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## Cannabis compliance: A Q&A with Fox Rothschild Partner Jennifer Benda

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Fox Rothschild Partner Jennifer Benda is a member of the law firm's cannabis group and created a nationwide guide to assist cannabis companies in tax compliance. She took some time to chat with Denver Business Journal about the most pressing issues for the industry, as well as Colorado's role in a growing marketplace.

**Your team at Fox Rothschild has put together a quick-reference guide for the cannabis sector that looks at tax law in all 50 states. It also goes pretty in-depth for those who want to take a deeper dive. What was the impetus to create something like this?** I began working with cannabis businesses in 2015 after my move to Fox Rothschild. Since then, the firm established a cannabis law practice group and quite a few of the states where Fox has offices have legalized either medical or adult-use marijuana or both. Due to the growth of this industry, I am working with clients in so many different states that I needed a quick reference guide to help me keep track



PROVIDED BY JENNIFER BENDA

Jennifer Benda is a partner at Fox Rothschild.

of all the different state tax regimes. This gave me the idea of developing a 50-state tool that we could provide as a resource. I have dealt with enough state tax issues over the years to know how helpful these guides can be. I could not find a comprehensive external resource, so I saw this as an opportunity to get out front on this issue. We've received many compliments on the Cannabis Industry State Tax Guide and I'm very proud of the work we did to make it so accessible and useful.

**Your guide focuses heavily on U.S. Tax Code Section 280E, something a lot of people outside the cannabis industry probably don't know a whole lot about. Tell me what the code means, and how it affects cannabis companies.** Section 280E was added to the Internal Revenue Code in 1982 during the war on drugs, and it imposes a unique tax regime for drug dealers. Essentially the way this provision works is that the only cost recognized for federal income tax purposes is cost of goods sold, or the cost of inventory. Section 280E is unique because no other section of the Internal Revenue Code denies all deductions to any other business, whether legal or illegal. Before states began legalizing marijuana, it applied only to illegal businesses which primarily operated in the dark. Now, it applies to state-legal businesses, which operate like real businesses with bank accounts, accounting systems, and various recordkeeping requirements. As a result of Section 280E, most cannabis businesses are subject to very high effective tax rates and very low after-tax profit margins.

**We hear that, even though Colorado has taken legislative measures to shield its cannabis companies from 280E, many of them are still operating at a 70-80 percent tax rate. Does that sound right to you?** I believe that's true. The fact that Colorado has adjusted the state income tax rules means that the burden of Section 280E is slightly mitigated. But it did take Colorado four years to get around to fixing that. So what I see when I talk to people in other states is that if state [governments] aren't thinking about this at the beginning, there's going to be a lag. I encourage new businesses in other states to understand early whether this is an issue in the state and make sure that while the laws and rules are being written, the legislature is addressing the issue.

**And give a quick description of IRS Form 8300 requirements and how that impacts a largely cash-only business like those operating in the leaf-touching cannabis sector.** IRS Form 8300 is a form that must be completed whenever a business receives more than \$10,000 in cash. Every time you receive more than

\$10,000, you have to fill it out and submit it to the IRS within 15 days. There are also rules that require you to aggregate payments and to get personal information from the people who gave you the money, as well as information about your business. Because cannabis businesses are often primarily cash-based businesses with restricted access to banking, they are required to file Form 8300 frequently and this compliance regime is another burden that costs money and keeps cannabis businesses mired in regulatory compliance tasks. Businesses providing goods and services to cannabis businesses are also potentially subject to these reporting requirements, and often it is a reporting regime that is new to them and requires them to put in place new policies and procedures.

**Former Gov. John Hickenlooper vetoed 2018 legislation that many in the industry believe would have made Colorado more competitive in a fast-growing industry that's going global. Is Colorado being left behind?** Colorado's laws limit the Colorado cannabis industry's ability to raise capital. The Pubco bill that was vetoed would have changed this. Things will shift once the ability to raise capital is expanded. One example of how the current law limits Colorado businesses is the trend to go public in Canada. Colorado businesses are not able to engage in these transactions and must wait while the rest of the industry moves forward with these transactions. Many Colorado cannabis entrepreneurs are prioritizing opportunities in other states while maintaining the status quo for their Colorado operations.

**Industry insiders are hopeful that Gov. Jared Polis will sign similar legislation. What would that mean for Colorado businesses?** I think if Polis does sign a bill and people want to sell or raise capital, they will have that opportunity. However they need to be ready for due diligence. I notice that many companies don't have audited financials. Companies that have audited financials will be in the best position to capitalize on new opportunities once Colorado changes its laws.

**Is that necessarily a good thing for small mom-and-pop shops? What's their future in an industry that could quickly see massive mergers and acquisitions with outside cash?** I think the mom-and-pop shops that have survived operating in Colorado since the beginning are exhausted. It's a tough business and many are ready to sell. They're waiting for that moment when they can get a big deal done. I do think the way you survive is by operating extremely efficiently until the tax laws change, because your cash flow is probably relatively negligible if the business has fully complied with Section 280E. I also think the way those moms and pops will

stay in the business is to shift from day-to-day operators to become consultants and take advantage of opportunities to assist with the expansion of the industry in other states or even other countries.

**Tell me what Colorado's done right.** I think Colorado's regulatory regime is the reason the legalization movement has been able to evolve. Because of Colorado, the federal government was willing to sit back and watch the experiment move forward and potentially consider policy changes in this area. Somebody had to do it in a way that gave them comfort that the cannabis industry wasn't going to be run by foreign drug cartels. I think Colorado did a very good job of that and provided a model for other states. What I see from a market perspective is that other states are doing things like limiting the number of licenses — that's something that didn't really happen in Colorado. Wholesale prices in other states are multiples of what we have here. I think the regulatory regime has been extremely helpful, but the marketplace itself has been more uncertain.

**What are the odds the federal government will take steps to decriminalize, deschedule or totally legalize the commercial cultivation, sale and use of cannabis? And what should Colorado companies do to prepare?** The STATES Act, introduced by Senators Cory Gardner and Elizabeth Warren, is the one piece of legislation in Congress that may have some momentum because it changes the tax and banking rules only in states where marijuana laws have passed. It does nothing to change the federal drug laws themselves. One interesting observation I had is that at a dozen or so co-sponsors were added in the House in December and that got me thinking that maybe they're going to try to tee this up. I haven't heard of anything gaining traction as far as federal legalization for marijuana as we have with the Farm Bill that legalized hemp. So we're probably not going to shift away from the continued federal-state disconnect for marijuana. I think we're in a place where the state-by-state movement will continue.

**Jonathan Rose**

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