

Banking Issues in the Cannabis Industry

**USLFG Corporate/Securities Committee
October 9, 2015**

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Basic Problem

On the one hand:

Federal law makes it a crime to possess, sell, or manufacture marijuana, or to aid or abet others in doing so.

21 U.S.C. § 841(a)(1) and 18 U.S.C. § 2

On the other hand:

Numerous states have medical marijuana laws and Washington (through Initiative Measure No. 502- “I-502”) and other states (including Colorado, Oregon and Alaska) have legalized recreational marijuana.

Under Article VI, Paragraph 2 of the U.S. Constitution (the Supremacy Clause):
“[t]he Laws of the United States . . . shall be the supreme Law of the Land”

Bank Regulatory Risks

- The regulation of banks is among the most extensive of any industry and among the most complex.
- Depending on the bank charter, regulators dictating or affecting bank activities might include: the Federal Reserve Board of Governors; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Consumer Financial Protection Bureau; the Financial Crimes Enforcement Network (“FinCEN”); and state banking agencies.
- In addition, as with most other businesses, banks are subject to other criminal and civil authorities, including the Department of Justice, State Attorneys General, the Federal Trade Commission, and others.
- Also, especially after the 2008 financial crisis and the passage of the Dodd-Frank Act, banks have even heightened concerns about anything that could have reputational risk on their businesses.

Limited Help From The Federal Government

1. The seminal “Cole Memo,” issued August 29, 2013 by Deputy Attorney General James M. Cole, provides “Guidance Regarding Marijuana Enforcement” to all U.S. Attorneys. It instructed U.S. Attorneys to use their discretion and generally defer to state law enforcement concerning state laws allowing the possession of small amounts of marijuana or the production, processing, or sale of marijuana, except in the eight circumstances listed on the following page.

Limited Help From The Federal Government, continued

1. Distribution to minors;
2. Money flows to criminal enterprises;
3. Prohibiting diversion of marijuana from states where marijuana is legal to other states;
4. Use of legal marijuana as a pretext for trafficking other illegal drugs or activity;
5. Preventing violence or the use of firearms in connection with marijuana collection or distribution;
6. Preventing drugged driving or other public health issues;
7. Preventing marijuana growth on public lands; and
8. Preventing marijuana possession on federal property.

Of course, this is only guidance, and can be modified or retracted at any time by the Department of Justice.

Limited Help From The Federal Government, continued

- 2. FinCEN Guidance of February 17, 2014 concerning “BSA Expectations Regarding Marijuana-Related Businesses.”** This modifies, but does not eliminate, a financial institution’s obligation to file Suspicious Activity Reports (“SARs”) for every marijuana business , as these businesses are all illegal under federal law. The Guidance merely classified the type of SAR reporting required in light of the Cole Memo. The SAR reporting for marijuana businesses is now split into three types of SARs: “Marijuana Limited,” “Marijuana Priority” and “Marijuana Termination.”

The Guidance also makes it clear that financial institutions remain subject to all the general rules requiring Cash Transaction Reports to be filed for all cash transactions of more than \$10,000.

Tax and Social Issues

1. Federal tax law prohibits business expense deductions (including employee salaries) for businesses “trafficking” in controlled substances.” 26 U.S.C. §280E.
2. Other tax rules can apply. For example, the Washington Department of Revenue held, on a technicality (the statute states that obtaining medical marijuana requires “valid documentation” instead of a “prescription”), that medical marijuana does not qualify for the state’s sales tax exemption for prescription drugs. (WA DOR Det. No. 14-0386, 34 WTD 273 (2015)).

Tax and Social Issues, continued

3. **Lawyers also have to be concerned about counseling marijuana businesses as an ethical matter. Under ABA Rule 1.2(d), a “lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent.” Some states, like Washington, have modified these rules with respect to counseling about the state’s marijuana laws (*see* Comment 18 to Washington’s RPC 1.2, specifically referring to I-502).**
4. **Importantly, as a result of all these rules and concerns, banks typically do not bank marijuana businesses or only do so at very high fees. Some entrepreneurs have attempted to organize financial institutions to service the marijuana business, but they have, so far, had little success in gaining bank charters. (N.Y. Times, Nathaniel Popper, “DealBook,” 7/31/15; Huffington Post, Post of Matt Ferner, 4/13/15.)**

Tax and Social Issues, continued

5. **Meanwhile, without banking services being available, marijuana businesses that are legal under state law have to keep, and make all payments with, large amounts of cash, leading to significant public safety concerns. (ThinkProgress, Alan Pyke, “Colorado’s Pot Industry Shut Out of Banks, Forced to Operate Entirely With Cash,” 8/11/15).**
6. **Other issues that may arise in connection with cannabis businesses:**
 - a. **The effect of KYC (Know Your Customer) rules on potential financings for cannabis-related enterprises.**
 - b. **Will real property leases (which typically allow termination for “illegal activity”) to cannabis businesses limit the lease’s enforceability for the lessee/business? And might the landlord’s lease to a cannabis business breach an underlying building financing’s mortgage or deed of trust?**

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