Reefer Tax *Cont'd from page 7*

template. Using a joint powers authority, the governmental agency could sell or lease the proposed project area to the JPA pursuant to a an installment sale or lease agreement, and then purchase the newly constructed improvements back from the JPA, which would pledge those sale or lease payments to the investors in the municipal security.

But What About the Fed?

One of the great advantages that issuers of municipal securities enjoy derives from the exemption of interest payments available to investors. When an investor can avoid taxation on its muni bond interest, the low interest bond is able to compete with higher interest corporate bonds for a spot in the investor's portfolio. But when such exemption is unavailable, or only available on a state level and not from the federal government, the interest rate that the issuer would have to pay to make up for the loss of that exemption can quickly become prohibitively high.

The tax analysis for marijuana bonds will be interesting, to be sure. Notwithstanding the various marijuana laws throughout the country (twenty states and D.C. currently have laws legalizing marijuana in some form), the sale and use of marijuana is still illegal under federal law. The federal government has been inconsistent in its approach to the legalization of marijuana at the state level. In 2009, Attorney General Eric Holder announced that the Department of Justice would stop enforcing the federal marijuana laws against persons and business in compliance with local and state law. Nevertheless, in 2011, the Department of Justice began notifying property owners that any property being utilized by medical marijuana tenants was subject to seizure and forfeiture by the federal government. Yet, after the passage of the Washington and Colorado laws permitting the recreational use of marijuana, the Obama administration announced that it would not challenge laws legalizing marijuana, so long as those states maintained strict rules involving the sale and distribution of the drug. Deputy Attorney General James M. Cole followed with a memo that directed federal prosecutors to focus on eight areas of enforcement, rather than spending time targeting individual users. Those areas include preventing distribution of marijuana to minors, stopping the growing of marijuana on public land, keeping pot from falling into the hands of cartels and gangs, and preventing the diversion of marijuana to states where it remains illegal.

Further complicating matters, many potential underwriters for bonds secured by a marijuana tax, including state-chartered banks, are reluctant to provide traditional services to marijuana businesses, fearing that federal regulators and law enforcement authorities might fine them or otherwise impose sanctions for violating prohibitions on money-laundering, among other federal laws and regulations.

Another impediment to marketing a "weed bond" is the potential resistance on the part of the IRS in upholding an exemption of interest on a validly issued municipal security that is secured by revenue from an activity that is illegal under federal law. If the IRS balks, the question becomes: will the exemption from state taxes (if available) be incentive enough for investors to purchase the securities at an interest rate that is affordable to the municipality?

However, a potential work-around is to have the municipalities pledge an amount equal to the marijuana generated sales tax from their general fund. Thus, the municipality would be committed to pay the bond debt service from its coffers irrespective of the source. The increase in general fund dollars from the sale of marijuana would allow for the coverage on the bonds, but the security would not be from the tax itself.

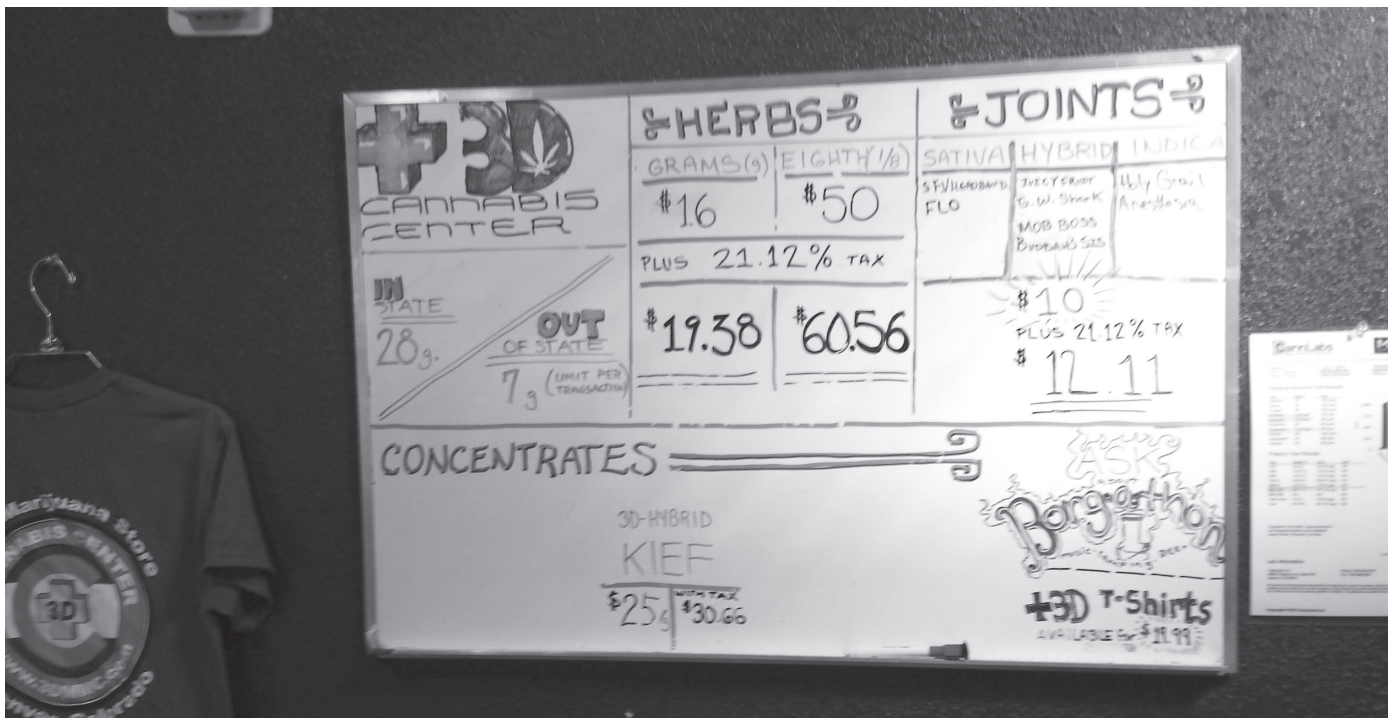
Given the mounting pressures on municipalities to find funding sources for their ever-increasing costs, answers to questions of tax exemption and use of proceeds hopefully will be worked out in short order. As the country's laws and customs ease with respect to the regulation and taxation of marijuana, great benefit could result for local governments if the federal government and bond market embrace the new revenue source with equal acceptance. It may not be long, then, before the walls of your neighborhood school smell slightly of oregano.

EDITOR'S NOTE:

The mind-blowing fiscal dimensions of legalized marijuana were robustly demonstrated at IMLA's recent Top 50 meeting in Denver. Hosted by City Attorney Scott Martinez and Deputy City Attorney Cristal De-Herrera, our two-day event in early June concluded with a field trip to the nation's largest legal weed cultivation facility.

Housed in a nameless and non-descript warehouse on the edge of the Mile High City, the indoor farm covers nearly three acres–120,000 square feet– of carefully coddled cannabis. The plants, all females, live in individual tubs, tens of thousands of them, organized by genotype and provenance. Insulated from insects, herbivores and poachers, they mature rapidly, stretching upward beneath the relentless haze of enough grow lamps to illuminate a triple-A baseball stadium, nursing on precisely-titrated feedings of mountain water and select nutrients.

It takes an army of 430 workers to serve this windowless hive, arrayed across many disciplines. Some raise newborns in a segregated compound, where select clippings from adult plants magically clone, spawning future generations. Battalions comb through the shoulder- high forest of mature specimens, laboriously snipping prime buds and leaves of optimal potency, like pickers in a tea plantation. Their harvest is then sorted at a score of large metal tables, where dozens separate the valuable bits from the chaff. Other employees staff the facility's extraction area, coaxing rich molasses residues from mounds of green silage. A kitchen team carefully incorporates the dark extract into precisely-crafted chocolate wafers, to be sheathed in foil and commercial wrappers looking as all-American as a Hershey bar. Behind it all, a technical



squad monitors a network of sensors, cameras and proprietary applications and ensures that the facility complies with "MITS" - Colorado's Marijuana Inventory Tracking System, which requires that each plant be identified by a separate RFID chip. Still more employees are deployed in other functions—maintaining the physical plant, shipping, security, logistics, sales and marketing, human resources. And there is executive management and finance.

This last component—tracking the dollars and cents of the operation –must be a daunting and enjoyable exercise. While our hosts would not disclose any real metrics of the business, they did reveal one figure: a single pound of their high-quality snippings wholesales for $1,875. Even in the absence of hard numbers, one can assume that the tens of thousands of robust plants thriving in this well-ordered dormitory literally yield tons of prime cannabis. Sales estimates rise rapidly into the millions. With retail and medical stores booming around the state (in Denver, they already far outnumber Starbucks locations), the near-term growth trajectory and profit potential for pot cultivation leaves soybean, corn and wheat farming in the dust.

If large-scale *growing* of cannabis generates an amazing bottom line, the retail *selling* of legalized pot is apparently even more lucrative. Our second stop on the IMLA magical mystery bus tour brought us to Colorado's first recreational use retail store, authorized last November. Its mission is to serve the consumer, 21-years and older, with a wide array of herbal delights. Salespersons spend an average of six minutes per purchase, advising buyers on the characteristics of various offerings like "Hindu Kush" and "Blueberry." The latter is an "Indica-dominant hybrid 80/20, recommended for pain, muscle spasms and insomnia." Its effects? "A long-lasting euphoric high, starts off cerebrally and creeps down through the body." Prices are posted, and are the same for all species of the raw herb: $16 per gram or $50 per 1/8 ounce (3.5 grams)—a rate exceeding $6,000 per pound. Joints are a flat $10 each. (All prices are before tax.)

Here, there was much less secrecy than at the farming operation. The owner volunteered that the shop serves approximately 200 buyers per day, many from out of state. According to her, this one location, in operation for barely six months, generates $11,000 per day, totally in cash. It employs more than 40 workers. The operation supplies its own raw ingredients via an attached indoor farm of 14,000 square feet. She is already looking to expand.

With a single retail outlet generating roughly $2.5 million in annual sales, the tax implications for Colorado are clearly enormous. The state has cast a wide net. It exacts a 15 percent excise tax at the wholesale level. It then levies a 10 percent sales tax on retail transactions, while the city of Denver adds its own 3.5 tax on top of that. According to City Attorney Scott Martinez, marijuana sales will add roughly $7 million to Denver's tax coffers this year alone.

Given these metrics, it doesn't seem implausible that "legal weed" will soon be taking root–or at least be seriously considered–in a town near you. ML