PLANNING FOR UNIQUE, ILLIQUID, ILLEGAL AND UNUSUAL ASSETS: GOOD GRIEF, GRANDMA'S GOT A GUN COLLECTION!

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These materials are intended to provide the reader with guidance in estate planning. The materials do not constitute, and should not be treated as, legal advice regarding the use of any particular estate planning technique or the tax consequences associated with any such technique. Although every effort has been made to assure the accuracy of these materials, the author and Stoel Rives LLP do not assume responsibility for any individual's reliance on these materials. The reader should independently verify all statements made before applying them to a particular fact situation, and should independently determine both the tax and nontax consequences of using any particular estate planning technique before recommending or implementing that technique.

I. INTRODUCTION

This outline examines a few unusual and highly regulated assets that an estate planner may encounter from time to time, often after the client has died. While the list of unusual assets can be long, this outline examines issues in connection with planning for guns, wine, aircraft and cannabis. While the rules with respect to handling these assets can vary widely from state to state, this outline is intended to provide a broad overview.

II. GUNS AND GUN TRUSTS

When an estate includes firearms, a fiduciary must be careful to avoid violating federal, state, and local firearms laws. Federal law prohibits possession of and access to certain weapons, regulates the transfer of permissible weapons, and bars certain persons from owning or having access to firearms. Failure to comply with these laws may result in criminal liability, fines and forfeiture of any weapons involved.[1]

A. Regulatory Scheme.

First, an understanding of the basic regulatory scheme under federal and state law governing firearms is helpful. Federal firearms laws, codified under the Gun Control Act of 1968 (GCA), categorizes weapons as either Title I firearms or Title II firearms.

Title I of the GCA, 18 U.S.C. ch. 44, generally regulates the interstate disposition of rifles, shotguns, and handguns, the vast majority of guns privately owned in the United States.[2] State law generally regulates the intrastate transfer of Title I firearms.[3]

The National Firearms Act of 1934 (NFA), 26 U.S.C. ch. 53, regulates Title II firearms (also referred to as NFA weapons), which include automatic firearms (machine guns), silencers, short or short-barreled (that is, sawed-off) shotguns, short or short-barreled rifles, destructive devices (such as missile bearing rockets, grenades, and bombs), and "any other weapon."[4]

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[1] *See* I.R.C. §5872; 27 C.F.R. §479.182.

[2] *See* Gun Control Act of 1968, Pub. L. No. 90-618, 82 Stat. 1213 (codified at 18 U.S.C. §§921–931 (2006)).

[3] See http://smartgunlaws.org/ for a state by state summary of gun regulations. I-594, in Washington State, institutes background checks and certain additional notification requirements, for the possession and transfer of firearms by fiduciaries and their transferees. RCW 9.41.113. I-594 exempts the transferee (presumably a personal representative or trustee) of "a firearm *other than a pistol*" from its provisions where the firearm was acquired by operation of law upon the death of the former owner. RCW 9.41.113(4)(g) (emphasis added). The transferee who acquires a pistol upon the death of the former owner, however, must either lawfully transfer it (i.e., through a Federal Firearm Licensee), or notify the Department of Licensing that "he or she is in possession of the pistol and intends to retain possession of the pistol, in compliance with all federal and state laws." So, in theory, a fiduciary can transfer a long gun without having to notify the Department of Licensing, but not so a pistol (unless the transferee takes it to a Federal Firearm Licensee to effect a transfer).

[4] *See* I.R.C. §5845(a)–(h); 27 C.F.R. §479.11. The definition of "any other weapon" includes smooth-bore rifles, muzzle-loading cannons, and other somewhat exotic firearms.

The NFA Branch of the Bureau of Alcohol, Tobacco, Firearms, and Explosives ("BATFE," also known as the "ATF") administers the National Firearms Registration and Transfer Record (NFA Registry).[5] The transfer or possession of an unregistered Title II weapon is a criminal act covered by Code §5861(e).

Under the NFA, Title II weapons are subject to strict registration, transfer, and tax requirements.[6] It is illegal for any person to possess an NFA weapon that is not registered to that person in the NFA Registry.[7]

B. Transfer of an NFA Firearm.

Transferring an NFA weapon without complying with several NFA transfer rules[8] or possessing such a weapon is also illegal.[9] Transfer of a NFA firearm includes "selling, assigning, pledging, leasing, loaning, giving away or otherwise disposing of an NFA firearm."[10] When an individual transfers or purchases an NFA weapon, the Chief Law Enforcement Officer (CLEO) of the city or county where the individual resides must sign a document called a Form 4, Application for Transfer and Registration of Firearm.[11] Title II has a broad definition of *transfer*.

Any transfer is also subject to a transfer tax, and the transferor must submit and attach to the form a photo of the transferee, as well as the transferee's fingerprints in duplicate.[12] A Form 4 is also required for the transfer to a trust.[13] The transfer by a fiduciary requires the filing of Form 5, Application for Tax Exempt Transfer and Registration of a Firearm.

Finally, under federal law certain persons cannot possess or receive any firearms (whether Title I or Title II).[14] These excluded individuals include convicted felons, persons either adjudicated a "mental defective" or committed to a mental institution, and persons convicted of misdemeanor domestic violence offenses.[15] However, the list also includes categories that may not be so self-

[5] 27 C.F.R. §479.101.

[6] *See* I.R.C. §5861(d) (requiring the registration of certain particularly dangerous weapons under the NFA); *see also id.* §5845(a) (listing those weapons that require registration under title 18, section 5861(d) of the U.S. Code).

[7] *See* I.R.C. §5861(d). Other federal law prohibits possession of any machine gun not registered with BATFE by May 19, 1986. *See* 18 U.S.C. §922(o) (2006). Under the NFA, constructive possession will be treated the same as actual possession. *See United States v. Turnbough*, 114 F.3d 1192 (7th Cir. 1997).

[8] *See* I.R.C. §5861(e).

[9] *Id.* §5861(b).

[10] 26 U.S.C. §5845(j).

[11] *Id.* §5812; 27 C.F.R. §479.84–.85 (2011).

[12] *See* 27 C.F.R. §479.85.

[13] Until June 13, 2016, Form 5 did not require a photo or fingerprints, discussed below.

[14] *See* 18 U.S.C. §922(d), (g) (2006).

[15] *Id.* §922(g).

evident, including users of any illegal drug, dishonorably discharged veterans, and persons who have renounced their U.S. citizenship.[16]

What happens when a person previously permitted to own a firearm is no longer qualified to do so? In a May 2015 decision, the Supreme Court unanimously held that while a convicted felon is prohibited from possessing a firearm, nothing strips the individual of his property interest in the firearm, and thus he retains the right to sell or otherwise dispose of it.[17] In addition, the Court held that 18 U.S.C. §922(g) does not bar such a transfer if the court is satisfied that the recipient will not give the felon control over the firearm, so that he could either use it or direct its use.[18] In other words, the felon will not need to turn over his firearms to law enforcement; instead he may dispose of it by giving it to a friend or family member (a provision that could be inserted into a trust, discussed below).

C. Fiduciaries and Firearms.

Fiduciaries need to determine the registration status of firearms coming into their possession. Retroactive registration may not be an option, putting the fiduciary in the position of having to turn over an unregistered weapon to law enforcement. Transfers of firearms to satisfy bequests could subject a fiduciary, an heir, or both, to criminal penalties.[19] Life gets worse for both the fiduciary and an heir if the fiduciary unlawfully transfers an NFA weapon to an out-of-state heir.[20] Federal law makes it unlawful for certain categories of persons to ship, transport, receive, or possess Title II firearms. These categories include convicted felons, wanted fugitives, users of illegal controlled substances, individuals adjudicated as mentally defective or those committed to any mental institution, illegal aliens, those who have renounced U.S. citizenship, and individuals dishonorably discharged from the military.[21]

Appraisals, an integral part of any estate administration, can be problematic. Fiduciaries should only use appraisers who are licensed to take possession of the weapons to be appraised. Appraisers are usually licensed gun dealers. Before returning a weapon, an appraiser may ask the fiduciary to confirm that the he or she is lawfully able to possess a firearm. If the fiduciary is not, then the appraiser may not return the weapon.

Effective June 13, 2016, the Department of Justice added a new section to 27 C.F.R. Part 479 to address the possession and transfer of NFA items registered to a decedent. The new section clarifies that the executor, administrator, personal representative, or other person authorized under state law

[16] *Id.* §922(g)(3), (6)–(7); *see also* Nathan G. Rawling, *A Testamentary Gift of Felony: Avoiding Criminal Penalties from Estate Firearms*, 23 Quinnipiac Prob. L.J. 286 (2010) (discussing who may possess firearms, the various restrictions on transfer, and penalties for impermissible transfers).

[17] *Henderson v. U.S.*, 135 S. Ct. 1780 (2015).

[18] *Id.*

[19] *See* 18 U.S.C. §922(d).

[20] *See* I.R.C. §5861(b), (e).

[21] 18 U.S.C. §922(d), (g).

to dispose of property in an estate may possess a firearm registered to a decedent during the term of probate without such possession being treated as a "transfer" under the NFA. It also specifies that the transfer of the firearm to any beneficiary of the estate may be made on a tax-exempt basis. Because of the importance of this section, it is reproduced below:

> (a) The executor, administrator, personal representative, or other person authorized under State law to dispose of property in an estate (collectively "executor") may possess a firearm registered to a decedent during the term of probate without such possession being treated as a "transfer" as defined in §479.11. No later than the close of probate, the executor must submit an application to transfer the firearm to beneficiaries or other transferees in accordance with this section. If the transfer is to a beneficiary, the executor shall file an ATF Form 5 (5320.5), Application for Tax Exempt Transfer and Registration of Firearm, to register a firearm to any beneficiary of an estate in accordance with §479.90. The executor will identify the estate as the transferor, and will sign the form on behalf of the decedent, showing the executor's title (*e.g.,* executor, administrator, personal representative, etc.) and the date of filing. The executor must also provide the documentation prescribed in paragraph (c) of this section.
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> (b) If there are no beneficiaries of the estate or the beneficiaries do not wish to possess the registered firearm, the executor will dispose of the property outside the estate (*i.e.,* to a non-beneficiary). The executor shall file an ATF Form 4 (5320.4), Application for Tax Paid Transfer and Registration of Firearm, in accordance with §479.84. The executor, administrator, personal representative, or other authorized person must also provide documentation prescribed in paragraph (c) of this section.
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> (c) The executor, administrator, personal representative, or other person authorized under State law to dispose of property in an estate shall submit with the transfer application documentation of the person's appointment as executor, administrator, personal representative, or as an authorized person, a copy of the decedent's death certificate, a copy of the will (if any), any other evidence of the person's authority to dispose of property, and any other document relating to, or affecting the disposition of firearms from the estate. [22]

While federal law provides a safe harbor to the fiduciary, state and local laws may complicate the fiduciary's job. Several states have assault weapons bans that make it illegal to own some Title I weapons (mostly certain semi-automatic rifles, pistols, and shotguns) that would be legal to possess

[22] ATF-41F, 81 FR 2723, Jan. 15, 2016, codified at 27 C.F.R. §479.90a.

under federal law.[23] States or localities might further regulate or prohibit ownership of NFA weapons. State law must be reviewed for proper compliance, before transferring any weapon to another person.

Because of the potential liability a fiduciary faces when transferring a firearm to a beneficiary, a fiduciary may want to consider adding special provisions to a receipt when releasing a firearm to a beneficiary, such as the following:

> I certify that: I possess a valid, current [State] Weapons Carry License; I am legally entitled to receive, own, possess and use the Gun[s], under all applicable federal, state and local laws and regulations; I have no knowledge of, and I have never been informed of, any restrictions or prohibition on my right to receive, own, possess or use the Gun[s] or other such firearms; and I will fully comply with all federal, state and local laws and regulations regarding my ownership, possession and use of the Gun[s].

D. Gun Trusts.

Individuals may transfer NFA weapons to, and fiduciaries may purchase NFA weapons in, an entity, such as a corporation, limited liability company (LLC), or revocable trust, to avoid some of the rules that otherwise regulate such transfers. Individuals often opt for trusts because they avoid annual filing fees, public disclosure, or a separate tax return.[24] A trust designed specifically for the ownership, transfer, and possession of an NFA weapon may be known as a gun trust, NFA Trust, Firearm Trust, or Title II Trust. While a gun trust could be used to hold both Title II and Title I firearms, doing so could unwittingly subject Title I firearms to rules that would otherwise only apply to Title II firearms. (Ownership and transfer of Title I firearms can generally be handled through a standard estate planning revocable trust.)

According to IRS Info. Ltr. 2015-0039 (Dec. 24, 2015), a gun trust is still considered a "trust" for tax purposes under Treas. Reg. §301.7701-4 even when there are no ascertainable beneficiaries.[25]

While NFA firearms can only be transported and shot by their registered owner, a trust can name numerous trustees, each of whom may lawfully own the weapon without triggering transfer requirements. Once a weapon becomes a trust asset, any beneficiary may use it (including a trustee, but only if named as a beneficiary and not solely in a trustee capacity). Conversely, if an individual owner allowed another individual owner subject to trustee approval to use an NFA weapon not held in a trust, that use could be considered an unlawful transfer subject to criminal penalties. The trust

[23] *See, e.g.,* Cal. Penal Code §12280 (2009).

[24] David Goldman, an attorney in Jacksonville, Florida is credited with drafting the first gun trust, which he refers to as an NFA firearms trust, in 2007. *See* Margaret Littman, *Florida Lawyer Fashions Gun Trust (and Niche Practice),* A.B.A. J. (Feb. 1, 2011, 3:20 AM CST), http://www.abajournal.com/magazine/article/in_goldman_guns_trust.

[25] Dep't of the Treasury, Internal Revenue Service (Nov. 9, 2015), *available at* https://www.irs.gov/pub/irs-wd/15-0039.pdf (last visited May 1, 2016).

can name minors as beneficiaries, subject to any state mandated use restrictions, until they are old enough to possess the weapon outright. Moreover, the grantor can be a life beneficiary—although not the sole beneficiary (or the doctrine of merger will cause the trust to be disregarded).

A thorough discussion concerning the unique provisions of an NFA gun trust is beyond the scope of this article, but the provisions are numerous and complex. A standard revocable trust form is wholly inadequate in this context. The trust agreement should specifically state that its purpose is to own, possess, manage, and dispose of NFA firearms. The settlor need not be a trustee, however, the settlor may not use a trust-owned firearm unless also named as a trustee. Where multiple persons will use trust property, each should be named as a trustee.

Gun trusts may be irrevocable, but generally they are revocable so that the settlor may retain the power, among other things, to add or remove trust property, as well as add and remove beneficiaries.

Gun trusts have been popular historically because of the ability to avoid federal laws requiring an NFA trust to submit fingerprints or seek CLEO approval required for individual firearm purchases or transfers. Instead, the federal government would verify and investigate the application.[26]

Effective June 13, 2016, the Department of Justice amended the regulations of the BATFE regarding the making or transferring of a firearm under the NFA. [27] This final rule, referred to as "41F," defines a new term, "responsible person." A "responsible person" is any individual who possesses the power to direct the management and policies of a gun trust and includes persons with such power and those who have the power to receive, possess, ship, transport, deliver, transfer or otherwise dispose of a firearm for or on behalf of the trust.[28] Responsible persons include settlors, trustees and trust protectors of gun trusts. The purpose of this rule change was to apply identification and background check regulations uniformly to individuals, trusts and other entities.[29]

41F also requires *each* responsible person, in connection with a trust or legal entity holding an ATF firearm, to complete ATF Form 5320.23, entitled "Responsible Person Questionnaire" and to submit photographs and fingerprints when the trust or legal entity files an application to make an NFA firearm a trust asset. It requires that a copy of all applications be forwarded to the CLEO of the locality in which the applicant/transferee or responsible person is located. But it eliminates the requirement for a certification signed by the CLEO. The purpose of the new form is to ensure that the purported responsible person is not in fact a "prohibited person" who may not possess an NFA firearm.

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[26] *See* 18 U.S.C. §923 (2006 & Supp. 2010); 28 C.F.R. §25.1 (2010).

[27] 27 C.F.R. pt. 479, *as amended by* Docket No. ATF 41F; AG Order No. 3608-2016, Fed. Reg. Vol. 81, No. 10 (Jan. 15, 2016).

[28] 27 C.F.R. §479.11.

[29] *See* RIN 1140-AA43, 27 CFR Part 479 [Docket No. ATF 41F; AG Order No. 3608-2016, p. 214], Machineguns, Destructive Devices and Certain Other Firearms; Background Checks for Responsible Persons of a Trust or Legal Entity With Respect to Making or Transferring a Firearm, available at https://www.atf.gov/file/100896/download.

Any new responsible persons added to the trust now must submit Form 5320.23. If a trust was executed and funded prior to the new rules coming into effect, new beneficiaries may be added without having to comply with the responsible person questionnaire filing requirement.

The trust agreement can direct the disposition of NFA weapons in the event an owner becomes an excluded person by, for example, providing that upon a felony, the felon is no longer a "responsible person," and will therefore lose all ability to have direct or indirect use of the weapons in the trust and that the weapons will pass outright or in trust to the contingent beneficiaries.

A trustee has an obligation to safeguard firearms owned by a gun trust. The trust agreement should include details that provide guidance to the trustee and beneficiaries to assist them in avoiding unintentional violations of the NFA rules. Specifically, the trust agreement should provide which trustees and beneficiaries can have access to firearms and ammunition, under what circumstances, and what happens if a trustee, successor trustee, trust protector, or beneficiary becomes a "disqualified person." Persons who are not allowed to buy or own firearms cannot serve as trustees. The trust agreement should also require trustee compliance with any applicable transfer rules.

The risk created by new 41F is that a successor trustee appointment becomes effective and the new trustee is not aware of the need to qualify as a responsible person, thus failing to comply with 41F. Similar situations could arise for beneficiaries or for people later appointed to a trust containing firearms subject to 41F. New trusts should also contain guidance and savings language with respect to "responsible persons," to avoid non-compliance with 41F.

The trust may not permit the transfer a firearm to a person who may not lawfully buy or own firearms. The transfer of an NFA firearm into a trust or other entity will be subject to a transfer fee. Accordingly, a trustee often purchases NFA weapons directly to avoid the second transfer fee that would accrue if an individual purchaser purchased a weapon and then transferred it to the trust. While the transfer of an NFA weapon to an heir in satisfaction of a bequest is exempt from the transfer tax, such a transfer still requires the filing of Form 5\. Any distribution of a Title II firearm should not be permitted until approval of Form 5 has been obtained.

The trustee's power to change the trust name should be limited. Because a firearm is registered in the trust's name in the NFA Registry, a change in trust name would require re-registration of the firearms and payment of a transfer tax.

Because each state has different laws and local ordinances regulating firearms, unlike revocable trusts used for general estate planning purposes, trusts used to hold NFA firearms are not necessarily portable.[30] A gun owner desiring to cross state lines must still provide advance notice to the BATFE and receive approval. Generally, the BATFE will approve a 365 day period to multi-state use.

When drafting a gun trust, using a prohibition against the sale of a gun should be carefully considered and not simply included in the boilerplate. Some states have abolished the rule against

[30] *See* NFA Gun Trust Lawyer Blog, http://www.guntrustlawyer.com (last visited Mar. 30, 2016) (compiling applicable state laws).

perpetuities, allowing for perpetual trusts; but, only if the trustee has the power of sale. Those states may consider a trust void if it eliminates the power of alienation of trust property for longer than the perpetuities period. And even in some states without a rule against perpetuities, there may be a separate rule against the suspension of alienation.[31]

Gun trusts are not a panacea. They do not avoid constructive possession, which can occur when a gun owner leaves a firearm where a prohibited person or any other individual not allowed to possess the firearm resides or has access to such weapon. Gun trusts do not bypass rules regarding waiting periods nor do they avoid criminal liability if prohibited parties are allowed to use firearms.

Even with a gun trust, the trustee is responsible for determining the capacity of the beneficiary and the federal, state, and local laws that apply to the individual before allowing a beneficiary to use a trust weapon or distributing an NFA weapon to a beneficiary. Unlike a traditional revocable trust, which can be revoked at any time by the grantor, the BATFE must approve termination of the gun trust and distribution of its assets to its beneficiaries, as it would any other transfer. Nor may a trustee or beneficiary transport any of the assets across state lines where registered, without prior BATFE approval.

III. WINE

With the wine market expanding, nationally and internationally, it is not unusual for a fiduciary to come into the possession of a sizeable and valuable wine collection in an estate or trust. Ideally, this would not come as a surprise to the fiduciary or his counsel, because the estate planning attorney would have asked the clients at the planning stage whether their portfolio included unique assets that might require special care and/or a fiduciary with special knowledge. Often this is not the case.

It is important to keep in mind that wine is a regulated asset and, therefore, selling it is different from selling most other estate assets. The sale of wine in most states is subject to the three-tier system. This system is a byproduct of the Twenty-First Amendment of the U.S. Constitution. When first passed in 1933, it overturned the Eighteenth Amendment, which outlawed the manufacture, distribution, and sale of all types of alcoholic beverages in 1919 (with only a few exceptions regarding medicinal or religious uses).

As a result of the three-tier system, which is still in place in most states, retailers can only purchase alcohol from distributors, and distributors can only purchase from manufacturers or importers. The typical personal representative does not fit into any one of these categories and, therefore, must typically turn to someone who does.

A. Drafting for the Wine Collector.

At the planning stage, a collector should consider special provisions in his or her estate planning documents for the distribution of wine—whether to distribute to individuals, give to charity, sell at

[31] *See, e.g.*, N.C. Gen. Stat. §41-23 under which a trust may be voided if it suspends the power of alienation of trust property for longer than the applicable rule against perpetuities period.

auction, or store long-term, for either sale or consumption, in which case a wine trust should be considered. As discussed below, maintaining the collection, which will involve inventories, appraisals, insurance, storage, and transportation, comes at a steep price. There is also the option of simply having it consumed by the collector's loved ones at the funeral or memorial service. (Keep in mind that the value of the collection will still be included in the decedent's gross estate for estate tax purposes.)

When handling an estate, one of the fiduciary's first and most important jobs is to marshal the assets. This includes locating the wine collection. Often a fiduciary might use a personal property insurance rider as a guide to a client's most valuable assets. These are often incomplete as to typical valuables such as art and jewelry, and rarely list (or cover) fine wine. Therefore, a fiduciary is going to have to dig deeper, sometimes literally.

This might be an easy task for clients who have built sophisticated cellars to properly store and often display their prized wines. However, for most families, the wine is often located in basements so dusty and dirty that the identity of its contents can be obscured. On the other hand, the urban client might have what appears to be a small collection at home, but may have rented temperature controlled off-site storage for a collection, or at least for part of a collection that did not fit in the home storage. Moreover, the collector may also have placed orders for future distributions, even future releases, or may belong to a wine club that ships regularly. An older client may have decided to downsize a collection, and consigned bottles or cases to be sold. In other words, never assume that what you see is all there is. A thorough review of a collector's records (i.e., letters, faxes, confirmation emails, invoices, canceled checks, credit card bills, etc.) by a fiduciary is necessary to locate all of the bottles, present and future.

Planning ahead can increase the value of the wine, if sold, and increase the potential that it will be enjoyed, if left to individuals. Tasting notes and a spreadsheet as to when wine should be consumed will increase the chances that it is appreciated by heirs. There are a number of databases that can be used to keep track of relevant information that will be useful to the collector while alive, and later, fiduciaries, heirs, auction houses or other third party sellers, fiduciaries, heirs and potential buyers. New and more advanced apps come available all the time, but a few of the more popular inventory apps include CellarTracker, VinoCell, Vivino Wine Scanner, Wine Cellar Database, VNTG Wine Cellar, and Cellar-App, many of which are free or nearly free. Collectrium, owned by Christie's, is a high end full-service digital platform that allows all types of collectors to manage, value, track, insure, and transport their collections, as well as interact with their professional advisors.[32]

B. Advising the Fiduciary.

Like jewelry and artwork, the fiduciary has a duty to preserve and store a collection appropriately. If the fiduciary does not have experience with fine wine, he or she may need to be educated about the basics: store it on its side to avoid drying out the cork, do not store it on wood that emits fumes that

[32] *See* Collectrium, www.collectrium.com, a subscription cloud-based service that provides a platform to integrate all collection data, management, market information, and maintenance in one place. Similar programs are reviewed at http://www.gallerysoftware.com/.

could seep into the wine, and avoid sunlight, which degrades the wine over time. Storage should be not only humidity-and temperature-controlled (55˚ F is considered ideal by some), but secure. Stories abound of the fiduciary showing up with an appraiser to find that the collection had already been consumed by thirsty heirs. If the temperature is maintained with a heating or cooling system, it should have a backup power supply. It should also be protected from flooding and moisture damage. Humidity may not ruin wine, but it may ruin the label, causing a reduction in value, or worse, cause the label to melt off, reducing the value to zero. If that is done with a sump pump, it too needs a backup power supply. And on and on.

A fiduciary should not put off having a collection inventoried, and if appropriate, appraised. It is important to know the extent of the collection to determine whether it needs to be insured, or if the insurance in place is adequate. An appraiser will determine if wine is authentic, and then value it based on bottle fill level, label condition, cork condition, capsule condition, and color.[33]

If the estate is taxable for federal or state purposes, the fiduciary must ascertain the value of the collection at the time of the decedent's death or as of six months after the decedent's death, if the alternate valuation date is elected.[34] The necessity for an appraisal arises where one bottle of wine may have a value of more than $3,000, or a collection in its entirety may have a value that totals more than $10,000.[35]

C. Estate Tax Issues.

Wine is reported on Schedule F, "Other Miscellaneous Property Not Reportable Under Any Other Schedule," of the estate tax return. Even if consumed at the funeral, it is considered an asset of the estate (although the value might be deducted as a funeral expense). Liquidity (no pun intended) is going to be an important concern for the fiduciary of an estate. It may be necessary to sell some of the wine to raise funds for taxes. So, the fiduciary will need to begin planning early for the payment of estate tax on the illiquid "liquid assets." On the other hand, putting too much of one wine on the market at once may result in a blockage discount when it comes to pricing it, a concept borrowed from the securities market and now frequently used for the sale of large collections, such as art and wine.[36] Many contributing factors enter into the blockage discount, somewhat based on a sense of supply and demand. In other cases, factors such as the quality of the wine, whether the bottle is in pristine condition, or its rarity may be considered.

To protect against blockage discounts and allow wine to be sold over an extended period of time, or simply to hold wine to be consumed by extended family members, wine could be left in trust.

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[33] See Heritage Auctions, Key to Condition Descriptions and Bottle Sizes at https://wine.ha.com/information/wine-condition.s (accessed Apr. 17, 2018).

[34] Treas. Reg. §§20.2031-1(b), 2032-1(a).

[35] Treas. Reg. §20.2031-6(b).

[36] The IRS recognizes that the price may be depressed when multiple cases or bottles of the same wine are appraised or placed on the market. This is referred to as a blockage discount. Treas. Reg. §§20.2031-2(e), 25.2512-2(e).

If wine is to be distributed to an individual or charity, or auctioned off, the fiduciary should consider distribution as soon as feasible, to eliminate the risk of loss from theft or damage in the estate, and to reduce the expense of storage and insurance. In other circumstances, the decedent may not have left provisions in his or her estate plan for the distribution of the wine collection. Thus, a fiduciary may simply elect to sell the collection as part of settling the estate.

Prior to selling, however, the fiduciary must consider federal and state alcohol distribution laws. Some states still maintain a three-tier system for distribution of alcohol, put in place following the end of prohibition. In these states, individuals may only buy from retailers, who may purchase from importers or manufacturers. A few states allow direct sales to the consumer or have exceptions for brewpubs. And a few allow a one-time permit to sell from an estate. Otherwise, it is necessary to use an auction house to facilitate a sale.[37]

In those states that permit private sales, many require accommodation sale permits, which allow an individual or business to sell a private collection of wine or spirits to another individual or business. In Washington, for example, a permit is issued by the Washington State Liquor and Cannabis Board (WSLCB), which allows the one-time sale of a private collection to a licensee. Both the seller and buyer must be located in Washington State.[38]

D. Practice Tips.

Trusts should not be forgotten as a planning tool for a wine collection meant to be held long-term. When wine is left in trust, the fiduciary should waste no time in making arrangements for long-term storage. If collectors opt for a trust, they should also direct that sufficient funds be distributed to the trust to maintain the collection.

A wine trust is a good candidate for a trust protector. A trust should either name one or contain a mechanism for the appointment of one. The trust agreement could give a trust protector the power to remove and replace fiduciaries, periodically check on the wine, and review trust records, including records of sales, auction results, and consignment agreements. The trust should also contain a provision for termination—when the wine has been sold, drunk, or otherwise liquidated. Or, perhaps, when the inventory reaches a certain level, the remaining bottles could be donated to charity.

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[37] More and more places conduct wine auctions now – not just Christie's. Beyond Christie's, a fiduciary may also look to organizations such as New York-based Scarsdale, Zachy's, winebid.com, winecommune.com or Chicago-based Hart Davis Hart to auction the estate's wine collection.

[38] "Where the application is for a special permit by an individual or business to sell a private collection of wine or spirits to an individual or business. The seller must obtain a permit at least five business days before the sale, for a fee of twenty-five dollars per sale. The seller must provide an inventory of products sold and the agreed price on a form provided by the board [LIQ1289 Application for Accommodation Sale Permit]. The seller shall submit the report and taxes due to the board no later than twenty calendar days after the sale [LIQ1290 Accommodation Sale Inventory Report]. A permit may be issued under this section to allow the sale of a private collection to licensees, but may not be issued to a licensee to sell to a private individual or business which is not otherwise authorized under the license held by the seller. If the liquor is purchased by a licensee, all sales are subject to taxes assessed as on liquor acquired from any other source." RCW 66.20.010 (16).

Alternatively, a client who holds wine solely for investment purposes and not for personal enjoyment or consumption, may want to establish a wine LLC. This would allow a third-party professional to manage the collection. That entity could survive the death of the owner/member, and could continue to be managed in the owner's estate, relieving an untrained fiduciary from having to handle a complex and valuable asset class.

IV. AIRCRAFT

Aircraft ownership and registration is a technical area not typically familiar to the average estate planning attorney. The following is by no means a thorough examination of the laws applicable to aircraft owners. Rather, it outlines considerations for the attorney advising aircraft owners with respect to estate planning, and fiduciaries who find themselves in possession of aircraft. It is, as they say, just enough to make you dangerous. It should also cause sufficient fear to convince you to seek the help of an expert any time things with wings in an estate plan are involved.

Aircraft include airplanes, rotorcraft, gliders, and anything else that may become airborne and is required to be registered with the Federal Aviation Administration (FAA). Planning should also cover an interest in a fractional ownership program, hangar leases, long-term service contracts, expensive aviation equipment, and certain aircraft components and parts.

Because aircraft are generally depreciating assets and expensive to use and maintain, they are not ideal assets for lifetime gifting. However, they often show up on the inventory of a high-net-worth decedent's estate. Because aircraft can be quite valuable, illiquid, and subject to multiple regulatory schemes, they can make an estate administrator's job extremely complex.

Federal excise tax, as well as state sales and use tax, while not discussed in detail below, must also be addressed when advising clients regarding the purchase or lease of aircraft.

The FAA's Aircraft Registration Branch regulates aircraft registration and transfers.

Like cars, weapons, and cannabis (in states where legal), aircraft are highly regulated. Aircraft owners must be registered with the FAA civil aircraft registry.[39] Owners may include individuals and entities, including trusts. Where an owner is a non-U.S. citizen, specialized trusts or corporations are required. Failing to follow the strict regulations of the FAA can result in an invalid registration, leading to a cascade of further problems, including loss of insurance coverage.

A. Transfer of Ownership.

[39] 49 U.S.C. §44102; 14 C.F.R. §47.3. Documentation required for registration includes original signed documents filed with the FAA, a bill of sale transferring title (which reflects a complete chain of title from the last registered owner), and an Aircraft Registration Application (AC Form 8050-1, found at https://www.faa.gov/forms/index.cfm/go/document.information/documentID/185220), which requires detailed information regarding the aircraft and the owner, and proof of citizenship of the individual owners or the underlying owners of an entity (for trusts, all trustees and beneficiaries must be U.S. citizens unless a "non-U.S. citizen trust" is used, in which the beneficiary is not a U.S. citizen but the trustee-owner is).

Transfer of an aircraft is accomplished using FAA form "Aircraft Bill of Sale," available online at http://www.faa.gov/documentLibrary/media/form/ac8050-2.pdf. Where an estate or trust is involved, additional rules apply. When a transfer is by an estate executor or administrator, a certified copy of Letters of Administration or Letters Testamentary must be included. Where no probate was conducted, an heir may submit an affidavit attesting to a lack of probate and legal entitlement to ownership. A trustee may transfer ownership by including a certified copy of the court order appointing the trustee or, if no court order is involved, a certified copy of the trust instrument.

B. Taxation Basics.[40]

Many states impose a personal property sale or use tax on transfers of aircraft, in addition to annual excise taxes. For example, information regarding registration and taxation of aircraft in Washington is found at http://www.wsdot.wa.gov/aviation/registration/register3steps.htm. Washington imposes an annual excise tax on any aircraft, with limited exceptions, used within the state.[41]

If an aircraft is first delivered in a state without a sales tax, it still may be subject to use tax if later brought into a state that imposes one. If sales tax was previously paid, use tax may be imposed on the difference between the state's sales or use tax and the tax paid to the state where the sale occurred. A fiduciary delivering aircraft to a beneficiary in another jurisdiction must keep these potential taxes in mind when completing the transfer.

Keep in mind that some states, like Washington, consider an aircraft owned by a non-resident to be based in-state if it has spent more than 90 days in the state during any 12-month period, subjecting the aircraft to use tax in that state.[42] This is true even if the aircraft is legally based and pays tax in another state.

Most states consider transfers of aircraft to a revocable trust not to be a taxable event.[43] Nevertheless, in some jurisdictions, taxes may be imposed when ownership is restructured and even when ownership of the aircraft is transferred to a trust simply for estate planning purposes.[44] Moreover, some jurisdictions tax the transfer of a plane by a corporation or partnership to one of its affiliates solely for liability protection purposes.[45]

C. Ownership Through an Entity.

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[40] A good resource for taxes applicable to aircraft owners is maintained by the Aircraft Owners and Pilots Association (AOPA), *available at* http://www.aopa.org/Pilot-Resources/Aircraft-Ownership/The-Pilots-Guide-to-Taxes.aspx (last visited Apr. 17, 2018).

[41] RCW 82.48.020, 82.48.100 (exempt aircraft).

[42] RCW 8.48.100(3).

[43] *See, e.g.*, Cal. Rev. & Tax Code §6285(b); 68 Okla. Stat. §6003(17).

[44] *See, e.g.*, 35 Ill. Comp. Stat. 157/10-15.

[45] *See, e.g.*, Fla. Admin. Code r. 12A-1.007(25)(d). *But see* 23 Va. Admin. Code §10-220-5 (transfer to corporate affiliate is exempt).

An LLC or corporate entity is often used to hold aircraft and shelter the owner's other assets from the high possibility of owner or operator liability. For estate planning purposes, revocable trusts are commonly used simply for probate avoidance, but they do not afford liability protection. To obtain both liability protection and probate avoidance, a revocable trust may hold interests in the entity to which the aircraft is registered, but raises new issues, discussed below.

D. Trusts.

A trust holding an airplane is a type of purpose trust.[46] Similar to the structure of an Illinois Land Trust, the trustee is the titled and registered owner of the aircraft, but the beneficiary has the right to dissolve the trust at any time and return possession of the aircraft back to him- or herself, or on to a qualified third party. Furthermore, the FAA has the right to obtain information directly from the owner/operators because, in spite of the trust structure, they have non-delegable regulatory obligations to the FAA. Typically, the beneficiary will be the one to insure the aircraft, and to operate and maintain it in accordance with FAA requirements.

Also similar to an Illinois Land Trust, title to the aircraft can be transferred at any time from the trustee to any party designated by the beneficiary using an FAA form bill of sale. This, however, would have the effect of cancelling the aircraft's registration. The trustee cannot sell the aircraft without the beneficiary's direction. While this is an inherent aspect of a trust holding aircraft, it should be specifically provided in the trust instrument.

The trust agreement should create an affirmative duty on the part of the aircraft operator (where the operator is not the beneficial owner) to regularly maintain and provide current information regarding the aircraft and its operations.

The FAA imposes a number of requirements for trusts holding aircraft. Under Federal Aviation Regulation (FAR) 47.7(c), each trustee must be either a U.S. citizen or a resident alien.[47] The trustee must also submit an Affidavit of Citizenship from each trustee, a copy of the trust agreement, and an Aircraft Registration Application to the FAA. If the trustee does not want to make a representation regarding the citizenship of the beneficiary, the beneficiary must provide a separate affidavit of citizenship.

Again, states may subject the transfer of title to a special purpose entity to sales or use tax.

E. Advising the Trustee.

If a trust was established during the grantor's lifetime, a successor fiduciary should, immediately upon appointment, confirm that registration with the FAA and airworthiness directives (ADs) are all in good standing. ADs are legally enforceable regulations issued by the FAA in accordance with 14 C.F.R. Part 39 to correct an unsafe condition in a product. Part 39 defines a product as an aircraft,

[46] A purpose trust exists to carry out a specific objective, in this case holding and maintaining aircraft, rather than for the benefit of individual beneficiaries.

[47] U.S. citizen is defined for FAA purposes under 14 C.F.R. §47.2.

engine, propeller, or appliance. Note that ADs[48] are delivered electronically or by paid subscription, so a search of the grantor's email may be necessary. A periodic review of the FAA website by product name for applicable ADs is also a prudent practice. If ADs are not timely acted upon, registration may lapse.

Aircraft can be registered to a single applicant as trustee, or to several applicants as co-trustees. To register, the trustee(s) must submit:[49]

- An affidavit showing that each beneficiary under the trust is either a U.S. citizen or a resident alien. This includes each person whose security interest in the aircraft is incorporated in the trust. If any beneficiary is not a U.S. citizen or a resident alien, the trustee must provide an affidavit stating that the trustee is not aware of any reason or relationship that would give the non-citizen a share of control greater than 25% to influence or limit the exercise of the trustee's authority. Furthermore, the trust agreement must provide that those persons together may not have more than 25% of the aggregate power to direct or remove a trustee for cause.[50]

- A certified copy of the complete trust instrument and a "copy of each document legally affecting a relationship under the trust."[51]

- An original signed bill of sale from the present registered owner to the trustee(s).

- An original application for registration showing the trustee(s) as applicant, signed by the trustee(s).

- A $5 registration fee payable to the FAA.

If a client prefers to use an existing trust or a trust organized for a different purpose to own the aircraft, the trust agreement will need to be amended in order to satisfy the FAA requirements mentioned above. The FAA must approve all trust agreements used to register an aircraft. Because the agreement will be shared with the FAA, confidentiality of the terms regarding other assets held in a trust will be lost. Where confidentiality is a concern, clients should use a single purpose trust for aircraft.

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[48] Airworthiness Directives, both current and historical, may be found here: http://www.airweb.faa.gov/Regulatory_and_Guidance_Library/rgAD.nsf/MainFrame?OpenFrameSet.

[49] For more information, download the form at Information to Aid in the Registration of U.S. Civil Aircraft, AC Form 8050-94 (Feb. 2009).

[50] 14 C.F.R. §47.7(c)(3). While the C.F.R.s do not define "cause," the FAA's Notice of Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations Involving Non-U.S. Citizen Trustors and Beneficiaries, 78 Fed. Reg. 36,412 (June 18, 2013), refers to the Restatement of Trusts as illustrative of the definition, and suggests that willful misconduct and gross neglect satisfy this limitation.

[51] 14 C.F.R. §47.7(c)(2)(i).

Finally, like in a family cabin trust, the grantor should be encouraged to fund the trust with either a substantial endowment or a life insurance policy to fund the maintenance and operation of the aircraft in the future. Without this sinking fund, it is not likely that multiple family members will be able to agree upon how to maintain the aircraft, and it will likely be sold.

F. Corporations and LLCs.

It is important that a client have a clear understanding of the type of conduct qualifying as commercial versus non-commercial use. FAA regulations classify aircraft into various categories, generally commercial and non-commercial, and grant airworthiness certificates authorizing aircraft for flights under one of these categories. An owner who operates aircraft for personal use holds a certificate under 14 C.F.R. Part 91 of the FAA regulations. The personal use regulations impose significantly less stringent operational and maintenance standards than those applicable to charter carriers, which may include family offices (under 14 C.F.R. Part 135) and airline carriers (under 14 C.F.R. Part 121).

The inclination in estate planning is to use an entity—a corporation or LLC—to own property with which risk is associated, to shield a client from liability. However, where the sole purpose for an entity's existence is to hold title to aircraft, there is a risk that this will be considered a commercial arrangement, subject to the more stringent rules applicable to charter carriers under 14 C.F.R. Part 135.

Under Part 91, the owner/user of the aircraft is responsible for full control over the operation of the aircraft. The flight crew may not operate the plane for compensation. Practically speaking, the owner must also be the operator. The mere fact that the owner/operator funded the expenses of a flight crew has brought the operator within the definition of a commercial operator and no longer covered by Part 91. The practical solution to this problem is typically to have the owner/operator enter into a "dry lease" arrangement with an entity, which provides support services, including pilots, crew and maintenance.

The FAA classifies aircraft leases as either "dry leases" or "wet leases."

Under a dry lease, the aircraft owner provides only the aircraft and no crew to the lessee.[52] An entity may be formed for the sole purpose of ownership of an aircraft by the lessor. It may lease that aircraft without a crewmember or any other amenities to a related company or party, the lessee. The lessee is considered to be in "operational control" of the aircraft in a dry lease arrangement, and provides its own flight crew, maintenance, and any other amenities. Dry leasing is not considered a commercial operation from the FAA's perspective as long as the pilots do not have a financial or employment relationship with the lessor.

A wet lease is a leasing arrangement, defined under FAR 91.501(c)(1), whereby the lessor of an aircraft provides the aircraft, crew, maintenance, and any other services required by the lessee. The

[52] 14 C.F.R. §91.1001(b)(2).

lessee typically pays the lessor based on hours operated. The lessee may also be required to cover the cost of fuel, airport fees, and any other fees.

Operation under the wrong certificate is subject to steep fines.[53] On top of the fines, insurance coverage is contingent on the aircraft being operated in compliance with FAA regulations, and may be lost if an operator is not covered by the proper certificate.

It is important to note that a power of attorney used to transfer ownership in an aircraft must either contain a stated expiration date or expire by its own terms three years from the date it was signed.[54]

G. Private Foundations.

A note about families that use their aircraft for personal or business use as well as their private foundation business. It is imperative that the foundation bear the cost of this travel.

The IRS has addressed self-dealing with respect to private foundations and private foundations.

In one case involving the rental of a charter aircraft by a disqualified person to a private foundation, the IRS ruled that the rental was an act of self-dealing even if the rate charged is comparable to rates charged by other aircraft companies. [55] But in another case, the IRS ruled that a disqualified person may provide free use of a plane to a private foundation, which is not an act of self-dealing. [56] In this case, the furnishing of "goods, services or facilities" by a disqualified person to the Foundation was not self-dealing because the airplane was furnished without charge, and even though the Foundation paid for its transportation cost in using the airplane, those costs were paid to an unrelated party and no portion of such cost was reallocated or credited back to any disqualified person.[57]

H. Practical Alternatives to Aircraft Ownership.

Some families are attached to their planes, especially those with historic, sentimental, or collectible value. However, for the client who strictly wants to provide the convenience of private travel to her heirs, she might consider the advantages of fractional ownership or a jet card.[58] The testator needs to realize that once a plane passes to multiple heirs, it cannot be in two places at once, making its use even harder to allocate than the family cabin, which at least stays in one place. Either

[53] 14 C.F.R. §13.305(d) (providing for fines of $11,000 for each violation of operating under a Part 91 certificate rather than a Part 135 certificate).

[54] See Form REGAR-94 Information to Aid in the Registration of Imported Aircraft par. 33 (last updated April 2017) available at https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/media/REGAR-94.pdf.

[55] Rev. Rul. 73-363, 1973-2 CB 383.

[56] PLR 9732031 (May 14, 1997).

[57] Treas. Reg. §53.4941(d)-3.

[58] Some of the more popular fractional ownership companies include NetJets, FlexJet or FlightOptions; and popular charter jet card arrangements are provided through companies such as Marquis Jet (a division of NetJets), Blue Star Jets, Skyjet and JetCard.

arrangement— fractional ownership or a jet card (akin to an expensive Starbucks card)—can provide the family with on-demand transportation with less cost, liability, and opportunity for family strife.

V. CANNABIS

A. Introduction.

For decades, cannabis[59] transactions in the United States have been conducted on what essentially is the black market. In the last few years, many states have moved to legalize, tax, and regulate cannabis for medical and/or recreational purposes.

Since 1970, cannabis is considered a Schedule I substance under the federal Controlled Substances Act (CSA)—up there with heroin, LSD, and cocaine. Unauthorized cultivation, distribution, or possession of cannabis and knowingly or intentionally manufacturing, distributing, or dispensing it are federal crimes, unless used for federally approved research.[60] Federal law also makes illegal certain financial transactions connected to unlawful activity, including transferring monetary instruments or funds with the intent to promote the carrying on of specified unlawful activity, including the manufacture, importation, sale, or distribution of a controlled substance.[61]

As of January 2018, 29 states, Guam, Puerto Rico, and the District of Columbia permit its use for medical reasons, and eleven states for recreational purposes.[62] Retail sales are permitted in Alaska, California, Colorado, Nevada, Oregon, and Washington, with Maine and Massachusetts set to begin later this year. Washington, D.C. permits recreational use but not retail sales, and not on federal property, which significantly limits the application of the law.[63] Vermont permits recreational use but not retail sales effective July 1, 2018.[64]

While the lack of legal clarity at the federal level adds greater confusion to the already complex area of law, it is not likely that, after gaining such momentum so quickly, that it will come to an abrupt halt anytime soon. According to studies by Arcview Market Research, legal cannabis is among the

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[59]The terms "marijuana" and "cannabis" are often used interchangeably. Furthermore, some consider the term "marijuana" to have a pejorative connotation. For background on the derivation and meaning of these terms see Jon Gettman, *Marijuana Vs. Cannabis: Pot-Related Terms to Use and Words We Should Lose*, High Times (Sept. 10, 2015), available at http://hightimes.com/culture/marijuana-vs-cannabis-pot-related-terms-to-use-and-words-we-should-lose/.

[60] Controlled Substances Act, 21 U.S.C. §831(a). Very narrow exceptions to the federal prohibition do exist. For example, one may legally use marijuana if participating in a Federal Drug Administration-approved study or in the Compassionate Investigational New Drug program.

[61] Money Laundering Control Act of 1986, 18 U.S.C. §1956, §1957.

[62] See National Conference of State Legislatures, State Medical Marijuana Laws (Sept. 14, 2017), http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx, regarding the current status of the law concerning recreational and medical use, state-by-state.

[63] Initiative 71, also known as the *Legalization of Possession of Minimal Amounts of Marijuana Personal Use Act of 2014*.

[64] Vermont House Bill 511 (Jan. 22, 2018).

fastest-growing markets in the United States.[65] Arcview estimates that $9.2 billion worth of legal cannabis was sold in 2017, up from $6.7 billion in 2016.[66]

Because legalized and decriminalized cannabis is becoming a national and international issue, estate planners to consider cannabis as an asset, and sometimes an investment, perhaps the way we might currently plan for a wine collection, except for the fact that, unlike wine, cannabis is still illegal under federal law.

The path to how some states have navigated these punitive statutes and passed legislation allowing the medical and even the recreational use and sale of marijuana is not a straight line. Below is a description of the major points on that path. But, it is not yet clear that the path is a completely legal one. For the brave, yet cautious, the following is a general overview of the federal and state legal landscape and discussion of the estate planning, tax and ethical considerations for attorneys giving advice where cannabis is part of an estate plan or probate.

B. Federal Law.

1. The Ogden Memo.

When states began legalizing marijuana, the Department of Justice (DOJ) made it clear that it intended to pursue any commercial enterprise selling or producing cannabis. On October 19, 2009, Deputy Attorney General David W. Ogden (under Attorney General Eric Holder) issued a memorandum known as the "Ogden Memo" confirming that the DOJ remained "committed to the enforcement of the [CSA] in all States."[67] However, given the DOJ's "limited investigative and prosecutorial resources," the Ogden Memo advised U.S. Attorneys to focus on prosecuting "significant marijuana traffickers" and not on those whose actions are in "clear and unambiguous compliance with existing state laws providing for the medical use of marijuana."[68]

2. Cole Memoranda.

In light of the developments at the state level, Ogden's successor, U.S. DOJ Deputy Attorney General James Cole issued a memorandum ("Cole I") expressing the DOJ's position that the federal government will not pursue legal challenges in jurisdictions that authorize marijuana use, assuming those state and local governments maintain strict regulatory and enforcement controls on marijuana

[65] *See The State of Legal Marijuana Research, 5th ed*. available at https://arcviewgroup.com/research/.

[66] *Id.*

[67] Deputy Attorney General David W. Ogden, U.S. Department of Justice, Memorandum for Selected United States Attorneys, *Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana* at 1 (Oct. 19, 2009), https://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf.

[68] *Id.* at 1-2.

cultivation, distribution, sale, and possession that limit the risks to "public safety, public health, and other law enforcement interests."[69]

Then, in August 2013 a communication known as "Cole II" expanded on Cole I. It makes clear that the Ogden Memo was never intended to shield from federal enforcement action and prosecution marijuana related cultivation and distribution for medical use or lower level marijuana-related crimes already being prosecuted by state laws.[70] But Cole II instructs federal prosecutors to prioritize their "limited investigative and prosecutorial resources to address the most significant [cannabis-related] threats."[71]

3. Enforcement Guidelines Regarding Cannabis Under the Trump Administration.

Early in the Trump administration, Attorney General Jeff Sessions privately reassured some Republican Senators that he would not deviate from the Obama-era policy of allowing states to implement their own marijuana laws except for the enforcement priorities outlined in the Ogden and Cole Memos, which gave local control to federal prosecutors to determine how and where to deploy Justice Department resources in the fight the country's drug crisis. Then, in early January 2018--four days after retail marijuana became legal in California--Attorney General Sessions that he would be rescinding the Obama-era policy and free federal prosecutors to aggressively enforce federal marijuana laws.[72] This announcement appears to be an attempt to wage a war that has already been lost. Not only did he fail to recognize that his boss, President Donald Trump, had previously made it clear that he had no objection to the legalization of marijuana at the state level. But, in the same month, the Pew Research Center found 61% of Americans supportive of legalization, with support reaching 70% among millennials.

Even those Americans who have no intent to participate in the cannabis industry are tired of the fact that too many people have spent too much time in jail for possession of small amounts of marijuana and current laws have had a disproportionate effect on minority communities.

Furthermore, a majority of Americans now live in the 29 states and D.C., where they have some form of legal cannabis - medical, recreational, or both.

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[69] James M. Cole, Deputy Att'y Gen., Memorandum for United States Attorneys: Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use (June 29, 2011).

[70] James M. Cole, Deputy Attorney General, Memorandum for All United States Attorneys, *Guidance Regarding Marijuana Enforcement* (Aug. 29, 2013), http://www.justice.gov/iso/opa/resources/305201382913275685746 7.pdf.

[71] *Id*. at 1. It identified eight activities as those that the federal government wants most to prevent, which include: (i) distribution to children; (ii) use of revenue to further other criminal enterprises; (iii) diverting cannabis from states that have legalized its possession to states that prohibit it; (iv) using authorized cannabis activity as a pretext for the trafficking of other illegal drugs; (v) using firearms or violent behavior in the cultivation and distribution of cannabis; (vi) exacerbating public health and safety risks due to cannabis use, including driving while under the influence of cannabis; (vii) growing cannabis on public land; and (viii) possessing or using cannabis on federal property.

[72] Jefferson B. Sessions, III, Attorney General, Memorandum for All United States Attorneys, Marijuana Enforcement (Jan. 4, 2018) available at https://www.justice.gov/opa/press-release/file/1022196/download.

Since then the administration seems to have backed off from that position with an announcement by Republican Sen. Cory Gardner on Friday, April 13, 2018 that he had received assurances from the president that he would support legislation protecting the marijuana industry in states that have legalized its use.[73] The latest development came last Friday, April 21st, when the Senate's minority leader Charles Schumer (D-NY) announced that he is introducing legislation to decriminalize marijuana.

While these announcements add to the confusion as to which laws will apply going forward, without an increase in resources it is not likely that the industry projected to bring in billions of dollars in tax revenue in California alone in the next few years will shut down without a fight.

C. Treasury Department Guidance.

In addition to the guidance issued by the DOJ, the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department, issued its own guidance in 2014 to clarify Bank Secrecy Act (BSA) expectations for financial institutions seeking to provide services to cannabis-related businesses in light of state initiatives to legalize certain cannabis-related activity. In addition to the guidance issued by the DOJ, the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department, issued its own guidance in 2014 to clarify Bank Secrecy Act (BSA) expectations for financial institutions seeking to provide services to cannabis-related businesses in light of state initiatives to legalize certain cannabis-related activity.[74]

Thorough customer due diligence is a critical aspect of making this assessment. In assessing the risk of providing services to a cannabis-related business, a financial institution is obligated to conduct customer due diligence that includes:

1. Verifying with the appropriate state authorities whether the business is duly licensed and registered;

2. Reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its cannabis-related business;

3. Requesting from state licensing and enforcement authorities available information about the business and related parties;

[73] Nicholas Riccardi, Associated Press, *Trump Vows to Back Law to Protect Marijuana Industry*, New York Times (Apr. 13, 2018, 7:25 P.M. E.D.T.) available at https://www.nytimes.com/aponline/2018/04/13/us/ap-us-trump-marijuana.html.

[74] James M. Cole. Deputy Att'y Gen., Memorandum for All United States Attorneys: *Guidance Regarding Marijuana Related Financial Crimes* (Feb. 14, 2014), *available at* https://dfi.wa.gov/documents/banks/dept-of-justice-memo.pdf. *See also* https://www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses.

4. Developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type[s] of customers to be served (e.g., medical versus recreational customers);

5. Ongoing monitoring of publicly available sources for adverse information about the business and related parties;

6. Ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and

7. Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.[75]

The FinCEN guidance points out that the 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. 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.[76] In addition, under the FinCEN guidance, a financial institution that decides to provide financial services to a cannabis-related business would be required to file a Suspicious Activity Report if the financial institution knows, suspects, or has reason to suspect that a transaction involves funds derived from a cannabis-related business.

Finally, based on recent statements from current Attorney General, Jeff Sessions, there is an indication that under the Trump administration, the Department of Justice may--or may not--do more to enforce federal marijuana laws.[77] Early in the Trump administration, Attorney General Jeff Sessions privately reassured some Republican Senators that he would not deviate from the Obama-era policy of allowing states to implement their own marijuana laws except for the enforcement priorities outlined in the Ogden and Cole Memos.[78] However, in early January 2018-- four days after retail marijuana became legal in California--Attorney General Sessions did an about-face and announced that he would be rescinding the Obama-era policy and free federal prosecutors to aggressively enforce federal marijuana laws. However, he did not order them to do so.

Sessions' policy announcement would let U.S. attorneys across the country decide what federal resources to devote to marijuana enforcement. While this announcement adds to the confusion as to which laws apply, without an increase in resources it is not likely that the industry projected to bring in billions of dollars in tax revenue in California alone in the next few years will shut down without a fight.

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[75] *Id.*

[76] *Id.*

[77] Attorney General Jeff Sessions, U.S. Department of Justice, Memorandum for All United States Attorneys, Marijuana Enforcement (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196/download.

[78] http://www.politico.com/story/2017/03/jeff-sessions-marijuana-crackdown-senators-react-235616.

D. State Law.

In spite of the many federal roadblocks, the sale and use of recreational cannabis first became legal after voters approved an amendment to the Colorado Constitution in the November 2012 elections. Many states had legalized small amounts of medical cannabis before 2012, starting with California in 1996, and many have legalized both recreational and medical use since then.[79] Generally, states limit possession, use, and ownership of retail licenses based on age, residency, and criminal history.

Each state's laws differ. Below is a summary of the laws currently in effect in California, Colorado, Alaska, Washington and Oregon.

1. California.

California adopted Proposition 215, the Compassionate Use Act of 1996 (CUA), which provided that seriously ill Californians had the right to obtain and use marijuana for medical purposes.[80] With the passage of the CUA, patients and primary caregivers did not risk criminal prosecution (under California law) for obtaining and using marijuana upon the recommendation or approval of a California-licensed physician.[81]

Prop. 215 applies to physicians, osteopaths and surgeons who are licensed to practice in California, and their primary caregivers. A "primary caregiver" is narrowly defined under Prop. 215 to be "the individual designated [by a legal patient] who has ***consistently assumed*** responsibility for the housing, health, or safety of that person." Under Prop 215, individual patients and their caregivers may possess and cultivate as much as is required for the patient's persona medical use.

California's medical marijuana law was expanded by SB 420, the Medical Marijuana Protection Act (MMPA), on January 1, 2004.[82] Among other things, the MMPA defined who is a qualified patient, primary caregiver, or attending physician, and what constitutes a serious medical condition for which marijuana may be used.[83] It also authorized patient organized "cooperatives" or "collectives" to grow, distribute and/or sell medical marijuana on a **non-profit** basis to their members. It allows designated primary caregivers who *consistently* attend to patients' needs to charge for their labor and services in providing marijuana. It also mandated a voluntary state ID card system run through county health departments so that law enforcement could identify legitimate users under the law.[84]

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[79] *See, e.g.*, Melia Robinson, Business Insider, It's 2017: Here's Where You Can Legally Smoke Weed Now (Jan. 8, 2017), http://www.businessinsider.com/where-can-you-legally-smoke-weed-2017-1.

[80] Cal. Health & Safety Code §11362.5.

[81] Cal. Health & Safety Code §11362.5(d).

[82] California H&SC 11362.7-.83.

[83] *Id.* at § 11362.7.

[84] *Id.* at § 11362.71.

The MMPA also established guidelines as to how much marijuana patients and their caregivers could grow and possess.[85] The state default guidelines are 6 mature plants or 12 immature plants per patient, and 8 ounces of dried marijuana. By state law, individual counties and cities are allowed to set higher but not lower limits; however cities and counties may outlaw cultivation altogether.

In 2008, the California Attorney General's office issued additional guidelines for medical marijuana enforcement explaining its interpretation of SB 420 and Prop. 215. The guidelines note that storefront "dispensaries" are not explicitly recognized in state law, but that a "properly organized collective or cooperative" may legally dispense medical marijuana through a storefront *provided* it complies with certain conditions.

In 2015 California's legislature enacted a licensing and regulatory system for medical marijuana businesses, the Medical Cannabis Regulation and Safety Act (MCRSA), which took effect January 1, 2016. It established permitting for marijuana cultivation and dispensaries. Under MCRSA, qualified patients can cultivate up to 100 square feet for personal medical use, and primary caregivers with five or fewer patients are allowed up to 500 square feet. As under SB 420, local governments may further restrict or even ban the cultivation of medical cannabis. MCRSA provided for the sale of retail medical marijuana beginning in 2018.

Then, in 2016, California passed Proposition 64, known as the Adult Use of Marijuana Act (AUMA). AUMA paved the way for the implementation of a system to regulate, tax, and treat recreational marijuana by adults over age 21 similar to alcohol. Retail recreational marijuana became available beginning January 1, 2018.

As in other states, Prop. 64 still specifically allows employers to continue to prohibit marijuana use by its employees. Medical marijuana patients can be fired for failing an employment drug test.

On June 27, 2017 Governor Jerry Brown approved SB 94, entitled the Medical and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA).[86] MAUCRSA joined the medical and recreational systems, MCRSA and AUMA. By doing so, the more industry-friendly rules of the AUMA, such as allowing applicants to obtain licenses in different phases of the industry—cultivation, manufacture, distribution and retailing—could apply to the medical sector. It eliminated the restriction on vertical integration under the MCRSA. It also authorizes the issuance of temporary special-event licenses, and removed the California residency requirement for license applicants.

California created an information portal to access regulations and applications as they become available.[87] The California Department of Food and Agriculture has also published a checklist of

[85] *Id.* at § 11362.77.

[86] Codified at BPC Code Div. 10. Cannabis [26000 - 26231.2], available at https://leginfo.legislature.ca.gov/faces/codes_displayexpandedbranch.xhtml?tocCode=BPC&division=10.&title=&part=&chapter=&article= as modified by Assembly Bill 133 (Sept. 16, 2017) available at https://leginfo.legislature.ca.gov/faces/codes_displayexpandedbranch.xhtml?tocCode=BPC&division=10.&title=&part=&chapter=&article=.

[87] https://cannabis.ca.gov/ and https://aca5.accela.com/bcc/Welcome.aspx.

information required for the application for licenses, when they became available on January 1, 2018.[88]

2. Colorado.

Colorado took a different path. In November 2012, Colorado voters approved an amendment to the Colorado Constitution to ensure that it "shall not be an offense under Colorado law or the law of any locality within Colorado" for an individual 21 years of age or older to possess, use, display, purchase, consume, or transport one ounce of cannabis, or to possess, grow, process, or transport up to six cannabis plants.[89]

The amendment also provides that it shall not be unlawful for a cannabis-related facility to purchase, manufacture, cultivate, process, transport, or sell larger quantities of cannabis so long as the facility obtains a current and valid state-issued license. However, the amendment expressly permits local governments within Colorado to regulate or prohibit the operation of such facilities.

Colorado's law also sets forth a three-tier distribution and regulatory system involving the licensing of cannabis cultivation facilities, cannabis product manufacturing facilities, and retail cannabis stores.

Unlike the relatively specific Washington initiative (discussed below), Colorado's constitutional amendment provided only a general framework for the legalization, regulation, and taxation of cannabis in Colorado—leaving regulatory implementation to the Colorado Department of Revenue.

On September 9, 2013, the Colorado Department of Revenue and State Licensing Authority adopted regulations to implement licensing qualifications and procedures for retail cannabis facilities. The regulations establish procedures for the issuance, renewal, suspension, and revocation of licenses; provide a schedule of licensing and renewal fees; and specify requirements for licensees to follow regarding physical security, video surveillance, labeling, health and safety precautions, and product advertising.[90]

In late 2013, the Colorado Marijuana Enforcement Division issued its first recreational cannabis licenses to 348 businesses (136 retail stores, 31 product companies, 178 growing facilities, and 3

[88] https://cannabis.ca.gov/wp-content/uploads/sites/13/2017/03/17-188_Application_Checklist_v2.pdf. See also http://cannabis.ca.gov/wp-content/uploads/sites/13/2017/09/Temporary-License-Application-Information.pdf for additional licensing information. (A temporary license is a conditional license that will allow a business to engage in commercial cannabis activity for a period of up to 120 days. Within that 120 day period, the business must apply for a permanent license. If a permanent license is not obtained within that period, provided that it is not the fault of the applicant, the state will grant extensions to the temporary licensee until the full license is issued.) The Bureau can only issue a temporary license if the applicant has valid license, permit, or other authorization issued by the local jurisdiction. Cal. Bus. & Prof. Code §26050.1.

[89] Colo. Amend. 64 (2012), *amending* Colo. Const. art. XVIII, §16(3), www.fcgov.com/mmj/pdf/amendment64.pdf (last visited Jan. 2, 2018).

[90] *Id.*

testing laboratories).[91] While these businesses were granted state approval to produce and sell cannabis, they may have also needed to gain additional licensing approval from local governments prior to their operation.

In Colorado, to be eligible to apply for a Colorado Retail Marijuana Business License, all owners must meet each of the following statutory requirements:

1. Must be a resident of Colorado for two years prior to application;

2. Must be 21 years of age;

3. May not have any controlled substance felony conviction in the 10 years immediately preceding his or her application date;

4. May not have any other felony convictions that have not been fully discharged for five years immediately preceding his or her application date;

5. May not be financed in whole or in part by any other person whose criminal history indicates he or she is not of good moral character (after considering the factors in Colo. Rev. Stat. § 24-5-101(2)) and reputation satisfactory to the respective licensing authority;

6. May not have a criminal history that indicates that he or she is not of good moral character after considering the factors in Colo. Rev. Stat. § 24-5-101(2);

7. May not employ, be assisted by, or financed, by any other person whose criminal history indicates he or she is not of good character and reputation;

8. May not be a sheriff, deputy sheriff, police officer, or prosecuting officer, or an employee of a local or state licensing authority; and

9. May not employ any person at the retail cannabis business who has not passed a criminal history record check.[92]

3. <u>Alaska.</u>

Alaska passed Measure 2 on November 4, 2014, legalizing recreational use of cannabis by adults. Measure 2 went into effect 90 days later, on February 24, 2015, and regulations were issued governing retail licenses, zoning, what kind of products may be sold and to whom.[93]

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[91] John Ingold, *Colorado Issues First Licenses for Recreational Marijuana Businesses,* Denver Post, Dec. 23, 2013.

[92] Colo. Rev. Stat. §12-43.4-306.

[93] Alaska Stat. ch. 17.37

The following is a summary of the law, which can be found in more detail on the Alaska Department of Commerce, Community and Economic Development, Alcohol & Marijuana Control Office web site at: https://www.commerce.alaska.gov/web/amco/MarijuanaFAQs.aspx.

a. Use. Like alcohol, adults 21 and over can possess, consume, and purchase products from a recreational marijuana store. All recreational products must be consumed in Alaska. There are limits as to how much you can possess at any one time. Growing your own marijuana plants for personal use, privately and away from public view in a secure place is legal for adults 21 and over. Property owners can ban the cultivation of marijuana on their property. Multiple people living in a single residence cannot combine personal-use plants and/or harvested marijuana limits to increase the amount of marijuana they can possess and cultivate in their residence. Any violation of the cultivation rules is subject to a fine.

b. Medical Marijuana. Medical marijuana has been legal in Alaska since 1998. Measure 2 does not affect the medical marijuana system. The possession rules are the same as those for recreational use. Measure 2 provides that "nothing in this chapter shall be construed to limit any privileges or rights of a medical marijuana patient or medical marijuana caregiver."[94]

c. Purchasing Marijuana. Licensed recreational stores are the only outlets that may sell marijuana in Alaska.

d. Consumption. It's legal to use cannabis products in Alaska on private property and outside the view of the general public. Marijuana may not be consumed in public[95,] on federal land, and on some Indian reservations.[96] An employer is under no obligation to accommodate even the medical use of marijuana in any workplace.[97]

> Lieutenant Governor Byron Mallott released an emergency regulation defining "in public" as "a place to which the public or a substantial group of persons

[94] Alaska Stat. 17.38.010(d).

[95] Alaska Stat. 17.38.040.

[96] Monty Wilkinson, Director of the Executive Office for U.S. Att'ys, *Policy Statement Regarding Marijuana Issues in Indian Country* (Oct. 28, 2014), available at https://www.justice.gov/sites/default/files/tribal/pages/attachments/2014/12/11/policystatementregardingmarijuanaissuesinindiancountry2.pdf.

[97] Alaska Stat. ch. 17.38.

has access."[98] Consumption in a banned place may be fined.

e. Enforcement. Measure 2 specifically states it makes no changes to Alaska impaired driving laws, which already contained a provision for driving under the influence of an intoxicating substance.

f. Commercial Licenses. The State of Alaska Alcohol & Marijuana Control Office issues four types of licenses to approved parties, which include: (i) Marijuana cultivation facilities and growers, (ii) Marijuana product manufacturing facilities – the processors that turn plants into bud, extracts, and other cannabis products; (iii) Marijuana testing facilities – the testers who will make sure products meet quality control requirements, and (iv) Marijuana retail stores – the shops that will sell weed and cannabis products to adults 21 and over

g. Taxes.

(1) Income Tax. Alaska's corporate income tax applies to the cannabis industry.

(2) Sales Tax. Alaska does not impose a general sales tax and no sales tax applies to cannabis.

(3) Excise Tax. Alaska imposes an excise tax on the sale or transfer of marijuana from a marijuana cultivation facility to a retail marijuana store or marijuana product manufacturing facility. Alaska Stat § 43.61.010, 15 Alaska Admin Code § 61.100. Although certain parts of the marijuana plant are exempt from the excise tax or are subject to tax at a lower rate. Alaska § 43.61.010(b). The excise tax does not apply to the sale of medical marijuana.

4. Washington.[99]

On November 3, 1998, Washington voters approved Ballot Initiative 692,[100] making small amounts of cannabis legal for medical purposes. The Washington Supreme Court ruled in 2010 that "I-692

[98] Memorandum from the Office of Lieutenant Governor Alaska, Emergency Regulations re: definition of "in public" (3 AAC 304.990), Feb. 24, 2015 available at https://aws.state.ak.us/OnlinePublicNotices/Notices/Attachment.aspx?id=98820.

[99] For a brief history of cannabis legislation in Washington see Wikipedia contributors, *Cannabis in Washington (state)*, Wikipedia, The Free Encyclopedia, https://en.wikipedia.org/wiki/Cannabis_in_Washington_(state) (accessed Apr. 17, 2018) and for FAQs on current legislation see Washington State Liquor and Cannabis Board FAQs, available at https://lcb.wa.gov/mj2015/faqs_i-502 (accessed Apr. 17, 2018).

[100] Codified at RCW ch. 69.51A.

did not legalize marijuana, but rather provided an authorized user with an affirmative defense if the user shows compliance with the requirements for medical marijuana possession."[101]

Two years later, Washington voters approved Ballot Initiative 502, an initiative amending state law to provide that the possession of small amounts of cannabis by individuals over the age of 21 is not a violation of Washington law. In addition, the initiative provided that the "possession, delivery, distribution, and sale" by a validly licensed producer, processor, or retailer, in accordance with the regulatory scheme administered by the Washington State Liquor and Cannabis Board (formerly known as the Washington State Liquor Control Board) (WSLCB), is not a criminal or civil offense under Washington state law.[102] Nevertheless, an employer is under no obligation to accommodate the medical use of cannabis in any place of employment. Additionally, an employer may terminate an employee based on a failed drug test even where employee is a qualifying patient engaged in only at-home use of medical cannabis.[103]

The initiative established a three-tier production, processing, and retail licensing system, similar to Colorado's, that permits the state to retain regulatory control over the commercial life cycle of cannabis.[104] As with alcohol after Prohibition, those in the cannabis industry are barred from complete vertical integration.

The WSLCB adopted detailed rules for implementing the initiative, including cannabis license qualifications and an application process, application fees, cannabis packaging and labeling restrictions, recordkeeping and security requirements for cannabis facilities, reasonable time, place, and manner advertising restrictions, and taxation.

The recreational use of cannabis is regulated and taxed in a manner similar to alcohol, although at a significantly higher rate.[105] Retail licensees are required to collect and remit to the WSLCB an excise tax of 37 percent on all taxable sales of cannabis, cannabis concentrates, useable cannabis, and cannabis-infused products.[106] In addition, Washington's business and occupation tax and sales tax also apply. Because both the cannabis and sales taxes are based on the price charged by the retailer, recreational customers in Seattle end up paying almost 50 percent in taxes that are added at the register.[107]

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[101] *State v. Fry*, 168 Wn. 2d 1, 10, 228 P.3d 1, 6 *(*2010*).*

[102] Wash. Ballot Initiative 502, §4 (2012). See Washington State Liquor and Cannabis Board, Know the Law, http://lcb.wa.gov/mj-education/know-the-law, and FAQS on Marijuana, http://lcb.wa.gov/mj2015/faqs_i-502 (last visited Jan. 2, 2018), for detailed explanations of Washington cannabis law.

[103] RCW ch. 69.51A.

[104] *Id*.

[105] RCW ch. 69.50.

[106] RCW 69.50.535 and WAC 314-55-089.

[107] The 37 percent marijuana excise tax plus Seattle's 10.1 percent sales tax rate equals an overall rate of 47.1 percent in taxes that are collected from the customer.

The WSLCB is prohibited from issuing a license to: (a) an individual under the age of 21 years; (b) a person doing business as a sole proprietor who has not lawfully resided in the state for at least six months prior to applying for a license; (c) a partnership, employee cooperative, association, non-profit corporation, or corporation, unless it is formed under the laws of the state, and unless all of the members thereof are qualified to obtain a license; or (d) a person whose place of business is conducted by a manager or agent, unless the manager or agent possesses the same qualifications required of the licensee.[108] Applicants must have been Washington residents for six months prior to submitting their application.[109] The WSLCB may conduct a criminal background information check, and consider any prior criminal conduct of the applicant, including an administrative violation history record with the WSLCB.[110]

Unless an applicant is able to capitalize a business with cash, they face harsh regulations regarding financing. Washington requires that all capital contributed to a business must be declared before a license will be issued. Any additional contributions to capital or loans (except loans from chartered financial institutions) must be approved by the WSLCB. As a result, unlike other commercial operations in Washington, cannabis businesses need to maintain large cash reserves to create a safety net for the unexpected.

Prior to the passage of I-502, a qualifying patient or designated provider could lawfully use, produce, possess, or administer cannabis to treat a terminal or debilitating illness. A qualifying patient or designated provider could not be arrested, prosecuted or subject to other criminal sanctions or civil consequences for possession, manufacture, or delivery, or possession with intent to manufacture or deliver, of cannabis under state law. Qualifying patients could possess amounts of cannabis in various forms as specified under the statute. In 2015, Senate Bill 5052 brought medical cannabis under the system and rules of I-502.[111]

Recently, the Washington legislature closed a gap in the law caused by the merger of the two systems. Medical cannabis patients could grow cannabis for personal use, but had no legal pathway to acquire plants. Engrossed Substitute Senate Bill 5131 (ESSB 5131), signed by Governor Inslee on May 16, 2017, and effective July 23, 2017,[112] allows qualifying patients and their designated caregivers to purchase plants and cultivate plants for personal use, and join state-registered medical cannabis cooperatives to grow cannabis with up to four other patients. Those who hold a recognition card issued by the state are able to grow and purchase larger quantities.

ESSB 5131 added a number of additional restrictions on production, processing and selling cannabis in Washington, including intellectual property disclosure requirements, restrictions on advertising,

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[108] RCW 69.50.331.

[109] WAC 314-55-020(10) and RCW 69.50.331 (1)(b).

[110] *Id*.

[111] Adopts a comprehensive act that uses the regulations in place for the recreational market to provide regulation for the medical use of cannabis.

[112] Amending scattered sections of RCW ch. 69.50 and RCW ch. 69.50 and other sections of the RCW.

restrictions on the term "organic," and changes in the number of licenses and stores an individual or entity may own, making it the most highly regulated of the states permitting recreational cannabis.[113]

Both Washington and Oregon require licensees to track certain information. One purpose of the tracking is to comply with the Cole memo and demonstrate that the state is complying with the federal directive to protect the state's legal cannabis operations from federal prosecution. In accordance with WAC 314-55-083(4), Washington cannabis licensees must track cannabis from seed to sale to prevent diversion, promote public safety, and collect tax revenue. That information is submitted to the WSLCB along with excise taxes. Licensed cannabis producers, processors, and retailers are free to employ their own inventory tracking system as long as it complies with the WSLCB's seed-to-sale inventory rules. Since October 31, 2017 the state has contracted with Leaf Data Systems operated by MJ Freeway to track data and licensees, and licensees are required to enter their data through that system.

Finally, Washington strictly governs the operation of a business of a deceased or incapacitated license holder:

> WAC 314-55-140: Death or incapacity of a cannabis licensee.
>
> (1) The appointed guardian, executor, administrator, receiver, trustee, or assignee must notify the WSLCB's licensing and regulation division in the event of the death, incapacity, receivership, bankruptcy, or assignment for benefit of creditors of any licensee.
>
> (2) The WSLCB may give the appointed guardian, executor, administrator, receiver, trustee, or assignee written approval to continue cannabis sales on the licensed business premises for the duration of the existing license and to renew the license when it expires.
>
> (a) The person must be a resident of the state of Washington.
>
> (b) A criminal background check may be required.
>
> (3) When the matter is resolved by the court, the true party(ies) of interest must apply for a marijuana license for the business.[114]

5. Oregon.[115]

[113] The Bill may be found at http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/Session%20Laws/Senate/5131-S.SL.pdf.

[114] WAC 314-55-140.

[115] For frequently updated information see Wikipedia contributors, "Cannabis in Oregon," *Wikipedia, The Free Encyclopedia*, https://en.wikipedia.org/w/index.php?title=Cannabis_in_Oregon&oldid=835816748 (accessed April 15,

In 2014, voters in Oregon approved a ballot measure legalizing the recreational use of cannabis. Measure 91, the Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act, allows Oregonians over the age of 21 to cultivate limited amounts of cannabis on their property and to possess and gift limited amounts of recreational cannabis, plants and products for personal use as of July 1, 2015. Adults in their homes may also lawfully cultivate, possess and use certain amounts, so long as they are out of the public view. As in Washington, use is prohibited in public places, near schools and in public view.

Generally, as in Washington, cannabis retailers may not be located within 1,000 feet of a school and licensed businesses must be located in an area that is appropriately zoned. In addition, local jurisdictions have authority to adopt reasonable regulations regarding the location of cannabis businesses, including regulations requiring that the businesses be located no more than 1,000 feet from one another. Oregon does not apply the 1,000-foot regulation to other places that minors might frequent, such as playgrounds, child care centers, public parks, public transit centers, and libraries. However, local governments may pass an ordinance to allow for a reduction in the 1,000-foot buffer requirement to 100 feet around all entities except elementary and secondary schools and public playgrounds.

Measure 91 also gave the Oregon Liquor Control Commission (the "OLCC) authority to tax, license and regulate recreational cannabis grown, sold, or processed for commercial purposes. Unlike almost all other products sold in Oregon, cannabis and cannabis-infused products are subject to a 17 percent state sales tax.[116] In addition, local governments may impose an additional local sales tax not to exceed 3 percent.

Since October 1, 2015, adults 21 years or older and their designated caregivers have been able to purchase cannabis, plants and products from medical dispensaries.[117] The OLCC began accepting applications for growers, wholesalers, processors and retail outlets on January 4, 2016.[118] Unlike in Washington, where no vertical integration is permitted, a person or business entity may hold one or more types of licenses.

Oregon made an attempt to prohibit employers from restricting or penalizing off-duty cannabis consumption by employees and making its use similar to tobacco (with exceptions for collective bargaining agreements and consumption that would impair performance).[119] Several business and schools groups, including Oregon School Boards Association, the Oregon Association of Hospitals and Health Systems and Associated General Contractors – Oregon Columbia Chapter argued that

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2018) and *OLCC Marijuana Program: Frequently Asked Questions (all)* available at http://www.oregon.gov/olcc/marijuana/Documents/MJ_FAQS.pdf (updated March 30, 2018).

[116] ORS 475B.705.

[117] SB 460 (2015). The Medical Marijuana Act is codified beginning at ORS 475.300.

[118] See http://www.oregon.gov/olcc/marijuana/Documents/BusinessReadinessGuide_Recreational Marijuana.pdf and http://www.oregon.gov/olcc/marijuana/pages/default.aspx for a guide to cannabis businesses, and recreational and medical use in Oregon.

[119] *See, e.g.*, SB 301 (2017).

forced compliance with such a state law would prevent compliance with the federal Drug-free Workplace Act, which would endanger federal grants and contracts. A subsequent attempt to cover only medical cannabis cardholders also failed.[120]

A number of bills were passed in the 2017 legislative session, overhauling cannabis regulations. Oregon still regulates medical cannabis, recreational cannabis and hemp by way of three separate agencies: recreational and medical cannabis are regulated by the OLCC; medical cannabis is also regulated by the Oregon Health Authority; and industrial hemp is regulated by the Oregon Department of Agriculture. Senate Bill 302, effective April 21, 2017, removed cannabis-related offenses from the Oregon Uniform Controlled Substances Act, placing them instead in a category similar to alcohol-related crimes.

Oregon has contemplated, to a limited extent, what happens to cannabis in a decedent's estate. ORS 475B.033 provides: "The Oregon Liquor Control Commission may, by order, provide for the manner and conditions under which: (1) Cannabis items left by a deceased, insolvent or bankrupt person or licensee, or subject to a security interest, may be foreclosed, sold under execution or otherwise disposed. (2) The business of a deceased, insolvent or bankrupt licensee may be operated for a reasonable period following the death, insolvency or bankruptcy." Unlike Washington, Oregon does not provide a clear procedure for continuation of a decedent's business. Presumably, like Washington, any beneficiary and/or operator of a cannabis business would need to independently qualify to hold any applicable licenses and permits.

6. Industrial Hemp: Washington and Oregon.

Industrial hemp and recreational cannabis are varieties of the *cannabis sativa* plan hybridized for different purposes.[121] Industrial hemp is used for its fiber and seed oil. By both federal and state law, industrial hemp must contain less than 0.3 percent tetrahydrocannabinol (also known as "THC) (the psychoactive chemical compound in cannabis), on a dry weight basis.

Industrial hemp is legal for very limited purposes under federal law. Section 7606 of the Agricultural Act of 2014 provides that "an institution of higher education...or a state department of agriculture may grow or cultivate industrial hemp if...the industrial hemp is grown or cultivated for purposes of research conducted under an agricultural pilot program or other agricultural or academic research."[122]

In Washington, industrial hemp is no longer a Schedule I controlled substance as of July 23, 2017, but it may only be grown or processed and marketed within the research goals of the Industrial

[120] Proposed Amendments to SB 301 introduced April 14, 2017.

[121] Matt Price, *What Is Hemp? Understanding the Differences Between Hemp and Cannabis*, MedicalJane, *available at* https://www.medicaljane.com/2015/01/14/the-differences-between-hemp-and-cannabis/ (accessed Apr. 17, 2018).

[122] 7 U.S.C. 5940.

Hemp Research Pilot (IHRP).[123] The IHRP licenses research concerning the growth, cultivation and marketing of industrial hemp. The research structure may allow for exploring the commercial viability of industrial hemp agriculture in the future.

Applications for industrial hemp licenses in Washington were first issued on May 15, 2017. Licenses expire annually and you must reapply each year.

Production, possession and commerce in industrial hemp have been legal in Oregon since Jan. 1, 2010 (SB 676). In 2015, the Oregon Department of Agriculture finalized rules implementing the Oregon Industrial Hemp Program. The Oregon Department of Agriculture issues licenses to cultivate and process industrial hemp, and to produce and sell agricultural hemp seed.

In the 2017 legislative session, Oregon passed Senate Bill 1015, which provides regulations concerning the transfer of hemp concentrates and extract by growers to processors licensed by the OLCC. In addition to being used traditionally for rope, hemp is also used in a broad range of consumer products, including clothing, cosmetics, construction materials, food, fuel and paper. Hemp in Oregon is processed to extract a non-psychoactive component called cannabidiol, or CBD, used topically for medicinal purposes.

E. Cannabis in the Estate Plan.

It is likely that more and more estate planners will find themselves in the position of advising clients with cannabis-related assets, and how to handle the potentially tremendous revenue in, light of federal banking, money-laundering and other regulations.

The first hurdle will be the client intake procedure. There are two general categories of potential clients in the cannabis arena: (1) clients that have direct contact with cannabis because they manufacture, distribute, or sell marijuana in compliance with state law, and (2) third parties that assist or advise on cannabis topics and refer clients to the businesses with direct contact. These include doctors, bankers, investors, lawyers, landlords, real estate brokers, accountants, and ancillary service providers. The first category carries more risk.

The lawyer may want to consider a questionnaire and/or a criminal background check to be certain that the potential client may engage in such business activities. It would also be prudent, in the attorney's engagement letter, to disclose to the potential client that because cannabis is illegal under federal law, if the federal law were to enforce the CSA against activities otherwise lawful under state law, the terms of representation would have to be revisited and representation may have to be terminated. A client should understand that the risks associated with a cannabis business under federal law, include federal prosecution, fines and imprisonment. The attorney should consider advising the client that if he or she engages in violations of applicable state law, or in a manner that

[123] "[I]ndustrial hemp is an agricultural product that may be grown, produced, possessed, processed, and exchanged in the state solely and exclusively as part of an industrial hemp research program supervised by the department [of agriculture]." RCW 15.120.020.

would be cause for federal prosecution under the Cole memoranda, the lawyer may withdraw from representation. And a client should also understand the limitations on confidentiality if the lawyer's services are enlisted to plan or commit a crime.

Where a beneficiary of a marijuana related asset may be a minor, it is important to contemplate how that beneficiary may benefit from inherited assets without running afoul of the many laws preventing minors from possessing or owning any such assets outright. While the laws in each state will differ and the following has not yet been tested, perhaps the following limitation may allow a trustee to hold such an asset during the minority of a beneficiary (if not longer):

> Any beneficiary who has not reached the age of majority at the time of my death may not receive such assets outright. Instead, he or she may receive financial benefits, in the sole discretion of my trustee, from a legally operated cannabis-related business so long as the trustee manages the funds generated by such business until said beneficiary reaches the age of majority. Once such beneficiary reaches the age of majority, he or she must obtain the appropriate licenses and permits and comply with all applicable regulations to qualify to legally own the business outright and free of trust.

At the document drafting stage, testators and grantors often wish to limit gifts based on certain conditions, one of which is often the use of illegal drugs. Drafters will now need to carefully specify when the restriction applies, what law applies (if state law, then which one, or federal law), and whether cannabis is included as an illegal drug. One option would be to refer instead to abuse of "mind-altering drugs, whether legal or illegal." The following is an example of a clause making distributions conditional on drug use:

> Suspension of Distributions. If the trustee at any time suspects that a beneficiary is using any substance (including, without limitation, drugs, chemicals, or alcohol) in an abusive manner or is engaging in any abusive addictive behavior, the trustee is authorized to request that the beneficiary submit to one or more examinations determined to be appropriate by a licensed and practicing physician, psychiatrist, or other appropriate health care professional selected by the trustee. The trustee may request the beneficiary to consent to full disclosure by the examining doctor or facility to the trustee of the results of all such examinations, and the trustee may totally or partially suspend or withhold all distributions until the beneficiary consents to one or more examinations and disclosure to the trustee, and those examinations indicate no such use or behavior.

When an estate or trust includes a retail, processor, or producer cannabis license, a named fiduciary first must determine whether he, she, or it is willing to serve, given cannabis's status as a Schedule I controlled substance. While an individual may be comfortable relying on the enforcement priorities outlined in Cole II, it is likely that a named corporate fiduciary will decline its appointment when the trust or estate includes a cannabis license. In addition, given the FinCEN guidance, described above,

a fiduciary should consider whether a financial institution will work with a trust or estate that even includes property related to or derived from the production or sale of cannabis.

Once it is established that a testamentary instrument may legally transfer ownership the next step will be to determine whether the beneficiary may take ownership. The laws governing the transfer of assets by a decedent are those of the decedent's domicile prior to death. But the law of the beneficiary's domicile will apply to determine whether or not he or she may take possession.

Each state's procedures to transfer ownership of a license are different, but the goal is the same: to ensure that the transferee is qualified to hold a license.

For estate planners, understanding these rules is critical, to ensure that a license holder has a viable business succession plan in place. Washington requires approval from the WSLCB for a transfer to anyone other than a surviving spouse.[124] To date, no state anticipates ownership of a license by a trust, nor is there guidance for a fiduciary that may be tasked with managing a cannabis license.

In Oregon, two rules, in particular, must be followed when a change in ownership occur: OAR 845-025-1160(4) provides that "[a] licensee that proposes to change its corporate structure, ownership structure or change who has a financial interest in the business must submit a form prescribed by the Commission… prior to making such a change." And, OAR 845-025-1160(4)(d) provides that "[i]f a licensee has a change in ownership that is 51% or greater, a new application must be submitted in accordance with OAR 845-025-1030."

Presumably, the death of the holder of a license and the appointment of a personal representative or Trustee would be considered a 51 percent or greater change in ownership. Whether the new applicant is the fiduciary or the beneficiary (if that can even be established immediately following the death of a license holder), a new license must be applied for and issued. In light of these strict rules, it may be a good business practice to make sure that an entity is structured so that no single owner has more than a 51 percent interest. Other states have similar statutes that must be carefully followed.

At the death of a client, the laws governing the transfer of assets by a decedent are those of the decedent's domicile prior to death. But the law of the beneficiary's domicile will apply to determine whether or not he or she may take possession.

Once it is established that a testamentary instrument may legally transfer ownership the next step will be to determine whether the beneficiary may take ownership. How a cannabis-related asset will be delivered to a beneficiary by a fiduciary needs to be carefully considered. As a Schedule 1 drug, using the U.S. Postal Service is a federal crime, punishable by a minimum of up 5 years in a federal penitentiary plus a fine of up to $250,000, increasing from there.[125] So, the traditional delivery by mail of an asset to a beneficiary is yet another challenge for the fiduciary.

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[124] RCW 69.50.339.

[125] 18 U.S.C. §1716. The most lenient penalty for violation of 18 U.S.C. §1716 is up 5 years in a federal penitentiary plus a fine of up to $250,000, increasing from there.

Where a business is an asset of the estate, whether the new applicant is the fiduciary or the beneficiary (if that can even be established immediately following the death of a license holder), a new license may need to be applied for and issued before the fiduciary or the beneficiary can legally stand in the shoes of the decedent. In light of these strict rules, it may be a good business practice to put in place a well-thought-out business succession plan.

If a fiduciary agrees to serve and is qualified to do so, he or she must then determine whether the estate, any trusts and individually named beneficiaries are eligible to own licenses under applicable state laws. Both Washington and Oregon impose age, residency, and criminal history requirements on license ownership.[126] It is unclear how those requirements will be interpreted if a trust or estate becomes the owner of a license. The fiduciary will need to work with the state or local licensing authority to determine whether a trust or estate is eligible for a license.

What can be done during the estate planning process to diminish the risks associated with post-death transfers? Individuals who own cannabis licenses or interests in entities that own such licenses should carefully consider business succession planning strategies, to avoid transfers to individuals not qualified to become owners.

When a cannabis business is owned by two or more unrelated entities, the owners should investigate cross-purchase plans, buy-sell agreements, or entity purchase plans. Through careful planning, individuals may be able to avoid some of the more difficult issues related to the transfer of cannabis licenses.

A testamentary instrument transferring any interest in cannabis (or any other highly regulated asset) should consider allowing the fiduciary to appoint an independent fiduciary to carry out those duties the appointing fiduciary may not. Ideally, the independent trustee would be permitted and willing to deal with any regulated assets that a conventional fiduciary is not able to administer because of state law or other circumstances that prevent that fiduciary from administering such assets.

The following is a provision identifying only a partial list of tasks for an independent trustee:

> Independent Trustee – Special Powers. In addition to all other powers as Trustee, an independent trustee shall have the following powers and authority: (i) to amend the trust as the independent trustee deems necessary to carry out my intent in establishing the trust or to otherwise allow the trust to be administered in a more administrative or tax efficient manner given current or future federal or state laws; provided that any amendment may not affect the beneficial enjoyment of the trust estate; (ii) in general, to avail the trust and beneficiaries of opportunities under existing and future laws that may require extraordinary action such as, but not limited to: division of trusts into separate shares, creation of new trusts for the purposes of holding specific property or interests, limiting

[126] RCW 69.50.331; Or. Admin. R. 845-025-1115.

> distributions from a new trust to an ascertainable standard or to permissible recipients, and (iii) to deal with any regulated assets that a fiduciary is not able to administer because of state law or other circumstances, which prevent such fiduciary from administering such assets. All actions taken by an independent trustee hereunder should be consistent with, though not necessarily in literal compliance with, the dispositive scheme of the trust. An independent trustee shall be under no duty to exercise any power granted under this section and shall be held harmless and indemnified against any liability, claim, judgment, expense or cost arising from or attributable to his or her exercise or failure to exercise any power granted under this section, except as provided in [section re trustee standard of care].

Finally, delivery of a cannabis-related asset to a beneficiary by a fiduciary needs to be considered. As a Schedule 1 drug, it may not be sent using the U.S. Postal Service.[127] The most lenient penalty for violation of 18 U.S.C. §1716 is five years in a federal penitentiary, increasing from there.[128]

F. Federal Income and Estate Tax Considerations.

Because marijuana remains illegal under federal law, few business deductions are allowed on federal tax returns, and the gross revenue is taxable.[129] Although beyond the scope of this outline, in some instances, the cost of goods sold (costs incurred for the purchase, conversion, materials, labor, and allocated overhead incurred in bringing the marijuana inventories to their present location and condition) may be deductible under Code §280E,[130] but the ordinary and necessary expenses related to sale are not. However, in some cases, expenses in connection with ancillary businesses still may be deductible.

Finally, it is important that clients with an interest in a successful cannabis business keep in mind that even illegal property has a value. The IRS has held that the fact that a market is illicit does not obviate the existence of that market for estate tax valuation purposes.[131]

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[127] 18 U.S.C. §1716.

[128] https://www.dea.gov/druginfo/ftp3.shtml.

[129] I.R.C. §280E, enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. IRC § 280E provides that:

> 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.

[130] Jeffrey Gramlich, Ph.D., & Kimberly Houser, *Marijuana Business and Sec. 280E: Potential Pitfalls for Clients and Advisers*, The Tax Adviser (June 30, 2015), *available at* http://www.thetaxadviser.com/issues/2015/jul/houser-jul15.html.

[131] *Jones v. Comm'r*, T.C. Memo. 1991-28 (Jan. 24, 1991) (the street market of illicit drugs was the relevant market for 42 kilograms of cocaine); *Browning v. Comm'r*, T.C. Memo. 1991-93 (Mar. 4, 1991) (the fair market value of cannabis

To make matters more complicated, under the Electronic Federal Tax Payment System, since January 11, 2011, tax payments may not be made in cash.[132] A 10 percent penalty may be imposed for each cash payment, although exceptions may be made for certain taxpayers unable to obtain bank accounts.[133]

G. Leasing Issues.

While leasing issues are seemingly beyond the scope of estate planning, many of our clients make their fortunes in real estate. Some will be tempted to branch out into leasing to the cannabis industry. And some of those leases will be left behind to be handled by a fiduciary and heirs. The following are a few tips when dealing with cannabis-related leases.

First, it is important to understand that the timeline for starting a cannabis venture is different from other conventional businesses. It begins with an initial application submission. Assuming that is accepted, documents including the lease, the operating plan, and the site plan must be submitted for approval. Following that, there is a build out and a final inspection, and *then* a license may or may not be issued. At each point on this timeline, a lessor may want to retain the right to terminate the lease, receive partial payments, and enter the premises.

A lease should include a number of escape clauses, including the right for the landlord to terminate upon a change in the law, a federal forfeiture action, or a foreclosure or call on the lessee's financing. In addition, at a minimum, a landlord should require a bond to cover business interruption.

While lessees of real property are not subject to the same strict regulations that apply to producers, retailers, and processors, they can unwittingly get caught up in their tenants' misdeeds or in the conflict between federal and state law. For example, a landlord in Oakland, California leased a portion of commercial real estate to a medical cannabis dispensary. The U.S. Attorney filed a civil *in rem* forfeiture action against the property, seeking to shut down the dispensary. After receiving notice of the action, the landlord attempted to evict the dispensary, but when the dispensary declined to stop its operations, a California state court refused to allow the eviction, and the forfeiture action proceeded. The City of Oakland attempted to prevent the forfeiture by bringing a collateral suit, but the Ninth Circuit rejected its claim, thereby allowing the forfeiture action to continue.[134] If a lessee is involved in criminal activity, the land may be held as evidence during an investigation.

The rent must not be connected in any way to the success or failure of the cannabis business. A landlord may not have any ownership interest in the underlying business, which would include a percentage of profits.

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based on the wholesale street market value). *See also* William J. Turnier, *The Pink Panther Meets the Grim Reaper: Estate Taxation of the Fruits of Crime*, 72 N.C. L. Rev. 163 (1993). Available at: http://scholarship.law.unc.edu/nclr/vol72/iss1/7.

[132] Treas. Reg. §31.6302-1(h)(3).

[133] IRM 20.1.4.2.

[134] *City of Oakland v. Lynch*, 798 F.3d 1159 (9th Cir. 2015).

Finally, a tenant should also be given the right to terminate a lease due to a change in the law or a license application denial after the lease commencement date.

In any legal document involving cannabis, whether a lease or other type of contract, the forum selection clause should provide that any litigation must take place in state court so long as there is a concern over the conflict between state and federal interpretation of applicable law.

California dealt with the concern over enforceability of cannabis contracts by passing AB 1159, signed by Governor Brown on October 6, 2017, which provides that commercial activity relating to medicinal cannabis or adult-use cannabis conducted in compliance with state law and any applicable local standards and regulations is a lawful object of a contract, is not contrary to an express policy or provision of law or to good morals, and is not against public policy.[135]

H. Intellectual Property Issues.

Major innovation is occurring in the cannabis industry, and as a result, patents, trademarks, copyrights, and trade secrets will become assets of our clients or their businesses.

United States trademark law is mainly governed by the Lanham Act.[136] Under the Lanham Act, the U.S. Patent and Trademark Office will only register trademarks relating to commerce "which may lawfully be regulated by Congress."[137] Specifically the USPTO requires that the "use of a mark in commerce must be lawful use to be the basis for federal registration of the mark." As a result, the USPTO refuses to issue trademarks to cannabis products. Courts have held that use of a trademark can create rights only when the use is lawful and that it is illogical to extend government benefit to a seller based on the seller's actions in violation of law.[138] So enforcement under federal law is not an option as long as there can be no federal trademark to enforce.

Fiduciaries will need to consider the intellectual property implications of any cannabis-related asset of a trust or estate. Fiduciaries should also be aware of possible trademark infringement litigation. For example, in 2014, the Hershey Company sued Conscious Care Cooperative, a Washington medical cannabis dispensary, alleging that the retailer sold infringing products such as "Reefer's Peanut Butter Cups" and "Mr. Dankbar."[139]

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[135] Section 1 of the bill states that "commercial activity relating to medicinal cannabis or adult-use cannabis conducted in compliance with California law and any applicable local standards, requirements, and regulations shall be deemed to be: (1) A lawful object of a contract; (2) Not contrary to, an express provision of law, any policy of express law, or good morals; and (3) Not against public policy." Section 1 of AB 1159 adding Section 1550.5 to the Civil Code (Oct. 6, 2017).

[136] 15 U.S.C. ch. 22.

[137] 15 U.S.C. §1127.

[138] *CreAgri, Inc. v. USANA Health Scis., Inc.*, 474 F.3d 626 (9th Cir. 2007); *see also United Phosphorus, Ltd. v. Midland Fumigant, Inc.*, 205 F.3d 1219 (10th Cir. 2000).

[139] Complaint, *Hershey Co. v. Conscious Care Coop.,* No. 2:14-cv-00815 (W.D. Wash. 2014).

But, a company may still obtain some protection of their intellectual property. A marijuana business owner can obtain trademark protection for its products that are not related to the production and dissemination of marijuana. For an example, many dispensaries and manufacturers sell other products within their stores, such as non-marijuana infused candies or food, that would be eligible for trademark protection.

Federal copyright protection has been extended to a variety of marijuana-content works, including cannabis growing guides and cookbooks.

Common law trademark rights are acquired automatically when a business uses a name or logo in commerce. However, this only applies if the mark is not confusingly similar and not already in use. Common law trademark protection has its limits: it only provides protection within the geographical area of the trademark's use. Lastly, in states where cannabis has been legalized, state registration may be possible and would give the right to sue under state law.

As of January 1, 2018, California's Prop. 64 expressly authorized trademark classifications for "goods that are cannabis or cannabis products, including medicinal cannabis or medicinal cannabis products" and "for services related to cannabis or cannabis products, including medicinal cannabis or medicinal cannabis products." California cannabis businesses may register trademarks and service marks for cannabis goods and services, including trademarks for specific cannabis strains.[140]

I. Ethical Considerations.

Because of the ever-changing legal landscape around state-licensed cannabis regulation, it is critical for investors, producers, processors, retailers, and other stakeholders within the legal cannabis industry to understand how to comply. This presents obvious ethical challenges for lawyers seeking to represent the interests of cannabis industry members or fiduciaries who must administer property derived from the cannabis industry. Despite efforts of several states to legalize the production, distribution, and use of cannabis, a lawyer must consider whether he or she may ethically advise and assist a client seeking to engage in conduct that the lawyer knows is criminal under federal law or (in one or more states).

Most states have adopted American Bar Association Model Rule 1.2 that prohibits assisting a client in the violation of law:

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning, or application of the law.[141]

[140] See CannaBizfile, http://www.sos.ca.gov/business-programs/cannabizfile/, California's online portal for all information relevant to cannabis-related business filings with the Secretary of State.

[141] Model Rules of Prof'l Conduct r. 1.2(d) (Am. Bar Ass'n 1980).

Several state bar associations have issued guidance as to whether an attorney may assist clients with complying with state medical and recreational cannabis laws that conflict with the Controlled Substances Act. Most states that have considered the issue have concluded that the attorney does not run afoul of state ethical rules. It is important to note that most of the opinions are limited to medical and not recreational marijuana.

The following is a summary of a few state opinions.

1. Arizona. In 2011, the State Bar of Arizona concluded that an attorney could ethically perform legal services related to the state's Medical Marijuana Act so long as (i) the conduct was expressly permitted under the Act, (ii) the lawyer advised the client on potential federal law implications and consequences, and (iii) the client, having received full disclosure, elected to proceed with a course of action specifically permitted by the Act. The State Bar of Arizona recognized that disciplining attorneys for working within a complex regulatory system would deprive the state's citizens of legal services "necessary or desirable to implement and bring to fruition that conduct expressly permitted under state law."[142] The opinion declined to read Arizona Ethics Rule 1.2 to forbid attorney assistance regarding conduct prohibited by the CSA yet compliant with state law. To do so, the bar reasoned, would "depriv[e] clients of the very legal advice and assistance that is needed to engage in the conduct that the state law expressly permits."

2. Colorado. In 2014, the Colorado Supreme Court adopted a comment to the state's RPCs regarding the provision of legal services to state-regulated medical and recreational cannabis businesses. The comment to RPC 1.2 regarding the scope of representation and allocation of authority between the client and the lawyer now states:

> A lawyer may counsel a client regarding the validity, scope, and meaning of Colorado Constitution article XVIII, secs. 14 & 16, and may assist a client in conduct that the lawyer reasonably believes is permitted by these constitutional provisions and the statutes, regulations, orders, and other state or local provisions implementing them. In these circumstances, the lawyer shall also advise the client regarding related federal law and policy.[143]

Previously, the Colorado RPCs had prohibited attorneys from aiding clients "in conduct that the lawyer knows is criminal." [144] Despite the fact that medical and recreational use of cannabis is legal within the state, lawyers were left at an impasse because the production, use, sale, and distribution of the drug are still illegal under federal law. Based on this prior rule, a Colorado lawyer providing anything more than basic legal advice to cannabis

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[142] *See* Ariz. Ethics Comm. Op. 11-01 (2011), *available at* http://www.azbar.org/Ethics/EthicsOpinions/ViewEthicsOpinion?id=710.

[143] Colo. RPC 1.2 (2015). [Comment [14] added and effective Mar. 24, 2014.]

[144] Colo. Ethics Comm. Formal Op. 125 (2013) (withdrawn May 17, 2014).

businesses could run afoul of ethical obligations and face disciplinary action. The comment provides a safe harbor for lawyers seeking to represent those engaged in the legal cannabis industry within Colorado.

3. California. California does not follow the Model Rules when examining the extent to which an attorney must avoid advising clients on matters that may be illegal on a local, state or federal level. Cal. R. Prof. Conduct 3-210, entitled "Advising the Violation of Law," provides: "A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid. A member may take appropriate steps in good faith to test the validity of any law, rule, or ruling of a tribunal."

   California's standing Committee on Professional Responsibility and Conduct (COPRAC) has not issued an opinion on the issue of whether an attorney may ethically advise clients on the possession, use, cultivation, or sale of marijuana under California law. But the Bar Association of San Francisco (SFBA) and the Los Angeles County Bar Association (LACBA) have. Both opinions concluded that an attorney may ethically advise a client on how to comply with California law in regards to the use, cultivation, or operation of a dispensary of medicinal marijuana, but may not advise the client to violate federal law and must advise the client that the conduct may violate the federal Controlled Substances Act.[145]

   While the opinions issued from the SFBA and LACBA provide guidance for attorneys, those opinions deal with medical marijuana. The State Bar of California is yet to issue its own opinion, so the ethical implications of advising on recreational marijuana are yet to be determined.

4. Connecticut. In 2013, the Connecticut Bar Association Professional Ethics Committee concluded that while an attorney could safely advise a client on the requirements of state and federal cannabis law, advice and services in aid of functioning cannabis enterprises could run afoul of RPC 1.2(d).146 They advised lawyers to "carefully assess" the distinction between consultation and explanation versus participating in criminal enterprises.

   Subsequently, the Connecticut Supreme Court amended Rule 1.2 to permit lawyers to provide advice without being subject to discipline under the rules of professional conduct concerning conduct prohibited under federal or other law but expressly permitted under Connecticut law, such as Connecticut's medical marijuana laws.[147]

5. Illinois. The Illinois Rules of Professional Conduct permit lawyers to counsel clients on activities permitted in Illinois that may violate federal law, so long as the lawyer counsels the client on the potential consequences:

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[145] LACBA, Comm'n on Prof'l Responsibility & Ethics, Formal Op. 527, 9 (2015); SFBA, Formal Op. 2015-1, 2-3.

[146] Informal Opinion 2013-02, Jan. 16, 2013.

[147] An Act Concerning the Palliative Use of Marijuana, Public Act 12-55, eff. Oct. 1, 2012.

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may (1) discuss the legal consequences of any proposed course of conduct with a client, (2) counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning or application of the law, and (3) counsel or assist a client in conduct expressly permitted by Illinois law that may violate or conflict with federal or other law, as long as the lawyer advises the client about that federal or other law and its potential consequences.[148]

6. Maine. The Maine Professional Ethics Commission, similar to Connecticut, concluded in 2010 that representing or advising clients under Maine's Medical Marijuana Act would "involv[e] a significant degree of risk which needs to be carefully evaluated."149 The Commission recognized that the federal government had deprioritized enforcement of the CSA in medical cannabis cases, but reasoned that Maine's rule governing attorney conduct "does not make a distinction between crimes which are enforced and those which are not."150

   In March 2017 the Commission issued a new opinion entitled Attorneys' Assistance To Clients Under Rule 1.2 Regarding The Use And Sale Of Medical And Recreational Marijuana, establishing that: [N]otwithstanding current federal laws regarding use and sale of marijuana, Rule 1.2 is not a bar to assisting clients to engage in conduct that the attorney reasonably believes is permitted by Maine laws regarding medical and recreational marijuana, including the statutes, regulations, Orders and other state or local provisions implementing them. [151]

7. New York. New York has only opined on the ethics concerning medical marijuana related advice. New York's State Bar issued an ethics opinion concluding that:

> As Rule 1.2(d) makes clear, although a lawyer may not encourage a client to violate the law or assist a client in doing so, a lawyer may advise a client about the reach of the law. *See* N.Y. State 455 (1976) ("[W]here the lawyer does no more than advise his client concerning the legal character and consequences of the act, there can be no professional impropriety. That is his proper function and fully comports with the requirements of Canon 7. . . . But, where the lawyer becomes a motivating force by encouraging his client to commit illegal acts or undertakes to bring about a violation of law, he

[148] Ill. PR Rule 1.2(d)(3) [Adopted July 1, 2009, eff. Jan. 1, 2010; amended Oct. 15, 2015, eff. Jan. 1, 2016]. See also Ill. State Bar Ethics Op. 14-07 (Oct. 2014).

[149] Maine Prof'l Ethics Comm'n, Op. 199 (July 7, 2010).

[150] *Id*.

[151] Maine Prof'l Ethics Comm'n, Op. #215 (Mar. 1, 2017) vacating opinion #214.

> oversteps the bounds of propriety."). Thus, a lawyer may give advice about whether undertaking to manufacture, transport, sell, prescribe or use marijuana in accordance with the CCA's regulatory scheme would violate federal narcotics law. If the lawyer were to conclude competently and in good faith that the federal law was inapplicable or invalid, the lawyer could so advise the client and would not be subject to discipline even if the lawyer's advice later proved incorrect.[152]

It further provides that Rule 1.2(d) "does not forbid lawyers from providing the necessary advice and assistance…" to marijuana business owners because of the non-enforcement of federal policy.[153] However, this presumably is limited to medical and not recreational marijuana.

8. Oregon. In 2015 the Oregon Supreme Court adopted RPC 1.2(d), which states:

> Notwithstanding paragraph (c), a lawyer may counsel and assist a client regarding Oregon's marijuana-related laws. In the event Oregon law conflicts with federal or tribal law, the lawyer shall also advise the client regarding related federal and tribal law and policy.[154]

While the rule does not require a lawyer to provide advice regarding the intricacies of federal and tribal law, a lawyer will need to be familiar with those areas in order to spot issues and adequately advise his or her clients about those conflicts.

9. Washington. In 2014, the Washington Supreme Court adopted a comment to the Washington State Rules of Professional Conduct regarding the provision of legal services to cannabis businesses. The comment to RPC 1.2 regarding the scope of representation and allocation of authority between the client and the lawyer now states:

> At least until there is a change in federal enforcement policy, a lawyer may counsel a client regarding the validity, scope and meaning of Washington Initiative 502 (Laws of 2013, ch. 3) and may assist a client in conduct that the lawyer reasonably believes is permitted by this statute and the other statutes, regulations, orders, and other state and local provisions implementing them.[155]

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[152] N.Y. Comm. on Prof'l Ethics Op. 1024 (2014). New York's medical marijuana statute is known as the Compassionate Care Act (CCA), Laws of 2014, Chap. 90 (signed by the Governor and effective on July 5, 2014).

[153] *Id.*

[154] Or. RPC 1.2(d) (2015).

[155] Wash. RPC 1.2 (2015) (comment 18 added and effective Dec. 9, 2014).

> In addition, in June 2015, the Washington State Bar Association issued Advisory Opinion 201501, which asked and answered five specific questions regarding the provision of legal services in the legal cannabis industry within Washington.[156] The opinion provided that a lawyer may advise a client about compliance with state retail and medical cannabis law, the lawyer may assist in the formation and operation of a cannabis business, and the lawyer may operate an independent cannabis business. Assuming a lawyer's use of medical or retail marijuana do not otherwise affect the lawyer's substantive competence or fitness to practice as a lawyer, he or she may purchase and consume it without violating the RPCs. However, the opinion included the qualification that "if the federal government changes its position and again seeks to enforce the CSA against the kinds of activities made lawful under I-502 and the [Cannabis Patient Protection Act] as a matter of state law, the application of the RPCs may have to be reconsidered."[157]

Regardless of state law, attorneys need to keep in mind that federal law continues to makes illegal certain financial transactions connected to unlawful activity, including transferring monetary instruments or funds with the intent to promote the carrying on of specified unlawful activity, including the manufacture, importation, sale, or distribution of a controlled substance.[158] Most attorney malpractice policies exclude coverage for criminal acts. If a lawyer is sued for malpractice on a marijuana-related issue, an insurance carrier may deny coverage based on the criminal acts exclusion. And to compound matters, fees derived from marijuana businesses, including fees for advising a marijuana business, may be subject to forfeiture under federal law as coming from an illegal source.

J. Engagement Letters.

In states where an attorney may advise a client on cannabis-related activities, it is prudent to re-think the standard client intake procedure. It is not sufficient to run a conflict check and sent a standard engagement letter. There are two general categories of potential clients in the cannabis arena: (1) clients that have direct contact with cannabis because they manufacture, distribute or sell marijuana in compliance with state law, and (2) third parties that assist or advise on cannabis topics and refer clients to the businesses with direct contact. These include doctors, bankers, investors, lawyers, landlords, real estate brokers, accountants and ancillary service providers. The first category carries more risk.

The lawyer may want to consider a questionnaire and/or a criminal background check to be certain that the potential client may engage in such business activities. It would also be prudent, in the attorney's engagement letter, to disclose to the potential client that because cannabis is illegal under federal law, if the federal law were to enforce the CSA against activities otherwise lawful under state law, the terms of representation would have to be revisited and representation may have to be terminated. A client should understand that the risks associated with a cannabis business under

[156] *See* Wash. State Bar Ass'n Advisory Op. 201501 (2015), http://mcle.mywsba.org/IO/print.aspx?ID=1682.

[157] *Id*.

[158] Money Laundering Control Act of 1986, 18 U.S.C. §§1956, 1957.

federal law, include federal prosecution, fines and imprisonment. The attorney should consider advising the client that if he or she engages in violations of applicable state law, or in a manner that would be cause for federal prosecution under the Cole memoranda, the lawyer may withdraw from representation. And a client should also understand the limitations on confidentiality if the lawyer's services are enlisted to plan or commit a crime.

The following is a sample of such disclosure:

> [Law Firm] advises clients on state laws governing the business of cannabis to facilitate compliance with those state laws. Federal laws concerning cannabis currently conflict with state laws in states that have legalized cannabis or possession of cannabis. Although federal enforcement policy may at times defer to these states' laws and not enforce conflicting federal laws, interested businesses and individuals should be aware that compliance with state law in no way assures compliance with federal law. There remains a risk that conflicting federal laws may be enforced in the future.

Attached as Exhibit A is a form of engagement letter that may be adapted, based on applicable state law, when representing cannabis industry service providers.

K. Final Note.

While the majority of states (and the District of Columbia) have legalized cannabis in some form, cannabis use, possession, production, distribution, and marketing remain illegal under federal law. The Cole Memos, which are only policy statements Cole I, which is only a policy statement, suggests suggest that the federal government is uninterested in overturning state laws legalizing cannabis or prosecuting individuals and businesses unless their conduct implicates one of the listed enforcement priorities. However, the DOJ policy is evolving. Therefore, cannabis users and businesses remain at risk of civil and criminal prosecution by the DOJ. Whether legal or not, individuals with a business interest related to cannabis must consider how this asset is to be handled in their estate, and lawyers need to be prepared.

VI. CONCLUSION

While many practitioners will go an entire career without running into certain regulated assets, chances are that one or two will pop up now and then. This outline is intended to provide a starting point for ways of dealing with just a few. Unless the practitioner asks about the existence of these assets, their existence may never even be disclosed. Therefore, it is important to ask questions about whether these assets exist and whether the named fiduciaries and beneficiaries are qualified to own them. Without this inquiry, both the fiduciary and the fiduciary's advisor may encounter additional and otherwise avoidable complexities as a result of the strict regulations in place.

EXHIBIT A
CANNABIS ENGAGEMENT LETTER:
CLIENT IS SERVICE PROVIDER TO CANNABIS INDUSTRY

Dear _____:

Thank you for engaging LAW FIRM to provide the legal services described below to _____ (the "Company"). I am writing to confirm this representation and to indicate how our services will be provided.

Scope of Representation

Our client in this engagement will be the Company. We have discussed the firm's capabilities to assist the Company with regard to _____. As an initial matter, you have asked us to {itemize tasks we are currently undertaking – e.g., prepare a form of lease to use with tenants intending to grow cannabis on the Company's property}. The terms described in this letter will also apply to such other engagements as you specifically request and we agree to undertake on behalf of the Company and/or its affiliates.

The Company will not produce, process, or sell cannabis, but it will do business with companies engaged in one or more of those activities. Doing business in this sector of the economy presents some risks, as discussed below.

Potential Risks under Federal Criminal Law

Although the Company will not produce, process or distribute cannabis, and although some states have decriminalized such activity if it complies with their statutes and implementing regulations, you should be cognizant of potential risks under federal criminal law.

The Company will do business with individuals or entities whose conduct will be illegal under one or more federal statutes, even if their conduct fully complies with state law. Consequently, the Company and its owners and management face potential risks. For example, the federal government can seize, and seek the civil forfeiture of, real or personal property used to facilitate sales of cannabis as well as money or other proceeds from such sales. In addition, there is potential risk of criminal investigation or prosecution for aiding and abetting violation of federal law or for conspiring to violate federal law. A conviction on a conspiracy charge carries a mandatory minimum prison term of five years for a first offense and, depending on the quantity of cannabis involved, a fine for such a conviction could be as high as $10 million.

Although the U.S. Department of Justice has noted that an effective state regulatory system and a cannabis operation's compliance with such a system should be considered in the exercise of investigative and prosecutorial discretion, its authority to prosecute violations of federal law is in no way diminished by recent changes in the laws of some states. Indeed, due to the federal government's jurisdiction over interstate commerce, when businesses provide services to cannabis

producers, processors or distributors located in multiple states, they potentially face a higher level of scrutiny from federal authorities than do their customers with local operations.

Terms of Engagement

Insert firm language regarding terms of engagement, availability, conflicts of interest and legal fees.

We appreciate your expression of confidence in LAW FIRM. If you have any questions or concerns during the course of our relationship, I encourage you to raise them with _____, who may be reached at _____. We look forward to working with you.

Very truly yours,

INSERT NAME OF LAW FIRM

By_____

_____

[Name of entity] *agrees to the terms of engagement stated above.*

[NAME OF ENTITY]

_____
[Printed Name of Contact]
Title: _____
Date: _____