the outstanding issues discussed above in subsequent legislation. The MORE Act has significant momentum in Congress. It has already passed the House and its fate in the Senate remains to be seen.

If the MORE Act is enacted, many of the root problems created by federal prohibition will be resolved. Banks should be less wary of dealing with Cannabusinesses and Cannabusinesses will no longer be disqualified from business expense deductions on their taxes. At some point, however, Congress will have to address the lack of federal cannabis industry standards or risk a chaotic and uncertain regulatory landscape with vast regulatory differences from state-to-state. Cannabusinesses will have trouble sourcing product across state lines because trafficking laws will remain in place in states which choose to continue prohibition. The federal

[99] *See* 42 U.S.C. § 262.
[100] *Id*. § 262(k)(2)(A)(i)(I)(cc).

government should ensure protection for those businesses which operate across state lines by establishing federal standards as soon as possible.

VI. Conclusion

To further the social justice goals of state-level cannabis legalization, the federal government must prioritize reforms that facilitating the safe and economic operation of Cannabusinesses. The best way to ensure Cannabusinesses have a future is to federally legalize cannabis and establish a strong regulatory framework. This will remove the harms to Cannabusinesses caused by their lack of access to banking services, which force Cannabusinesses to operate cash-only. A strong federal regulatory framework would also establish a unified national standard for the states in establishing their own markets and licensing Cannabusinesses.