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Legally Operating a Medical Marijuana Business in California



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Establishing and operating a medical marijuana business in the state of California is, as one correctly would assume, quite different from other enterprises. However, if the unique legal requirements are understood and properly followed, there are many similarities with other business structures. Due to the current legal climate at the local, state and federal levels, it is imperative to know and comply with the applicable laws, rules and regulations to the fullest extent possible. This article is intended only to provide some general information on this unique area of business law and should not be construed as legal advice or legal opinion on any specific facts or circumstances.

Differences

Business Form. California law requires all businesses that cultivate and distribute medical cannabis to be organized and operated as cooperatives or collectives. A cooperative is defined by California statutory law and is required to organize in a specific way, to register with the state, and to follow strict rules on operating and reporting on their activities. Alternatively, collectives are not defined in the law and, thus, have a greater degree of flexibility in their establishment and operations. Whichever structure is chosen, creating and using good membership documentation is a definite necessity.

Nonprofit Operation. California Health and Safety Code section 11362.765(a) states, in part, as follows: "...nor shall anything in this section authorize any individual or group to cultivate or distribute marijuana for profit." Nonetheless, as explained by retired California State Senator John Vasconcellos, who was co-chair of the Medical Marijuana Task Force, which drafted SB 420, although nothing in the section explicitly authorizes profit, nothing prohibits it either. However, there is case law indicating that entities cannot be formed as for-profit enterprises. Accordingly, these businesses should be established as nonprofit entities. Thus, the most widely recommended and utilized business form in California is the nonprofit mutual benefit corporation, which is one of the three primary types of nonprofit corporations, the other two being religious and public benefit.

Membership Requirements. All of the organization's members must be qualified patients that have a valid physician's recommendation indicating that marijuana would be a beneficial treatment for a serious medical condition. Additionally, primary caregivers also may be members of the group, although they must consistently assume responsibility for the housing, health or safety of the patient and cannot only maintain a source of marijuana.

Specific Purpose. Medical cannabis businesses cannot purchase marijuana from or sell marijuana to nonmembers. Moreover, the corporations themselves do not produce or provide cannabis to their members. The specific purpose of these corporations is to provide a means for facilitating and coordinating transactions between their qualified patient members and/or primary caregiver members relating to medical cannabinoids, the production and provision of which only being performed by the members.

Possession Quantities. A qualified patient in California may possess medical marijuana in an amount consistent with his/her medical needs. However, the recognized safe harbor for all patients is 8 oz. of dried marijuana and no more than 6 mature or 12 immature plants. Consequently, collectives and cooperatives may cultivate, transport and possess marijuana in aggregate amounts tied to their membership numbers.

Permissible Reimbursements. Although the legality of earning a profit from the distribution of cannabis is somewhat uncertain (as discussed above), medical marijuana may be distributed by an organization to its members for a fee that is reasonably calculated to cover overhead costs and operating expenses.

Federal Law. The federal government views marijuana as a drug with “no currently accepted medical use” (21 U.S.C. § 812(b)(1)) and, thus, manufacturing, distributing or possessing it is a federal criminal offense. (*Id.* at §§ 841(a)(1), 844(a).) However, as explained by then-Attorney General and now-Governor, Edmund G. Brown, Jr., in the *Guidelines for the Security and Non-diversion of Marijuana Grown for Medical Use*, dated August 2008, California law does not conflict with federal law because, “in adopting these laws, California did not ‘legalize’ medical marijuana, but instead exercised the state’s reserved powers to not punish certain marijuana offenses under state law when a physician has recommended its use to treat a serious medical condition.” Nevertheless, federal agents have taken action against numerous individuals and groups in California, either on their own or at the behest of certain municipal authorities. In addition, although the entity may be established as a nonprofit corporation, the Internal Revenue Service refuses to grant these types of businesses tax-exempt status, therefore requiring them to pay income tax, unlike most other nonprofits.

Similarities

Although there are some unique requirements governing medical marijuana establishments in California, there also are quite a few similarities to setting up and running businesses in other industries. Some of the main ones are as follows.

Taxes & Permits. As previously mentioned, the IRS does not grant tax exempt status to these businesses and, likewise, the California Franchise Tax Board does not either. Accordingly, collectives and cooperatives are required to pay federal and state income tax just like any other for-profit company. Further, the California State Board of Equalization considers the sale of medical cannabis to be taxable and, as such, medical marijuana sellers are required to obtain a seller’s permit, to file the appropriate returns, and to pay the applicable tax.

Business Licenses. Medical marijuana establishments must obtain business licenses within those cities and counties that require other businesses to do the same. Although many municipalities have utilized this requirement to deter collectives and cooperatives from operating within their jurisdiction by denying the application for the license, these actions have resulted in the filing of numerous lawsuits by operators against the cities.

Corporate Maintenance. If the organization incorporates as a nonprofit corporation, there are no shareholders or owners of the business. The nonprofit is operated by its board of directors, who appoint officers, who can hire staff to run the business. Further, the operators must adhere to the proper corporate formalities regarding the operation and maintenance of corporations in California, e.g., holding director meetings, not mixing corporate and personal funds, and keeping adequate records.

Personal Liability. By incorporating the business and following all of the applicable laws and requirements, operators of collectives and cooperatives significantly can limit their personal legal liability. What this means is that the operators’ personal assets are protected from creditors of the corporation, unless certain exceptions apply, such as personally guaranteeing a loan or debt, intentionally doing something fraudulent or illegal, or treating the corporation as an extension of his or her personal affairs, rather than as a separate legal entity.

Operating Expenses. Just like any other for-profit or nonprofit business, medical cannabis organizations will have a variety of overhead costs, including paid employees (plus benefit packages and health coverage), fixed expenses (e.g., rent, utilities, Internet, telephone), variable costs (such as marketing, attending or hosting events and fundraisers), and the expenses associated with the group's specific purpose, which can include research, public education programs, and community outreach efforts. Of course, it is advisable to hire a knowledgeable accountant to help adequately plan for and record the organization's expenses.

Insurance Coverage. As with any company, medical marijuana businesses should maintain, at a minimum, a good liability insurance policy. This will help protect against many of the risks of doing business. In addition to liability insurance, other possible types of coverage could include business interruption and key man policies. Additionally, if the organization has one or more employees, it is required to have workers' compensation insurance.

Conclusion

Medical marijuana businesses legally are allowed to operate in California. In order for them to do so, they and their members must strictly follow the applicable laws, rules and regulations pertaining to medical cannabis at the state, county and municipal levels. Further, these organizations need to fully comply with the requirements of all companies as they relate to doing business, paying taxes, etc., not just because it is the law, but also due to the increased level of scrutiny currently being placed on this industry.

Another important consideration is the fact that marijuana still is classified under the federal Controlled Substances Act as a Schedule I drug, thereby making its cultivation, distribution and possession a federal offense. Consequently, medical cannabis businesses may encounter federal pressure and/or action being taken against them, their members, and their landlords.

Because there are apparent conflicts between the laws at the federal and state levels, and within the state itself, quite a bit of confusion and uncertainty exists on the part of the general public, the medical cannabis industry, the law enforcement community, and the legal system regarding what these groups can and cannot do. Thus, medical marijuana organizations must contend with unique risks and challenges, in addition to those involved with operating any business. Accordingly, it is imperative that operators do their research, so that they are informed on how to establish and maintain these businesses. Lastly, it is especially important with these undertakings that they retain competent legal counsel who is experienced and knowledgeable in the areas of corporate and nonprofit law, in addition to those relating to medical marijuana.

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