



TESTIMONY OF AARON SMITH

EXECUTIVE DIRECTOR

NATIONAL CANNABIS INDUSTRY ASSOCIATION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

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Introduction

Chairwoman Bass, Vice Chair Demings, Ranking member Ratcliffe, members of the subcommittee, good morning. I am Aaron Smith, Executive Director and Co-Founder of the National Cannabis Industry Association (NCIA). NCIA is the largest national trade association dedicated to protecting state-regulated cannabis businesses and advancing policy reforms needed to harmonize federal marijuana law with the successful medical and adult-use state cannabis programs that exist throughout the country. Founded in 2010, NCIA represents nearly 2,000 cannabis-related member-businesses and tens of thousands of cannabis professionals across the United States.

On behalf of our diverse membership, comprised of both large and small cannabis businesses as well as a variety of ancillary companies doing business in every U.S. state, we thank you for the opportunity to discuss our unwavering support for de-scheduling cannabis, social equity, and racial justice reforms, and responsibly regulating cannabis at both the state and federal levels. We are hopeful that social equity and racial justice reforms will be an integral part of any end-of-prohibition efforts.

I've been at this for a long time and I can't express how excited I am for this moment. To date, forty-seven states and the District of Columbia, as well as Guam, the Northern Mariana Islands, and Puerto Rico have passed legislation authorizing some form of cannabis for regulated medical or adult-use purposes and thirty-three states have enacted laws regulating the commercial production and sale of medical or adult-use marijuana. The time for comprehensive federal action is upon us.

There have been scores of cannabis-related bills introduced over the past few years, including the Marijuana Justice Act, the Strengthening The Tenth Amendment Through Entrusting States (STATES) Act, the Secure And Fair Enforcement (SAFE) Banking Act, the Small Business Tax Equity Act, and most recently, the Marijuana Freedom and Opportunity Act, to name a few. NCIA has been at the forefront, advocating in support of each and every one of these bills on behalf of our broad membership base. It is our sincere hope that Congress will take a more comprehensive, end-of-prohibition approach. Our NCIA member businesses, consumers, the American banking industry, and yes, the federal government, would benefit most from more comprehensive reforms that remove marijuana from the Controlled Substances Act and begin the process of regulating the substance at the federal level.

De-scheduling is the best approach that would immediately solve myriad problems related to banking, payment processing, tax parity, and other issues critical to the success of this burgeoning American industry. Because cannabis currently remains a Schedule I drug under the Controlled Substances Act, additional economic opportunity for states and localities is currently obstructed or has been lost to the illicit cannabis market. As a result, state-licensed cannabis businesses, as well as ancillary entities that serve cannabis-related businesses, are often blocked from accessing basic banking and payment processing services. Many of these businesses are forced to operate in an all-cash environment, creating a public safety risk for employees, consumers, and local law enforcement. Additionally, while state-licensed cannabis businesses pay upwards of an 80% effective tax rate to the federal government due to 26 USC § 280E, they

are not eligible to receive SBA small business and commercial loans, credit assistance, or technical assistance to spur economic development. These are the same loans that assist those in disadvantaged communities to access the resources necessary to become small business owners. The de-scheduling of cannabis immediately corrects all of these issues and is the first step toward a shared federal-state regulatory regime that works for policymakers, small and large entrepreneurs, and consumers alike.

De-scheduling cannabis at the federal level would also harmonize federal law with the successful medical and adult-use state cannabis programs that exist throughout the country. Most significantly, de-scheduling would also provide the federal government with an opportunity to tax and regulate cannabis products, much as it does with other products, such as alcohol or dietary supplements. NCIA wholeheartedly endorses the de-scheduling of cannabis in all forms and, as always, we stand ready to assist Congress with making sure that we get this right.

The Economic Benefits of De-Scheduling

Taxing and regulating cannabis sales has been an economic boon for states. From November 2018 to March 2019, it is estimated that seven states that taxed and regulated adult-use cannabis sales (Alaska, California, Colorado, Massachusetts, Nevada, Oregon, and Washington) collected more than \$1 billion in state tax revenue and created thousands of jobs. Colorado alone generated \$266,529,637 in legal marijuana taxes, licenses, and fees at the state level in 2018. That's just one year in one relatively small state. California, the most populous state and the nation's largest cannabis market, collected roughly \$345,200,000 in taxes in the first year of adult-use sales. In Nevada, retail marijuana sales exceeded an average of \$1 million per day through the first six months of operations. The windfall of state tax revenue from cannabis is only just beginning.

BDS Analytics and ArcView Market Research project that the U.S. sales of cannabis and hemp-derived CBD products are expected to surge to \$20 billion by 2024 with the possibility of employing one million people. An analysis from New Frontier Data estimates that the cannabis industry could generate \$131 billion in federal tax revenue if it is legalized for adult use in all 50 states. That same analysis found that if the U.S. were to legalize cannabis federally today, it would add 782,000 jobs to the economy.

Tax revenues derived from the state-regulated cannabis industry are used to fund a number of state and local priorities, such as: education (i.e. hiring more teachers and school infrastructure); mental health and substance abuse services; transportation/infrastructure projects; and law enforcement initiatives aimed at more serious issues like the opioid crisis. However, the illicit cannabis market in the US is currently estimated to be valued near \$30 billion. This adverse ratio between the legal and illegal cannabis marketplace is a direct result of outdated federal policy toward a responsible industry operating at the state and local level.

Today's hearing, and a path forward on de-scheduling, marks a dramatic shift in those outdated federal policies. Imagine the day when cannabis is de-scheduled, and the federal government is able to tax and regulate retail purchases of cannabis. Those tax revenues would be a significant boon to the United States economy. And the federal government would retain control over how products are manufactured, marketed, and sold. It's a win/win.

De-Scheduling is Good Politics

Not only is federal marijuana reform and de-scheduling good public policy, it is also good politics. The vast majority of the American public supports some legalization of cannabis. According to Gallop, support for legalizing marijuana possession and use for adults now regularly polls consistently above 64% nationally, including majorities among conservatives, liberals, and independents. According to a recent Quinnipiac poll, support for medicinal cannabis has achieved near unanimous backing, with national polls regularly showing support at about 90%, including supermajorities across age ranges and the political spectrum. At a time when nearly two-thirds of

Americans live in a state with some form of comprehensive legal cannabis access, it now falls on Congress to determine when and how the federal government will end its conflict with these state programs. Congress should do what it can to allow states to create legal cannabis markets, enable access to banking services, bring about tax equity to businesses that abide by these laws, and allow their constituents to realize the full potential economic and societal benefits of legalized marijuana. De-scheduling is the best path forward to achieve these goals.

While the first and most important step of any comprehensive regulatory system would be to de-schedule marijuana and delta-9 tetrahydrocannabinol (THC) from the Controlled Substances Act, this would by no means be the end of the road. The Schedule I status of marijuana, THC, and until recently, hemp, criminalized their use, hindered research, and driven most cannabis product sales to the illicit market. It is for these reasons that NCIA strongly supports de-scheduling and subsequent taxation and federal regulatory regime that sets a roadmap for state-legal cannabis businesses to remain compliant with state and federal laws.

Social Equity and Expungement

We can't debate the merits of de-scheduling, or any other cannabis policy reform, without considering the historical consequences of cannabis' drug scheduling. We need to incorporate social equity provisions in any federal legalization effort. The fact is the cannabis prohibition inflicts severe and disproportionate damage to communities of color in multiple ways. It's time that the industry, lawmakers, and federal and state regulators, make social equity a real priority. We can start with the expungement of low-level cannabis-related offenses. But progress can't end there. We need to create the opportunity for people who have been historically disenfranchised.

One of the societal benefits of marijuana legalization is a reduction in arrests and law enforcement costs. Fewer arrests for marijuana offenses means that limited law enforcement resources can be re-directed toward preventing violent and other crimes involving victims. However, the reduction in marijuana arrests has not eliminated racial disparities in marijuana enforcement. In Colorado, marijuana arrests have dropped 51% for whites, but only 33% for Latinos and 25% for Black persons. This is more troubling when one considers that arrest rates for non-whites prior to legalization were proportionately greater than the arrest rates for whites at that time. Youth arrest rates have not dropped in proportion to the number of adult arrests despite teen use remaining stable or falling in states that have legalized cannabis. As the racial disparity numbers show, Latino and Black youths are disproportionately the targets of those arrests. This demonstrates public officials need to examine ways to ensure that the benefits of legalization reach all Americans.

We have to acknowledge that cannabis prohibition was not only aimed to prevent individuals from possessing and using cannabis, but also to install a criminal punishment regime that enforced prohibition through federal, state, and local prosecutions. This regime did not affect everyone equally, as there is a clear history of racial disparities in cannabis arrests and convictions. Arrests happen far more frequently in heavily policed areas, which are disproportionately areas where people of color reside. Punishments, which tend to be harsher for people of color even when the underlying conduct is the same, include an elaborate array of collateral consequences that can hinder or eliminate future job prospects, educational opportunities, and other avenues for legitimate financial achievement. A cannabis arrest starts a cycle of detrimental governmental action that can wreck families and communities across the country. When too many arrests occur in the same geographic location, the economic and social viability of entire neighborhoods can be negatively affected for generations.

Although cannabis legalization at the federal level ends prohibition, it does not stop or reverse the harm created by previous public policy decisions. As state-level legalization spreads, and the legal cannabis market expands, the individuals and communities most impacted by cannabis prohibition have all too often been left behind. To create a legal cannabis market accessible to all, the laws need to be designed and implemented with equity and fairness in mind. Thankfully, a number of states and jurisdictions are taking steps to ensure equitable participation in the state-

legal cannabis industry by those communities that have been historically most harmed by prohibition enforcement. For example, Massachusetts is giving priority business licensing certification to applicants from areas with historically high rates of arrest, conviction, and incarceration related to marijuana crimes. Similarly, the city of Oakland, California is setting aside a minimum of half of all initial cannabis business permits to applicants from “police beats with a disproportionately higher number of cannabis-related arrests.” And countless bills on record expungement have been filed across the country. This is a good start, but we can do more – we need to do more. Federal de-scheduling efforts should incorporate some of these social equity best practices.

Some members of Congress are pushing to right the wrongs of racially disparate enforcement. One of the strongest advocates for marijuana reform and social equity is Representative Barbara Lee of California. Congresswoman Lee is the co-chair of the Congressional Cannabis Caucus and has co-sponsored multiple cannabis-related bills, including the Realizing Equitable & Sustainable Participation in Emerging Cannabis Trades (RESPECT) Resolution during the 116th Congress. This resolution proposes a set of best practices to address industry inequalities. Collectively, the best practices suggest that the legal cannabis market can be a force for justice, but only if implemented fairly. Congresswoman Lee also introduced the Marijuana Justice Act of 2019, which would withhold some federal funding from states with disproportionate cannabis arrest and incarceration rates and use the savings to reinvest in communities most affected by the war on drugs, by establishing a grant program to fund job training, libraries, community centers, and health education programs. That bill was referred to this Committee in April. NCIA strongly supports Representative Lee’s efforts. We have also worked closely with the Minority Cannabis Business Association (MCBA) to create the nation’s first-ever Model Municipal Social Equity Ordinance, based on the recommendations in the RESPECT Resolution, and we will continue to push for laws and regulations that embrace diversity and the inclusion of communities that disproportionately impacted by cannabis prohibition. The emerging cannabis industry must work for all people and we should endeavor to fix these problems right out of the gate, as this chamber considers broader reforms.

Recently, NCIA published a white paper on “Increasing Equity in the Cannabis Industry, Six Achievable goals for Policy Makers.” We released the paper at a breakfast event in the House of Representatives this spring, where a number of members spoke about the importance of social equity. That paper outlines six key goals for social equity programs: (1) repair the damage to individuals caused by discriminatory enforcement prohibition, (2) create more equitable licensing outcomes through the application process, (3) ensure the industry reflects the local community, (4) address financial barriers to market entry, (5) support companies and individuals entering the industry from disproportionately-impacted communities, and (6) invest tax revenues in communities harmed by prohibition. We hope that members of this committee will seriously consider and incorporate our social equity recommendations, which can be found on our website at www.thecannabisindustry.org, into any post-prohibition de-scheduling bill.

NCIA remains committed to working with the Minority Cannabis Business Association, the Congressional Black Caucus, the Congressional Hispanic Caucus and our new partner – the Last Prisoner Project, to find solutions to the myriad problems facing people of color, women, and other minorities and help them to realize opportunities in the cannabis industry and reverse unacceptable trends. We are hopeful that any de-scheduling legislation will include some, if not all, of NCIA’s social equity goals for policymakers.

Public Health and Safety

A common concern that lawmakers have expressed when considering marijuana reform proposals is what impact legalization would have on crime. While there is no greater calling in public service than public safety, and lawmakers should always consider the health and safety of Americans in everything that they do, data shows that legal marijuana businesses do not present a threat to public safety and they may even have a dampening effect on crime. A number of studies, including studies from *Preventative Medicine* and the *Journal of Urban Economics* from 2017, found that the presence of dispensaries actually reduces property crimes in the neighborhood. Data from Colorado and Washington,

two early adopters of legalized cannabis, showed drops in property and violent crimes post-legalization.

Notwithstanding this encouraging data, NCIA remains committed to finding solutions to some of the important public safety issues facing the industry, like youth use, impaired driving, and diversion. People should not be violating state law, they should not be selling cannabis to minors, they should not be consuming cannabis and driving, and they should not be transporting cannabis across state lines into states that have not legalized cannabis.

NCIA remains committed to working through these public policy issues that affect the health and safety of consumers and non-consumers alike. We are hopeful that with the end of prohibition will come a renewed sense of common purpose with the law enforcement community and that collaboration on public health and safety will be the norm. NCIA stands ready to work with the Fraternal Order of Police, the National Sheriffs Association, the International Association of Chiefs of Police, and any other law enforcement groups interested in finding public policy solutions to any public health and safety issues related to federal legalization of cannabis.

A Regulatory Path Forward Post De-Scheduling

With momentum building and public support increasing, the critical question is shifting from “should cannabis be legalized,” to “how should we regulate the commercial cannabis market at the federal level?” The de-scheduling of cannabis would immediately bring us into the post-prohibition world, and we need to be ready. NCIA is proactively considering these important issues, and we will be releasing a white paper in the coming weeks with recommendations for how the federal government should regulate cannabis post-prohibition. It’s important that we build the appropriate regulatory scheme right out of the gate because one thing remains clear: the current diversity of products that contain cannabis means that a “one size fits all” regulatory scheme would be ineffective and likely have unintended consequences.

In the coming weeks, NCIA will recommend that four different regulatory “lanes” be utilized, based on the characteristics and intended use of specific cannabis products. Because human consumables are already regulated by the federal government through a variety of lanes that are designed for these purposes, most cannabis products can simply follow analogous products already sold legally through these lanes. By building off existing systems and making modifications where necessary, all cannabis products can be properly regulated by existing federal agencies.

Currently, because of marijuana’s status as a Schedule I drug, the Drug Enforcement Administration (DEA) is cannabis’ primary regulator. This federal control consists entirely of criminal enforcement. Following the lead of similar products, NCIA believes that cannabis products should be regulated by the government agencies that regulate most human consumables, primarily the Food and Drug Administration (FDA) and the Alcohol and Tobacco Tax and Trade Bureau (TTB). This bifurcated system would allow the federal government to regulate the cannabis industry, based on the relative “dangers” of each product, with high THC products receiving the greatest regulatory oversight. Stripping the DEA of its regulatory authority and replacing it with a consumer health and safety approach headed by the FDA would go a long way towards correcting the failed criminal enforcement approaches of the past.

Combined, these four lanes will allow cannabis products to be sold legally while providing for regulatory oversight dependent on public policy concerns. A comprehensive regulatory scheme that accurately tailors regulatory lanes to a product’s risk profile is vital to creating a vibrant, competitive marketplace where products are effectively and efficiently cultivated, manufactured, and sold. We look forward to working with Congress on a regulatory approach post-de-scheduling that works for all Americans.

The SAFE Banking Act and Expanding Access to Capital

Companies that are transparent about providing ancillary services to the state-compliant cannabis industry have experienced their financial institutions shut off their banking and payment processing accounts, despite the fact that they don't operate "plant-touching" businesses. This even extends to law firms, accounting firms, and other professional organizations. In addition, other professionals like electricians, contractors, and plumbers are also at risk of losing their bank accounts for accepting payment from cannabis businesses. Other companies may be forced to choose between taking a job and generating revenue for their small business and doing business with a cannabis-related entity solely based on their geographic location. For instance, a plumbing company in Denver, Colorado may be called and offered a job to service a cannabis cultivation facility's water system. That plumbing company now faces a choice: service a cannabis-related business and risk losing SBA backed-loans -- or lose the revenue from that job. Given a majority of states have some form of legalized medical or adult-use cannabis, this is a large customer base and revenue source that is not available to these small businesses. This situation is untenable and unfair for small businesses in states that have chosen to legalize cannabis in some form, and the issue can only be corrected at the federal level. De-scheduling cannabis in all forms would cure all of these woes in one fell swoop.

Since 2014, the U.S. Department of the Treasury's Financial Crime Enforcement Network (FinCEN) has maintained guidance regarding the conditions under which financial institutions may work with cannabis-related businesses. These conditions include a bevy of federal requirements financial institutions must meet in order to provide banking services to licensed cannabis-related business. However, the number of banks working with cannabis-related businesses remains marginal in the current context of an emerging global industry. Moreover, permitted cannabis-related businesses are always under threat of having their bank accounts and payment processing services closed without warning. Additionally, a cannabis-related business might be charged \$10,000 to \$1,000,000 annually for compliance and regulatory costs required for a financial institution to successfully follow obligations under federal anti-money-laundering laws. These excessive annual compliance fees could be otherwise invested to enhance business operations and expansion.

Earlier this year, Treasury Secretary Steve Mnuchin confirmed that the Department is reviewing existing FinCEN guidance and does not want to rescind the current guidance without having a replacement policy to address public safety concerns. Additionally, before the House Committee on Financial Services in May, the Treasury Secretary testified that banking regulators are currently constrained by conflicts between federal and state cannabis law and encouraged Congress to find a legislative solution. NCIA and its members appreciate the Secretary's decision to preserve FinCEN's 2014 guidance as the regulated cannabis industry continues to grow. And we agree that the industry needs a legislative solution, namely de-scheduling.

To operate safely and successfully, cannabis-related businesses must have access to working capital like any other legal enterprise in the United States. The regulated cannabis industry should also have full access to all federal resources, including SBA loans. By denying these basic financial services, we run the risk of hampering future economic development and job growth, including in areas that have been rejuvenated by the cannabis industry, and where tax revenue generated by the industry has helped fund infrastructure and transportation projects, expand education programs, and support public services. Without access to working capital, business owners may struggle to retain workforce talent and may be unable to create good-paying jobs in communities where they are needed most.

Because of continuing federal prohibition, many banks are reluctant to work with cannabis businesses out of fear of being prosecuted under federal money laundering statutes. As a result, many state-licensed cannabis businesses are forced to operate on a cash-only basis, which makes them targets for robberies. Ancillary businesses serving the industry, such as child-proof packaging manufacturers, compliance consultants, and law firms, are routinely denied basic financial services. A lack of access to financial services also means that cannabis businesses must pay their local, state and federal taxes in cash, creating logistical headaches for regulators and a security risk for employees of state

and local tax agencies and cannabis entrepreneurs alike.

Since most small business entrepreneurs, particularly those in low-income and minority communities, have traditionally had limited access to wealth networks and large investors, access to financial services in the form of bank loans would provide much-needed capital options for smaller operators and those who have been most harmed economically by prohibition. Legislation to address issues faced by small businesses in the cannabis industry has been introduced by the Chairwoman of the Committee on Small Business, Nydia Velazquez. The Ensuring Safe Capital Access for All Small Businesses Act (H.R. 3540), which was introduced by the Chairwoman of the Committee on Small Business, which would not only deschedule cannabis, but would also prohibit the Small Business Administration (SBA) from declining to provide a loan guarantee under the 7(a) Loan Guaranty Program, the Disaster Assistance Program, Microloan program, or the 504/Certified Development Company program to a cannabis-related legitimate business or service provider. That legislation also seeks to be inclusive by ensuring that minority, women, and veteran entrepreneurs in the legitimate cannabis industry are able to fairly and affordably access capital from the Small Business Administration.

As of May 2019, a measure to provide safe harbor for financial institutions that want to work with state-legal cannabis businesses and their employees, known as the Secure And Fair Enforcement (SAFE) Banking Act, has been introduced in both chambers of Congress and most recently was approved by the House Financial Services Committee while garnering 206 co-sponsors in the House and 30 co-sponsors in the Senate. We should not delay action on that bill while we await action on legalization through de-scheduling or another means. The industry needs access to banking services as soon as possible, and we hope that we will see action in both chambers later this month, with passage soon after the August recess.

280E Tax Reform

Notwithstanding the significant economic and related contributions delivered by these small businesses, company owners are facing fierce headwinds. While some of these headwinds are no different in the cannabis industry than those facing other state-legal small business owners (i.e. payroll, employee health insurance, etc.), the cannabis businesses (including ancillary businesses) must also deal with significant challenges such as staying compliant with stringent state/local laws and finding creative ways to access capital (and even rudimentary banking services). Perhaps the most difficult challenge is section 280E of the federal tax code, which results in state-legal cannabis businesses paying an effective 80% tax rate, which would be unsustainable for any business.

Section 280E of the Internal Revenue Code prohibits businesses engaged in the “trafficking” of Schedule I or Schedule II controlled substances in contravention of state or federal law from deducting normal business expenses, including payroll, employee benefits, and rent from gross income. While 280E was originally intended to penalize drug cartels, it now applies to licensed cannabis businesses that operate in compliance with state laws and regulations. This amounts to a significant financial burden for legitimate cannabis producers, processors, and retailers who often pay effective tax rates of 60% to 90% because of this arcane provision in the federal tax code. And because businesses are not able to make federal tax deductions, they sometimes end up paying higher rates at the state level as well.

Reforming 280E for businesses engaged in state-legal cannabis activities would generate revenue through expanded operations by enabling them to hire more employees and make capital improvements to their businesses, which reinvests money back into the local economy. States are further harmed by 280E because it provides an incentive to those seeking to sell cannabis for profit to do so outside of the regulated system. Entities that complete the arduous state licensing process, comply with stringent state regulations, and pay a variety of taxes imposed at each level of government are at an economic disadvantage relative to the criminal market operators for whom 280E was truly intended. Of course, fundamental fairness dictates that businesses that play by the rules should not be subject to excessive financial burdens that are not faced by untaxed illicit operations that do not adhere to the requirements of

licensing and regulation. While it is possible that 280E reform could lead to some short-term losses in federal tax revenue from state-licensed businesses because of newly allowed deductions, however, these losses would likely only last for a handful of years. Within five years of reforming 280E, the federal government could potentially see increased tax revenues under cautious low-growth assumptions for the industry. Again, it is our hope that Congress will move quickly to find a permanent fix to 280E, even while it debates the merits of de-scheduling. Of course, de-scheduling cannabis in all forms would immediately cure the problems associated with section 280E of the tax code.

Conclusion

The cannabis industry has evolved into a national commercial enterprise generating significant tax revenue, generating hundreds of thousands of jobs, and providing people access to plant-based medicines that work to alleviate pain and treat symptoms of myriad diseases. State laws that have replaced the criminal markets with systems that provide for tightly regulated production and sale of cannabis to patients and adults over 21 are improving public safety. But, the unnecessary burdens caused by outdated federal policies must be resolved to benefit our communities' entrepreneurs.

De-scheduling cannabis cures most of the problems plaguing the industry all at once, rather than an incremental approach that leaves significant problems remaining. It's time to look ahead, move forward, balance the needs of small and large businesses alike, and legislate toward an approach that leaves no significant issues for tomorrow. De-scheduling is the only viable solution to the issues facing the cannabis industry at large. And it's the right public policy solution for an end to failed federal prohibition policies that have not worked for anyone, but particularly for small businesses.

I want to thank the Chair, Vice Chair, Ranking Member, and members of the Subcommittee for your time to discuss the de-scheduling of cannabis and a path forward. As always, NCIA remains ready to work with Congress on public policy solutions that will benefit the burgeoning American cannabis industry, small and large businesses, lawmakers, and the American public.