Advanced Legal, Tax, Financial & Insurance Planning for Medical Marijuana Industry Businesses

by Thomas A. Cifelli, J.D., CPA* (*inactive)

Summary
Of all the industries in the US, medical marijuana businesses face the greatest operational challenges today. The legal regulatory environment for any medical marijuana enterprise is full of landmines. This article addresses strategic methods to retain and protect more of the income and wealth being accumulated by successful businesses in the burgeoning medical cannabis industry.

Introduction

All successful entrepreneurs who make a lot of money building valuable enterprises start to worry and lose sleep over income taxes, estate taxes and losing everything they worked so hard to build due to disputes, mistakes or catastrophic events beyond their control.

Some experienced lawyers can help you recognize the issues and implement well established strategies and techniques involving tax, asset protection and estate planning. Few lawyers however also have experience in designing advanced risk management science structures, precisely what is needed by medical marijuana industry businesses in light of the complex and controversial legal environment they must navigate.

Asset Protection/Estate Planning

Asset protection involves techniques designed to prevent a loss of assets in the event of catastrophic unfavorable litigation, bankruptcy and even potentially protecting assets from government forfeiture proceedings. Estate planning involves techniques to efficiently manage and fairly distribute tax efficiently accumulated wealth during one's lifetime and on one's death.

Implementing asset protection techniques after you know about a problem threatening your assets is usually not effective due to fraudulent conveyance statutes and similar case law created judicial doctrines that make it improper to move or hide assets once you know they may be needed by a 3rd party who has claims against you. Basically if you procrastinate and delay planning until your assets need protection from a known 3rd party, it is likely already too late to assure success. In fact it could be criminal to attempt to hide assets after someone makes a rightful claim against you or their right to has already arisen due to something you or your business did that injured or damaged them.

Typical asset protection techniques include but are not limited to:

- planned systematic gifts of personal and business assets to children or others directly or indirectly through complex trusts and other vehicles;
- creation of affiliate businesses owned by children or family trusts;
- taking advantage of special protective legislation, such as homestead exemptions excluding the value of personal residence from creditors.

Typical estate planning techniques often considered include but are not limited to:

- (basic plan) having a revocable living trust, a will, one or more powers of attorney, a living will and some manner of testamentary instructions;
- (more advanced) one or more irrevocable trusts in combination with the above;
- structured business ownership interests with varying classes of ownership, buy-sell agreements, options to acquire and other complex business transaction agreements.

The most important thing about effective asset protection and estate planning is to get started early with fact finding and due diligence followed with documenting alternative solutions and associated costs to implement and maintain.

Risk Management & Finance - Custom Privately Held Captive Insurance Company Solutions

Good insurance for medical marijuana operations has always been difficult to find, and was expensive. This is more the case now than ever. On June 3, 2015, Lloyd's of London announced a ban on its insurance broker syndicates writing any new policies in the USA to businesses growing or selling medical marijuana. Lloyds was not the only source for insurance but they were the most competitive. Other insurance carriers may follow since cash generated from the sale of marijuana, even when used to buy insurance, invariably implicated federal Anti-Money Laundering laws, even though for the time being the US federal government has indicated an intention not to enforce them against businesses operating legally under state medical marijuana laws.

Fortunately there exists a well established method of addressing risk management and risk finance objectives of medical marijuana businesses - closely held captive insurance companies, known as CICs. CICs are now licensed by over 30 US states. CICs are designed to provide custom insurance coverage that is not available from commercial insurers, is too expensive, or is simply not adequate in coverage design or claims handling to meet business needs.

Most of the Fortune 1000 have had CICs for some time. In the past 10 years, more and more successful closely held businesses in nearly every industry have formed their own affiliate CIC.

The benefits of CICs are many and are most easily understood when compared to retail insurance and self insurance as shown in the chart below:

Feature to Compare	Retail Insurance	Self Insurance	Captive Insurance
Risk protection	yes	no	yes
Tax deductible premiums	yes	no	yes
Income tax benefits	yes	no	yes
Asset protection	yes	no	yes
Can lower insurance costs	no	yes	yes
Policy design control	no	n/a	yes
Claims Control	no	yes	yes
Underwriting income	no	no	yes
Investment income	no	no	yes
Competitive advantages possible	no	yes	yes
Estate planning benefits	no	no	yes
Access reinsurance markets	no	no	yes
New revenue stream options	no	no	yes
© Tom Cifelli, CaptiveExperts.com, 2012			

CICs are licensed insurance companies, under special provisions that allow them to sell insurance to affiliated businesses, but not the general public. This allows them to be more economic to form and operate, as compared to traditional insurance companies.

Because the tax advantages of CICs can be substantial, the IRS has made it clear they do not like CICs. Nevertheless designed and operated correctly, provided your primary reason is to improve enterprise risk management, and not tax avoidance, your CIC could very well create significant income and estate tax savings, not to mention if claims losses are controlled, accumulate significant investment reserves assets that could also be asset protected. CICs certainly allow far greater control over your insurance and claims handling practices then does commercial insurance even if affordably available.

Types of Insurance Coverage a CIC Can Write to Protect a Medical Marijuana Business

CICs can write a host of insurance policies. The following are some of the types of insurance a CIC can write that are particularly appropriate for medical dispensaries and cultivators:

- crop insurance
- loss of producing plants
- product liability

- product recall
- intellectual property
- unfair competition
- legal defense
- regulatory liability risks
- crime
- employee theft

IRC Section 831(b)

One special tax provision designed to encourage use of CICs to finance insurable risks is known as section 831(b). This special income tax provision allows all underwriting income of a qualifying CIC to be exempt from federal income tax. This results in premiums paid by the operating medical marijuana business to deduct the insurance premiums paid the CIC if they qualify under section 162 (ordinary and necessary business expense), yet not be subject to income tax by the CIC. This creates a more economically efficient method to build loss reserve investments inside the CIC over self insuring risk.

IRC Section 280E

Another special obstacle medical marijuana businesses face is the US Treasury I.R.C. Section 280E provision, pertaining to expenditures in connection with the illegal sale of drugs, which states in part "*no deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business ... consist of trafficking in controlled substances...."*

Most tax advisers believe expenses which comprise cost of goods sold (COGS) are deductible under 280E. It is important when designing a CIC for a medical dispensary or cultivator to be aware if 280E and maximize insurance coverage which can be included as COGS.

Conclusion

Medical marijuana dispensaries and medical marijuana cultivators have great need to do advanced planning to address acute problems they face involving legal, tax, financial and insurance impacts of their business operations. Opportunities for effective solutions exist if you contact qualified professionals. We encourage readers to discuss the above topics with their legal, tax, financial and insurance advisers.

About the Author:
Thomas A. Cifelli is an Arizona attorney and also owns a specialty captive insurance solution provider firm. Visit www.TomCifelliLaw.com and www.CaptiveExperts.com for more information.