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## The Real Green Issue Regarding Recreational Marijuana: Federal Tax and Banking Laws in Need of Reform

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# THE REAL GREEN ISSUE REGARDING RECREATIONAL MARIJUANA: FEDERAL TAX AND BANKING LAWS IN NEED OF REFORM

## INTRODUCTION

Less than ten years ago, the United States Supreme Court held that the Commerce Clause of the United States Constitution permits Congress to regulate the cultivation and use of medicinal marijuana.<sup>1</sup> After the Supreme Court's decision, many states have decriminalized and legalized the use and cultivation of medical marijuana in clear violation of federal law.<sup>2</sup> Receiving minimal repercussions for contravening the law of the land, Colorado<sup>3</sup> and Washington<sup>4</sup> took defiance one step further by extending legalization not only to medical marijuana, but also to small amounts of recreational marijuana.<sup>5</sup> Though many predicted an aggressive response by the federal government, on August 29, 2013, the United States Department of Justice (DOJ) shocked Americans by advising prosecutors to exercise discretion in pursuing marijuana trafficking, reasoning that prosecutors should use the operation of state law to determine whether unlawful conduct affects several specified federal enforcement policies due to limited resources.<sup>6</sup>

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1. *Gonzales v. Raich*, 545 U.S. 1, 22 (2005).

2. *23 Legal Medical Marijuana States and DC*, PROCON.ORG, <http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881> (last updated Jan. 8, 2015, 2:50 PM) (listing Alaska (1998), Arizona (2010), California (1996), Colorado (2000), Connecticut (2012), Delaware (2011), District of Columbia (2012), Hawaii (2000), Illinois (2013), Maine (1999), Maryland (2014), Massachusetts (2012), Michigan (2008), Minnesota (2014), Montana (2004), Nevada (2000), New Hampshire (2013), New Jersey (2010), New Mexico (2007), New York (2014), Oregon (1998), Rhode Island (2006), Vermont (2004), and Washington (1998)).

3. COLO. CONST. art. 18, § 16.

4. WASH. REV. CODE §§ 69.50.360(3), 69.50.401(3) (2014).

5. Evan Perez, *No Federal Challenge to Pot Legalization in Two States*, CNN, <http://www.cnn.com/2013/08/29/politics/holder-marijuana-laws> (last updated Aug. 30, 2013, 6:36 AM). Two other states, Oregon and Alaska, have also legalized recreational marijuana since this Comment was written. See *State Marijuana Laws Map*, GOVERNING: THE STATES & LOCALITIES, <http://www.governing.com/gov-data/state-marijuana-laws-map-medical-recreational.html> (last updated Apr. 17, 2015).

6. Memorandum from James M. Cole, Deputy Att'y Gen., U.S. Dep't of Justice, on Guidance Regarding Marijuana Enforcement (Aug. 29, 2013) [hereinafter Cole Memorandum], available at <http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>; see also *infra* notes 64–70 and accompanying text.

Despite the ostensible green light to business owners endeavoring to sell recreational marijuana, the government has failed to provide federal assistance in the areas of federal banking and tax laws to aid states like Colorado and Washington in their “legalization experiments.”<sup>7</sup> The lack of access to banking services, according to the deputy director of the National Cannabis Industry Association, is the single most dangerous thing about the legal sale of marijuana.<sup>8</sup> Moreover, according to the marijuana industry’s principal publication, the inability to deduct business expenses from a seller’s federal income tax is the largest threat to the success of marijuana businesses and risks pushing the entire industry underground.<sup>9</sup>

The importation, distribution, cultivation, and sale of marijuana were federally taxed at prohibitive levels in 1937<sup>10</sup> and prohibited outright in 1970.<sup>11</sup> In the Controlled Substances Act of 1970 (CSA), Congress classified marijuana as a Schedule I substance, the most severely restricted category out of five distinct categories used to classify a drug depending on its accepted medical use and its abuse or dependency potential.<sup>12</sup>

Though the CSA’s bottom-line marijuana prohibition is still the law of this country, the federal government has adopted a strategy of non-enforcement concerning recreational marijuana, which was formalized in the DOJ’s 2013 Memorandum from James M. Cole, the U.S. Deputy Attorney General (Cole Memorandum). The Cole Memorandum updates its prior guidance in light of state initiatives that legalize the

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7. Cf. Jon Walker, *6 Things Obama Could Do To Help the Pot Legalization Experiment*, JUST-SAY-NOW (Jan. 21, 2014, 10:51 AM), <http://justsaynow.firedoglake.com/2014/01/21/six-things-obama-could-to-help-the-pot-legalization-experiment-go-forward/>.

8. Matt Ferner, *Marijuana Businesses Should Have Access to Federal Banking System: Denver City Council*, HUFFINGTON POST (Jan. 7, 2014), [http://www.huffingtonpost.com/2014/01/07/marijuana-banking\\_n\\_4555586.html](http://www.huffingtonpost.com/2014/01/07/marijuana-banking_n_4555586.html).

9. *Marijuana Business Conference Wrapup: 36 Tips, Lessons & Takeaways for the Cannabis Industry*, MED. MARIJUANA BUS. DAILY (Nov. 15, 2012), <http://mmjbusinessdaily.com/marijuana-business-conference-wrapup-36-tips-lessons-take-aways-for-the-cannabis-industry/>.

10. RUDOLPH J. GERBER, *LEGALIZING MARIJUANA: DRUG POLICY REFORM AND PROHIBITION POLITICS* 2–16 (2004).

11. Alex Kreit, Comment, *The Future of Medical Marijuana: Should the States Grow Their Own*, 151 U. PA. L. REV. 1787, 1793–94 (2003) (“While effectively eliminated, medical use and distribution was still technically allowed under the Marihuana Tax Act until the passage of the Controlled Substances Act in 1970.”).

12. See Controlled Substances Act (CSA), 21 U.S.C. § 811; see also Robert A. Mikos, *On the Limits of Supremacy: Medical Marijuana and the States’ Overlooked Power To Legalize Federal Crime*, 62 VAND. L. REV. 1421, 1434–35 (2009); 21 U.S.C. § 812(b)(1) (2012); Jack Park, *Obama’s DOJ (Again) Limits Enforcement of Federal Marijuana Law*, EXECUTIVE BRANCH PROJECT (Sept. 13, 2013), <http://executivebranchproject.com/obamas-doj-again-limits-enforcement-of-federal-marijuana-law/>; *Drug Schedules*, U.S. DRUG ENFORCEMENT ADMIN., <http://www.dea.gov/druginfo/ds.shtml> (last visited June 20, 2015).

possession of small amounts of marijuana and provide for the regulation of marijuana production, processing, and sale.<sup>13</sup> Instead of prosecuting in compliance with the CSA, the Cole Memorandum instructs federal prosecutors to focus enforcement efforts on certain specified priorities, relying on the states that have enacted laws authorizing the sale of recreational marijuana to implement strong and effective regulatory systems.<sup>14</sup>

Although the Obama Administration is affording states leeway to experiment with recreational marijuana legalization in response to the national movement for relaxed marijuana laws,<sup>15</sup> such latitude is conditioned on states, such as Washington and Colorado, implementing regulatory systems in compliance with the Cole Memorandum.<sup>16</sup> However, the DOJ and the Obama Administration fail to realize that federal banking and tax laws will likely make this endeavor an impossibility. The implications of the Obama Administration's failure to amend current banking and tax regulations is the equivalent of actually enforcing the CSA; therefore, there is no feasible way for states to comply with the DOJ's stated objectives in the Cole Memorandum.

Under the CSA, any bank that takes money from an illegal enterprise may lose its Federal Deposit Insurance Corporation (FDIC) coverage and be prosecuted.<sup>17</sup> Consequently, states are left to figure out how cash generated from marijuana cultivation and sales can be deposited into banks without violating federal money-laundering laws. Without access to banking services, marijuana businesses are required to hold onto large amounts of cash, making them vulnerable to theft and difficult to regulate. Additionally, legal marijuana businesses

13. Cole Memorandum, *supra* note 6, at 1.

14. *Id.* at 2.

15. David Ingram, *U.S. Allows States To Legalize Recreational Marijuana Within Limits*, REUTERS (Aug. 29, 2013, 7:01 PM), <http://www.reuters.com/article/2013/08/29/us-usa-crime-marijuana-idUSBRE97S0YW20130829>.

The Justice Department could have sued to block the Colorado and Washington laws from taking effect under the theory that they conflict with the [CSA] . . . .

Coupled with the decision not to sue, the [DOJ] sent a four-page memorandum to federal prosecutors nationwide outlining eight priority areas for marijuana enforcement.

*Id.*

16. Cole Memorandum, *supra* note 6, at 2–3 (“A system adequate to that task must not only contain robust controls and procedures on paper; it must also be effective in practice. Jurisdictions that have implemented systems that provide for regulation of marijuana activity must provide the necessary resources . . . to enforce their laws [without] undermin[ing] federal enforcement priorities.”).

17. Maggie Clark, *States with Legal Marijuana Ask Feds To Update Banking Regulations*, GOVERNING (Sept. 13, 2013), <http://www.governing.com/news/state/sl-legal-marijuana-states-ask-congress-for-banking-changes.html>.

without bank accounts are assessed a 10% penalty for paying federal payroll taxes in cash.<sup>18</sup> This tax penalty, however, seems minimal in comparison to the Federal Income Tax Code's § 280E, which prevents traffickers of controlled substances from receiving deductions for any expenses beyond the cost of producing or buying inventory.<sup>19</sup> Although income derived from marijuana sales is taxable, taxpayers engaged in marijuana sales are unable to deduct ordinary and necessary business expenses due to marijuana's Schedule I status.<sup>20</sup>

This Comment argues that if the federal government refuses to enforce the CSA and instead allows states to offer for sale recreational marijuana, it must reform the banking and tax laws that hamper the creation of legitimate businesses. First, in the area of banking, Congress should enact legislation allowing banks to offer financial services without fear of prosecution; anything less leaves financial institutions subject to prosecution, and continues the status quo that forces otherwise law-abiding businesses to operate on a cash-only basis. First, in the area of tax the IRS should suspend the penalty that marijuana businesses are assessed for paying employee-withholding taxes in cash until the banking issue is resolved. Second, and most importantly, Congress should exempt state-licensed marijuana businesses from § 280E, enabling owners to deduct necessary and ordinary business expenses from their federal income taxes.

This Comment proceeds as follows: Part II (1) provides a brief legal history of marijuana in the United States;<sup>21</sup> (2) describes state action to legalize marijuana for medical use and the federal government's response;<sup>22</sup> (3) explains the structure of newly enacted state recreational marijuana laws;<sup>23</sup> and (4) describes the relevant banking and tax

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18. David Migoya, *IRS Fines Unbanked Pot Shops for Paying Federal Payroll Tax in Cash*, DENVER POST (July 2, 2014, 11:17 PM), [http://www.denverpost.com/business/ci\\_26075425/irs-fines-unbanked-pot-shops-paying-federal-payroll](http://www.denverpost.com/business/ci_26075425/irs-fines-unbanked-pot-shops-paying-federal-payroll).

19. 26 U.S.C. § 280E (2012).

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 other 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.

*Id.*

20. Pat Oglesby, *Marijuana Advertising: The Federal Tax Stalemate*, HUFFINGTON POST (Oct. 25, 2013, 5:12 AM), [http://www.huffingtonpost.com/pat-oglesby/marijuana-advertising-the\\_b\\_3810341.html](http://www.huffingtonpost.com/pat-oglesby/marijuana-advertising-the_b_3810341.html).

21. See *infra* notes 27–34 and accompanying text.

22. See *infra* notes 35–63 and accompanying text.

23. See *infra* notes 64–96 and accompanying text.

laws that impede effective regulation.<sup>24</sup> Part III of this Comment analyzes how Congress can reform federal banking and tax laws to foster the creation of legitimate businesses.<sup>25</sup> Part IV explains how the success of states like Colorado and Washington in implementing regulatory systems will have a dramatic impact on whether more states move to legalize recreational marijuana use.<sup>26</sup>

## II. BACKGROUND

### A. *Brief History of Marijuana's Legal Status*

Although the Obama Administration has embraced a relaxed prosecutorial approach to both medicinal and recreational marijuana users,<sup>27</sup> the use of marijuana in the United States is illegal under federal law.<sup>28</sup> The Controlled Substances Act (CSA) was enacted in 1970 and prohibits the cultivation, possession, sale, or distribution of marijuana and its derivatives.<sup>29</sup> The CSA does not distinguish between medicinal and recreational uses of marijuana, and lawmakers have rejected campaigns to reschedule marijuana from Schedule I to a lesser class and have refused to carve out exceptions regarding marijuana users.<sup>30</sup> Although one might honestly be unaware of marijuana's legal status due to the wave of legalization in the states, violation of the federal prohibition continues to carry with it the possibility of significant criminal penalties.<sup>31</sup>

Drug policy reformers began promoting marijuana legalization by stressing marijuana's potential medical benefits.<sup>32</sup> In 1972, the Na-

24. See *infra* notes 98–139 and accompanying text.

25. See *infra* notes 140–224 and accompanying text.

26. See *infra* notes 225–254 and accompanying text.

27. See Cole Memorandum, *supra* note 6.

28. 21 U.S.C. §§ 811–812, 814 (2012).

29. Comprehensive Drug Abuse Prevention and Control Act of 1970 (Controlled Substances Act or CSA), Pub. L. No. 91-513, tit. II, 84 Stat. 1236, 1242–84 (1970) (codified as amended at 21 U.S.C. §§ 801–904 (2000)).

30. Robert Mikos, *A Critical Appraisal of the Department of Justice's New Approach to Medical Marijuana*, 22 STAN. L. & POL'Y REV. 633, 1434–35 (2001); see also *United States v. Oakland Cannabis Buyers' Coop.*, 532 U.S. 483, 491 (2001). If marijuana were rescheduled from a Schedule I substance to a Schedule II substance, medical use would be permissible because Schedule II substances are approved for medical use despite having a high potential for abuse. See 21 U.S.C. §§ 812(b)(1), 812(b)(2) (2012); see also Melanie Reid, *The Quagmire That Nobody in the Federal Government Wants To Talk About: Marijuana*, 44 N.M. L. REV. 169, 191–92 (2014).

31. 21 U.S.C. § 841(b)(1)(D). For example, possession with the intent to distribute, manufacture, or distribution of any amount of marijuana constitutes a felony, carrying a maximum sentence of five years imprisonment and a maximum fine of \$250,000 for individuals and \$1 million for entities. *Id.*

32. See LESTER GRINSPOON & JAMES B. BAKALAR, *MARIJUANA, THE FORBIDDEN MEDICINE* 13 (rev. & expanded ed. 1997).

tional Organization for the Reform of Marijuana Laws (NORML) filed an administrative action seeking to remove marijuana from the CSA entirely, or in the alternative, assign it to a lesser schedule.<sup>33</sup> Despite extensive hearings, the U.S. Drug Enforcement Agency (DEA) eventually prevailed,<sup>34</sup> and marijuana remained a Schedule I substance. The federal government's position rejecting a national medical marijuana regime remained unwavering, which forced proponents of medical marijuana to seek new forums to challenge the federal ban.

*B. State Action To Legalize Medical Marijuana and the  
Federal Government's Response*

Reform advocates struggled with challenging federal drug laws due to marijuana's illegal status as a Schedule I drug under the CSA.<sup>35</sup> Consequently, marijuana reform activists adopted new strategies by which they instead utilized the voter proposition process.<sup>36</sup> Such measures have been employed since the early 1990s with regard to medicinal marijuana use, and continue to be employed today as an avenue to legalize recreational marijuana use.<sup>37</sup>

In 1996, advocates placed initiatives on the ballot in California and Arizona to decriminalize medical marijuana under state law.<sup>38</sup> Though the initiatives passed in both states, Arizona's Proposition 200 was never enacted due to a language technicality in the statute.<sup>39</sup> Cali-

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33. Nat'l Org. for the Reform of Marijuana Laws v. DEA, 559 F.2d 735, 741-43 (D.C. Cir. 1977). The petition sought to reclassify marijuana as a Schedule V drug, the least restrictive class, consisting of drugs with a low potential for abuse and that are currently accepted for medical use. *Id.* at 741.

34. Alliance for Cannabis Therapeutics v. DEA, 15 F.3d 1131, 1137 (D.C. Cir. 1994) (denying a petition to review an order rejecting the assignment of marijuana as a Schedule II drug under the CSA).

35. See Kreit, *supra* note 11, at 1788-89.

36. *Id.*

37. See K.K. DuVivier, *State Ballot Initiatives in the Federal Preemption Equation: A Medical Marijuana Case Study*, 40 WAKE FOREST L. REV. 221, 284 (2005); David Blake & Jack Finlaw, *Marijuana Legalization in Colorado: Learned Lessons*, 8 HARV. L. & POL'Y REV. 359, 359 (2014).

38. See Brooke Mascagni, *The Politics of Exclusion in California's Marijuana Reform Movement*, 15 UDC/DCSL L. REV. 33, 36 (2011) (discussing marijuana legalization via state initiatives and direct-democracy campaigns).

39. Kreit, *supra* note 11, at 1796-97; see also Elvia Diaz, *Medical Marijuana Debate Flares*, ARIZ. REPUBLIC, Oct. 20, 2002, at 7B. Proposition 200 "allowed physicians to prescribe Schedule I drugs 'to treat a disease, or to relieve the pain and suffering of a seriously ill patient or terminally ill patient.'" Michael Berkey, Note, *Mary Jane's New Dance: The Medical Marijuana Tango*, 9 CARDOZO PUB. L., POL'Y & ETHICS J. 417, 429 (2011); see also Drug Medicalization, Prevention, and Control Act of 1996, ARIZ. REV. STAT. ANN. § 13-3412.01(A) (West 2010).

ifornia's Compassionate Use Act, however, passed by 56% of the vote, making it the first state to legalize medical marijuana.<sup>40</sup>

In order to combat these voter initiatives, the Office of National Drug Control Policy developed a coordinated administrative strategy with federal agencies to minimize drug abuse.<sup>41</sup> Accordingly, the Department of Justice (DOJ) and the Department of Health and Human Services targeted doctors by threatening to revoke DEA registrations and withhold Medicare and Medicaid reimbursements to any physician who recommended or prescribed marijuana.<sup>42</sup> However, the Ninth Circuit upheld a district court ruling in favor of the doctors, and enjoined the federal government from either revoking a physician's license to prescribe controlled substances or conducting an investigation of a recommending physician that might lead to such revocation.<sup>43</sup>

The campaign against medical marijuana continued throughout the George W. Bush Administration, during which the U.S. Attorney's Office prosecuted high-profile medical marijuana suppliers.<sup>44</sup> The DEA specifically targeted medical dispensaries, conducting over 200 raids in California alone.<sup>45</sup> The DEA also warned landlords that their property would be seized if they failed to evict marijuana-dispensing tenants.<sup>46</sup>

Consequently, proponents of medical marijuana sought protection from the federal courts. However, the Supreme Court in *Gonzales v. Raich*<sup>47</sup> firmly upheld marijuana's prohibition, and held that Congress has the power to regulate even intrastate cultivation and consumption of marijuana.<sup>48</sup> Further, in *United States v. Oakland Cannabis Buyers' Cooperative*,<sup>49</sup> the Supreme Court refused to allow medical marijuana dispensaries to escape liability by using a medical-necessity defense.<sup>50</sup>

40. See Laura P. Gouldin, *Cannabis, Compassionate Use and the Commerce Clause: Why Developments in California May Limit the Constitutional Reach of the Federal Drug Laws*, 1999 N.Y.U. ANN. SURV. AM. L. 471, 481.

41. Statement from Barry R. McCaffrey, Dir., Office of Nat'l Drug Control Policy: The Administration's Response to Passage of California Proposition 215 and Arizona Proposition 200, at 1 (Dec. 30, 1996), available at <http://www.drugpolicy.org/docuploads/ondcp1296.pdf>.

42. Berkey, *supra* note 39, at 429–30.

43. Conant v. Walters, 309 F.3d 629, 632 (9th Cir. 2002).

44. See, e.g., Bob Egelko, *Pot Advocate Gets 1 Day in Jail and Gives Judge a Piece of His Mind*, S.F. CHRON., July 7, 2007, at B3.

45. Mikos, *supra* note 30, at 638.

46. See *id.*; see also Wyatt Buchanan, *Pot Dispensaries Shut in Response to Federal Threat*, S.F. CHRON., Feb. 7, 2008, at B1.

47. 545 U.S. 1 (2005).

48. *Id.* at 29.

49. 532 U.S. 483 (2001).

50. *Id.* at 491.

Although these Supreme Court decisions reinforced the federal government's power to prosecute those individuals who violated the CSA, they did not stop, or even hinder, state legalization campaigns.<sup>51</sup>

Starting with California in 1996, twenty-three states and the District of Columbia have legalized medical marijuana via the voter-initiative process of state law.<sup>52</sup> These laws remove criminal sanctions for the medical use of marijuana, define eligibility for such use, and allow some means of access—home cultivation or dispensaries.<sup>53</sup> Generally, all of the laws permit residents to possess, consume, and grow marijuana by obtaining a qualifying diagnosis and recommendation from a licensed physician.<sup>54</sup>

The proliferation of legalized medical marijuana has led to an increase in demand, causing the creation of medical marijuana collectives and cooperatives.<sup>55</sup> In Colorado alone, entrepreneurs have taken advantage of the vague constitutional amendments regarding marijuana sales and opened hundreds of medical dispensaries across the state since Amendment 20 passed in 2001.<sup>56</sup> Consequently, states began to regulate dispensaries more closely, with most states requiring that owners be primary caregivers, operate as nonprofits, acquire business licenses and sellers' permits, and remit sales tax.<sup>57</sup>

Notwithstanding state laws regulating medical marijuana dispensaries, the DOJ has confused matters further by initially indicating leniency toward such dispensaries and then calling for raids on hundreds of dispensaries and encouraging the IRS and other federal law en-

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51. See David B. Rivkin & Elizabeth Price Foley, *Federal Antidrug Law Goes Up in Smoke*, WALL ST. J. (Dec. 28, 2014, 6:52 PM), <http://www.wsj.com/articles/david-b-rivkin-jr-and-elizabeth-price-foley-federal-antidrug-law-goes-up-in-smoke-1419810742>.

52. See sources listed *supra* note 2; see also Mikos, *supra* note 45, at 636. Currently, there is pending legislation to legalize medical marijuana in seven states. See *Medical Marijuana*, PROCON.ORG (May 19, 2015), <http://medicalmarijuana.procon.org/view.resource.php?resourceID=002481>.

53. *The Twenty-Three States and One Federal District with Effective Medical Marijuana Laws*, MARIJUANA POL'Y PROJECT, <http://www.mpp.org/assets/pdfs/library/MMJLawsSummary.pdf> (last updated July 25, 2014).

54. Mikos, *supra* note 30, at 636.

55. Berkey, *supra* note 39, at 447. Medical marijuana collectives are groups of qualified patients or caregivers that share a common interest in the production and distribution of medical marijuana among the group. Medical marijuana cooperatives are nonprofit organizations created by cultivators, groups of qualified patients, or both, to distribute medical marijuana to the group.

56. Sean T. McAllister, *The New, More Regulated Frontier for Medical Marijuana*, 39 COLO. LAW. 29, 30 (2010); Sam Kamin, *Medical Marijuana in Colorado and the Future of Marijuana Regulation in the United States*, 43 MCGEORGE L. REV. 147, 149 (2012).

57. See CAL. DEP'T OF JUSTICE, GUIDELINES FOR THE SECURITY AND NON-DIVERSION OF MARIJUANA 5–11 (2008).

forcement officials to target banks and landlords that conduct business with these distributors.<sup>58</sup>

Specifically, in 2009, the Obama Administration broke from its predecessors and announced a new federal policy toward medical marijuana—a policy to cease DOJ enforcement of the federal ban, disregarding the Supreme Court’s ruling in *Raich*.<sup>59</sup> The Administration’s radical shift in federal drug policy was outlined in a 2009 DOJ memorandum from Deputy Attorney General David W. Ogden (2009 Memorandum), which advised prosecutors to only focus attention on “significant traffickers” of illegal narcotics, reasoning that the federal government’s limited resources for waging the war on drugs should not be used to target individuals complying with state laws.<sup>60</sup>

However, in 2011, just eighteen months later, the Obama Administration’s Deputy Attorney General James M. Cole, in yet another Memorandum (2011 Memorandum), departed from the unenforcement policy due to an increase in the scope of commercial cultivation, sale, distribution, and use of marijuana for medical purposes.<sup>61</sup> He reasoned that the 2009 Memorandum was never intended to shield privately operated industrial marijuana cultivation centers from federal enforcement action or prosecution, even where those activities purport to comply with state law.<sup>62</sup>

However, following the 2012 presidential election, President Obama publicly retreated from enforcement of even recreational marijuana users, and remarked on the need to reconcile a federal law that says marijuana is illegal and state laws that say it is not, adding that “[i]t would not make sense for us to see a top priority as going after recreational users in states that have determined that it’s legal. . . . We’ve got bigger fish to fry.”<sup>63</sup>

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58. Ryan Grim & Ryan J. Reilly, *Obama’s Drug War: After Medical Marijuana Mess, Feds Face Big Decision on Pot*, HUFFINGTON POST (Feb. 8, 2013, 1:09 PM), [http://www.huffingtonpost.com/2013/01/26/obamas-drug-war-medical-marijuana\\_n\\_2546178.html](http://www.huffingtonpost.com/2013/01/26/obamas-drug-war-medical-marijuana_n_2546178.html).

59. *Gonzales v. Raich*, 545 U.S. 1, 22 (2005).

60. Memorandum from David W. Ogden, Deputy Att’y Gen., U.S. Dep’t of Justice, on Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana (Oct. 19, 2009) [hereinafter 2009 Memo], available at <http://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf>.

61. Memorandum from James M. Cole, Deputy Att’y Gen., U.S. Dep’t of Justice, on Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use 1–2 (June 29, 2011) [hereinafter 2011 Memo], available at <http://www.justice.gov/oip/docs/dag-guidance-2011-for-medical-marijuana-use.pdf>.

62. *Id.* at 2.

63. Paul Armentano, *Will Obama Go After Legal Pot in Washington and Colorado?*, ALTERNET (Dec. 19, 2012), <http://www.alternet.org/drugs/will-obama-go-after-legal-pot-washington-and-colorado> (alteration in original).

C. *Structure of Newly Enacted State Recreational Marijuana Laws*

The final step for state decriminalization—authorizing marijuana for recreational use without criminal sanctions or fines—occurred in November 2012, when Washington and Colorado became the first states to legalize recreational marijuana through referendums.<sup>64</sup> Nearly 55% of Colorado voters approved Amendment 64, The Regulate Marijuana Like Alcohol Act of 2012, authorizing possession by adults of up to one ounce and the cultivation of up to six cannabis plants in an enclosed, locked space.<sup>65</sup> Likewise, Washington's Initiative 502, approved by 55.7% of voters, legalizes up to one ounce of marijuana possession, 16 ounces of a solid product such as marijuana cookies, or 72 ounces of marijuana infused liquid, for personal use by adults.<sup>66</sup>

Though many perceived these state initiatives as crossing the Obama Administration's gray enforcement line, the DOJ's Cole Memorandum made clear the Administration's decision not to block the Colorado and Washington laws.<sup>67</sup> The four-page letter generally outlined eight objectives for states to incorporate when implementing regulatory schemes, including preventing (1) the distribution of marijuana to minors; (2) revenue from the sale of marijuana going to criminal enterprises and drug cartels; (3) the diversion of marijuana to states that deem marijuana illegal; (4) state-authorized marijuana activity from being used as a pretext for trafficking other illegal drugs; (5) violence in the cultivation and distribution of marijuana; (6) drugged driving; (7) the cultivation of marijuana on public lands; and (8) marijuana use or possession on federal property.<sup>68</sup>

However, the Cole Memorandum also made clear that federal laws concerning marijuana can still be enforced, regardless of state law, very much like the DOJ's 2009 Memorandum concerning medicinal

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64. Alison Vekshin, *Legal-Marijuana Trend Spreads as More States Weigh Votes*, BLOOMBERG (Oct. 7, 2013, 11:01 PM), <http://www.bloomberg.com/news/2013-10-08/legal-marijuana-trend-spreads-as-more-states-weigh-votes.html>.

65. COLO. CONST. art. 18, § 16(3)(a), (b); *Amendment 64—Legalize Marijuana Election Results*, DENVER POST, <http://data.denverpost.com/election/results/amendment/2012/64-legalize-marijuana/> (last visited Apr. 13, 2015); see also *Amendment 64: The Regulate Marijuana like Alcohol Act of 2012*, CAMPAIGN TO REGULATE MARIJUANA LIKE ALCOHOL, <http://www.regulatemarijuana.org/s/regulate-marijuana-alcohol-act-2012> (last visited Jan. 8, 2015).

66. WASH. REV. CODE § 69.50.360(3); *Washington Marijuana Legalization and Regulation, Initiative 502 (2012)*, BALLOTPEdia, [http://ballotpedia.org/Washington\\_Marijuana\\_Legalization\\_and\\_Regulation\\_Initiative\\_502\\_%282012%29](http://ballotpedia.org/Washington_Marijuana_Legalization_and_Regulation_Initiative_502_%282012%29) (last visited Apr. 13, 2015).

67. See Cole Memorandum, *supra* note 6, at 2.

68. *Id.* at 1–2.

marijuana.<sup>69</sup> The proclamation gave states like Colorado and Washington leeway to enact regulatory structures that aim to incorporate the stated objectives while still reserving its right to prosecute such endeavors through the CSA's prohibition.<sup>70</sup> Stated otherwise, recreational marijuana business owners and financial institutions offering banking services are afforded no impunity; they enter the market at their own peril.

### 1. *Colorado's Recreational Marijuana Law*

On November 6, 2012, Colorado voters approved an amendment to the Colorado Constitution, Article XVIII, section 16, popularly known as "Amendment 64," which not only legalized up to an ounce of marijuana for personal use by persons 21 or older, but also legalized the retail sale of medical and recreational marijuana by licensed establishments.<sup>71</sup> Governor John Hickenlooper established the Amendment 64 Implementation Task Force, which proposed extensive policy recommendations to Colorado's General Assembly on how to govern businesses cultivating and selling marijuana.<sup>72</sup> On September 9, 2013, Colorado became the first state to adopt final rules governing recreational marijuana businesses.<sup>73</sup> The rules cover licensing, inventory tracking, advertising, and many other areas, and are the most comprehensive effort of any state thus far to transform the marijuana market into a controlled, legitimate industry.<sup>74</sup>

Recreational marijuana storeowners first opened their doors on January 1, 2014.<sup>75</sup> All marijuana stores, cultivation centers, and marijuana-infused product makers must be licensed and must pay fees ranging from \$2,800 to \$14,000, which do not include an initial appli-

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69. Cf. Paul Armentano, *What the Justice Department Pot Memo Means*, *HIGH TIMES* (Sept. 4, 2013), <http://www.hightimes.com/read/what-justice-department-pot-memo-means>.

70. Cole Memorandum, *supra* note 6, at 4.

71. Kelly Damewood, *Colorado Introduces New Standards for Marijuana-Infused Food*, *FOOD SAFETY NEWS* (Sept. 25, 2013), <http://www.foodsafetynews.com/2013/09/colorado-introduces-new-rules-on-marijuana-infused-food/>.

72. MARIJUANA ENFORCEMENT DIV., COLO. DEP'T OF REVENUE, *PERMANENT RULES RELATED TO THE COLORADO RETAIL MARIJUANA CODE 1 (2013)*, available at [www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251883847085&ssbinary=true](http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251883847085&ssbinary=true).

73. Eliza Gray, *New Laws Chart Course for Marijuana Legalization*, *TIME* (Oct. 19, 2013), <http://nation.time.com/2013/10/19/new-laws-chart-course-for-marijuana-legalization/>.

74. John Ingold, *Colorado First State in Country To Finalize Rules for Recreational Pot*, *DENVER POST* (Sept. 10, 2013, 3:20 PM), [http://www.denverpost.com/breakingnews/ci\\_24062676/colorado-first-state-country-finalize-rules-recreational-pot](http://www.denverpost.com/breakingnews/ci_24062676/colorado-first-state-country-finalize-rules-recreational-pot).

75. Michael Martinez, *Colorado's Recreational Marijuana Stores Make History*, *CNN* (Jan. 1, 2014, 8:47 PM), <http://www.cnn.com/2013/12/31/us/colorado-recreational-marijuana/>.

cation fee of \$5,000.<sup>76</sup> Notwithstanding these barriers to entry, according to the state's Department of Revenue's Marijuana Enforcement Division (MED), as of October 1, 2014, 496 licensed medical marijuana stores were in current operation, as well as 242 recreational shops.<sup>77</sup>

Logistically, Colorado residents are allowed to buy one ounce of marijuana per visit, as compared to nonresidents, who are limited to purchasing only one quarter of an ounce.<sup>78</sup> Moreover, Colorado residents may home-grow up to six marijuana plants and also have the option of purchasing edible products.<sup>79</sup> In order to keep marijuana away from minors, containers must be opaque and child proof and must have detailed labels;<sup>80</sup> there are also strict advertising guidelines designed to minimize exposure to anyone under the age of 21.<sup>81</sup> Marijuana businesses cannot be within 1,000 feet of another marijuana business or other sensitive locations, such as schools and playgrounds.<sup>82</sup>

## 2. Washington's Recreational Marijuana Law

Washington's I-502 establishes a precedent for growing, processing, retailing, and possessing marijuana.<sup>83</sup> On October 16, 2013, the Washington State Liquor Control Board (LCB) officially adopted regulations for state-licensed marijuana growers, processors, and retailers, and businesses officially opened their doors on July 8, 2014.<sup>84</sup>

According to the regulations, a person must be 21 years old to legally possess marijuana, hold a marijuana license, or enter a licensed

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76. *Colorado Recreational Marijuana Rules Finalized*, STRAINWISE, <http://www.strainwise.com/2013/09/colorado-recreational-marijuana-rules/> (last visited Jan 8, 2015) [hereinafter *Marijuana Rules Finalized*].

77. Katie Kuntz, *Colorado's Marijuana Industry Got a Bit Bigger This Week as State Issues 96 New Licenses*, ROCKY MOUNTAIN PBS (Oct. 3, 2014), <http://inewsnetwork.org/2014/10/03/colorados-marijuana-industry-got-a-bit-bigger-this-week-96-new-licenses/>.

78. Alexandra Stambaugh, *Legal Marijuana Laws: Colorado v. Washington*, L. STREET (July 11, 2014), <http://lawstreetmedia.com/issues/law-and-politics/legal-marijuana-laws-colorado-v-washington/> (stating that price in Colorado averages from \$16 to \$20 per gram).

79. *Id.*

80. *Marijuana Rules Finalized*, *supra* note 76.

81. *Id.*

82. *Id.*

83. Jonathan Kaminsky, *Washington State Floats Stricter Controls on Lightly Regulated Medical Pot*, REUTERS (Oct. 23, 2013, 1:49 PM), <http://www.reuters.com/article/2013/10/23/usa-marijuana-washington-idUSL1N0IC1VE20131023>.

84. Jacob Sullum, *Washington's Goal for State-Licensed Pot Shops: Just 25% of the Market?*, REASON.COM (Oct. 17, 2013), <http://reason.com/blog/2013/10/17/washingtons-goal-for-state-licensed-pot>; see also Matt Ferner, *Recreational Marijuana Shops Open in Colorado*, HUFFINGTON POST (Jan. 1, 2014, 7:02 AM), [http://www.huffingtonpost.com/2014/01/01/marijuana-shops-open-colorado\\_n\\_4519506.html](http://www.huffingtonpost.com/2014/01/01/marijuana-shops-open-colorado_n_4519506.html) ("Washington state's recreational marijuana shops are expected to open later this year."); Stambaugh, *supra* note 78.

marijuana business.<sup>85</sup> Unlike Colorado, both Washington residents and nonresidents may possess one ounce of useable marijuana, sixteen ounces of marijuana-infused product in solid form, or seventy-two ounces of marijuana-infused product in liquid form.<sup>86</sup>

Moreover, Washington integrates both medical and recreational producer and processor licenses into one system.<sup>87</sup> Under the rules, the board will issue licenses for up to 334 marijuana stores across the state, with no distinction between medical and recreational marijuana.<sup>88</sup> In order to qualify for a license, Washington imposes a three-month residency requirement, with personal criminal history, fingerprint, and background checks of all applicants.<sup>89</sup>

Both medical and recreational marijuana are taxed the same, but an exemption is provided from state and local retail sales and use taxes on purchases by medical marijuana patients registered with the Department of Health.<sup>90</sup> Unlike Colorado's 15% excise tax, 10% sales tax, and 2.9% standard sales tax, producers in Washington must pay a 25% excise tax on wholesale sales in addition to business and occupation taxes as a wholesaler.<sup>91</sup> Processors must pay a 25% excise tax on wholesale sales and business and occupation taxes as a manufacturer.<sup>92</sup> Lastly, retailers must pay a 25% excise tax and business and occupation taxes on retail sales, and collect state and local retail sales and use taxes.<sup>93</sup> These taxes are in addition to standard state sales tax of 8.75%, and are projected to add 37% to the retail price of marijuana.<sup>94</sup>

Moreover, Washington has imposed a restriction on the total amount of marijuana that can be produced per year in the state.<sup>95</sup> Regulators at the Liquor Control Board decided to cap the legal market at eighty metric tons—forty for usable marijuana and forty for

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85. WASH. STATE LIQUOR CONTROL BD., DRAFT RECOMMENDATIONS OF THE MEDICAL MARIJUANA WORK GROUP 1 (2013) [hereinafter DRAFT RECOMMENDATIONS], available at <http://dispensarypermits.com/pdf/wash-draft-10-21-13.pdf>.

86. *Id.* at 3.

87. *Id.*

88. Gene Johnson, *Washington State Approves Rules for Marijuana Industry*, WASH. TIMES (Oct. 17, 2013), <http://www.washingtontimes.com/news/2013/oct/17/washington-state-approves-rules-marijuana-industry/>.

89. Draft Recommendations, *supra* note 85, at 3.

90. *Id.* at 4.

91. *Id.*

92. *Id.*

93. *Id.*

94. Brian Bremner & Vincent Del Giudice, *Legal Weed's Strange Economics in Colorado*, BUSINESSWEEK (Jan. 9, 2014), <http://www.businessweek.com/articles/2014-01-09/colorado-legal-marijuanas-strange-economics>.

95. *Id.*

other marijuana products—reasoning that such a limit will avoid “diversion,” where surplus legal marijuana is smuggled to other states.<sup>96</sup> Diversion is a major concern of federal authorities, and while Colorado has not imposed a cap, regulators are willing to in the future if necessary.<sup>97</sup>

*D. Current Federal Tax and Banking Laws in Need of Reform*

Marijuana businesses, even those that are legally licensed, are considered criminal enterprises under federal law, which makes handling their money a crime in the eyes of the DOJ.<sup>98</sup> Therefore, processing money from marijuana sales puts federally insured banks at risk of drug racketeering charges because any bank that takes money from an illegal enterprise can lose its FDIC coverage under the CSA.<sup>99</sup> Consequently, financial institutions often refuse to do business with marijuana-related businesses, fearing criminal prosecution.<sup>100</sup> Marijuana businesses cannot open bank accounts, secure lines of credit, or obtain loans from these federally insured financial institutions.<sup>101</sup> Thus, legitimate marijuana businesses are operating on a cash-only basis, which is a prescription for safety concerns, tax evasion, and other criminal activity.<sup>102</sup> Given that the status quo is unworkable and presents safety concerns, the federal government must reform the banking and tax laws that hamper the creation of legitimate marijuana businesses. Specifically, Congress should enact legislation giving banks the authority to service the marijuana industry without fear of prosecution or sanctions. Moreover, the IRS should suspend the penalty it imposes on marijuana businesses until access to financial services is granted. Lastly, Congress should create an exception to § 280E, permitting business owners to deduct their necessary and ordinary business expenses from their federal income taxes.

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96. *Id.*

97. Gray, *supra* note 73.

98. Jerry Cornfield, *Banks Willing To Serve Pot Industry, but Not Able*, HERALD BUS. J. (Oct. 28, 2013, 12:01 AM), <http://www.heraldnet.com/article/20131028/BIZ/710289959/Banks-willing-to-serve-pot-industry-but-not-able>; see also 18 U.S.C. § 1956(2)(A) (2012); Brian Kindle, *SAR Data Reveals Few Institutions Willing To Bank the Marijuana Industry, Despite FinCEN and DOJ Guidance*, ASS'N CERTIFIED FIN. CRIMES SPECIALISTS (Aug. 13, 2014), <http://www.acfcs.org/sar-data-reveals-few-institutions-willing-to-bank-the-marijuana-industry-despite-fincen-and-doj-guidance/> (“Conducting transactions with the proceeds of marijuana sales is considered a ‘specified unlawful activity’ under the primary US money laundering law.”).

99. See Clark, *supra* note 17.

100. Pete Yost, *Feds Seek To Legalize Marijuana Industry Banking*, ASSOCIATED PRESS (Sept. 10, 2013, 9:07 PM), <http://bigstory.ap.org/article/congress-looks-justices-marijuana-decision>.

101. Cornfield, *supra* note 98.

102. Yost, *supra* note 100.

Although the Obama Administration appears to have given the green light for states to legalize recreational marijuana so long as their regulations comply with the objectives of the Cole Memorandum, its apparent approval clearly does not apply to access to financial resources. The DOJ first addressed this issue in 2011, when American Express announced it would no longer handle medical marijuana related transactions for fear of federal prosecution.<sup>103</sup> Just one month later, Deputy Attorney General Cole gave banks an explicit directive, stating that “[t]hose who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financing laws.”<sup>104</sup> The message to banks was clear: don’t do it. Consequently, Bank of America avoided handling accounts from marijuana dispensary businesses.<sup>105</sup> Wells Fargo, which served dispensaries in Colorado until 2011, backed away in light of the CSA’s treatment of cannabis as a controlled substance.<sup>106</sup>

In an October 2, 2013 letter to the Treasury Department, the FDIC, the National Credit Union Association, and the Comptroller of Currency, Governors Hickenlooper and Inslee of Colorado and Washington, respectively, urged federal financial institutions to find a way to permit normal banking transactions, the use of credit cards, and other activities for marijuana businesses.<sup>107</sup> In light of these requests, Attorney General Holder told the governors that the DOJ was “actively considering” how to regulate interactions between banks and state-licensed marijuana shops that do not violate other federal law enforcement priorities.<sup>108</sup> According to their conversation, “[F]inancial institutions and other enterprises that do business with marijuana shops that are in compliance with state laws are unlikely to be prosecuted for money laundering or other federal crimes that could be brought under existing federal drug laws.”<sup>109</sup>

On February 14, 2014, in response to the governors’ requests, the DOJ and the U.S. Treasury Department’s Financial Crimes Enforce-

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103. *Id.*

104. *Id.*

105. Amanda Alix, *Bank of America: Legalized Pot Revenues Are OK*, MOTLEY FOOL (Sept. 29, 2013), <http://www.fool.com/investing/general/2013/09/29/bank-of-america-legalized-pot-revenues-are-ok-with.aspx#commentsBoxAnchor>.

106. *Id.*

107. Cornfield, *supra* note 98.

108. Ryan Grim & Ryan J. Reilly, *Department of Justice “Actively Considering” How To Allow Bank, Pot Shop Transactions, Citing Public Safety*, HUFFINGTON POST (Aug. 30, 2013, 9:00 AM), [http://www.huffingtonpost.com/2013/08/30/banks-marijuana\\_n\\_3842526.html](http://www.huffingtonpost.com/2013/08/30/banks-marijuana_n_3842526.html).

109. *Id.*

ment Network (FinCEN) issued new banking guidelines.<sup>110</sup> According to FinCEN Director Jennifer Shasky Calvery, the guidance signals that it is possible to provide financial services to state-licensed marijuana businesses and still be in compliance with federal anti-money-laundering laws.<sup>111</sup> According to the guidance, “[T]he decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution.”<sup>112</sup> In assessing the risk of providing services to a marijuana-related business, the guidance provides that a financial institution should conduct customer due diligence,<sup>113</sup> which includes measures such as verifying a business is duly licensed and registered, and determining whether a potential client implicates one of the Cole Memorandum priorities or violates state law.<sup>114</sup>

If a financial institution does decide to provide services to a marijuana-related business, it must file a Suspicious Activity Report (SAR) pursuant to the Bank Secrecy Act (BSA).<sup>115</sup> The BSA requires

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110. FIN. CRIMES ENFORCEMENT NETWORK, DEP’T OF THE TREASURY, FIN-2014-G001, BSA EXPECTATIONS REGARDING MARIJUANA-RELATED BUSINESSES 1 (2014) [hereinafter FINCEN GUIDANCE], available at [http://www.fincen.gov/statutes\\_regs/guidance/pdf/FIN-2014-G001.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf); see also Serge F. Kovalski, *U.S. Issues Marijuana Guidelines for Banks*, N.Y. TIMES, Feb. 15, 2014, at A10.

In a seven-page document explaining the guidelines, FinCEN called for “due diligence” by financial institutions in monitoring their marijuana customers, including reviewing their applications for state licenses and understanding their “normal and expected activity” such as the types of products they sell and whether they have medical or recreational customers.

Kovalski, *supra*.

In a three-page memo to prosecutors issued in conjunction with the new banking guidelines, Deputy Attorney General James M. Cole wrote that prosecutions may not be “appropriate” when banks do business with marijuana entities that are operating legally under state law and do not violate any of the eight priorities set forth in a Justice Department memo last August.

*Id.*

111. Evan Perez, *Banks Cleared To Accept Marijuana Businesses*, CNN (Feb. 17, 2014, 8:39 PM), <http://www.cnn.com/2014/02/14/politics/u-s-marijuana-banks/>; see also Kovalski, *supra* note 110 (“The guidance ‘will provide transparency and mitigate the risks to the financial system,’ Ms. Shasky Calvery said. The authorities do not intend to crack down on banks ‘for a technical mishap,’ she said, adding: ‘We are not looking to have a gotcha [sic] enforcement regime.’”).

112. FINCEN GUIDANCE, *supra* note 110, at 2 (“These factors may include its particular business objectives, an evaluation of the risks associated with offering a particular product or service, and its capacity to manage those risks effectively. Thorough customer due diligence is a critical aspect of making this assessment.”).

113. *Id.* at 2–3 (outlining seven due diligence factors).

114. *Id.* at 3.

115. See 31 C.F.R. § 1020.320 (2012).

A financial institution is required to file a SAR if it knows, suspects, or has reason to suspect that a transaction conducted or attempted by, at, or through the financial institution: (i) involves funds derived from illegal activity or is an attempt to disguise funds derived from illegal activity; (ii) is designed to evade regulations promulgated under the BSA, or (iii) lacks a business or apparent lawful purpose.<sup>116</sup>

Therefore, due to marijuana's classification as a Schedule I substance, a financial institution is always required to file a SAR on activity involving a marijuana business even if the business is licensed under state law.

Following the issuance of FinCEN's guidance, banks are now be required to file even more detailed SARs depending on whether the bank believes a marijuana business is running afoul of the priorities outlined in the Cole Memorandum or is violating state law. If a financial institution reasonably believes that a business is in compliance with both, it should file a "Marijuana Limited" SAR.<sup>117</sup> In contrast, if a financial institution reasonably believes a marijuana business implicates any one of the Cole priorities or state law, it should file a "Marijuana Priority" SAR.<sup>118</sup> If it becomes necessary to terminate a relationship with a marijuana business in order to maintain an effective anti-money-laundering compliance program, a financial institution should file a SAR using the term "Marijuana Termination" in the narrative section.<sup>119</sup> In order to determine whether a marijuana business is engaged in activity that implicates one of the Cole Memorandum priorities, the guidance sets forth a nonexhaustive list of red flags, including "tells" such as the business receiving substantially more revenue than its local competitors or the business is depositing

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116. FINCEN GUIDANCE, *supra* note 110, at 3.

117. *Id.* at 3–4.

The content of this SAR should be limited to the following information: (i) identifying information of the subject and related parties; (ii) addresses of the subject and related parties; (iii) the fact that the filing institution is filing the SAR solely because the subject is engaged in a marijuana-related business; and (iv) the fact that no additional suspicious activity has been identified. . . .

A financial institution should follow FinCEN's existing guidance on the timing of filing continuing activity reports for the same activity initially reported on a "Marijuana Limited" SAR.

*Id.* (footnote omitted).

118. *Id.* at 4.

119. *Id.* ("To the extent the financial institution becomes aware that the marijuana-related business seeks to move to a second financial institution, FinCEN urges the first institution to use Section 314(b) voluntary information sharing (if it qualifies) to alert the second institution of potential illegal activity.").

more cash than is commensurate with the amount of revenue it is reporting for federal and state tax purposes.<sup>120</sup>

Though FinCEN's guidance purports to enhance the availability of financial services for marijuana-related businesses,<sup>121</sup> it in no way grants banks immunity from prosecution or relief from civil penalties for serving legal marijuana businesses.<sup>122</sup> According to Frank Keating, President and CEO of the American Bankers Association, the new rules are not stringent enough, given that the possession and distribution of marijuana violates federal law, and banks that support those activities still face the risk of prosecution and sanctions.<sup>123</sup>

Furthermore, the current federal tax code discourages the formation of legitimate marijuana businesses. As an initial matter, legal marijuana businesses operating without bank accounts are assessed a ten percent penalty on federal employee withholding taxes that they are required to pay electronically but are forced to pay in cash.<sup>124</sup> The IRS requires all businesses to pay the quarterly tax via the Electronic Federal Tax Payment (EFTP) System—an impossibility for marijuana shops that are unable to obtain banking services.<sup>125</sup> Instead of waiving the penalty for cash-only businesses, the IRS denied a petition for abatement of these penalties, reasoning that alternatives to electronic filing are available—namely, relying on third parties.<sup>126</sup> However, according to a Denver attorney, these alternatives are criminal because they force taxpayers to engage in money laundering.<sup>127</sup>

More significantly, marijuana-related businesses are unable to deduct business expenses from their gross income when paying federal income taxes, regardless of whether the operation is licensed under

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120. *Id.* at 5. Some other red flags include (1) the business receives substantially more revenue than may reasonably be expected given the relevant limitations imposed by the state in which it operates; (2) the business is unable to demonstrate that its revenue is derived exclusively from the sale of marijuana in compliance with state law, as opposed to revenue derived from the sale of other illicit drugs, the sale of marijuana not in compliance with state law, or other illegal activity; (3) the business makes cash deposits or withdrawals over a short period of time that are excessive relative to local competitors or the expected activity of the business; and (4) the business is unable to demonstrate the legitimate source of significant outside investments. *Id.* at 5–6.

121. *Id.* at 1.

122. Kovaleski, *supra* note 110. The Guidance does, however, “direct[ ] prosecutors and regulators to give priority to cases where financial institutions fail to adhere to the guidance.” *Id.*

123. *Id.*

124. See Brian Mahoney, *Bank Regs Led to Tax Woes for Weed Dispensary, Court Told*, LAW 360 (June 20, 2014, 4:29 PM), <http://www.law360.com/articles/550375/bank-regs-led-to-tax-woes-for-weed-dispensary-court-told>.

125. *Id.*

126. *Id.*

127. *Id.*

state law. Section 280E of the Federal Income Tax Code states that taxpayers “trafficking in controlled substances” receive “no deduction” for any expenses beyond the cost of producing or buying inventory.<sup>128</sup> This provision was enacted at the height of the Reagan administration’s “war on drugs” in 1982, and intended to stop drug kingpins and cartels from claiming tax deductions.<sup>129</sup> However, this provision has yet to be amended despite twenty-three states and the District of Columbia legalizing medical marijuana, and Alaska, Colorado, Oregon, and Washington legalizing recreational marijuana.<sup>130</sup>

Due to marijuana’s Schedule I classification, income from the sale of marijuana is taxable, but all other business expenses, such as wages and salaries, health and other insurance premiums, rent, pension plans, equipment, and utility costs, are not deductible and thus negatively affect the company’s taxable profit.<sup>131</sup> In essence, marijuana businesses pay a gross receipts tax instead of an income tax.<sup>132</sup> Studies show that the code effectively gives marijuana businesses an 87.5% tax rate while other businesses function at 35% tax rate.<sup>133</sup>

To illustrate this disparity, if two nearly identical businesses each have \$600,000 in business revenue and one was a marijuana-related business, each business is allowed to deduct the costs of goods sold—say, \$300,000—but only the nonmarijuana business can deduct “ordinary and necessary” business expenses.<sup>134</sup> While the nonmarijuana business might deduct, for example, \$200,000 of ordinary and neces-

128. 26 U.S.C. § 280E (2012); *see also* Benjamin Moses Leff, *Tax Planning for Marijuana Dealers*, 99 IOWA L. REV. 523, 530 (2014) (“In order to determine the business’s taxable income, one starts with all of the money coming in to the business—its gross revenue—and then subtracts out all of the business expenses like salaries, rent, advertising, employee health insurance, state and local taxes, license fees, bookkeeping, accounting and legal services, among other things.”).

129. Miranda Green, *Congressmen Introduce Bills To Aid Legal Marijuana Businesses*, DAILY BEAST (Sept. 25, 2013), <http://www.thedailybeast.com/articles/2013/09/25/congressmen-introduce-bills-to-aid-legal-marijuana-businesses.html>; *see also* S. REP. NO. 97-494, at 309 (1982) (“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.”).

130. As of May 19, 2015, Alaska, Colorado, Oregon, and Washington have legalized recreational marijuana. *See State Marijuana Laws Map*, *supra* note 5.

131. *See* Oglesby, *supra* note 20.

132. Edward J. Roche, Jr., *Federal Income Taxation of Medical Marijuana Businesses*, 66 TAX LAW. 429, 457–58 (2013); *see also* Leff, *supra* note 128, at 526 (“Now that the [tax] provision applies to state-sanctioned marijuana sellers as well as illegal drug dealers, it creates a federal tax situation that some believe may drive legitimate marijuana sellers out of business.”).

133. Green, *supra* note 129.

134. Katie Rucke, *Trade Organization Pushes Federal Tax Reforms for Marijuana Businesses*, MINTPRESS NEWS (Sept. 14, 2013), <http://www.mintpressnews.com/trade-organization-pushes-federal-tax-reforms-for-marijuana-businesses/168953/>.

sary business expenses, § 280E bars the marijuana business from taking the same deduction.<sup>135</sup> And if both businesses were taxed at a 35% tax rate, the marijuana business would pay a tax bill \$70,000 greater than the other, and would have an average effective tax rate much higher than the nonmarijuana business.<sup>136</sup> Effectively, this discourages marijuana-related businesses from hiring more workers, increasing wages, providing additional benefits, or investing in capital expenditures.<sup>137</sup> According to House Representative Earl Blumenauer, legal marijuana businesses are barred from claiming advantages such as the work opportunity tax credit if they hire a veteran, or from depreciating their American-made irrigation equipment.<sup>138</sup> However, without congressional action in the form of an exception to § 280E, state-licensed marijuana businesses will continue to be disadvantaged by unequal tax treatment.<sup>139</sup>

### III. ANALYSIS

Ever since Colorado and Washington became the first jurisdictions in the world to legalize marijuana for recreational use,<sup>140</sup> the million-dollar question has been how the federal government would react. Proponents of legalization hoped that the time had finally come when President Obama, an admitted inhaler,<sup>141</sup> would finally end America's exhausted war on cannabis. However, instead of enforcing the CSA or attempting to reclassify marijuana,<sup>142</sup> the federal government has adopted an accommodation strategy that may sound progressive in theory, but is largely ineffective for entrepreneurs endeavoring to enter the recreational marijuana market. As long as marijuana remains criminalized at the federal level, Congress must take action in

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135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. Green, *supra* note 129.

140. Michael Kelley, *Colorado and Washington Are the First Places in the World Where Weed Is Truly Legal*, BUS. INSIDER (Nov. 8, 2012, 4:49 PM), <http://www.businessinsider.com/legal-marijuana-colorado-washington-2012-11> ("No modern jurisdiction has removed the prohibition on commercial production, distribution, and possession of marijuana for non-medical purposes. Not even Holland.").

141. Nick Gillespie, *8 Things We Won't Miss When Pot Is Legal Everywhere*, TIME (Oct. 24, 2013), <http://ideas.time.com/2013/10/24/8-things-we-wont-miss-when-pot-is-legal-everywhere/>.

142. For a discussion of the federal government's options concerning marijuana legalization, see Reid, *supra* note 30, at 173 ("The United States has three options: (1) legalize marijuana's production and use, (2) change marijuana from a Schedule I to a Schedule II substance, which would permit marijuana use for medical purposes, or (3) enforce current federal law under the CSA that criminalize the production and use of marijuana.").

the areas of banking and tax law to ensure that the sale of recreational marijuana is regulated, safe, and efficient.

Under the current system, limited access to financial services and the penal nature of § 280E present two very real concerns for recreational marijuana retailers that hope to surpass the limited success of medical dispensaries.<sup>143</sup> Though dispensaries have faced the same obstacles, the issues surrounding banking and taxing laws have taken greater urgency in light of the growing popularity for marijuana legalization and research projecting that the legal cannabis industry could generate revenues of \$35 billion by 2020.<sup>144</sup> However, given that the federal government reserved its right to shut down the entire industry, the government must enact banking and tax reforms to match its decision to unilaterally suspend the enforcement of federal drug laws.<sup>145</sup>

In the area of banking, Congress—instead of the DOJ or Treasury—should respond to pleas from states to allow access to financial services, which is a necessary component to ensuring a highly regulated marijuana system that will accurately track funds, prevent criminal involvement, and promote public safety.<sup>146</sup> Though the directives from FinCEN are a step in the right direction, our legislature needs to enact legislation establishing how banks can provide financial services to marijuana businesses without fear of federal prosecution. The risk is too great for many banks to rely on mere “guidance,” and Congress needs to open banking services to the marijuana market and put an end to dangerous cash-only businesses.

In the area of tax, the IRS should first suspend the penalty it assesses on marijuana businesses that are forced to pay quarterly employee-withholding taxes in cash until Congress provides access to banking services. Second, Congress should amend the current Internal Revenue Code, which threatens to tax recreational marijuana stores out of business, risking an increase in black market sales.<sup>147</sup> Given the unlikelihood of marijuana being rescheduled from its Schedule I classification, and thus making § 280E inapplicable, Congress should instead create an exception to § 280E allowing state-li-

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143. Gillespie, *supra* note 141.

144. Christopher Ingraham, *The Marijuana Industry Could Be Bigger than the NFL by 2020*, WASH. POST (Oct. 24, 2014), <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/10/24/the-marijuana-industry-could-be-bigger-than-the-nfl-by-2020/>.

145. *The President Inhales*, WALL ST. J. (Jan. 21, 2014, 7:41 PM), <http://online.wsj.com/news/articles/SB10001424052702303802904579334710499090836>.

146. Matt Ferner, *Marijuana Businesses Need More Flexibility in Federal Banking Regulations: Govs. Hickenlooper, Inslee*, HUFFINGTON POST (Oct. 3, 2013, 4:58 PM), [http://www.huffingtonpost.com/2013/10/03/marijuana-banking\\_n\\_4038955.html](http://www.huffingtonpost.com/2013/10/03/marijuana-banking_n_4038955.html).

147. *See* Leff, *supra* note 128, at 534.

censed marijuana businesses to deduct necessary and ordinary business expenses. Such an allowance would increase the cash flow of marijuana-related businesses, incentivizing owners to engage in activities such as awarding larger salaries and participating in investment opportunities.

*A. From Medical Dispensaries to Retail Marijuana Stores*

Marijuana businesses, which are rapidly entering the marketplace due to the success of state legalization campaigns, are drawing the eye of investors who see the trade as one of the largest growth sectors,<sup>148</sup> some even calling it the next “great American industry.”<sup>149</sup> Though the medical marijuana market is projected to grow into a \$9 billion industry by 2016,<sup>150</sup> these numbers hardly compare to the staggering \$35 to \$40 billion that the recreational marijuana industry could generate in the American market.<sup>151</sup> Consequently, the stakes are rising due to the amount of money that is being invested in the retail shops, but investment is nevertheless constrained given the possibility that the federal government can shut down a retail store at any time.<sup>152</sup>

Despite the risks associated with these types of ventures, the rapid growth in marijuana businesses is in large part attributable to the 51% of Americans who support the legalization of marijuana.<sup>153</sup> The national consensus in favor of legalization seems to be driving the green growing industry and business tripled in 2013, attracting hedge funds and institutional investors.<sup>154</sup>

Further, this investment action has only been increasing ever since Colorado and Washington began offering recreational marijuana for sale. According to Troy Dayton, cofounder and CEO of the AcrView Group, which conducts market research on the marijuana industry, the federal decision not to sue Colorado and Washington unleashed investors, and it is predicted that the legal marijuana business will top

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148. Jane Wells, *Investors See Legal Marijuana as Growth Industry*, NBC NEWS (Nov. 8, 2013, 2:28 PM), <http://www.nbcnews.com/business/investors-see-legal-marijuana-growth-industry-8C11565189>.

149. Tim Haack, *Investors Think Cannabis Is Worth the Risk*, MYNORTHWEST.COM (June 14, 2013, 10:35 AM), <http://mynorthwest.com/11/2295592/Investors-think-cannabis-is-worth-the-risk>.

150. J.J. Colao, *Meet the Yale MBAs Trying To Tame the Marijuana Industry*, FORBES (Mar. 26, 2013, 1:23 PM), <http://www.forbes.com/sites/jjcolao/2013/03/26/meet-the-yale-mbas-trying-to-tame-the-marijuana-industry/> (a Forbes Contributor blog).

151. *Id.*

152. *Id.* (“It’s a big industry, just not a real industry. It’s all still operating out of the shadows.”).

153. Lydia Saad, *Majority Continues To Support Pot Legalization in U.S.*, GALLUP (Nov. 6, 2014), <http://www.gallup.com/poll/179195/majority-continues-support-pot-legalization.aspx>.

154. Wells, *supra* note 148.

\$10 billion within five years.<sup>155</sup> Thus, the potential amount of money to be generated by marijuana businesses is the most persuasive reason for altering laws concerning financial services and taxation in order to ensure a highly regulated marijuana system.

In Colorado alone, there are more than 240 recreational marijuana shops in current operation, and that number is only projected to grow, given that the state issued at least 46 more licenses in October 2014.<sup>156</sup> Colorado officials project that the launching of this unprecedented commercial market will ultimately gross \$578 million in annual revenues, including \$67 million in tax receipts for the state.<sup>157</sup>

According to CEO Brendan Kennedy of Privateer Holdings Inc., a Seattle-based private equity firm, “There has been a shift in thinking. The majority now believe that marijuana will become legal. Investors are now not only more comfortable but they are doing more of their own due diligence and they are coming to us having already made their minds up about investing.”<sup>158</sup> In 2012, it took eighteen months to raise just \$7 million for investment in the medical marijuana sector;<sup>159</sup> however, in January 2014, Privateer raised \$15 million in just three weeks.<sup>160</sup>

Despite the projected value of the marijuana market, investors’ hopes are tempered by the risks.

There is a lot of money on the sidelines wondering what the government will look like in 2016, because that election could change everything. The feds have said as long as you are in compliance with the laws of your state, we will just be watching. But what happens in 2016?<sup>161</sup>

It seems clear that the federal government’s legal opposition to marijuana seriously constrains the potential growth of the industry given retailers’ limited access to financial institutions. The industry has been plagued by a lack of capital because most banks are wary of

155. *Id.*

156. Josh Voorhees, *Higher Learning: What the Next Wave of Pot-Legalizing States Can Learn from Colorado and Washington*, SLATE (Oct. 8, 2014, 2:42 PM), [http://www.slate.com/articles/news\\_and\\_politics/politics/2014/10/marijuana\\_legalization\\_what\\_the\\_next\\_wave\\_of\\_pot\\_legalizing\\_states\\_can\\_learn.html](http://www.slate.com/articles/news_and_politics/politics/2014/10/marijuana_legalization_what_the_next_wave_of_pot_legalizing_states_can_learn.html).

157. Keith Coffman, *World’s First State-Licensed Marijuana Retailers Open Doors in Colorado*, REUTERS (Jan. 1, 2014, 5:58 PM), <http://www.reuters.com/article/2014/01/01/us-usa-marijuana-colorado-idUSBREA0000K20140101>.

158. Bill Meagher, *Private Equity Firing Up Medical Marijuana Sector*, DEAL PIPELINE (June 16, 2014, 2:03 PM), <http://www.thedeal.com/content/private-equity/private-equity-firing-up-medical-marijuana-sector.php>.

159. *Id.*

160. *Id.*

161. *Id.*

doing business with anyone who handles a drug that is still illegal under federal law. In June 2013, Visa and MasterCard stopped processing transactions at dispensaries, while most banks refuse to work with them at all.<sup>162</sup> Consequently, more than 80% of marijuana-related start-ups are self-funded by their founders, with just 3% of funds coming from venture capital and 5% from angel investors.<sup>163</sup>

Instead of marijuana entrepreneurs having to rely on private investors to build these state-sanctioned businesses, the federal government should formally exempt banks that service marijuana retailers and afford them a genuine opportunity to craft transparent and regulated markets devoid of underground dealers. The potential revenue marijuana is projected to earn should only incentivize those in Washington D.C. to take action to allow marijuana-related businesses to have access to the banking system, legitimizing the creation of such ventures.

*B. Cash-Only Businesses Present the Real Green Issue  
in Marijuana Sales*

Due to the federal government's characterization of marijuana businesses as criminal enterprises, placing servicing banks at risk of criminal prosecution or loss of FDIC insurance coverage,<sup>164</sup> Ryan Kunkel found himself placing \$1,000 bricks of cash into a brown bag before quickly stashing the money into the trunk of his car to make the drive to downtown Seattle.<sup>165</sup> Despite the air of criminality, there is nothing illegal in what Mr. Kunkel was doing; as an owner of five medical marijuana dispensaries in Seattle, he was only lawfully preparing to pay his income taxes at the Department of Revenue.<sup>166</sup>

Carrying such large amounts of cash is a terrible risk that freaks me out a bit because there is the fear in my mind that the next car pulling up beside me could be the crew that hijacks us. So, we have to play this never-ending shell game of different cars, different routes, different dates and different times.<sup>167</sup>

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162. Colao, *supra* note 150.

163. *Angel Investor*, INVESTOPEDIA.COM, <http://www.investopedia.com/terms/a/angelinvestor.asp> (last visited Jan. 7, 2015) ("An investor who provides financial backing for small startups or entrepreneurs. Angel investors are usually found among an entrepreneur's family and friends. The capital they provide can be a one-time injection of seed money or ongoing support to carry the company through difficult times."); *see also* Shannon Bond, *High Finance as Cannabis Fund Pitches Weed at Waldorf*, CNBC (May 1, 2014, 2:57 AM), <http://www.cnbc.com/id/101631230#>.

164. *See* Cornfield, *supra* note 98.

165. Serge F. Kovaleski, *Banks Say No to Marijuana Money, Legal or Not*, N.Y. TIMES, Jan. 12, 2014, at A1, available at [http://www.nytimes.com/2014/01/12/us/banks-say-no-to-marijuana-money-legal-or-not.html?\\_r=1](http://www.nytimes.com/2014/01/12/us/banks-say-no-to-marijuana-money-legal-or-not.html?_r=1).

166. *Id.*

167. *Id.*

Like Mr. Kunkel, legal marijuana merchants regularly face these and other encumbrances associated with the current banking laws; without bank accounts, they are forced to operate just like drug dealers—cash only. Given that the voters have spoken and the federal government has opted for nonenforcement, it is time for legislators to give banks legally binding regulations necessary to extend financial services to state-licensed marijuana businesses.

While marijuana retailers hoped that the regulations issued by FinCEN and the DOJ would enable banks to open their doors, the language of the regulations fails to provide the type of clarity that banks are seeking to service the emerging marijuana industry.<sup>168</sup> Namely, the guidance fails to provide assurances that federal authorities will withhold prosecution or otherwise avoid assessing penalties against banks that engage with marijuana-related businesses. More assurance is required than memorandums to U.S. Attorneys to ensure that banks are not “aiding and abetting” a criminal enterprise if they provide services to marijuana businesses.<sup>169</sup>

Consequently, only 1% of banks nationwide are providing banking services to marijuana businesses.<sup>170</sup> And of the small handful of institutions that are providing services to the legal marijuana industry, many have terminated relationships with customers despite issuance of the FinCEN guidance. Between August 8, 2014 and February 14, 2015, when the guidance was issued, financial institutions filed over 475 “Marijuana Termination” SARs, which are used when a financial institution deems it necessary to terminate a relationship with a marijuana-related business.<sup>171</sup> These numbers suggest that a greater number of institutions severed ties with marijuana businesses during the period analyzed than those that provided services.

With only FinCEN’s guidance in place, the status quo will likely remain, forcing newly licensed retail stores to operate on a cash-only basis. This type of financial system not only raises safety concerns, but also is very difficult to audit, which can lead to tax evasion, wage theft, and diversion of resources needed to protect public safety.<sup>172</sup> Specifi-

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168. *Id.*

169. FINCEN GUIDANCE, *supra* note 110, at 1.

170. *Marijuana Dispensaries Need Access to Banking System*, Bos. GLOBE (Sept. 9, 2014) [hereinafter *Marijuana Dispensaries*], <http://www.bostonglobe.com/opinion/editorials/2014/09/09/legal-marijuana-sellers-need-access-banking-system/w2Dy5xWNqyHK09Ip5pZW5H/story.html#comments>.

171. Kindle, *supra* note 98.

172. See David Ingram, *U.S. May Help Marijuana Shops Get Banking Services*, REUTERS (Sept. 10, 2013, 5:45 PM), <http://www.reuters.com/article/2013/09/10/us-usa-crime-marijuana-idUSBRE9891EK20130910>.

cally, many business owners have been forced to install panic buttons for workers in the event of a robbery, as well as countless security cameras and floor sensors to monitor the stores.<sup>173</sup> Often, owners must employ security firms, such as Colorado's Blue Line Protection Group, comprised of military veterans, to protect dispensaries, cultivation centers, and transports.<sup>174</sup>

Besides the burden of security concerns, retailers are often forced to either pay employees with envelopes of cash or haul bags of cash to supermarkets to buy money orders.<sup>175</sup> If owners are able to open bank accounts, most commonly by establishing holding companies, they store money in plastic bags or sealed boxes to mask the smell of marijuana.<sup>176</sup> However, it is not unusual for a legitimate marijuana business to go through a half-dozen bank accounts in a few years due to accounts being closed after banks discover the nature of the underlying business.<sup>177</sup>

It may come as a surprise that states might be the first patrons that banks are willing to serve. Currently, both Colorado and Washington have banking partners that appear willing to accept state deposits related to recreational marijuana<sup>178</sup> despite marijuana's Schedule I classification. These state deposits will be derived from the hundreds of thousands of dollars collected for application and licensing fees and the millions of dollars in taxes derived from recreational marijuana sales.<sup>179</sup> Colorado's Department of Revenue (DOR) currently uses Wells Fargo, and according to the communications director for the agency, the bank has never questioned where the money comes from given that the DOR collects tax money for the entire state and does not differentiate deposits according to industry.<sup>180</sup>

Moreover, Washington received approval from Bank of America to deposit money generated by application and licensing fees and the taxes it collects via recreational sales.<sup>181</sup> Though Bank of America already acted as the state's financial institution, Washington did not deposit revenue derived from medical-marijuana dispensary applica-

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173. Kovaleski, *supra* note 165, at A4.

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Rise of Recreational Marijuana Market Could Usher in Banking Changes*, MARIJUANA BUS. DAILY (Sept. 27, 2013) [hereinafter *Rise of Recreational Marijuana*], <http://mmjbusiness-daily.com/could-adult-use-marijuana-market-lead-to-relaxed-cannabis-banking-policies/>.

179. *Id.*

180. *Id.*

181. *Id.*

tion or licensing fees because the state did not regulate the industry. However, dispensary owners still pay sales and business taxes, which go into Washington's bank account, and state officials told Liquor Control Board director, Rick Garza, that licensing would not affect the state's ability to deposit revenue.<sup>182</sup> These officials reasoned that "Washington is not the first state to license marijuana businesses, and the federal government has never cracked down on states' bank accounts."<sup>183</sup>

The ability of these states to deposit money from marijuana sales is necessary to comply with the DOJ's objectives; however, many financial institutions remain reluctant to extend services to retailers, and it is difficult to fathom a cash-only business being "tightly regulated."<sup>184</sup> Nevertheless, the willingness of Wells Fargo and Bank of America to conduct business with Colorado and Washington may be the first step in ending cash-only retail marijuana businesses. If major banks agree to accept deposits from states, there is a chance they would eventually loosen up their policies toward deposits from marijuana businesses.<sup>185</sup>

However, banks should not have to be persuaded by the growing appeal of gaining access to an entirely new profit stream, consisting of both money earned by state governments and profits generated by marijuana businesses, to service the industry. Instead, banks should be able to offer financial services under the auspices of a reformed federal law. For now, however, most banks will most likely continue to withhold services from marijuana merchants.

### *C. Proposed Congressional Action To Remedy Lack of Access to Banking Services*

Fortunately, Congress seems to be doing something about the problem. In July 2014, the U.S. House of Representatives approved a bipartisan amendment, H.R. 5016, which allows banks to accept deposits from marijuana businesses.<sup>186</sup> Although the bill fails to explicitly state that banks can service the industry legally, it prevents the Treasury Department from penalizing financial institutions that pro-

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182. Jordan Schrader, *Wash. State Shops for a Bank To Handle Marijuana Money*, KOMO NEWS (Sept. 22, 2013, 12:00 PM), <http://www.komonews.com/news/local/Wash-state-shops-for-a-bank-to-handle-pot-money-224785712.html>.

183. *Id.*

184. Brady Dennis, *Obama Administration Will Not Block State Marijuana Laws, if Distribution Is Regulated*, WASH. POST (Aug. 29, 2013), [http://www.washingtonpost.com/national/health-science/obama-administration-will-not-preempt-state-marijuana-laws—for-now/2013/08/29/b725bfd8-10bd-11e3-8cdd-bcdc09410972\\_story.html](http://www.washingtonpost.com/national/health-science/obama-administration-will-not-preempt-state-marijuana-laws—for-now/2013/08/29/b725bfd8-10bd-11e3-8cdd-bcdc09410972_story.html).

185. *Rise of Recreational Marijuana*, *supra* note 178.

186. *See Marijuana Dispensaries*, *supra* note 170.

vide services to state-licensed marijuana businesses, and advocates say it helps.<sup>187</sup> According to Taylor West, deputy director of the National Cannabis Industry Association,

It's essentially forbidding the use of funds to target these banks. . . . Given that many banks seemed to feel that the guidance issued in February was not concrete enough to give them the confidence to start taking cannabis-related clients, it would be a big deal to put that policy into actual law.<sup>188</sup>

Although representatives back the measure, approval in the Senate is far from certain. "If this provision eventually becomes law—and one vote is far from that—an initial reading is that this appears to remove some of the barriers for the (Office of the Comptroller of the Currency) to financial services being available to marijuana businesses," said Don Childears, president and CEO of the Colorado Bankers Association.<sup>189</sup> However, it remains unclear whether the amendment would apply to the Federal Reserve or FDIC.<sup>190</sup>

Although the measure fails to explicitly provide prosecutorial immunity to financial institutions given that it only cuts off Treasury Department funding, the Senate should approve the pending legislation to address the immediate and growing concerns associated with these cash-only businesses. Doing so would provide certainty for banks and allow business owners to begin applying for the services that they need.<sup>191</sup> While legislative action explicitly exempting financial institutions from prosecution or sanctions is ideal, this amendment, if nothing else, will help alter the current untenable status quo that forces otherwise law-abiding businesses to operate on a cash-only basis,

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187. Financial Services and General Government Appropriations Act, 2015, H.R. 5016, 113th Cong. (2014).

None of the funds made available in this Act may be used, with respect to the States of Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Iowa, Kentucky, Main, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oregon, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington or Wisconsin or the District of Columbia, to penalize a financial institution solely because the institution provides financial services to an entity that is a manufacturer, producer, or a person that participates in any business or organized activity that involves handling marijuana or marijuana products and engages in such activity pursuant to a law established by a State or a unit of local government.

*Id.* § 916.

188. *Id.*

189. David Migoya, *U.S. House OKs Bill that May Open Door to Bank Accounts for Pot Shops*, DENVER POST (July 17, 2014, 1:43 AM), [http://www.denverpost.com/business/ci\\_26160270/house-oks-bill-stop-feds-from-using-cash](http://www.denverpost.com/business/ci_26160270/house-oks-bill-stop-feds-from-using-cash).

190. *Id.*

191. Perez, *supra* note 111.

making them criminal targets and unduly burdening their operations.<sup>192</sup>

*D. The Current Tax Code Encourages Black Market Sales*

Though “SWAT-style raids” and threatening letters have become the most publicized measures used to target marijuana businesses, the IRS has been functioning as an arm of justice, employing the Internal Revenue Code as a weapon in the federal government’s ongoing war against marijuana.<sup>193</sup> As an initial matter, the IRS assesses penalties on all marijuana businesses that pay their employee-withholding taxes in cash due to the fact that it requires businesses to pay the tax via the Electronic Federal Tax Payment (EFTP) System—an impossibility for marijuana businesses that are denied banking services.<sup>194</sup> More significantly, under § 280E, individuals involved in the sale of controlled substances, including legalized marijuana, cannot deduct standard business expenses on their federal income taxes.<sup>195</sup> The IRS systematically targets marijuana establishments, relying on this obscure section that gives the taxing agency unintended power.<sup>196</sup> In light of state laws legalizing the sale of medicinal and recreational marijuana, it is well past time for the IRS to cease its persecution, which began long before California became the first state to legalize medicinal marijuana in 1996.<sup>197</sup>

Therefore, the IRS should suspend the penalty it assesses on marijuana businesses that are forced to pay quarterly employee withholding taxes until Congress adequately provides access to banking services. Next, Congress should create an exception for state-licensed marijuana businesses due to changed factual circumstances that did not exist and were not considered at the time of its adoption. The tax system, unchanged, threatens to tax marijuana retailers out of business, and also decreases state-licensed marijuana businesses’ cash flows, which creates a huge disincentive to hire more workers, increase wages, provide additional benefits, or invest in things such as infrastructure improvements. Moreover, there is no reason why the

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192. Migoya, *supra* note 189.

193. Clarence Walker, *The IRS War on Medical Marijuana Providers*, STOPTHEDRUGWAR.ORG (May 16, 2013, 12:24 PM), [http://stopthedrugwar.org/chronicle/2013/may/16/irs\\_war\\_medical\\_marijuana\\_provid](http://stopthedrugwar.org/chronicle/2013/may/16/irs_war_medical_marijuana_provid).

194. Migoya, *supra* note 18.

195. Walker, *supra* note 193.

196. Pat Oglesby, *CNN Misunderstands the IRS and Marijuana Tax Enforcement: No Other Shoe Can Drop*, NEWREVENUE.ORG (Aug. 17, 2013), <http://newrevenue.org/2013/08/17/cnn-misunderstands-the-irs-and-marijuana-tax-enforcement-no-other-shoe-can-drop/>.

197. *See* Mikos, *supra* note 45, at 636.

tax code should deny ordinary and necessary business expense deductions to legitimate businesses established under state law. The result is an arbitrary and punitive situation in which employers face very high average effective tax rates that Congress never sought to impose.

Through § 280E's current application, numerous dispensaries have become victims of tax enforcement, forcing them to close their doors and lay off their staffs because the tax burden was too great.<sup>198</sup> Though sales of illicit drugs have been purposely singled out since the Reagan Administration, other illegal activities—prostitution, gambling, and gunrunning—can still claim ordinary business expenses on their taxes.<sup>199</sup> This is because § 280E only singles out those trades or businesses that are engaged in the trafficking of controlled substances.<sup>200</sup> Unfortunately, the tax code does not make any distinction between illegal black market drug sales and state-established, legal marijuana businesses.<sup>201</sup> Thus, it should come as no surprise that business owners perceive federal tax hurdles as the biggest threat to the marijuana industry.<sup>202</sup>

What the government fails to realize is that taxing legitimate businesses out of operation or driving them underground actually encourages tax evasion by owners and only incites consumers to purchase

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198. *Marijuana Dispensaries Systematically Targeted by IRS*, CANNABIS L. GROUP'S MED. MARIJUANA LEGAL BLOG (June 5, 2013, 10:39 AM), <http://www.marijuanalawyerblog.com/2013/06/marijuana-dispensaries-systematically-targeted-by-irs.html>; see also Walker, *supra* note 193 (“The attacks on Harborside and Oaksterdam were part of an IRS campaign of aggressive audits using 280E to deny legitimate business expenses, such as rent, payroll, and all other necessary business expenses. These denials resulted in astronomical back tax bills for the affected dispensaries, threatening their viability—and patients’ access to medicine.”).

199. See Oglesby, *supra* note 20; see also Leff, *supra* note 128, at 533.

To be clear, this over-taxation of a marijuana seller's income is not simply the result of her engaging in an illegal business activity. If [a business] were engaged in murder for hire, [it] would owe federal income tax on the profits [it] made from such activity, but would be allowed to deduct as ordinary and necessary business expenses the cost of [its] gun and bullets, the cost of overnight travel to and from the crime scene, any amounts [it] paid to employees or contractors who helped [it] carry out [the] crime, and other expenses associated with . . . criminal activity. Section 280E only applies to income from selling controlled substances.

Leff, *supra* note 128, at 533 (footnotes omitted).

200. 26 U.S.C. § 280E (2012).

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.

*Id.*

201. See *id.*

202. Leff, *supra* note 128, at 525.

marijuana illegally on the black market.<sup>203</sup> The IRS routinely disallows normal tax deductions by marijuana-related businesses, effectively shutting them down with a tax bill three or four times above average.<sup>204</sup> Denver Relief, a medical marijuana center, does just over \$1 million a year in sales, and not being able to take standard business deductions costs the business tens of thousands of dollars annually with a projected tax rate of about 50%.<sup>205</sup> Moreover, an accountant in Colorado specializing in medical marijuana tax law said one client did not turn a profit in 2009, 2010, or 2011, but nevertheless was handed a \$300,000 tax bill from the IRS in 2012 for those three preceding years.<sup>206</sup> “If you have a license from the state hanging on your wall, that doesn’t fit the definition of drug trafficking. Yet the IRS is aggressively auditing this industry.”<sup>207</sup> These types of businesses are facing effective tax bills of 65% to 75% compared to 15% to 30% for businesses in general.<sup>208</sup>

In 2011, the IRS defended its actions by claiming it was merely enforcing existing law, and reiterated that Congress would need to either change the tax code or remove marijuana from its current classification under the CSA as a Schedule I drug if it did not want marijuana dealers caught up in these provisions.<sup>209</sup> The effects of these onerous provisions led Representative Earl Blumenauer to introduce the Small Business Tax Equity Act of 2013, with the goal of amending § 280E to resolve this emerging crisis in the newly legal billion-dollar industry.<sup>210</sup> However, after it went to the House Ways and Means Committee, it was “never heard from again.”<sup>211</sup> Consequently, other efforts to ignite code reforms are needed if marijuana retailers are to escape burdensome taxation.

According to Betty Aldworth, deputy director for the National Cannabis Industry Association, she is skeptical that members of Con-

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203. See Walker, *supra* note 193.

204. David Downs, *Marijuana’s IRS Problems Spark New Bill*, SMELL THE TRUTH (May 29, 2013, 4:14 PM), <http://blog.sfgate.com/smellthetruth/2013/05/29/marijuanas-taxation-problem-sparks-new-bill/>.

205. See Steve Hargreaves, *Marijuana Dealers Get Slammed by Taxes*, CNNMONEY (Feb. 25, 2013, 3:17 PM), <http://money.cnn.com/2013/02/25/smallbusiness/marijuana-tax/index.html>.

206. *Id.*

207. *Id.*

208. *Id.*

209. See Letter from Andrew J. Keyso, Deputy Assoc. Chief Couns. (Income Tax & Acct.), IRS, to Fortney Pete Stark, U.S. House of Representatives (Mar. 25, 2011), *available at* <http://www.irs.gov/pub/irs-wd/11-0005.pdf> (“The result you seek would require [ ] Congress to amend either the Internal Revenue Code or the Controlled Substances Act.”).

210. See Downs, *supra* note 204 (describing the Act’s goal of ending the IRS’s persecution of medical cannabis dispensaries).

211. See Walker, *supra* note 193.

gress have an appetite to discuss reclassifying marijuana, even as Americans seem against its current scheduling. “Chang[ing] [the] tax code to allow regulated businesses to be taxed fairly is an idea most people can agree with.”<sup>212</sup>

Though the ultimate goal for opponents of marijuana prohibition is federal legislation, it seems clear that any major reform of federal marijuana policy will most likely include a hefty federal excise tax to help fund regulatory mechanisms and garner support from lawmakers who would not otherwise be disposed to reform.<sup>213</sup> Currently, cultivators and distributors must pay federal income tax on their profits, though buyers do not pay a federal excise tax on marijuana purchases as they would if they bought alcohol or cigarettes.<sup>214</sup> Advocates of legalization understand how attractive a well-regulated and heavily taxed marijuana industry can be; but it is difficult to know at what point taxes will encourage an illicit market.<sup>215</sup>

“The black market generally imposes its own costs—purveyors can charge a premium because of the risks they incur.”<sup>216</sup> The regulatory burden for legal marijuana sales is also very high, especially since the advent of stringent state laws overseeing the industry; regulations, like the tax code proscribing business deductions, raise the price of legal marijuana, which in effect encourages black market sales.<sup>217</sup> The new “tax liability” would be primarily focused on buyers, while growers and sellers will continue to petition Congress for standard tax deduc-

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212. Rucke, *supra* note 134.

213. Christopher Matthews, *Will High Marijuana Taxes Encourage Black Markets?*, TIME (Feb. 25, 2013), <http://www.business.time.com/2013/02/25/will-high-marijuana-taxes-encourage-black-markets/>.

214. See Howard Gleckman, *Why Legal Marijuana Is a Good Argument for Tax Reform*, FORBES (Aug. 20, 2013, 3:52 PM), <http://www.forbes.com/sites/beltway/2013/08/20/why-legal-marijuana-is-a-good-argument-for-tax-reform/>.

215. Matthews, *supra* note 213.

It’s difficult to know for sure, but if a 50% tax were enacted on the federal level, the marijuana industry in a state like Washington would face at least \$1.92 in tax for every \$1 of product . . . produced. Whether this level of taxation is enough to encourage a black market is difficult to say.

*Id.*

216. *Id.*

217. *Id.*

In Colorado, for instance, where medical marijuana has been legal for more than a decade, growers are required to keep their operations under 24-7 video surveillance, produce criminal background checks on workers, and keep regulators alerted each and every time they move product. These are just a few of the regulations that can help drive up the price of legal cannabis cultivation and encourage illicit markets to develop.

*Id.*

tions.<sup>218</sup> “They may be [marijuana] sellers, but they are still business people who want to maximize after-tax returns.”<sup>219</sup>

The main point is that marijuana tax reform is finally about to receive the attention it deserves. As marijuana grows in popularity and continues to be legalized by states, marijuana businesses are in a stronger position to argue for tax breaks. Some warn that if Congress does not treat marijuana sellers like other businesses, affording them the same tax breaks, state plans to tax and regulate marijuana for recreational use are doomed to fail from the outset.<sup>220</sup> However, simple congressional awareness will not be enough to fight off skeptics. “If they don’t like the fact that they can’t take certain tax deductions because they’re in an illegal business, then they should go into some other business where they can take tax deductions,” says Jeffrey Miron, the director of undergraduate studies in the Department of Economics at Harvard University.<sup>221</sup>

Making it legal for marijuana-related businesses to deduct rent and other business expenses from federal taxes is an effort “to respect the law” that state voters passed approving recreational marijuana sales.<sup>222</sup> Moreover, considering the country’s burgeoning budget deficit, the potential for billions of dollars in new federal tax revenue, arguably extracted from criminal enterprises, should not be taken lightly, as Steve DeAngelo noted:

There’s not really any other industry in the country—let alone one that can bring in tens of billions of dollars in tax revenue—that’s standing up and raising its hand and saying we’re ready to step up to the plate and help the country solve its problems, but we are. We hope Congress will hear us.<sup>223</sup>

Though marijuana business owners are trying to signal Congress that the time is now to legalize marijuana, saying it is the “perfect moment” as the nation faces a fiscal crisis,<sup>224</sup> it seems more realistic that members of the legislature will respond more favorably to an exception to the tax code that permits state-licensed businesses to deduct business expenses. Advocates of such reform wish only to be

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218. Gleckman, *supra* note 214.

219. *Id.* (“For instance, retailers could deduct costs such as rent, legal fees, and wages. And, like other small businesses, they might write off automobiles and office equipment. Growers could deduct the cost of farm equipment and the like.”).

220. Rob Hotakainen, *Marijuana Industry Eager To Pay Taxes—and Cash In on Deductions*, *McCLATCHY WASH. BUREAU* (Aug. 19, 2013), [http://www.mcclatchydc.com/2013/08/19/199598\\_marijuana-industry-eager-to-pay.html](http://www.mcclatchydc.com/2013/08/19/199598_marijuana-industry-eager-to-pay.html).

221. *Id.*

222. *Id.*

223. *Id.*

224. *Id.*

taxed like other small businesses, and hope that the revenue derived from marijuana sales may help Congress realize the lucrative opportunities legalized marijuana presents to this country.

#### IV. IMPACT

The potential success or failure of recently opened recreational marijuana stores in Colorado and Washington, and those projected to open in Alaska and Oregon, will undoubtedly shape the future of drug policy in the United States. Retailers in these states represent “the institution of a major new public policy in America,”<sup>225</sup> with legal marijuana expected to be one of the world’s fastest-growing business sectors<sup>226</sup> “What we’re witnessing now is a political movement giving birth to an economic awakening.”<sup>227</sup> States eager to reap these potential benefits are closely analyzing the legalization process and are waiting to see whether other states will be able to prevent marijuana from ending up in the hands of teenagers, the amount of tax revenue raised, and whether drug traffickers will divert marijuana across state lines.<sup>228</sup> Specifically, “[i]f [a state] is able to successfully legalize marijuana without causing a social backlash, the tourism, tax and other considerations are likely to compel several other states to quickly follow suit.”<sup>229</sup> However, under the current banking and tax system, state-licensed marijuana businesses are treated as illegal drug traffickers, and in the absence of congressional action, state lawmakers, marijuana business owners, and innovative law school professors have been left with their own devices to craft ways to make the industry workable.

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225. Niraj Chokshi, *Marijuana Sales Commence in Colorado for Recreational Use*, WASH. POST (Jan. 1, 2014), [http://www.washingtonpost.com/politics/marijuana-sales-commence-in-colorado-for-recreational-use/2014/01/01/977040d0-7320-11e3-8b3f-b1666705ca3b\\_story.html](http://www.washingtonpost.com/politics/marijuana-sales-commence-in-colorado-for-recreational-use/2014/01/01/977040d0-7320-11e3-8b3f-b1666705ca3b_story.html).

226. Bruce Barcott, *A Tale of Two Drug Wars*, ROLLING STONE, Jan. 16, 2014, at 35.

227. *Id.*

228. *Legal Sales of Recreational Marijuana Begin in Colorado*, DRUGFREE.ORG (Jan. 7, 2014), <https://www.drugfree.org/join-together/legal-sales-of-recreational-marijuana-begin-in-colorado>; *see also* Barcott, *supra* note 226, at 36.

There are a lot of ways this could go wrong. A rise in DUIs, increased child access, diversion across state lines, and some criminal element slipping into the regulated side of the industry. It could be as simple as a tractor-trailer full of marijuana stopped a mile across the Utah border.

Barcott, *supra* note 226, at 36.

229. Chokshi, *supra* note 225.

A group of state lawmakers in Washington, unsure of the current prospects for federal legislation, proposed the establishment of a state bank that would deal with all marijuana business.<sup>230</sup>

The state, rather than the [FDIC], would guarantee deposits, providing additional protections from federal seizure, while profits from banking operations would be returned to the state. As a lending institution, the trust would also help the state with an additional mission to “facilitate investment in, and financing of, public infrastructure system that will increase public health, safety, and quality of life, improve environmental conditions, and promote community vitality and economic growth.”<sup>231</sup>

Washington Senator Bob Hasegawa has been advocating for a state-run bank for years, modeled off of a successful state bank in North Dakota.<sup>232</sup> But industry and legal experts counter that state-owned banks are unworkable in states legalizing recreational marijuana because federal law specifically prohibits commercial banks from accepting deposits suspected of deriving from profits of illegal activity;<sup>233</sup> the bottom line is that the marijuana trade in federal legal terms is still illegal. According to Childears,

[F]ederal law says any entity that holds deposits from another person, transfers funds between parties as in checks, debit cards, wire transfers, or otherwise is connected to the payments system—the movement of money from one financial entity to another party—must abide by federal law. . . . Without the payment system, such an entity would amount to a big vault—cash in, cash out.<sup>234</sup>

While laudable in their efforts to create state solutions to state problems, it seems that state lawmakers are saddled with the recent DOJ and FinCEN guidance, which require banks to follow a detailed list of rules. The Colorado Bankers Association has deemed these

230. Rachel Estabrook, *Even with New Federal Guidance, Colorado Bankers Wary of Marijuana Business*, COLO. PUB. RADIO (Jan. 28, 2014), <https://www.cpr.org/news/story/even-new-federal-guidance-colorado-bankers-wary-marijuana-business>; see also David “Goldy” Goldstein, *A State-Run Marijuana Bank: It Would Solve Two Problems at Once*, STRANGER (Dec. 18, 2013), <http://www.thestranger.com/seattle/a-state-run-marijuana-bank/Content?oid=18503399> (“SB 5955 would address these problems by creating the ‘Washington publicly owned trust’ to accept deposits from government agencies and legal marijuana businesses. The state would be required to deposit marijuana tax revenue in the trust, although businesses would be free to use private banks if they chose.”).

231. Goldstein, *supra* note 230.

232. David Migoya, *State-Owned Bank Won’t Work for Marijuana Cash*, DENVER POST (Dec. 29, 2013, 12:01 AM), [http://www.denverpost.com/marijuana/ci\\_24805239/state-owned-bank-wont-work-marijuana-cash](http://www.denverpost.com/marijuana/ci_24805239/state-owned-bank-wont-work-marijuana-cash).

233. *Id.*

234. *Id.* (“Essentially, banks would be a safe-deposit-box operation for a cash business that couldn’t pay employees with checks or even cash-loaded cards.”).

guidelines a “red light,”<sup>235</sup> and according to the association’s senior vice president, Jenifer Waller, the government has made it very clear that financial institutions still face the risk of criminal liability.<sup>236</sup> Waller stated that she did not know of a single bank that has changed its position as a result of the federal guidance.<sup>237</sup> “Operating on a memo that is in conflict with the law is just unwise for any business, including financial institutions.”<sup>238</sup> Furthermore, according to the association’s president, Don Childears, the guidance “reiterates reasons for prosecution and is simply a modified reporting system for banks to use,” noting that “no bank can comply.”<sup>239</sup>

According to Childears, an act of Congress is likely the only remedy that will change how bankers deal with marijuana businesses, and for that to happen banks need to lobby Congress to enact reforms.<sup>240</sup> “At some point, you reach a tipping point in Congress where people are willing to move ahead and amend the Controlled Substances Act.”<sup>241</sup> Momentum for reform may be building given financial institutions’ negative reactions toward FinCEN’s and the DOJ’s attempted guidelines. Disapproval of the FinCEN guidance by our nation’s banks could be the needed momentum to garner support for H.R. 5016 currently pending in the Senate, which bars treasury and securities regulators from spending money to penalize financial institutions that work with legal marijuana businesses. If the measure passes, it could be the initial step to legislation explicitly allowing banks to service marijuana-related businesses in states where the drug is legal.

Currently, state-licensed medicinal marijuana sellers often utilize a tax loophole, which provides that when a dispensary is carrying on more than one line of business, the expenses attributable to the

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235. Herb Weisbaum, *Banks Balk on Marijuana Money Despite US Guidelines*, CNBC (Feb. 21, 2014, 8:05 AM), <http://www.cnbc.com/id/101433431>; see also Jacob Sullum, *The Feds’ Scary Reassurances to Banks That Deal with State-Licensed Marijuana Businesses*, FORBES (Feb. 17, 2014, 5:00 PM), <http://www.forbes.com/sites/jacobsullum/2014/02/17/the-feds-scary-reassurances-to-banks-that-deal-with-state-licensed-marijuana-businesses> (a Forbes Contributor blog). According to Don Childears, president of the Colorado Bankers Association, “After a series of red lights, we expected this guidance to be a yellow one. This isn’t close to that. At best, this amounts to ‘serve these customers at your own risk,’ and it emphasizes all of the risks. This light is red.” Sullum, *supra*.

236. Weisbaum, *supra* note 235.

237. *Id.*

238. *Id.*

239. Sullum, *supra* note 235.

240. Estabrook, *supra* note 230.

241. *Id.*

nonmarijuana line of business are not covered by § 280E.<sup>242</sup> In 2007, the Tax Court held that a business that both operated a marijuana dispensary and provided caregiving services to patients could separate its business expenses and deduct those expenses associated with the caregiving activities.<sup>243</sup> Though helpful to medical dispensaries, § 280E still dramatically increases the cost of operating a legitimate marijuana business, especially recreational stores, which effectively incentivizes the creation of illegal or quasi-legal businesses.

In the absence of congressional action or agency discretion, scholars in the field have also crafted novel ways to manipulate the tax code in order to prevent state-sanctioned marijuana businesses from feeling its punitive effects. Professor Benjamin Moses Leff from the American University Washington College of Law advocates that sellers avoid the impact of § 280E by qualifying as an exempt organization under § 501(c)(4) of the Internal Revenue Code, which exempts “social welfare” organizations.<sup>244</sup> “[Because] social welfare organizations, like charities, are exempt from federal income tax—they pay no tax on either gross revenue or net income—§ 280E does not affect them.”<sup>245</sup> Professor Leff, however, notes that the Supreme Court held that the “public policy doctrine acts as an absolute bar to exemption as a charity under § 501(c)(3),”<sup>246</sup> but argues that holding inapplicable to social welfare organizations.<sup>247</sup> Though novel and creative, Professor Leff explains that qualifying as a “social welfare organization” could negatively impact the operation of marijuana businesses.<sup>248</sup> For

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242. Joel S. Newman, *Deductions on a Higher Plane: Medical Marijuana Business Expenses*, LEXIS FED. TAX J.Q., Sept. 2013, at § 3.01, § 3.02, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2333969](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333969).

243. *Californians Helping to Alleviate Med. Problems, Inc. v. Comm’r*, 128 T.C. 173, 183–85 (T.C. 2007).

244. Leff, *supra* note 128, at 527.

To qualify as a § 501(c)(4) organization, a marijuana seller would have to meet four statutory requirements: (1) it must have a proper tax-exempt purpose; (2) it must not distribute its profits to any private persons; (3) it must avoid excessive campaign-related political activity; and (4) it must not operate in an excessively commercial manner.

*Id.*; see also 26 U.S.C. § 501(c)(4) (2012).

245. Leff, *supra* note 128, at 527.

246. *Id.* at 558.

The Supreme Court has held that the common law “public policy doctrine” prevents organizations from qualifying for tax-exempt status as charities if their charitable purposes are illegal or contrary to a well-established, fundamental public policy. Because marijuana sales are still illegal under federal law, the public policy doctrine acts as an absolute bar to exemption as a charity under § 501(c)(3).

*Id.* (footnote omitted); see also *Bob Jones Univ. v. United States*, 461 U.S. 574, 591 (1983).

247. Leff, *supra* note 128, at 558.

248. *Id.* at 527–28.

instance, owners would be unable to distribute profits to owners or managers, lessening opportunities to raise start-up capital.<sup>249</sup> Moreover, according to Kris Hermes of the Americans for Safe Access, “[T]he IRS will refuse to grant tax-exempt status to a business that the agency believes is violating federal law. Perhaps, it would be possible for a [retailer] to obtain 501(c)(4) status under false pretenses, but such status would not very likely withstand an IRS audit.”<sup>250</sup>

Whether it is by an act of Congress, agency discretion, or even innovative thinking by law school professors, something has to give to allow state-sanctioned marijuana retailers to distinguish themselves from illegal drug traffickers. Though there is no constitutional bar preventing the federal government from employing the tax code discriminatorily against state-sanctioned marijuana businesses, fairness alone demands a remedy given the Obama Administration’s nonenforcement policy<sup>251</sup> and given that § 280E was enacted long before marijuana was legalized in the states.<sup>252</sup> Framing the issue in the context of fairness might be the only way to garner enough congressional support for a proposed exception to § 280E for marijuana retailers in states where sales are legal,<sup>253</sup> or for the IRS to decide unilaterally to not enforce § 280E.<sup>254</sup>

## V. CONCLUSION

This Comment urges the federal government to alter existing banking and tax laws if it refuses to enforce the Controlled Substances Act’s marijuana prohibition and instead allows states to offer recreational marijuana for sale. Though criminal prosecution is perhaps the most potent weapon for undercutting state marijuana laws,<sup>255</sup> such action has been unnecessary due to the Obama Administration’s decision to exercise “broad discretion” in prosecuting violations of the CSA. Despite opposition to and frustration with this nonenforcement

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249. *Id.* (“A § 501(c)(4) marijuana seller also would have to refrain from distributing its profits to any managers or owners; it may have to limit the amount of campaign-related political activities it engages in; and it may have to operate in a less ‘commercial’ manner than ordinary, for-profit marijuana sellers.”).

250. Walker, *supra* note 193.

251. See Cole Memorandum, *supra* note 6, at 2.

252. See Green, *supra* note 129.

253. See Small Business Tax Equity Act of 2013, H.R. 2240, 113th Cong. (2013).

254. See Samuel D. Brunson, *Watching the Watchers: Preventing I.R.S. Abuse of the Tax System*, 14 FLA. TAX REV. 223, 227 (2013) (“[W]here no taxpayer suffers from direct harm, nothing in the tax law prevents the I.R.S. from misinterpreting or ignoring the law as written.”).

255. TODD GARVEY & BRIAN T. YEH, CONG. RESEARCH SERV., R43034, STATE LEGALIZATION OF RECREATIONAL MARIJUANA: SELECTED LEGAL ISSUES 21 (2013), available at <http://brian.carnell.com/wp-content/uploads/2013/05/ddbdc9e7fc44f0c30cefa14643d7fd7c.pdf>.

policy, it seems unlikely that a completely prohibitive marijuana regime will reacquire vigor prior to 2016. Therefore, congressional reform of federal banking and tax regulations is necessary for states to implement safe and well-regulated marijuana markets.

Currently, state-licensed marijuana stores are systematically denied access to banking services due to marijuana's classification as a Schedule I substance.<sup>256</sup> Financial institutions, unwilling to lose FDIC coverage or risk federal drug-racketeering charges, refuse to service marijuana retailers, leaving them without bank accounts and forced to conduct cash-only business.<sup>257</sup> Moreover, the current tax code discourages the creation of legitimate businesses, first, by penalizing marijuana business owners who are forced to pay employee-withholding taxes in cash; and second, with § 280E, enacted fourteen years before the legalization movement began,<sup>258</sup> which specifically targets marijuana retailers by preventing them from deducting business expenses, while affording the same tax breaks to prostitutes and contract killers.<sup>259</sup> Consequently, its punitive application is not only outrageous, but encourages tax evasion and black market sales.<sup>260</sup>

The implications of the Obama Administration's failure to amend current banking and tax regulations is the equivalent of actually enforcing the CSA; therefore, there is no feasible way for states to comply with the DOJ's stated objectives in the Cole Memorandum,<sup>261</sup> and thus they may become subject to federal prosecution. The 2013 Cole Memorandum requires that states impose effective regulatory frameworks to control marijuana sales, highlighting the need to address public safety concerns and discourage underground trafficking.<sup>262</sup> Such an endeavor will ultimately fail without access to financial services and without incentivizing state-sanctioned businesses to practice transparency. In light of the current national trend favoring legalization,<sup>263</sup> and given the amount of potential revenue at

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256. See Kovaleski, *supra* note 165, at A1.

257. See Grim & Reilly, *supra* note 108.

258. See Green, *supra* note 129.

259. See Leff, *supra* note 128, at 533.

260. See Matthews, *supra* note 213.

261. See Cole Memorandum, *supra* note 6, at 1–2.

262. See *id.*

263. See Ray Sanchez & Michael Martinez, *Colorado Pot Law Called Springboard for Other States*, CNN (Jan. 6, 2014, 10:29 PM), <http://www.cnn.com/2014/01/03/us/marijuana-laws-united-states/>.

stake,<sup>264</sup> the time is now for the federal government to choose—enforcement or reform.

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264. See Barcott, *supra* note 226.

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