



Ethical Considerations When Your Potential Tax Client Is a Marijuana Business

WARNING: ASSISTING THIS BUSINESS MAY BE HAZARDOUS TO YOUR LICENSE

State-level actions allowing not only medicinal use

of marijuana, but also recreational use, will increase the number of marijuana businesses needing and seeking assistance from tax practitioners.¹ As a result, tax practitioners may increasingly find themselves faced with the question of whether to accept a marijuana business or to retain a client entering such a business.²

This article discusses legal and ethical issues a tax practitioner faces in serving a marijuana business. Suggestions are offered to help with these decisions and for alleviating practitioner concerns and better ensuring that legitimate businesses obtain needed tax assistance.

Conflict of Laws

Despite several states allowing for the production, sale, and/or use of marijuana, these activities remain a crime under the federal Controlled Substances Act (CSA) (21 U.S.C. 801, et seq.). The U.S. Drug Enforcement Administration (DEA) classifies marijuana as a Schedule I substance (“drugs with no currently accepted medical use and a high potential for abuse.”)³ In *Gonzales v Raich*, 545 U.S. 1 (2005), the Supreme Court held that Congress has authority under the commerce clause to prohibit marijuana production and use even if allowed under state law.

The Department of Justice (DOJ) has offered insights on how it will enforce the CSA in light of state actions. The most current guidance, issued by Deputy Attorney General James M. Cole on Aug. 29, 2013, notes that the federal government views marijuana as a “dangerous drug” and its distribution as a “serious crime.” However, given limited resources for investigations and prosecutions, the DOJ’s focus is on eight enforcement priorities. These priorities include:

- “Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.”

The Cole memo also states: “Nothing herein precludes investigation or prosecution, even in the absence of any one of the factors listed above, in particular circumstances where investigation and prosecution otherwise serves an important federal interest.” Examples of such actions exist. In *U.S. v. Oakland Cannabis Buyers’ Cooperative, et al.*,⁴ the Court held that there is no “medical necessity exception” to the CSA. In *Sacramento Nonprofit Collective, DBA El Camino Wellness Center v. Holder*,⁵ the court observed that “at no point did the Government promise not to enforce the CSA.”

Annette Nellen, CPA, is a professor in and director of San José State University’s (SJSU) graduate tax program (MST), teaching courses in tax research, accounting methods, property transactions, state taxation, employment tax, ethics, tax policy, tax reform, and high-technology tax issues. Ms. Nellen serves on the American Institute of Certified Public Accountants (AICPA) Tax Executive Committee and the AICPA Tax Reform Task Force. She is a past chair of the AICPA Individual Taxation Technical Resource Panel. In fall 2013, Annette completed a three-year term on the Executive Committee of the Taxation Section of the California Bar. Ms. Nellen is the author of Bloomberg BNA Tax Portfolio #533, Amortization of Intangibles and has testified before federal and state legislative committees on tax reform. Ms. Nellen maintains the 21st Century Taxation website and blog (www.21stcenturytaxation.com). Prior to joining SJSU in 1990, she was with Ernst & Young and the IRS. Annette is a graduate of California State University Northridge, Pepperdine (MBA), and Loyola Law School. This article was submitted on behalf of the FBA Section on Taxation; for more information on this section, please visit www.fedbar.org. © 2014 Annette Nellen. All rights reserved.

Tax Practitioner Dilemmas

A tax practitioner's dilemmas in assisting a marijuana business are at least twofold: is the practitioner (1) committing a federal crime and (2) acting contrary to applicable rules of conduct? There is also overlap here in that commission of a crime can subject attorneys and certified public accountants (CPA) to disciplinary action under their state licensing rules. Tax practitioners convicted of a crime may also face disciplinary action from the Internal Revenue Service (IRS) or be unable to obtain or renew a Preparer Tax Identification Number (PTIN).⁶ Another dilemma is possible risk to a firm's reputation of having a marijuana business as a client. The client is violating federal law and as noted above, there is no DOJ assurance that the law won't be enforced.

The focus of this article is on the rules of conduct dilemma.

To appreciate the dilemmas and how they can arise, consider the following scenarios:

- Sam seeks assistance in starting a business to sell marijuana. Tax-wise, this involves deciding on the form of entity, registering with tax agencies, and setting up recordkeeping. Non-tax legal issues for an attorney include helping Sam comply with the state's marijuana laws, which often have numerous, complex provisions and interact with other laws such as zoning, banking, and employment. Can the tax practitioner's assistance be viewed as enabling Sam to sell marijuana, such that the practitioner could be viewed as having committed a federal crime?⁷ Has the practitioner violated any rules of conduct?
- Jane set up her marijuana business on her own this year. She sells marijuana and related items (paper, vaporizers, etc.). The store also sells books and yoga classes. Jane seeks help preparing her federal and state income tax returns. To properly assist Jane, the preparer will need to determine whether Jane has a single or multiple business, how to separate cost of goods sold from other expenses, and what special rules may apply to Jane (such as asset expensing).⁸ Jane may also have sales or excise tax obligations. Helping Jane meet her tax obligations enables her to stay in business. Providing tax advice to lower Jane's tax obligations increases her cash flow. May a practitioner provide tax assistance without concern of violating federal drug laws or rules of conduct? Can the practitioner provide both tax preparation and planning services?
- Robert has been selling medical marijuana for several years, but now realizes he inadvertently collected too little of sales tax from customers. Robert seeks assistance from a tax practitioner who works with the state tax agency through its voluntary disclosure program to negotiate a settlement for less than the full amount and a waiver of penalties. Is this practitioner prohibited from doing so for Robert? Does the practitioner risk an ethical violation or malpractice claim by not following his normal practice to help Robert? What if the sales tax problem relates to a possible state law violation in how sales were transacted?

Rules of Conduct

Rules of conduct applicable to a tax practitioner serving or considering serving a marijuana business are unclear and incomplete. Attorneys have some guidance, CPAs very little. Practitioners must review the rules they are subject to in the context of the realm of tax



and non-tax issues that may arise in serving a marijuana business.

Attorneys: ABA Model Rule of Professional Conduct 1.2(d) states: "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning, or application of the law." The comment on this rule notes the existence of "a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity."

This rule leaves uncertainty with the scenarios mentioned earlier. For example, is advising a marijuana business on how to optimize tax deductions, "recommending the means by which a crime or fraud might be committed"? Is explanation and application of the tax rules permissible for past transactions, but not for future ones? Is all tax work permissible in that it is not enabling the federal crime, but only helping the client comply with tax obligations?

Colorado Opinion 125, *The Extent to Which Lawyers May Represent Clients Regarding Marijuana-Related Activities* (April 23, 2012; addendum Oct. 21, 2013) interprets Rule 1.2(d). It notes that a lawyer may represent a client accused of violating the state's marijuana law. It states though, that a lawyer cannot draft a contract to facilitate the purchase of marijuana, as that would assist the client with conduct that is a crime under federal law.

The Colorado opinion specifically mentions tax work, noting that

tax assistance that is “simply counseling a client about the legal consequences of past conduct” may comply with Rule 1.2(d). It also states:

“However, [t]here is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.’ Colo. RPC 1.2(d), cmt. [9]. Under Colo. RPC 1.2(d) as written, a lawyer violates that Rule at the point where tax preparation becomes tax planning, the intent of which is to assist a client with planning the violation of federal law.”

Not all states have clarified Rule 1.2(d) with respect to marijuana matters that are allowed under state law. Generally, existing opinions urge caution. For example, Opinion #199—*Advising clients concerning Maine’s Medical Marijuana Act (7/7/10)* notes “Participation in this endeavor by an attorney involves a significant degree of risk which needs to be carefully evaluated.” Connecticut Informal Opinion 2013-02, *Providing Legal Services to Clients Seeking Licenses under the Connecticut Medical Marijuana Law*, concludes that lawyers may advise clients on the requirements of that state’s marijuana laws, but may not assist them with conduct that violates federal criminal law. “Lawyers should carefully assess where the line is between those functions and not cross it.”

In contrast, Arizona suggests more leeway. State Bar of Arizona Ethics Opinion 11-01: *Scope of Representation (2/11)* interprets 1.2(d), with specified caveats, as allowing an attorney to “perform such legal acts as are necessary or desirable to assist the client to engage in the conduct that is expressly permissible under the [Arizona Medical Marijuana] Act.”

In March 2014, the Colorado Supreme Court added a comment to Rule 1.2 to provide that a lawyer “may counsel a client regarding the validity, scope, and meaning of” the state’s marijuana laws within specified parameters.⁹ Without specifics under state ethics rulings and no explicit statement that helping a business to be compliant with all tax laws is permissible (despite conducting a business that violates federal law), attorneys in most states face uncertainties in how tax assistance will be viewed under Rule 1.2(d).

CPAs: Two primary concerns CPAs have in advising a marijuana business are summarized below with examples:

- Acts discreditable. For example, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct § 501, *Acts Discreditable*, provides: “A member shall not commit an act discreditable to the profession.”
- Good moral character and compliance with laws. For example, the New York State Society of CPAs’ Rule 101—*Integrity*, states: “A member shall maintain integrity by ... (b) conducting oneself in the practice of public accountancy by evidencing moral fitness to practice; ...”

The AICPA and two state CPA organizations suggest that “CPAs considering whether to provide services for medical and/or recreational marijuana businesses need to proceed with caution.” The organizations note though, that state marijuana laws create marijuana businesses that need accounting and tax assistance, leaving “CPAs in a gray legal area.”¹⁰

Suggestions for Tax Practitioners

Following are suggestions that may help reduce the legal and ethical risks associated with providing tax assistance to a marijuana business.

Prospective client analysis: The following suggestions are intended to be ones performed beyond normal due diligence procedures for deciding whether to accept a client.

- Review the rules of conduct pertaining to your license(s).
- Review your umbrella, malpractice, and other relevant insurance policies.
- Ask your malpractice insurance carrier what concerns, if any, it has.
- Consult your legal counsel.
- Perform expanded due diligence. In addition to your usual process, consider taking measures to help you determine if the prospective client is in compliance with the state’s marijuana laws and the Cole memo. For example, ask for a legal opinion that the prospective client is in compliance with state law.¹¹
- Require that the client have a bank account, as it may increase the likelihood of compliance with state law. Financial institutions are reluctant to provide services to marijuana businesses due to provisions of the Bank Secrecy Act. However, in February 2014, the Financial Crimes Enforcement Network (FinCEN) of the Treasury Department issued guidance for these institutions that may alleviate some concerns (FIN-2014-G001). This guidance explains the type of suspicious activity report an institution must file for a marijuana business, ranging from “limited” (no suspicious activity noted) to “termination.”
- Implement the due diligence suggestions of FIN-2014-G001. While the FinCEN guidance is for financial institutions, the due diligence suggestions should prove useful for a tax practitioner. They include verifying the business is properly licensed and registered, reviewing the license application, and learning of the business such as expected activity and the nature of the products sold.
- Consider the possible impact on your firm’s reputation and your existing client base.
- Check the prospective client’s understanding of the federal, state, and local law governing marijuana. Determine if he or she has legal counsel to assist in understanding and complying with these laws.

Having a marijuana business client: Following are some considerations should you accept a marijuana business as a tax client:

- Engagement letters—Include that the client is expected to follow applicable laws and use a bank account for all transactions. Also remind the client of the limited privilege for tax work (IRC § 7525 and in general) and no privilege for non-tax related information (such as if the CPA learns the client sold beyond the state limits or sold outside the state).
- Follow normal billing practices ensuring that fees are not related to client profitability.
- Consider whether some tax-planning services or solicitations should not be extended to the client.
- Repeat the initial due diligence annually and be sure client knows this will occur.
- Be alert to any actions or comments of the client that indicate they may be in violation of state law or the Cole memo.

Other Issues

Beyond client matters, tax practitioners may have additional issues and concerns related to state marijuana laws. For example, can or should a firm prohibit personnel from using marijuana?

A Better Way

The issues described in this article have existed since 1996 when California allowed medicinal use of marijuana. As more states allow some use or broaden current laws, more businesses will need and seek tax assistance. In addition, states may follow Colorado's lead and create new taxes and compliance obligations.¹²

State tax agencies and the IRS would benefit from marijuana businesses having competent tax advisers, as these businesses are subject to complex tax rules. Outside of tax law, governments would benefit from marijuana businesses having competent legal and accounting assistance to be sure they operate within the law.

To reduce or eliminate the risks for practitioners, states should consider the following actions:

- Require marijuana businesses to certify annually that they have not violated the Cole memo priorities. Additional annual compliance checks could be included. This helps to limit the likelihood of advisers working with businesses at risk of federal or state prosecution.
- Enact laws providing that licensed practitioners will not be in violation of state licensing and disciplinary rules for assisting a client operating under state law where the practitioner reasonably believes the client is operating within state law.

In the meantime, tax practitioners should proceed with caution.¹³ ©

Endnotes

¹As of March 2014, 20 states plus the District of Columbia allow medical marijuana programs; Colorado and Washington allow recreational use. For details, see information from the National Conference of State Legislatures; www.ncsl.org/research/health/state-medical-marijuana-laws.aspx; and White House, Marijuana Resource Center; www.whitehouse.gov/ondcp/state-laws-related-to-marijuana.

²"Business" is used broadly here to include the variation of for profit and non-profit activities that may be allowed under state law, including cultivating, dispensing, and retailing,

³DEA, Drug Schedules; www.justice.gov/dea/druginfo/ds.shtml.

⁴*U.S. v. Oakland Cannabis Buyers' Cooperative, et al*, 532 US

483 (2001).

⁵*Sacramento Nonprofit Collective, DBA El Camino Wellness Center v. Holder*, No. 12-15991 (9th Cir., 2014) (not for publication).

⁶Circular 230, § 10.51 addresses disreputable conduct related to tax laws but notes that the list provided is not exhaustive. The preamble to TD 9503 (9/30/10) and Circular 230, § 10.5(d) refer to "suitability checks."

⁷Whether the work of the tax practitioner involves aiding and abetting the client in commission of a federal crime is beyond the scope of this article.

⁸A detailed discussion of applicable tax rules, beyond the scope of this article, involves Internal Revenue Code (IRC) § 280E and § 263A. Also see *Californians Helping to Alleviate Medical Problems, Inc. (CHAMP)*, 128 TC 173 (2007); *Olive*, 139 TC 19 (2012); and IRS Information Letter 2011-0005.

⁹Colorado Supreme Court Rule Change 2014(05), Rules of Professional Conduct Rule 1.2; www.courts.state.co.us/userfiles/file/Court_Probation/Supreme_Court/Rule_Changes/2014/2014%2805%29%20redlined.pdf and www.courts.state.co.us/Courts/Supreme_Court/Rule_Changes/2014.cfm.

¹⁰AICPA, Colorado Society of CPAs, and Washington Society of CPAs, *An Issue Brief on State Marijuana Laws and the CPA Profession*, May 2013, page 6; www.aicpa.org/Advocacy/State/Documents/MarijuanaCPAsIssueBrief_05162013.pdf. This brief includes seven questions CPAs should ask themselves, along with consulting legal counsel and their State Board of Accountancy, before assisting marijuana businesses.

¹¹The DEA has observed that some marijuana businesses are "fronts for drug dealers" or generating profits when they should be nonprofit. See DEA, *The DEA Position on Marijuana*, April 2013, page 13; www.justice.gov/dea/docs/marijuana_position_2011.pdf. In a Feb. 3, 2010 memo, California Board of Equalization Member Jerome Horton stated: "There is a clear indication that many dispensaries are intentionally evading their taxes, distributing illegal products and may be laundering illegally acquired money;" www.boe.ca.gov/news/2010/16-10-H.pdf.

¹²See Colorado Department of Revenue information at www.colorado.gov/cs/Satellite/Revenue/REVVX/1251649127637; and author's summary at 21st Century Taxation blog, 1/12/14 post; 21stcenturytaxation.blogspot.com/2014/01/marijuana-and-tax-law.html.

¹³For additional background on this topic and links, see the author's website at www.21stcenturytaxation.com/Links_Misc.html.

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