Denver Marijuana Management Symposium
Finance Panel
November 1, 2018
Presentation Road Map

Denver’s Revenue and Budgeting Approach
  Molly Duplechian-City of Denver

Hawaii’s Marijuana Banking Solution
  Iris Ikeda-State of Hawaii

Marijuana Taxation System in California
  Cara Martinson & Adam Crabtree-California Cannabis Authority

Tax Issues in the Cannabis Industry
  Mike Goral-SquarMilner

Questions?
Denver: Marijuana Business Licenses

<table>
<thead>
<tr>
<th>Licensed Business</th>
<th># of Licenses</th>
<th># of Locations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grows</td>
<td>562</td>
<td>276</td>
</tr>
<tr>
<td>Stores + Centers</td>
<td>352</td>
<td>216</td>
</tr>
<tr>
<td>MIPs</td>
<td>186</td>
<td>102</td>
</tr>
<tr>
<td>Testing Facilities</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Transporters</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1116</strong></td>
<td><strong>476</strong>*</td>
</tr>
</tbody>
</table>

*Some locations have several licenses and license types at one location. E.g., one location could have both medical and retail grow licenses, a MIP license and a retail and medical store license. Therefore, the total number of locations will not be a sum of the various location types.

Denver currently has **1116** active marijuana business licenses. That’s **36%** of the state’s marijuana licenses. Denver is home to **13%** of the state’s population.
# Marijuana Sales

## Denver Marijuana Sales

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>$149.7M</td>
<td>$219.3M</td>
<td>$291.5M</td>
<td>$377.5M</td>
</tr>
<tr>
<td>Medical</td>
<td>$180.1M</td>
<td>$191.4M</td>
<td>$212M</td>
<td>$206.4M</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$329.8M</td>
<td>$410.7M</td>
<td>$503.5M</td>
<td>$584M</td>
</tr>
<tr>
<td><strong>Total YoY% Change</strong></td>
<td>–</td>
<td>25%</td>
<td>23%</td>
<td>16%</td>
</tr>
</tbody>
</table>

## Colorado State Marijuana Sales

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Marijuana Sales</td>
<td>$303.2M</td>
<td>$577.5M</td>
<td>$861.6M</td>
<td>$1091B</td>
</tr>
<tr>
<td>Medical Marijuana Sales</td>
<td>$380.3M</td>
<td>$418.1M</td>
<td>$445.6M</td>
<td>$416.5M</td>
</tr>
<tr>
<td><strong>Total Marijuana Sales</strong></td>
<td>$683.5M</td>
<td>$995.6M</td>
<td>$130.7B</td>
<td>$150.8B</td>
</tr>
<tr>
<td><strong>Total YoY% Change</strong></td>
<td>–</td>
<td>46%</td>
<td>31%</td>
<td>15%</td>
</tr>
</tbody>
</table>
Denver Marijuana Sales

MEDICAL GROSS SALES

RETAIL GROSS SALES

2014

2015

2016

2017

2018

Millions
Marijuana - % of Colorado GDP

Approximately $1.5 Billion in sales in 2017

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>MJ Sales</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>$306 B</td>
<td>$699 M</td>
<td>0.23%</td>
</tr>
<tr>
<td>2015</td>
<td>$318 B</td>
<td>$996 M</td>
<td>0.31%</td>
</tr>
<tr>
<td>2016</td>
<td>$324 B</td>
<td>$1.3 B</td>
<td>0.40%</td>
</tr>
<tr>
<td>2017</td>
<td>$343 B</td>
<td>$1.5 B</td>
<td>0.40%</td>
</tr>
</tbody>
</table>
Retail Marijuana (7/1/17-10/1/18)

<table>
<thead>
<tr>
<th>State Special Sales Tax</th>
<th>Denver Special Sales Tax</th>
<th>Denver Standard Sales Tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>3.5%</td>
<td>3.65%</td>
<td>22.15%</td>
</tr>
</tbody>
</table>

Retail Marijuana (as of 10/1/18)

<table>
<thead>
<tr>
<th>State Special Sales Tax</th>
<th>Denver Special Sales Tax</th>
<th>Denver Standard Sales Tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>5.5%</td>
<td>3.65%</td>
<td>24.15%</td>
</tr>
</tbody>
</table>

Medical Marijuana

<table>
<thead>
<tr>
<th>State Special Sales Tax</th>
<th>State Standard Sales Tax</th>
<th>Denver Special Sales Tax</th>
<th>Denver Standard Sales Tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.0%</td>
<td>2.9%</td>
<td>0.0%</td>
<td>3.65%</td>
<td>6.55%</td>
</tr>
</tbody>
</table>
Marijuana Revenue in Denver

<table>
<thead>
<tr>
<th>Year</th>
<th>2014 Actuals</th>
<th>2015 Actuals</th>
<th>2016 Actuals</th>
<th>2017 Actuals</th>
<th>2018 Projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5M</td>
<td>$5,200,000</td>
<td>$5,200,000</td>
<td>$7,700,000</td>
<td>$10,200,000</td>
<td>$15,100,000</td>
</tr>
<tr>
<td>$10M</td>
<td>$2,800,000</td>
<td>$3,100,000</td>
<td>$4,300,000</td>
<td>$5,500,000</td>
<td>$6,100,000</td>
</tr>
<tr>
<td>$15M</td>
<td>$5,400,000</td>
<td>$5,100,000</td>
<td>$4,600,000</td>
<td>$5,700,000</td>
<td>$3,400,000</td>
</tr>
<tr>
<td>$20M</td>
<td>$6,500,000</td>
<td>$8,000,000</td>
<td>$10,600,000</td>
<td>$7,500,000</td>
<td>$15,800,000</td>
</tr>
<tr>
<td>$25M</td>
<td>$21,900,000</td>
<td>$30,900,000</td>
<td>$37,400,000</td>
<td>$44,700,000</td>
<td></td>
</tr>
<tr>
<td>$30M</td>
<td>$30,900,000</td>
<td>$7,700,000</td>
<td>$13,200,000</td>
<td>$48,100,000</td>
<td></td>
</tr>
<tr>
<td>$35M</td>
<td>$37,400,000</td>
<td>$7,500,000</td>
<td>$15,800,000</td>
<td>$7,700,000</td>
<td></td>
</tr>
<tr>
<td>$40M</td>
<td>$44,700,000</td>
<td>$13,800,000</td>
<td>$15,800,000</td>
<td>$7,700,000</td>
<td></td>
</tr>
<tr>
<td>$45M</td>
<td>$48,100,000</td>
<td>$15,800,000</td>
<td>$15,800,000</td>
<td>$7,700,000</td>
<td></td>
</tr>
</tbody>
</table>

- **Special Sales Tax - Retail 3.5%**
- **State Shareback**
- **Licensing Fees**
- **Standard Sales Tax - Retail**
- **Standard Sales Tax - Medical**
# Denver Marijuana Revenue as a % Denver General Fund

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Denver General Fund Revenue</td>
<td>$1.124 billion</td>
<td>$1.204 billion</td>
<td>$1.238 billion</td>
<td>$1.309 billion</td>
<td>$1.336 billion</td>
</tr>
<tr>
<td>Total Denver Marijuana Revenue</td>
<td>$21.9 million</td>
<td>$30.9 million</td>
<td>$37.4 million</td>
<td>$44.7 million</td>
<td>$48.1 million</td>
</tr>
<tr>
<td>% of Denver General Fund</td>
<td>1.95%</td>
<td>2.57%</td>
<td>3.02%</td>
<td>3.41%</td>
<td>3.6%</td>
</tr>
</tbody>
</table>
2017 Marijuana Revenue Breakdown

2017 Total Revenue = $44.7 million

- All revenues go to the General Fund
- The special retail sales tax and the state shareback are specifically used for marijuana regulation, enforcement and education.
Marijuana-Related Expenditures in Denver

![Graph showing expenditures in Denver from 2014 to 2018 for regulation, enforcement, and education.]

- **2014**: $4.4M total, $2,815,520 for regulation, $1,425,579 for enforcement, and $746,000 for education.
- **2015**: $5.5M total, $2,235,000 for regulation, $1,394,579 for enforcement, and $1,899,720 for education.
- **2016**: $7.7M total, $2,549,272 for regulation, $2,550,792 for enforcement, and $2,564,803 for education.
- **2017**: $8.6M total, $2,614,492 for regulation, $2,394,820 for enforcement, and $3,508,435 for education.
- **2018**: $8.8M total, $2,805,803 for regulation, $2,365,647 for enforcement, and $3,652,116 for education.
Denver has hired 58 FTEs specifically to handle regulation of the MJ industry

<table>
<thead>
<tr>
<th>Department</th>
<th>FTEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>1</td>
</tr>
<tr>
<td>Children’s Affairs</td>
<td>1</td>
</tr>
<tr>
<td>Behavioral Health</td>
<td>1</td>
</tr>
<tr>
<td>Office of Marijuana Policy (Excise and Licenses)</td>
<td>3.5</td>
</tr>
<tr>
<td>Community Planning and Development</td>
<td>5</td>
</tr>
<tr>
<td>Fire Department</td>
<td>7</td>
</tr>
<tr>
<td>Parks and Recreation</td>
<td>7.43</td>
</tr>
<tr>
<td>Environmental Health</td>
<td>8</td>
</tr>
<tr>
<td>Police Department</td>
<td>11</td>
</tr>
<tr>
<td>City Attorney’s Office</td>
<td>12</td>
</tr>
</tbody>
</table>
Denver – Marijuana Revenue vs Expenses

<table>
<thead>
<tr>
<th>Year</th>
<th>MJ Revenue</th>
<th>MJ Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>$22</td>
<td>$4</td>
</tr>
<tr>
<td>2015</td>
<td>$31</td>
<td>$6</td>
</tr>
<tr>
<td>2016</td>
<td>$37</td>
<td>$8</td>
</tr>
<tr>
<td>2017</td>
<td>$45</td>
<td>$9</td>
</tr>
</tbody>
</table>
Total “Dedicated” Expenditures = $21.1 million ($8.8 million, or 42%, are marijuana-related)
Cannabis is legal in my state, why can’t I find a BANK?

Iris Ikeda
Commissioner of Financial Institutions
Department of Commerce and Consumer Affairs
September 2018
Topics

- Federal laws
- State landscape
- Case study - Hawaii
- What to expect when you open an account
Overview of Federal Law: The Basics

- Controlled Substances Act (21 U.S.C. § 801 et seq.) ("CSA")
  - § 841: Makes it a crime to "manufacture, distribute, or dispense, or possess with intent to manufacture, distribute or dispense, a controlled substance"
  - § 856: Makes it a crime to "manage or control any place, and knowingly and intentionally rent, lease, or make available for use . . . the place for the purpose of unlawfully manufacturing, storing, distributing, or using a controlled substance"

  - Elements:
    - Proceeds of specified unlawful activity ("SUA")
    - Knowledge that proceeds are from some type of felony
    - A financial transaction intended to conceal the proceeds or promote an SUA

  - Elements:
    - Engage or attempt to engage in a monetary transaction in the U.S.
    - By, through, or to a financial institution
    - Knowing that the transaction involves property valued at over $10,000 and derived from an unlawful activity
Aiding and Abetting (18 U.S.C. § 2)

- A person who "aids, abets, counsels, commands, induces or procures" the commission of a federal crime "is punishable as a principal"
  - Elements:
    - Take an affirmative act in furtherance of a crime
    - With the intent of facilitating the crime's commission

- U.S. v. Rosemond, 134 S.Ct. 1240 (2014)
  - A defendant need only facilitate one component of a criminal offense to be liable; there is no need for a defendant to facilitate every element of an offense
  - "A person who actively participates in a criminal scheme knowing its extent and character intends that scheme's commission." Rosemond, 134 S.Ct. at 1249
  - Does not address whether third-party defendants who "incidentally facilitate a criminal venture rather than actively participate in it" (i.e., gun store owner who sells gun to criminal, knowing but not caring how the gun will be used) is liable for aiding and abetting. Id. at 1249 n.8
    - Possible relevance to businesses that provide necessary support to marijuana dispensaries
February 2016 GAO Report on DOJ Marijuana Enforcement

- Prompted by request from Sens. Grassley (R-Iowa) and Feinstein (D-Calif.) to review, among other things, "lessons learned from DOJ's enforcement efforts in response to states' medical marijuana laws"

- DOJ has taken the following actions to monitor the effects of state marijuana legalization relative to the enforcement guidance set forth in the Cole Memo:
  - U.S. Attorneys conduct individual enforcement actions in states that have legalized marijuana and consult with state and local agencies to address concerns regarding effects of marijuana legalization
  - Office of the Deputy Attorney General ("ODAG") officials collaborate with, and assess information provided by, DOJ components and other federal agencies (i.e., DEA)
  - DOJ has not identified how it would use data it collected to monitor "the effects of marijuana legalization relative to each of the eight marijuana enforcement priorities" in the Cole Memo
  - e.g., DOJ collects reports from DEA and other health policy studies, but has not identified how it would use the information contained in the reports
  - e.g., it is unclear how DOJ would use the collected data to determine whether the effects of state marijuana legalization necessitated federal action to challenge a state's regulatory system
U.S. Attorneys and DEA officials in some jurisdictions have targeted the commercial marijuana industry by:

- Sending "warning letters" to approximately 1,900 owners and lien holders of medical marijuana dispensaries from 2007 through 2013 in response to requests from civil leaders, municipalities, and law enforcement officials.
  - Warning letters stated that DOJ may enforce CSA, even if conduct permitted by state law; notified recipients they could be subject to civil and criminal penalties; advised dispensaries to stop distributing marijuana.
  - In the Central District of California, nearly 700 dispensaries closed after receiving warning letters.
  - Some letters stated that dispensaries were illegal under both CSA and state law.

- U.S. Attorneys conduct individual enforcement actions in states that have legalized marijuana and consult with state and local agencies to address concerns regarding effects of marijuana legalization.
Guidance was issued due to the recent state initiatives to legalize certain marijuana-related activity and related guidance by the U.S. Department of Justice ("DOJ") concerning marijuana-related enforcement priorities. This guidance clarifies how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations, and sets out the various BSA reports to be filed with federal and state law enforcement priorities. They believed this guidance would enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.
In general, the decision to open, close, or refuse any particular account or relationship should be made by each financial institution.

Use the appropriate CIP and CDD standard.

- Verifying that the business is duly licensed and registered;
- Reviewing the license application (and related documentation);
- Requesting information about the business and related parties;
- Developing an understanding of the normal and expected activity for the business;
- Ongoing monitoring for adverse information about the business and related parties;
- Ongoing monitoring for suspicious activity; and
- Refreshing CDD information on a periodic basis and commensurate with the risk.
Financial institutions providing financial services to a marijuana-related business that it reasonably believes, based on its customer due diligence, does not implicate one of the Cole Memo priorities or violate state law should file a "Marijuana Limited" SAR.

- Identifying the subject and related parties;
- Addresses of the subject and related parties;
- The fact that the filing institution is filing the SAR solely because the subject is engaged in a marijuana-related business; and
- Start with "MARIJUANA LIMITED" and describe the fact that no additional suspicious activity has been identified.

Know when to upgrade to "MARIJUANA PRIORITY."
FinCEN SAR filing – Marijuana Priority

- Based on its customer due diligence, implicates one of the Cole Memo priorities or violates state law.
- Start with “MARIJUANA PRIORITY” and describe in detail about the suspicious activity.
  - Identifying the subject and related parties;
  - Addresses of the subject and related parties;
  - Details regarding the enforcement priorities the financial institution believes have been implicated; and
  - Dates, amounts, and other relevant details of financial transactions involved in the suspicious activity.
FinCEN SAR – Marijuana Termination

- Used when a financial institution deems it necessary to terminate a relationship with a marijuana-related business in order to maintain their BSA/AML program.
- Start with “MARIJUANA TERMINATION” and note in the narrative the basis for the termination.
- FinCEN encourages Section 314(b) voluntary information sharing if the financial institution becomes aware that the business is opening an account at another financial institution.
FinCEN SAR – Red Flags

- A customer appears to be using a state-licensed marijuana-related business as a front or pretext to launder money derived from other criminal activity (i.e., not related to marijuana) or derived from marijuana-related activity not permitted under state law.

- The business is unable to produce satisfactory documentation or evidence to demonstrate that it is duly licensed and operating within the laws.

- The business is unable to demonstrate the legitimate source of significant outside investments.

- A customer seeks to conceal or disguise involvement in marijuana-related business activity by using a “consulting,” “holding,” or “management” company but is depositing cash that smells like marijuana.
FinCEN SAR – Red Flags (con’t)

- Publicly available sources and databases about the business, its owner(s), manager(s), or other related parties, reveal negative information.
- The business, its owner(s), manager(s), or other related parties are, or have been, subject to an enforcement action by the state or local authorities.
- A marijuana-related business engages in international or interstate activity, including by receiving cash deposits from locations outside the state or large interstate transfers, or otherwise transacting with persons or entities located in different states or countries.
The owner(s) or manager(s) of a marijuana-related business reside outside the state in which the business is located.

A marijuana-related business is located on federal property or the marijuana sold by the business was grown on federal property.

A marijuana-related business’s proximity to a school is not compliant with state law.

A marijuana-related business purporting to be a “non-profit” is engaged in commercial activity inconsistent with that classification, or is making excessive payments to its manager(s) or employee(s).
The Department's expectation is that states and local governments that have enacted laws authorizing marijuana-related conduct will implement strong and effective regulatory and enforcement systems that will address the threat those state laws could pose to public safety, public health, and other law enforcement interests.

If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.
DOJ Cole Memo – (08.29.13)

8 Priorities

- Prevent the distribution of marijuana to minors;
- Prevent revenue from sales to criminal enterprises, gangs, and cartels;
- Prevent the diversion of marijuana from state to state;
- Prevent marijuana to used as a cover/pretext for other illegal drugs or activity;
- Prevent violence and the use of firearms;
- Prevent drugged driving and other adverse public health consequences;
- Prevent the growing of marijuana on public lands; and
- Prevent marijuana possession or use on federal property.
DOJ Cole Memo – Update 02.14.14

- Provides updated guidance to federal prosecutors concerning marijuana enforcement in the exercise of investigative and prosecutorial discretion under the CSA.
- The Cole Memo guidance applies to all of DOJ’s federal enforcement activity, including civil enforcement and criminal investigations and prosecutions, concerning marijuana in all states.
- This guidance and any state or local law does NOT provide a legal defense to a violation of federal law, including any civil or criminal violation of the CSA, the money laundering and unlicensed money transmitter statutes, or the BSA, including the obligation of financial institutions to conduct customer due diligence.
Financial institutions and individuals choosing to service marijuana-related businesses that are not compliant with such state regulatory and enforcement systems, are more likely to risk activities that implicates the eight federal enforcement priorities.

Financial institutions must continue to apply appropriate risk-based anti-money laundering policies, procedures, and controls sufficient to address the risks posed by these customers.

Prosecutors will continue to review marijuana-related prosecutions on a case-by-case basis and weigh all available information and evidence in determining whether particular conduct falls within the identified priorities.
In the memorandum, Attorney General Jeff Sessions directs all U.S. Attorneys to enforce the laws enacted by Congress and to follow well-established principles when pursuing prosecutions related to marijuana activities. This return to the rule of law is also a return of trust and local control to federal prosecutors who know where and how to deploy Justice Department resources most effectively to reduce violent crime, stem the tide of the drug crisis, and dismantle criminal gangs.
State considerations

- Encourage financial institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers.

- Institutions are expected to assess the risks posed by an individual customer on a case-by-case basis.

- Implement controls to manage the relationship commensurate with the risks associated with each customer.
State considerations

- Banks are hesitant to provide certain types of banking services due to concerns that they will be unable to comply with BSA.
- It is not possible for a financial institution to detect and report all potentially illicit transactions.
- Isolated or technical violations, which occur within an otherwise adequate system of policies, procedures, and processes, generally do not prompt serious regulatory concern.
- The risk-based BSA/AML program established and maintained should allow the institution to appropriately manage customer accounts, while generally detecting and deterring illicit financial transactions.
Banks are hesitant to provide certain types of banking services due to concerns that they will be unable to comply with BSA.

It is not possible for a financial institution to detect and report all potentially illicit transactions.

Isolated or technical violations, which occur within an otherwise adequate system of policies, procedures, and processes, generally do not prompt serious regulatory concern.

The risk-based BSA/AML program established and maintained should allow the institution to appropriately manage customer accounts, while generally detecting and deterring illicit financial transactions.
Case Study – Hawaii solution

- **What makes this solution unique?**
  This solution would establish the first *cashless* system for cannabis related services in the nation.

- This process utilizes financial technology (“FinTech”) and a financial institution to help deliver services in a manner that is fast and safe for consumers. It also addresses public safety in making the transactions cashless so that consumers and retailers do not need to handle and store cash for product. The system establishes a safer environment for medical cannabis-using patients and businesses to operate.

- Hawaii could be the sandbox to test this type of payment system as a safe way for consumers to buy product, and for cannabis dispensaries to use traditional financial services to legally conduct transactions such as paying wages and vendors, including taxes.
Case Study – Hawaii solution

- **What is the Hawaii solution?**
  
  The state has identified a Colorado credit union to provide limited financial services for Hawaii medical cannabis dispensaries on a temporary basis, and for a vendor to process point of sale transactions at the dispensaries.

- A retail dispensary consumer would need to voluntarily signup with CanPay, a debit payment mobile application.

- When making a purchase, the consumer would use the mobile application to generate a QR code to facilitate payment from the patient’s checking account to the dispensary. The QR code is for one-time use and will expire after 30 minutes.
You found a bank – What to expect when you open the account...

- CIP – 10-25% ownership, executive officers
- CDD (new rules effective 5/11/2018)
- Current customer base
  - Customers
  - Private ATM
  - Armored cars
  - Security firms
- Currency transaction reporting (cash deposits)
- On-going monitoring (use of software, manual, frequency of monitoring)
- Fees
You found a bank – Here’s what the bank expects

- Maintain Reputation in the community
- Fines by bank regulators
- Enforcement by federal law enforcement
- Fees to cover compliance costs
  - Monitor current cannabis account and customer base
  - File Currency transaction reports (cash deposits)
  - On-going monitoring (use of software, manual, frequency of monitoring)
  - Continuous report filing to FinCEN
- Knowledgeable staff – from tellers to back office to execs to Board
Congressional actions

- Omnibus appropriation bill – rider that continues to bar the DOJ from enforcing the federal marijuana ban in some circumstances.
  - Use, distribution, possession, or cultivation of medical marijuana
  - Extended Dec 7, 2018

- States Act: introduced June 7, 2018 Senators Cory Gardner (R-Colorado) and Elizabeth Warren (D-Massachusetts). House companion bill Reps Earl Blumenauer (D-Oregon) and David Joyce (R-Ohio)
  - The act would amend the Controlled Substances Act of 1970 to exempt from federal enforcement individuals or corporations in states who are in compliance with U.S. state laws

- Safe Harbor:
  - To address the lack of clarity for how banks can serve this industry, without the threat of forfeiture of assets or criminal penalties, results in many transactions occurring in cash.
Conclusion

- Banks and other financial institutions may open accounts for high risk businesses such as medical marijuana related businesses based on the risk assessment and risk tolerance of the financial institution.
- Banks and other financial institutions must use the appropriate customer due diligence standards.
- Regulators will be examining banks for BSA/AML compliance.
- If violations are found, regulatory action will be taken.
Contact Information

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Twitter: @Hawaii DFI
Denver Marijuana Management Symposium
Cara Martinson, Executive Director - CCA
Adam Crabtree, CEO - NCS Analytics
November 1, 2018
CA California Cannabis Laws

• 1996 Proposition 215 - Medical Marijuana.

• 2015 MCRSA - Statewide Medical Marijuana Framework.

• 2016 Proposition 64 - Legalization of Adult Use Cannabis.

• 2017 MAUCRSA: SB 94/ AB 133 - One Med/Adult Use Framework.

• 2017/18 Implementation - Cities and counties begin to adopt local programs to implement dual licensing system.

• 2018/19 Additional Time - SB 1459 (2018) Allows State to issue a Provisional Annual License to a Temp License that hasn’t completed local permitting process.

• 2019 State Track & Trace Begins – Temp licenses expire & Tracing begins with the issuance of Annual, and/or Provisional Annual Licenses.
Dual Licensing Process

**Local Regulation**
- All cannabis businesses must obtain a local permit, license or other authorization in order to obtain a state license in California.

**State Bureau of Cannabis Control**
- Distributors
- Retailers
- Microbusinesses
- Testing Labs
- Temporary Event Permits

**State Department of Food & Agriculture**
- Cultivators
- Track and Trace System

**State Department of Public Health**
- Manufacturing
Proposition 64 Vote: 2016
19 Counties Permit & Regulate Commercial Cannabis Activity:
Alameda, Humboldt, Imperial, Inyo, Lake, Marin*, Mendocino, Mono, Monterey,
Santa Barbara, Santa Cruz, San Luis Obispo, San Mateo, Sonoma, Stanislaus,
Trinity, Yolo, San Francisco, Ventura*

9 Counties Actively In Process of Developing Ordinances:
Contra Costa, El Dorado, Kern, Los Angeles, Napa, Nevada, Plumas, San Benito,
San Joaquin

30 Counties Ban Commercial Cannabis Activity:
Alpine, Amador, Butte, Calaveras, Colusa, Del Norte, Fresno, Glenn, Kings,
Lassen, Madera, Mariposa, Merced, Modoc, Orange, Placer, Riverside,
Sacramento, Shasta, San Bernardino, San Diego, Santa Clara, Sierra, Siskiyou,
Solano, Sutter, Tehama, Tulare, Tuolumne, Yuba

*Allows Delivery Only
State & Local Taxes Rates

STATE TAXES

• 15% excise tax on all cannabis and cannabis products.
• Cultivation- $9.25 per dry-weight ounce of cannabis flower and $2.75 per dry-weight ounce of cannabis leaves.

LOCAL TAXES

• Cities and Counties have the ability to impose their own retail and cultivation taxes.
• Taxes range at the local level. For example:
  • Humboldt County: Cultivation Only, ranging from $1-3 per sq ft.
  • Yolo County: Up to 15% gross receipts, starting at 5%, 4% on cultivation increasing to 5% in the third year.
  • Santa Barbara: 1% gross receipts on nurseries and distributors; 3% on manufacturers; 4% on cultivation; 6% on retailers & microbusiness.
Identifying the Gaps

• State’s Track & Trace system is not directly accessible to local governments.
• Limited enforcement resources at the local level.
• Low tax compliance rates.
• Need for standardized data collection.
• Need for data verification & centralization.
• Need for common metrics to measure impacts.
• **A County Joint Powers Authority** - A public entity exercising common powers to collect and manage cannabis regulatory and taxation data.

• **Two primary goals:**

1. Provide actionable, real-time information to local governments for efficient and cost effective regulation.
2. Link willing financial institutions with cannabis businesses by providing banks with comprehensive, ongoing licensing and regulatory data on cannabis businesses.

• Authority has the power to request data from the state on behalf of Members, and compel businesses within Member’s jurisdiction to provide data.
CCA & NCS Analytics Partnership
NCS Analytics

Continuous monitoring is made easy as the platform refreshes client data on a daily or scheduled basis. Data is continuously analyzed and the most up to date information is presented to clients providing comprehensive view of activity in the fastest way possible.

Allowing regulators to configure and utilize GIS software creates a different view of the data to show trends and problem areas.
## Data Verification

### Taxation

#### Tax Gap

Applying to Cash-Intensive Businesses (especially CRBs)

#### Results and Returns

<table>
<thead>
<tr>
<th>Month</th>
<th>State</th>
<th>County Tax</th>
<th>Point-of-Sale</th>
<th>State Regulated Track and Trace</th>
<th>Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>16-Jan</td>
<td>No Data</td>
<td>No Data</td>
<td>No Data</td>
<td>No Data</td>
<td>No Data</td>
</tr>
<tr>
<td>16-Feb</td>
<td>No Data</td>
<td>No Data</td>
<td>$17,100.00</td>
<td>$463.14</td>
<td>$17,563.14</td>
</tr>
<tr>
<td>16-Mar</td>
<td>$122,055</td>
<td>$121,683</td>
<td>$59,102.65</td>
<td>$15,352.90</td>
<td>$74,455.55</td>
</tr>
<tr>
<td>16-Apr</td>
<td>$129,299</td>
<td>$148,073</td>
<td>$30,644.00</td>
<td>$23,401.00</td>
<td>$54,245.00</td>
</tr>
<tr>
<td>16-May</td>
<td>$148,312</td>
<td>$145,010</td>
<td>$66,405.00</td>
<td>$24,682.00</td>
<td>$91,087.00</td>
</tr>
<tr>
<td>16-Jun</td>
<td>$114,830</td>
<td>$111,842</td>
<td>$52,756.00</td>
<td>$31,346.00</td>
<td>$84,102.00</td>
</tr>
<tr>
<td>16-Jul</td>
<td>$90,561</td>
<td>$87,847</td>
<td>$75,247.00</td>
<td>$29,408.00</td>
<td>$101,657.00</td>
</tr>
<tr>
<td>16-Aug</td>
<td>$39,160</td>
<td>$38,258</td>
<td>$55,922.00</td>
<td>$30,801.00</td>
<td>$86,723.00</td>
</tr>
<tr>
<td>16-Sep</td>
<td>$47,691</td>
<td>$46,141</td>
<td>$65,867.00</td>
<td>$30,782.00</td>
<td>$96,649.00</td>
</tr>
<tr>
<td>16-Oct</td>
<td>$45,814</td>
<td>$43,966</td>
<td>$62,444.78</td>
<td>$32,280.00</td>
<td>$94,724.78</td>
</tr>
<tr>
<td>16-Nov</td>
<td>$37,402</td>
<td>$35,731</td>
<td>$62,792.00</td>
<td>$39,459.00</td>
<td>$102,251.00</td>
</tr>
<tr>
<td>16-Dec</td>
<td>$45,125</td>
<td>$43,415</td>
<td>$65,733.70</td>
<td>$41,493.00</td>
<td>$107,226.70</td>
</tr>
<tr>
<td>Average*</td>
<td>$82,025</td>
<td>$82,197</td>
<td>$55,819</td>
<td>$26,970</td>
<td>$65,409</td>
</tr>
</tbody>
</table>
# High Risk Reports – Red Flags

## NCS Month End Report

**Client:** COMPANY

**Business:** DISPENSARIES

### Dispensary Summary

NCS per-formed to include on a transactional report from September 2016 to November 2016. NCS used data from bank-verified data from various sources including bank transactions, state tax filings, POS data, and MME data for state tax filings.

### Gross Sales by Month

<table>
<thead>
<tr>
<th>Month</th>
<th>Sales Taxes</th>
<th>Deposits</th>
<th>MISC</th>
<th>POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>$144,580.60</td>
<td>$33,965.00</td>
<td>$555,516.16</td>
<td>$377,649.92</td>
</tr>
<tr>
<td>October</td>
<td>$442,700.00</td>
<td>$414,379.76</td>
<td>$361,016.16</td>
<td>$423,574.83</td>
</tr>
<tr>
<td>November</td>
<td>$575,385.69</td>
<td>$362,046.98</td>
<td>$362,093.56</td>
<td>$404,032.04</td>
</tr>
</tbody>
</table>

### Average Gross Sales by Month

<table>
<thead>
<tr>
<th>Month</th>
<th>Sales Taxes</th>
<th>Deposits</th>
<th>MISC</th>
<th>POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>$553,593.32</td>
<td>$362,046.98</td>
<td>$362,093.56</td>
<td>$404,032.04</td>
</tr>
</tbody>
</table>

### Gross Sales by Month (Variance)

<table>
<thead>
<tr>
<th>Month</th>
<th>Sales Taxes</th>
<th>Deposits</th>
<th>MISC</th>
<th>POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>$553,593.32</td>
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<td>$553,593.32</td>
<td>$362,046.98</td>
<td>$362,093.56</td>
<td>$404,032.04</td>
</tr>
</tbody>
</table>

## Market Analysis

### Product Cost per Unit (FLS)

<table>
<thead>
<tr>
<th>Product</th>
<th>September 2016</th>
<th>October 2016</th>
<th>November 2016</th>
<th>For the Month of November 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cannabis</td>
<td>$2,645.00</td>
<td>$2,165.13</td>
<td>$1,895.30</td>
<td>$2,754.70</td>
</tr>
<tr>
<td>MISC</td>
<td>$11.50</td>
<td>$12.31</td>
<td>$14.40</td>
<td>$15.05</td>
</tr>
<tr>
<td>Total</td>
<td>$2,656.50</td>
<td>$2,177.44</td>
<td>$1,879.70</td>
<td>$2,769.75</td>
</tr>
</tbody>
</table>

### Product Sold per Unit (for Rec Location 1)

<table>
<thead>
<tr>
<th>Product</th>
<th>September 2016</th>
<th>October 2016</th>
<th>November 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cannabis</td>
<td>9,317.00</td>
<td>8,710.00</td>
<td>4,997.00</td>
</tr>
<tr>
<td>MISC</td>
<td>3,000.00</td>
<td>2,500.00</td>
<td>1,000.00</td>
</tr>
<tr>
<td>Total</td>
<td>12,317.00</td>
<td>11,210.00</td>
<td>5,997.00</td>
</tr>
</tbody>
</table>

### Gross Sales by Month for Rec Location 1

<table>
<thead>
<tr>
<th>Month</th>
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<th>Deposits</th>
<th>MISC</th>
<th>POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>$10,000.00</td>
<td>$3,000.00</td>
<td>$4,000.00</td>
<td>$5,000.00</td>
</tr>
<tr>
<td>October</td>
<td>$15,000.00</td>
<td>$5,000.00</td>
<td>$6,000.00</td>
<td>$7,000.00</td>
</tr>
<tr>
<td>November</td>
<td>$20,000.00</td>
<td>$7,000.00</td>
<td>$8,000.00</td>
<td>$9,000.00</td>
</tr>
</tbody>
</table>

### Sales by Month for Rec Location 1

<table>
<thead>
<tr>
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<th>Sales Taxes</th>
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<th>POS</th>
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<td>$4,000.00</td>
<td>$5,000.00</td>
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<td>$15,000.00</td>
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<td>$6,000.00</td>
<td>$7,000.00</td>
</tr>
<tr>
<td>November</td>
<td>$20,000.00</td>
<td>$7,000.00</td>
<td>$8,000.00</td>
<td>$9,000.00</td>
</tr>
</tbody>
</table>

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Company Confidential
Broken down by previous three months as well as current MTD with near real-time capabilities.

Reports on each individual location within a larger company.

Shows each location’s specific products sold based on what is reported to the tracking system.

Near Real Time Monitoring

NCS analysts use internal tools and live data for near real-time alerts of produce-price variances.

### Cost Per Unit/Gram By Product Type

<table>
<thead>
<tr>
<th>Location - 120</th>
<th>Product Type</th>
<th>Sep-16</th>
<th>Oct-16</th>
<th>Nov-16</th>
<th>Dec-16</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Buds</td>
<td>$5.54</td>
<td>$6.49</td>
<td>$6.57</td>
<td>$6.62</td>
</tr>
<tr>
<td></td>
<td>Concentrate</td>
<td>$25.89</td>
<td>$25.62</td>
<td>$24.47</td>
<td>$22.60</td>
</tr>
<tr>
<td></td>
<td>Concentrate (Each)</td>
<td>$29.70</td>
<td>$16.64</td>
<td>$20.44</td>
<td>$15.10</td>
</tr>
<tr>
<td></td>
<td>Infused (edible)</td>
<td>$15.43</td>
<td>$16.61</td>
<td>$17.59</td>
<td>$19.44</td>
</tr>
<tr>
<td></td>
<td>Infused (non-edible)</td>
<td>$19.35</td>
<td>$21.13</td>
<td>$26.54</td>
<td>$17.80</td>
</tr>
</tbody>
</table>
Please send questions to:

Cara Martinson
CCA Executive Director
913-327-7500
cmartinson@cca.ca.gov

www.cca.ca.gov
Denver Marijuana Management Symposium

November 1, 2018

Mike Goral
Tax Partner
mgoral@squarmilner.com
Cases & Recent Developments

• IBM will provide block chain technology to British Columbia and Canada
  - Provides seed to sale track and trace
  - Can be expanded to include tax reporting and collection

• Bitcoin will not provide the necessary reporting structure to meet Financial Crimes Enforcement Network (FINCEN)

• Banking bill blocked in US House and Senate despite positive news from both parties towards cannabis industry

• California Banking Bill filed to pass

• US Tax Court Case – Alterman v. Comm TC Memo 2018-83
  - Colorado taxpayer argued CHAMP case and two lines of business
  - Court argued Canna Care case and one line of trafficking business
  - Bad facts: 1) Did taxpayer have the proper licenses?
                2) Taxpayer had poor records
Non Profit Mutual Benefit Corporation
Conversion to For Profit Entity

- Local government rule

- Tax considerations
  - Conversion
  - New Entity
    ✓ Cost Basis
    ✓ NOL’s other tax attributes
  - Place in overall corporate / pass through structure
  - Federal verses State tax treatment
    ✓ CA C corporation no IRC 280 E penalty
    ✓ CA Flow through or SMLLC – subject to IRC 280 E
  - Ownership Disputes
<table>
<thead>
<tr>
<th>C corporation</th>
<th>Flow Through Entity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Tax Rate = 21 %</td>
<td>• Top Individual Tax Rate = 37%</td>
<td></td>
</tr>
<tr>
<td>• Dividends = 23.8 %</td>
<td>• IRC Sec 199A</td>
<td></td>
</tr>
<tr>
<td>• Total = 44.8 %</td>
<td>– 20% deduction for qualified business income</td>
<td></td>
</tr>
<tr>
<td>• Subject to double tax</td>
<td>– Limited to taxable income below $157,500 for individual or $315,000 for joint filers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>– Not available to service businesses based on reputation or skill</td>
<td></td>
</tr>
</tbody>
</table>
Cultivation Tax
$ 9.25 per oz. – cannabis flower
$ 2.75 per oz. – cannabis leaves
$ 1.29 per oz. – fresh plant

Excise Tax
Cost + 60% x 15% = excise tax

Sales Tax
- 8.25% - 9.5% total retail price
- No sales tax for medical card holder but excise tax still applies

Local Tax
- Varies but approximately 6%
- Calculation varies with and without sales tax
Cases & Recent Developments

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