Planning for Unique, Illiquid, Illegal and Unusual Assets: Good Grief, Grandma's Got a Gun Collection! (Part 2)

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V. 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

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be registered with the FAA civil aircraft registry. 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

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[2]

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.[3]

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.[4] This is true even if the aircraft is legally based and pays tax in another state.

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1 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 http://www.faa.gov/documentLibrary/media/Form/AC 8050 1 OMB 4 2017.pdf), 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).

2 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 May 1, 2016).

3 RCW 82.48.020, 82.48.100 (exempt aircraft).

4 RCW 8.48.100(3).

Most states consider transfers of aircraft to a revocable trust not to be a taxable event.[5] 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.[6] Moreover, some jurisdictions tax the transfer of a plane by a corporation or partnership to one of its affiliates solely for liability protection purposes.[7]

C. Ownership Through an Entity

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.[8] 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.[9] 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.

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

6 *See, e.g.,* 35 Ill. Comp. Stat. 157/10 15.

7 *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).

8 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.

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

Again, beware that 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, engine, propeller, or appliance. Note that ADs [0] 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:

- 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. [2]

- A certified copy of the complete trust instrument and a "copy of each document legally affecting a relationship under the trust." [3]

- 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

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

11 For more information, download the form at Information to Aid in the Registration of U.S. Civil Aircraft, AC Form 8050 94.

12 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.

13 14 C.F.R. §47.7(c)(2)(i).

confidentiality is a concern, clients should use a single purpose trust for aircraft.

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. [4] 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 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. [5] On top of the fines, insurance coverage

14 14 C.F.R. §91.1001(b)(2).

15 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).

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.

G. 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. [6] 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 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.

VI. Cannabis

A. Introduction

For decades, marijuana transactions in the United States were conducted under implicit or explicit prohibition. In the last few years, states have increasingly moved to legalize, tax, and regulate marijuana for medical and/or recreational purposes. A November 2014 Gallup poll found that more than half of Americans think marijuana should be legal for both medical and recreational purposes. [7] A widespread shift in the public's attitude toward the substance is providing operators and investors with opportunities for business growth and development. Many believe that the industry is on the verge of becoming mainstream.

According to studies by ArcView Market Research, legal marijuana is among the fastest-growing markets in the United States. Researchers estimated that $3.5 billion worth of legal marijuana would be sold in 2015, up from $2.7 billion in 2014 and $1.55 billion in 2013. [8] It is likely that additional states will legalize marijuana for recreational adult use in the next several years, creating exponential growth in the cannabis market, significant wealth for many in the industry, and complex ethical and legal issues for estate planners. This commentary provides an overview of the federal and state legal landscape and discusses the estate planning, tax, leasing, intellectual property, and ethical considerations for attorneys advising in this area.

B. Federal Law

Under the federal Controlled Substances Act (CSA), the cultivation, distribution, and possession of cannabis are prohibited for any reason other than to engage in federally approved research. The purpose of the CSA is to regulate and facilitate the manufacture, distribution, and use of controlled substances for legitimate medical, scientific, research, and industrial purposes, and to prevent these substances from being diverted for illegal purposes. The CSA places various plants, drugs, and chemicals into one of five

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16 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.

17 Lydia Saad, Gallup, Inc., *Majority Continues to Support Pot Legalization in U.S.* (Nov. 6, 2014), *available at* http://www.gallup.com/poll/179195/majority continues support pot legalization.aspx.

18 *See* The Economist, *Silicon Valley Meets Bob Marley* (July 4, 2015), *available at* http://www.economist.com/news/united states/21656726 rise cannabis capitalism silicon valley meets bob marley.

schedules based on a substance's medical use, potential for abuse, and safety or dependence liability. [9] Schedule I substances are deemed to have no currently accepted medical use in treatment and can only be used in very limited circumstances, whereas substances classified in Schedules II, III, IV, and V have recognized medical uses and may be manufactured, distributed, and used in accordance with the CSA. Federal civil and criminal penalties are available for anyone who manufactures, distributes, imports, or possesses controlled substances in violation of the CSA.[20]

When Congress enacted the CSA in 1970, marijuana was classified as a Schedule I drug.[2] Today, marijuana is still categorized as a Schedule I controlled substance and is therefore subject to the most severe restrictions contained within the CSA. Pursuant to the CSA, the unauthorized cultivation, distribution, or possession of marijuana is a federal crime.[22]

C. State Legalization Initiatives

1. Washington and Colorado

In 2012, voters in Washington approved I-502, an initiative amending state law to provide that the possession of small amounts of marijuana is not a violation of Washington law.[23] Under the initiative, individuals over the age of 21 may possess certain quantities of marijuana for private use. In addition to legalizing possession, 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.[24]

The initiative established a three-tier production, processing, and retail licensing system that permits the state to retain regulatory control over the commercial life cycle of marijuana. Qualified individuals must obtain a producer's license to grow or cultivate marijuana; a processor's license to process, package, and label the drug; or a retail license to sell marijuana to the general public.[25] The WSLCB adopted detailed rules for implementing the initiative, including marijuana license qualifications and an application process, application fees, marijuana packaging and labeling restrictions, recordkeeping and security requirements for marijuana facilities, and reasonable time, place, and manner advertising restrictions. By lottery, the WSLCB issued 334 retail licenses in 2014. In 2015, Senate Bill 5052 brought medical marijuana under

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19 Controlled Substances Act, Pub. L. No. 91 513, 84 Stat. 1236 (1970).

20 For a detailed description of the CSA's civil and criminal provisions, see Brian T. Yeh, CRS Report RL30722, *Drug Offenses: Maximum Fines and Terms of Imprisonment for Violation of the Federal Controlled Substances Act and Related Laws* (Jan. 20, 2015), *available at* https://www.fas.org/sgp/crs/misc/RL30722.pdf.

21 21 U.S.C. §812(c).

22 Very narrow exceptions to the federal prohibition do exist. For example, one may legally use marijuana if participating in an FDA approved study or in the Compassionate Investigational New Drug program.

23 Washington Initiative 502 §20, *amending* RCW 69.50.4013 (July 8, 2011), *available at* http://sos.wa.gov/_assets/elections/initiatives/i502.pdf.

24 *Id.* §4.

25 *Id.*

the system and rules of I-502.[26]

Unlike the relatively specific Washington initiative, Colorado's constitutional amendment provided only a general framework for the legalization, regulation, and taxation of marijuana in Colorado leaving regulatory implementation to the Colorado Department of Revenue. 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 marijuana, or to possess, grow, process, or transport up to six marijuana plants.[27]

The amendment also provides that it shall not be unlawful for a marijuana-related facility to purchase, manufacture, cultivate, process, transport, or sell larger quantities of marijuana 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, similar to that established in Washington, involving the licensing of marijuana cultivation facilities, marijuana product manufacturing facilities, and retail marijuana stores. To implement the amendment, the Colorado General Assembly passed three bills that were signed into law on May 28, 2013.[28]

On September 9, 2013, the Colorado Department of Revenue and State Licensing Authority adopted regulations to implement licensing qualifications and procedures for retail marijuana 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.[29]

In late 2013, the Colorado Marijuana Enforcement Division issued its first recreational marijuana licenses to 348 businesses (136 retail stores, 31 product companies, 178 growing facilities, and 3 testing laboratories).[30] While these businesses were granted state approval to produce and sell marijuana, they may have also needed to gain additional licensing approval from local governments prior to their operation.

2. Transfer of Ownership in Washington and Colorado

Both Washington and Colorado limit ownership of retail licenses based on age, residency, and criminal history. Neither state anticipates ownership of a license by a trust, nor does either state provide guidance for a fiduciary that may be tasked with managing a marijuana license.

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26 Adopts a comprehensive act that uses the regulations in place for the recreational market to provide regulation for the medical use of marijuana.

27 Colorado Amendment 64, *amending* Colo. Const. art. XVIII, §16(3), *available at* www.fcgov.com/mmj/pdf/amendment64.pdf (last visited Mar. 30, 2016).

28 *See* Colo. Dep't of Revenue, Permanent Rules Related to the Colorado Retail Marijuana Code (Sept. 9, 2013).

29 *Id.*

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

Washington requires approval from the WSLCB for a transfer to anyone other than a surviving spouse.[3] As an initial matter, the WSLCB may not issue 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 three 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.[32] In addition, 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.[33]

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

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

b. Must be 21 years of age;

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

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

e. 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;

f. 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);

g. 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;

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

i. May not employ any person at the retail marijuana business who has not passed a criminal history record check.[34]

31 RCW 69.50.339.

32 RCW 69.50.331.

33 *Id.*

34 Colo. Rev. Stat. §12 43.4 306.

D. Other State Law Developments

In 2014, voters in Oregon and Alaska approved ballot measures legalizing the recreational use of marijuana.

In Oregon, Measure 91, the Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act, allows Oregonians to grow limited amounts of marijuana on their property and to possess personal limited amounts of recreational marijuana for personal use as of July 1, 2015 under Oregon law. The measure also gives the Oregon Liquor Control Commission (OLCC) authority to tax, license, and regulate recreational marijuana grown, sold, or processed for commercial purposes. The OLCC does not regulate the home growing and personal possession provisions of the law. Nor does it regulate the sale of small amounts of recreational marijuana through medical marijuana dispensaries that began on October 1, 2015. The OLCC began accepting applications for growers, wholesalers, processors, and retail outlets on January 4, 2016.

Alaska is still in the process of developing rules and regulations governing the issuance of marijuana licenses. In addition, other states are currently considering or have recently considered ballot measures dealing with medical, recreational, or decriminalized marijuana.

In some states, measures have been introduced that would establish a regulatory framework for commercial sales of marijuana and join the broader state-by-state effort to end prohibition of the drug. And other states are considering measures that would decriminalize marijuana by eliminating criminal penalties for possession of small amounts of the substance.

Although many initiatives and ballot measures have died in the legislatures, the continued introduction of these bills is a clear indication that the issue of legalized or decriminalized marijuana will remain on the table in the years to come.

E. Cole Memoranda

In light of the developments at the state level, U.S. Department of Justice Deputy Attorney General James Cole issued a memorandum in August 2013 (Cole II Memo) to all U.S. Attorneys that provides guidance to federal prosecutors concerning marijuana enforcement under the CSA.[35] The Cole II Memo guidance applies to all of the Department of Justice's federal enforcement activity, including civil enforcement and criminal investigations and prosecutions, concerning marijuana in all states.

The memorandum expanded upon an earlier memorandum, often referred to as the Cole I Memo, that expresses the Department of Justice's position that, although marijuana is a dangerous drug that remains illegal under federal law, the federal government will not pursue legal challenges against jurisdictions that authorize marijuana in some fashion, assuming those state and local governments maintain strict regulatory and enforcement controls on marijuana cultivation, distribution, sale, and possession that limit

35 James M. Cole, Deputy Attorney General, Memorandum for All U.S. Attorneys, *Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use* (June 29, 2011), *available at* http://www.drugpolicy.org/sites/default/files/DOJ_Guidance_on_Medicinal_Marijuana_1.pdf.

the risks to "public safety, public health, and other law enforcement interests."[36]

The Cole II Memo instructs federal prosecutors to prioritize their "limited investigative and prosecutorial resources to address the most significant [marijuana-related] threats"[37] and identified the following eight activities as those that the federal government wants most to prevent:

1. Distributing marijuana to children;

2. Revenue from the sale of marijuana going to criminal enterprises, gangs, and cartels;

3. Diverting marijuana from states that have legalized its possession to other states that prohibit it;

4. Using state-authorized marijuana activity as a pretext for the trafficking of other illegal drugs;

5. Using firearms or violent behavior in the cultivation and distribution of marijuana;

6. Exacerbating adverse public health and safety consequences due to marijuana use, including driving while under the influence of marijuana;

7. Growing marijuana on the nation's public lands; and

8. Possessing or using marijuana on federal property.[38]

The memorandum advises U.S. Attorneys and federal law enforcement to devote their resources and efforts toward any individual or organization involved in any of these activities, regardless of state law. Furthermore, the memorandum recommends that jurisdictions that have legalized some form of marijuana activity "provide the necessary resources and demonstrate the willingness to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities."[39] However, the memorandum cautions that, to the extent that state enforcement efforts fail to sufficiently protect against the eight harms listed above, the federal government retains the right to challenge those states' marijuana laws.

More recently, in *United States v. Marin Alliance for Medical Marijuana* (MAMM),[40] the U.S. District Court for the Northern District of California held that the Department of Justice's permanent injunction against MAMM's distribution of marijuana in violation of the CSA could only be enforced against MAMM to the extent it was in violation of state law concerning the use, distribution, possession, or cultivation of medical marijuana. While this is a medical marijuana case, it highlights the move toward ending federal government interference in marijuana-related activities that are legal under state law.

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36 James M. Cole, Deputy Attorney General, *Memorandum for All U.S. Attorneys, Guidance Regarding Marijuana Enforcement* (Aug. 29, 2013), *available at* http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

37 *Id.* at 1.

38 *Id.* at 1 2.

39 *Id.* at 2 3.

40 No. C 98 00086 CRB (N.D. Cal. Oct. 19, 2015).

F. Treasury Department Guidance

In addition to the guidance issued by the Department of Justice, 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 marijuana-related businesses in light of state initiatives to legalize certain marijuana-related activity.[4]

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. Thorough customer due diligence is a critical aspect of making this assessment. In assessing the risk of providing services to a marijuana-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;
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> 2. Reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business;
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> 3. Requesting from state licensing and enforcement authorities available information about the business and related parties;
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> 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);
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> 5. Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
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> 6. Ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and
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> 7. Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.[42]

In addition, under the FinCEN guidance, a financial institution that decides to provide financial services to a marijuana-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 marijuana-related business.

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41 FinCEN, BSA Expectations Regarding Marijuana Related Businesses (Feb. 14, 2014), *available at* http://www.fincen.gov/statutes_regs/guidance/html/FIN-2014-G001.html.

42 *Id.*

G. Cannabis in the Estate Plan

As the stigma around marijuana diminishes and the legal and regulatory environments evolve, estate planners will likely be in the position of advising clients with marijuana-related assets.

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

If a fiduciary agrees to serve and is qualified to do so, he or she must then determine whether trust, estate, and named beneficiaries are eligible to own licenses based on state law. Both Washington and Colorado impose age, residency, and criminal history requirements on license ownership.[43] 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 the 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 marijuana 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 marijuana 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 marijuana licenses.

H. 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.[44] Although beyond the scope of this outline, in some instances, the cost of goods sold may be deductible under Code §280E,[45] but the ordinary and necessary expenses related to sale are not.

At death, it is important to 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.[46]

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43 RCW 69.50.331; Colo. Rev. Stat. §12 43.4 306.

44 I.R.C. §280E.

45 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.

46 *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 marijuana based on the wholesale street market value).

To make matters more complicated, under the Electronic Federal Tax Payment System, since January 11, 2011, tax payments may not be made in cash.[47] A 10% penalty may be imposed for each cash payment, although exceptions may be made for certain taxpayers unable to obtain bank accounts.[48]

I. 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.

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.

The timeline for starting a cannabis venture is slightly 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 marijuana 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.[49] If a lessee is involved in criminal activity, the land may be held as evidence during an investigation.

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.

47 Treas. Reg. §31.6302 1(h)(3).

48 IRM 20.1.4.2.

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

J. Intellectual Property Issues

Major innovation is occurring in the marijuana industry, and naturally, patents, trademarks, copyrights, and trade secrets will be assets of our clients or their businesses. Fiduciaries will need to consider the intellectual property implications of any marijuana-related asset of a trust or estate. As a matter of policy, the United States Patent and Trademark Office 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.[50] However, in states where marijuana has been legalized, state registration may be possible and would give the right to sue under state law.[5] Fiduciaries should also be aware of possible trademark infringement litigation. For example, in 2014, the Hershey Company sued Conscious Care Cooperative, a Washington medical marijuana dispensary, alleging that the retailer sold infringing products such as "Reefer's Peanut Butter Cups" and "Mr. Dankbar."[52]

K. Ethical Considerations

Because of the ever-changing legal landscape around state-licensed marijuana regulation, it is critical for investors, producers, processors, retailers, and other stakeholders within the legal marijuana industry to understand how to comply. However, this presents obvious ethical challenges for lawyers seeking to represent the interests of marijuana industry members or fiduciaries who must administer property derived from the marijuana industry. Despite efforts of several states to legalize the production, distribution, and use of marijuana, 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 or fraudulent (in one or more states).

Several state bar associations have issued guidance where an attorney sought to assist clients with complying with state medical marijuana laws. Those states each arrived at different outcomes:

1. Maine. The Maine Professional Ethics Commission 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."[53] The Commission recognized that the federal government had deprioritized enforcement of the CSA in medical marijuana 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."[54] As long as the federal law and Maine's Rules of Professional Conduct (RPCs) remain unchanged, attorneys need to determine "whether the particular legal service being requested rises to the level of assistance in violating federal law."[55] If so, the attorney risks violating RPC 1.2.

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50 *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).

51 *See, e.g.*, Or. Rev. Stat. §647.095.

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

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

54 *Id.*

55 *Id.*

2. Connecticut. The Connecticut Bar Association Professional Ethics Committee reached a similar conclusion to that of the Maine Professional Ethics Commission: while an attorney could safely advise a client on the requirements of state and federal marijuana law, advice and services in aid of functioning marijuana enterprises could run afoul of RPC 1.2(d).

3. Arizona. In 2011, the State Bar of Arizona reached the opposite conclusion. 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." The bar advised 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."[56]

4. 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 marijuana 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.[57]

Previously, the Colorado RPCs had prohibited attorneys from aiding clients "in conduct that the lawyer knows is criminal." Despite the fact that medical and recreational use of marijuana 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 marijuana 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 marijuana industry within Colorado.

5. Washington In 2014, the Washington Supreme Court adopted a comment to the Washington State RPCs 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

56 *See* State Bar of Arizona Ethics Opinions (Feb. 2011), *available at* http://www.azbar.org/Ethics/EthicsOpinions/ViewEthicsOpinion?id=710.

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

> lawyer reasonably believes is permitted by this statute and the other statutes, regulations, orders, and other state and local provisions implementing them. [58]

In addition, in June of 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 marijuana industry within Washington.[59] The questions are as follows:

1. May Lawyer A advise Client A about the interpretation of and compliance with I-502 and the Cannabis Patient Protection Act (the "CPPA"), without violating the Washington Rules of Professional Conduct (the "RPCs")?

2. May Lawyer B provide legal advice and assistance to Client B in the formation and operation of a business entity so as to comply with I-502 and the CPPA without violating the RPCs?

3. May Lawyer C own and operate an independent business in compliance with I-502 and the CPPA without violating the RPCs?

4. Assuming that Lawyer D's need for and consumption of medical or retail marijuana do not otherwise affect Lawyer D's substantive competence or fitness to practice as a lawyer, may Lawyer D purchase and consume marijuana in compliance with I-502 and the CPPA without violating the RPCs?

5. May Lawyer E engage in the implementation of I-502 [and] the CPPA and, if Lawyer E's competence and fitness to practice as a lawyer is not affected, purchase marijuana subject to I-502 and the CPPA without violating the RPCs?

The Advisory Opinion concludes that the answer to each question is "Yes, qualified," and provides an analysis of each of the five issues with 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 CPPA as a matter of state law, the application of the RPCs may have to be reconsidered."[60]

1. 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.[6]

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

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

59 *See* Washington State Bar Association Advisory Opinion 201501 (2015), *available at* http://mcle.mywsba.org/IO/print.aspx?ID=1682.

60 *Id*.

61 Or. RPC 1.2(d) (2015).

advise his or her clients about those conflicts.

Engagement Letters.

In states where an attorney may advise a client on cannabis-related activities, it is not sufficient to use a standard engagement letter. In addition to a criminal background check to be certain that the client may engage in such business activities, it would 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.

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

VII. 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: pets, aircraft, wine, guns, and cannabis. 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 B[62]

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 current undertaking e.g., prepare a form of lease to use with tenants intending to grow marijuana 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 marijuana, 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 marijuana, 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 marijuana 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 marijuana 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 marijuana 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 marijuana producers, processors or distributors

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62 The author gratefully acknowledges Scott Warner of Garvey Schubert Barer for allowing the adaptation of their materials for this outline.

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: _____

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