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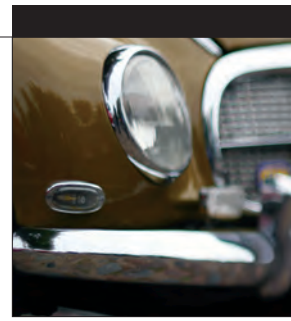

Clients and Cannabis: Do Not Let an Estate Plan Go Up In Smoke

Conflicts among state and federal laws regarding cannabis require special planning for the trust and estate administration and distribution of this asset.

WENDY S. GOFFE

For decades, cannabis[1] transactions in the U.S. 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 recreational purposes. As of January 2018, 29 states, Guam, Puerto Rico, and the District of Columbia permit its use for medical reasons, and 11 states for recreational purposes.[2] 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.[3] Vermont permits recreational use but not retail sales effective 7/1/2018.[4] While the recent announcement in early January by the Trump administration to aggressively enforce federal marijuana law adds greater confusion to the already complex area of law, it is not likely that, after gaining such momentum so quickly, the trend toward state legalization will come to an abrupt halt anytime soon.

Legalized and decriminalized cannabis is becoming a national issue, leaving 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.

Federal law and policy

Since 1970, cannabis has been 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.[5] 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.[6]

DOJ policies. When states began legalizing marijuana, the Department of Justice (DOJ) made clear that it intended to pursue any commercial enterprise selling or producing cannabis. On 10/19/2009, Deputy Attorney General David W. Ogden (under Attorney General Eric Holder) issued a memorandum known as the "Ogden Memo" con-

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firming that the DOJ remained "committed to the enforcement of the [CSA] in all States."[7] 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."

The lawyer may want to consider a questionnaire and a criminal background check to be certain that the potential client may engage in such business activities.

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 cultivation, distribution, sale, and possession that limit the risks to "public safety, public health, and other law enforcement interests."[8]

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. But Cole II instructs federal prosecutors to prioritize their "limited investigative and prosecutorial resources to address the most significant [cannabis-related] threats." It identified eight activities as those that the federal government wants most to prevent, which include:

1. Distribution to children.
2. Use of revenue to further other criminal enterprises.
3. Diverting cannabis from states that have legalized its possession to states that prohibit it.
4. Using authorized cannabis activity as a pretext for the trafficking of other illegal drugs.
5. Using firearms or violent behavior in the cultivation and distribution of cannabis.
6. Exacerbating public health and safety risks due to cannabis use, including driving while under the influence of cannabis.
7. Growing cannabis on public land.
8. Possessing or using cannabis on federal property.

FinCEN 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.[9] 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 factors specific to that institution. These factors may include:

1. Its particular business objectives.
2. An evaluation of the risks associated with offering a particular product or service.
3. Its capacity to manage those risks effectively.

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.

1 The terms "marijuana" and "cannabis" are often used interchangeably.

2 See National Conference of State Legislatures, State Medical Marijuana Laws (1/5/2018), 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.

3 Initiative 71, also known as the Legalization of Possession of Minimal Amounts of Marijuana Personal Use Act of 2014.

4 Vermont House Bill 511 (1/22/2018).

5 Controlled Substances Act, 21 U.S.C. section 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.

6 Money Laundering Control Act of 1986, 18 U.S.C. sections 1956 and 1957.

7 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 (10/19/2009), www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf.

8 James M. Cole, Deputy Attorney General, Memorandum for All United States Attorneys, Guidance Regarding Marijuana Enforcement (8/29/2013), www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

9 FinCEN, BSA Expectations Regarding Marijuana-Related Businesses (2/14/2014), www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses.

10 Attorney General Jeff Sessions, U.S. Department of Justice, Memorandum for All United States Attorneys, Marijuana Enforcement (1/4/2018), www.justice.gov/opa/press-release/file/1022196/download.

11 www.politico.com/story/2017/03/jeff-sessions-marijuana-crackdown-senators-react-235616.

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

13 Cal. Health & Safety Code § 11362.5.

14 Cal. Health & Safety Code § 11362.5(d).

15 Colo. Amend. 64 (2012), *amending* Colo. Const. art. XVIII, § 16(3), www.fcgov.com/mmj/pdf/amendment64.pdf (last visited on 1/2/2018).

16 Codified at RCW ch. 69.51A.

Justice Department position. Finally, based on recent statements from the 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.[10] 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.[11] 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.

Evolving state laws

Despite 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.[12] Generally, states limit possession, use, and ownership of retail licenses based on age, residency, and criminal history.

For example, 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.[13] 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.[14]

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 1/1/2018.

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.[15]

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.

On 11/3/1998, Washington voters approved Ballot Initiative 692,[16] making small amounts of cannabis

legal for medical purposes. The Washington Supreme Court ruled in 2010 that "I-692 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."[17]

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.[18]

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.[19] As with alcohol after Prohibition, those in the cannabis industry are barred from complete vertical integration.

Estate planning concerns

More and more estate planners will likely 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 who have direct contact with cannabis because they manufacture, distribute, or sell marijuana in compliance with state law.
2. Third parties who 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.

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.

The first category carries more risk.

The lawyer may want to consider a questionnaire and 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 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.

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

17 State v. Fry, 168 Wn. 2d 1, 228 P.3d 1 (2010).

18 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 on 1/2/2018), for detailed explanations of Washington cannabis law.

19 *Id.*

20 RCW 69.50.339.

21 18 U.S.C. section 1716. The most lenient penalty for violation of 18 U.S.C. section 1716 is up to five years in a federal penitentiary plus a fine of up to $250,000, increasing from there.

22 RCW 69.50.331; Or. Admin. R. 845-025-1115.

23 Jones, TCM 1991-28 (the street market of illicit drugs was the relevant market for 42 kilograms of cocaine); Browning, TCM 1991-93 (the fair market value of cannabis based on the wholesale street market value).

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.

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.[20] 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.

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 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 I drug, using the U.S. Postal Service is a federal crime, punishable by a minimum of up to five years in a federal penitentiary plus a fine of up to $250,000, increasing from there.[21] So, the traditional delivery by mail of an asset to a beneficiary is yet another challenge for the fiduciary.

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.[22] 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.

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.

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.[23]

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 com-

ply. 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).

If a lawyer is sued for malpractice on a marijuana-related issue, an insurance carrier may deny coverage based on the criminal acts exclusion.

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.[24]

Several state bar associations have issued guidance as to whether an attorney may assist clients with complying with state medical and recreational cannabis laws. 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.

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 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.[25]

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.[26] 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 does 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."

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.[27] 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.

Conclusion

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. Cole I, which is only a policy statement, suggests 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. ■

24 Model Rules of Prof'l Conduct r. 1.2(d) (Am. Bar Ass'n, 1980).

25 Wash. RPC 1.2 (2015) (comment 18 added and effective 12/9/2014).

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

27 Money Laundering Control Act of 1986, 18 U.S.C. sections 1956 and 1957.