



## Staff Notes

### Federal Laws Affecting California’s Cannabis Industry

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#### Comprehensive Drug Abuse Prevention and Control Act or “Controlled Substances Act” (CSA) (1970)

- Signed by President Richard Nixon in 1970.
- Combined federal drug laws into a single statute.
- Regulates possession, manufacture, and distribution of “controlled substances,” including:
  - Narcotics
  - Hallucinogens
  - Depressants
  - Stimulants
- Controlled substances are organized into five categories (“schedules”) characterized by potential for abuse, status in international treaties, effects on the body, and accepted medical uses.
- Marijuana classified as a Schedule I controlled substance, placing it in the same category as heroin, LSD, and MDMA.
- Cocaine and crack are categorized as Schedule II drugs.
- Penalties generally based on drug schedule and quantity.

#### Racketeer Influenced and Corrupt Organizations Act (RICO) (1970)

- Introduced new penalty: forfeitures of property involved in criminal activity.
- Purpose: eliminate organized crime in interstate commerce. Also interpreted to be applicable in foreign commerce.
  - Forfeit to the U.S. “any property constituting, or derived from, any proceeds which the person obtained, directly or indirectly, from racketeering activity.”
- Racketeering activity includes narcotics-related violations:
  - “felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in a controlled substance or listed chemical (as defined in section 102 of the Controlled Substances Act), punishable under any law of the United States.”

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Prepared by San Francisco Office of Small Business

- May expose anyone who provides services to a marijuana operation (including banks).
  - “It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity ... to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.”
  - Example: Bank of the West was included in a lawsuit for servicing bank accounts belonging to Medical Marijuana of the Rockies.

### **Currency and Foreign Transactions Reporting Act or “Banking Secrecy Act” (BSA) (1970)**

- Federal banking + anti-money laundering law
- Purpose: to help identify the source, volume, and movement of funds into or out of the U.S. or deposited in financial institutions.
- Created recordkeeping and reporting requirements for private individuals and financial institutions.
- Requires banks to assist in federal anti-money laundering enforcement:
  - Monitor clients’ transactions.
  - Establish customer ID procedures.
  - Enhance due diligence procedures for high-risk customers.
  - File Suspicious Activity Reports (SARs) for suspicious (re: illegal activities) transactions of \$5,000 or more.
  - File Currency Transaction Reports (CTRs) for cash transactions over \$10,000.
- Enforced by Financial Crimes and Enforcement Network (FinCEN) (under Department of the Treasury) and DOJ, which may bring criminal action against banks and agents.
- FinCEN guidance issued February 14, 2014
  - Created regulatory structure for banks to serve cannabis customers, involving due diligence and reporting.
    - At beginning of banking relationship: Marijuana Limited SAR, includes identifying information of client.
    - Thereafter: activity reports every 120 days (confirm).
    - Marijuana Priority SAR if bank suspects activity that goes against Cole Memo priorities.
- Applies to financial institutions (bank, credit union, operator of a credit card system, insurance company, loan or finance company, etc.).

### **Money Laundering Control Act (1986)**

- Established money laundering as a federal crime. Individuals and entities subject to criminal liability.
- Money laundering: the act of making illegal funds appear legitimate (introduced into legitimate financial system; sometimes moved around through multiple accounts to create confusion; integrated into financial system until it appears “clean”).
- Prohibited the structuring of transactions to evade Currency Transaction Report (CTR) filings.
  - Banks must electronically file a Currency Transaction Report (CTR) for each transaction (deposit, withdrawal, exchange, or other payment or transfer) of more than \$10,000 by, through, or to the bank.
- Introduced civil and criminal forfeiture for BSA violations.

- Directed banks to establish and maintain procedures to ensure and monitor compliance with the reporting and recordkeeping requirements of the BSA.

### Internal Revenue Code

- Medical marijuana businesses are obligated to pay federal income tax because the relevant section of the IRC does not differentiate between income derived from legal and illegal sources.
- Schedule I controlled substances sellers taxed on gross income vs. net income.
  - Gross income includes net gains derived from controlled substances produced or acquired for resale.
- Section 280E (enacted in 1982) disallows deduction or credit “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.”
  - Businesses may not deduct cost of salaries, rent, or telephone.
  - However, they can still deduct the cost of the controlled substances (allowed in order to preclude challenges on constitutional grounds re: cost of goods sold).

### Dual Chartering System

Banks/Credit unions may choose a federal or state charter.

- Federal charter
  - Chartering authority and primary regulator is the Office of the Comptroller of the Currency for banks and the National Credit Union Administration (NCUA) for credit unions.
- State charter
  - In California, the Department of Business Oversight's Division of Financial Institutions is the chartering authority and primary regulator for both banks and credit unions.

National financial institutions must follow federal law and state financial institutions must follow state law. If state-chartered banks and credit unions *only* had to follow state laws, California cannabis businesses could solve banking problems by choosing option 2 above. However, state financial institutions are subject to some oversight and regulatory control from the federal government and they must comply with federal criminal laws (including the Controlled Substances Act).

### Rohrabacher-Blumenauer Amendment

(a.k.a. Hinchey-Rohrabacher, Rohrabacher-Farr)

- Funds appropriated to the Department of Justice (DOJ) may not be used to prevent the implementation of laws that authorize the use, distribution, possession, or cultivation of medical marijuana.
- First enacted in 2014 (after failing 6 times before).
- Renewal at risk under Trump and Sessions.
  - Trump has expressed support for medical marijuana in the past but seemed to reserve the right to prosecute medical marijuana businesses when signing a spending bill in May 2017.
  - Sessions wrote a letter to congressional leaders (Senators McConnell and Schumer, Speaker Ryan, Rep. Pelosi) urging them to exclude the amendment language because it

interferes with the DOJ's ability to enforce the Controlled Substances Act (CSA), under which marijuana is considered unlawful.

- Approved by Senate Appropriations Committee. Floor vote blocked by House Rules Committee on 9/6/17. Currently (as of 9/8) pending conference committee action.

### Cole Memoranda

- Deputy Attorney General James Cole released new guidelines in 2 memos to all U.S. Attorneys (August 2013 and February 2014).
- August 29, 2013 memo outlined 8 enforcement priorities
  - Preventing the distribution of marijuana to minors;
  - Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
  - Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
  - Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
  - Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
  - Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
  - Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
  - Preventing marijuana possession or use on federal property.
- “Outside of these enforcement priorities, however, the federal government has traditionally relied on state and local authorities to address marijuana activity through enforcement of their own narcotics laws. This guidance continues that policy.” (Justice Department, August 29, 2013)
- At that time, Colorado and Washington had already legalized cannabis. The Justice Department expected those states to set up strict regulations, provide adequate funding, and properly enforce (= state-based enforcement efforts) to protect the 8 priorities. If states followed those guidelines, the Justice Department informed governors in CO and WA that it would defer its right to challenge those states' legalization laws, subject to change if the harms (from the list of 8) were not avoided.
- February 13, 2014 memo
  - Addressed DOJ's position on prosecution of financial institutions.
  - Confirmed possibility of criminal prosecution under AML statutes and BSA.
  - Reaffirmed commitment to using limited resources for the most significant cases (those related to the 8 enforcement priorities) vs. prosecuting financial institutions serving clients whose activities do not implicate any of the 8 priorities.
- Neither is legally binding (not codified in formal rulemaking).