FEDERAL MARIJUANA POLICY: HOMAGE TO FEDERALISM IN FORM; POTEMKIN FEDERALISM IN SUBSTANCE

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Laws or ordinances unobserved, or partially attended to, had better never have been made.
George Washington[1]

The law relating to public policy cannot remain immutable. It must change with the passage of time.
Lord Judge Danckwerts[2]

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I. Introduction

Societal views concerning a controversial issue were changing rapidly and such changes were reflected in a plethora of state laws that altered long-standing principles. Federal law, however, remained static, unable or unwilling to adapt to societal undercurrents. This state of affairs described the not too long ago uneasy co-existence of federal and

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1. Letter from George Washington to James Madison (Mar. 31, 1787) (on file with the National Archives, Washington Papers, Confederation Series), https://founders.archives.gov/GEWN-04-05-02-0111.

2. Nagle v. Feilden, 1 All E.R. 689, 696 (1966).

state laws governing same-sex marriage. This aptly describes the current legal landscape with respect to marijuana. Congress, however, was relieved of responsibility over the marriage issue by the Supreme Court but Congress is unlikely to be so fortuitous with marijuana. Federal policy with respect to marijuana consists of open flouting of federal law. This policy comes with a real cost for little benefit.

Part II of this article discusses the Controlled Substances Act, state law legalization initiatives, and current federal enforcement policy. This part also examines the application of the Supremacy Clause and the Tenth Amendment to the current legal landscape with respect to marijuana. Presently, the federal government has respected state policy preferences through Executive branch non-enforcement policies and Congressional de-funding of enforcement efforts. Unfortunately, these measures are subject to changing political winds and, in any event, are half-measures at best.

Part III of this article illustrates that the current state of marijuana regulation is Potemkin federalism. Despite the Department of Justice's homage to state policy in its enforcement policies, the collateral consequences of Congressional inaction mitigate, to a great extent, the ability of state preferences to come to full fruition. There are a number of collateral consequences to the fact that marijuana remains a Schedule I narcotic under federal law. Most significantly, state sanctioned marijuana enterprises have difficulty in accessing the banking system, are subject to federal income tax on a higher tax base than other businesses that operate legally under state law, and face great uncertainty over whether their contracts will be enforced.

Part IV argues that federal law should adopt a cooperative regulatory model under which the federal government assists the states in enforcing policies that are determined by the states. A model for such an approach exists with respect to gambling, an activity that shares a number of similarities to marijuana. Gambling long has been considered an activity that generates negative externalities, takes place whether it is legalized or not, and has its virtues. With the exception of sports gambling, federal law defers to the states regarding gambling policy and serves to buttress state enforcement efforts. This part also asserts that non-enforcement of federal law, in this context, comes at a cost but yields little benefit. Categorical refusals to enforce federal law erode respect for such law. In some circumstances, the benefits of non-enforcement may very well exceed this cost. However, this is not the case here. Non-enforcement of federal criminal law provides some comfort to marijuana enterprises but the collateral consequences that result from the current state of the law on such enterprises begs the question of just what the federal government

hopes to achieve. Justification for the Department of Justice's transparent signal that it will not enforce federal law and for Congress's refusal to appropriate funds for such enforcement has to be more than political expediency. Congress and the Executive branch should be very cautious in setting policies that encourage the belief that the law, in the right circumstances, is appropriately ignored—a caution that the current controversy over federal immigration laws should heighten.

II. FEDERAL MARIJUANA REGULATION AND STATE LEGALIZATION: A STRAINED FEDERALISM

State legalization of marijuana rests uncomfortably with federal law. Congress made clear that federal law was not intended to occupy the field of narcotics regulation. However, it is a good assumption that when the current federal law governing narcotics was enacted almost fifty years ago, it never occurred to most, if any, members of Congress that more than half the states would someday legalize marijuana to some degree. It appears that state laws that run counter to federal law with respect to marijuana do not violate the Supremacy Clause and, in the event that they did, such a result would offer little practical assistance to the federal government due to Tenth Amendment barriers. For the most part, the federal government has chosen to acquiesce to the states. This acquiescence offers little comfort to operators of state legalized marijuana businesses because this acquiescence, embodied in administrative discretion, may prove ephemeral. Moreover, despite federal discretion regarding law enforcement, the collateral consequences of federal law on marijuana businesses are most burdensome to such businesses.

A. The Controlled Substances Act

Current federal marijuana regulation dates to the Nixon administration and the passage of the Controlled Substances Act.[3] This

3. The Controlled Substances Act was enacted as Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-513, 84 Stat. 1236, 1242 (codified as amended at 21 U.S.C. §§ 801–889 (2012)). Prior to this legislation, federal anti-marijuana legislation did not criminalize marijuana activities, but instead first subjected the product to labeling requirements and later, with the enactment of the Marijuana Tax Act of 1937, subjected manufacturers, distributers, dispensers, and certain other persons in the marijuana business to occupational registration with the federal taxing authorities and to an occupational privilege tax. *See generally* Pure Food and Drug Act of 1906, Pub. L. No. 59-384, § 8, 34 Stat. 768, 769 (1906) (repealed 1935); Marijuana Tax Act of 1937, Pub. L. No. 75-238, 50 Stat. 238 (1937) (repealed 1970). The

legislation set forth five schedules of drugs—Schedules I–V—each with their own set of restrictions whose severity are greatest for Schedule I drugs and least for Schedule V drugs.[4] Marijuana is listed as a Schedule I narcotic, a drug or substance that has a high potential for abuse, has no medically accepted use, and lacks safe use under medical supervision.[5] As a controlled substance, marijuana cannot be manufactured, distributed, dispensed, or possessed with the intent to manufacture, distribute, or dispense.[6] As a Schedule I narcotic, marijuana, unlike Schedule II–V controlled substances, cannot be prescribed by a physician.[7] There was some doubt in Congress prior to the passage of the legislation as to whether marijuana should be classified as a Schedule I narcotic and numerous unsuccessful court challenges have been brought to remove it from such a schedule.[8]

Marijuana Tax Act of 1937 was held to be unconstitutional because its registration requirement had the propensity to self-incriminate the registrant with respect to state law prohibitions, and the Act had certain due process deficiencies. *See* Leary v. United States, 395 U.S. 6 (1969). This statute was repealed in 1970. *See* Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-513, § 1101, 84 Stat 1236, 1292 (1970). State registration requirements may raise similar constitutional issues. *See generally* Joseph A. Goldstein, Note, *Taxing Legal Marijuana: How Courts Should Treat Drug Tax Statutes in Light of the Fifth Amendment's Self-Incrimination Clause and Executive Non-Enforcement of the Controlled Substances Act*, 37 CARDOZO L. REV. 793 (2015).

4. *See generally* 21 U.S.C. § 812 (2012). Controlled substance analogues, to the extent used for human consumption, are treated as controlled substances. A controlled substance analogue is a substance whose chemical structure is substantially similar to a controlled substance listed on Schedules I or II and that has certain effects on the central nervous system. *See* 21 U.S.C. §§ 802(32)(A), 813 (2012).

5. 21 U.S.C. § 812(b)(1) (2012); 21 U.S.C. § 812 Sched. I(c)(10) (West Supp. 2016). Marijuana is defined as:

> [A]ll parts of the plant Cannabis sativa L., whether growing or not; the seeds thereof; the resin extracted from any part of such plant; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds or resin. Such term does not include the mature stalks of such plant, fiber produced from such stalks, oil or cake made from the seeds of such plant, any other compound, manufacture, salt, derivative, mixture, or preparation of such mature stalks (except the resin extracted therefrom), fiber, oil, or cake, or the sterilized seed of such plant which is incapable of germination.

21 U.S.C. § 802(16) (2012).

6. 21 U.S.C. § 841(a) (2017).

7. 21 U.S.C.A. § 829(a)–(c) (West Supp. 2017).

8. Efforts to remove marijuana as a scheduled drug or to reclassify it began shortly after the passage of the Act. *See* Nat'l Org. for Reform of Marijuana Laws v. Drug Enforcement Admin., 539 F.2d 735 (D.C. Cir. 1977); Nat'l Org. for Reform of Marijuana Laws v. Ingersoll, 497 F.2d 654 (D.C. Cir. 1974); Erwin Chemerinsky, et al., *Cooperative Federalism and Marijuana Regulation*, 62 U.C.L.A. L. REV. 74, 82 n.22 (2015) (discussing the controversy over the legislation's treatment of marijuana and court challenges to its current designation).

The Supreme Court upheld the constitutionality of the statute's application to legalized marijuana in *Gonzales v. Raich*.[9] In that case, the petitioners asserted, among other claims, that the enforcement of the Controlled Substances Act against locally produced and consumed marijuana for medical uses, as permitted under California law, was beyond Congress's power to regulate interstate commerce.[10] The Court, relying heavily on *Wickard v. Filburn*, rejected the petitioners' claim.[11] Several years earlier the Court held that the Controlled Substances Act does not provide, nor is required to provide, a medical necessity exception to its prohibitions.[12] Recently, the Court declined to decide a dispute between Nebraska and Colorado in which Nebraska claimed that Colorado's marijuana law violated the Controlled Substances Act and that Colorado's legislation caused marijuana to flow into its jurisdiction thereby undermining its drug policies and draining its resources.[13]

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9. Gonzales v. Raich, 545 U.S. 1 (2005).

10. *Id.* at 7–8.

11. *Id.* at 17–27. Wickard v. Filburn, 317 U.S. 111 (1942) was a seminal case that greatly expanded the Commerce power. In that case, the Court held that Congress' power to regulate interstate commerce includes the power to regulate activity that has an indirect effect on such commerce. Although the Court had been trending in the direction of expansive federal power, *Wickard* laid to rest any doubts about the extent of such power. The Progressive period, which resulted in the increased regulation of railroads, the institution of occupational licensing, and the enactment of the Sherman Antitrust Act, spawned the growth of the federal bureaucracy. *See generally* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 439–66 (2d. ed. 1985). The aims of the Progressive movement were hindered during the *Lochner* era. *See* Lochner v. New York, 198 U.S. 45 (1905) (holding that a New York statute regulating the hours of bakers was an unconstitutional infringement on the right and liberty to contract). The Court's resistance to expansive federal powers over economic matters manifested itself dramatically in *Hammer v. Dagenhart*, 247 U.S. 251 (1918) (holding that compliance with child labor standards was beyond the reach of Congress's power to regulate interstate commerce). The Court's narrow interpretation of the commerce power came to an end with its decisions in *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937) (upholding the constitutionality of the National Labor Relations Act of 1935) and *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937) (upholding the constitutionality of a Washington state minimum wage law and overturning an earlier precedent to the contrary); Adkins v. Children's Hospital, 261 U.S. 525 (1923).

12. United States v. Oakland Cannabis Buyers' Coop., 532 U.S. 483 (2001).

13. *See* Nebraska v. Colorado, 136 S. Ct. 1034 (2016). Pursuant to Article III, § 2, cl. 2 of the Constitution, the Court has original jurisdiction over controversies between states. Two justices dissented from the Court's refusal to hear the case on the grounds that the Court lacks the discretion on whether to hear such cases. *See id.* at 1034–36 (Thomas, Alito, J.J., dissenting). Two scholars believe that, rather than putting forth preemption arguments to challenge states that have legalized marijuana, a more effective approach may be to base such challenges on common law nuisance principles. *See* Chad Deveaux & Anne Mostad-Jensen, *Fear and Loathing in Colorado: Invoking the Supreme Court's State-Controversy Jurisdiction to Challenge the Marijuana-Legalization*

It is possible that the growing acceptance of the medicinal benefits of marijuana will cause the Court to reconsider its position on medical necessity or to consider whether federal resistance to accepted medical opinion renders the current scheduling of marijuana irrational. [14] The recognition by the Court of a constitutional right to same-sex marriage was inconceivable as recently as a decade ago and perhaps critics of the federal prohibition on marijuana use may find the constitutional route as their best path in preventing federal intrusion on state marijuana policy preferences. One commentator has argued that state legalization efforts, if successful in the containment of spillover effects on neighboring states, may cause the federal prohibition on marijuana to violate the Necessary and Proper Clause.[15]

When Congress enacted the Controlled Substances Act, every state maintained prohibitions against marijuana and, since its enactment, nearly all marijuana arrests have been made pursuant to state laws.[16] The public's attitude toward marijuana became more accommodative principally due to support for medical use of marijuana and to

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Experiment, 56 B.C. L. REV. 1829, 1845–59 (2015). State law provisions that attempt to mitigate the possibility that marijuana is diverted by out of state buyers may be subject to challenge on dormant Commerce Clause grounds. The Dormant Commerce Clause, a doctrine developed by the Court in the nineteenth century, precludes a state from interfering with interstate commerce and arises by implication from Congress's power to regulate interstate commerce. *See* Reading R.R. v. Pennsylvania., 82 U.S. 232 (1872). A law motivated by economic protectionism that facially discriminates against out-of-state interests or that favors in-state economic interests over out-of-state interests violates the Commerce Clause unless the state can show that the law in question is the only means by which it can advance a legitimate state purpose. However, if a law is not motivated by economic protectionism but does affect interstate commerce incidentally, the Court has applied a balancing test to determine whether such law is permissible. *See generally* Brown-Forman Distillers v. N.Y. State Liquor Auth., 476 U.S. 573 (1986); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978), Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333 (1977); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970).

14. The Court held that Congress had a rational basis for rejection of a necessity exception. Gonzales v. Raich, 545 U.S. 1, 26–28 (2005).

15. *See* William Baude, *Marijuana, Federal Power, and the States: State Regulation and the Necessary and Proper Clause*, 65 CASE W. RES. L. REV. 513 (2015). Nebraska has claimed that spillover effects have not been contained. *See supra* note 11 and accompanying text. The Necessary and Proper Clause grants Congress the power to "make all laws which shall be necessary and proper for carrying into execution the foregoing powers . . ." U.S. CONST. art. I, § 8, cl. 18. This provision is not an independent grant of authority. Instead, it grants to Congress the authority to enact provisions "'incidental to the [enumerated] power'" and is "'merely a declaration, for the removal of all uncertainty, that the means of carrying into execution those [powers] otherwise granted are included in the grant.'" Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 559 (2012) (quoting McCulloch v. Maryland, 17 U.S. 316, 418 (1819) and Kinsella v. United States *ex rel.* Singleton, 361 U.S. 234, 247 (1960)).

16. Chemerinsky, et al., *supra* note 8, at 84 (citations omitted).

perceptions that enforcement of legal prohibitions of the substance was futile, consumed enormous amounts of state resources, and burdened minority groups disproportionately.[17] Public attitudes manifested themselves politically and, in 1996, California voters passed Proposition 215, thus making California the first state in which medical uses of marijuana was permissible.[18] By the beginning of the millennium, an additional six states followed suit.[19] After the 2016 elections, twenty-eight states, the District of Columbia, Guam, and Puerto Rico have enacted medical marijuana laws.[20] Eight states and the District of Columbia have legalized, to varying degrees, recreational use of marijuana.[21]

In certain respects, federal law with respect to marijuana is reminiscent of the federal government's intransigence with respect to same-sex marriage. Public attitudes toward a controversial subject shifted rapidly and those attitudes were manifested by changes to state law despite federal government disapproval. By 2015, thirty-seven states, the District of Columbia, and Guam had recognized same sex marriage.[22] In less than twenty years, same sex marriage went from a status that was affirmatively denied by the federal government to a status that is now constitutionally required to be sanctioned. The Defense of Marriage Act (DOMA), a 1996 federal statute enacted in response to the distinct possibility of state law same-sex marriages, stated that, for purposes of any federal legislation, marriage is defined as the legal union of one man

17. *Id.* at 85.

18. CAL. HEALTH & SAFETY CODE § 11362.5 (1996) (also known as Compassionate Use Act, Prop. 298).

19. *Id.*

20. *See* MARIJUANA POLICY PROJECT, STATE-BY-STATE MEDICAL MARIJUANA LAWS: HOW TO REMOVE THE THREAT OF ARREST (2015 & 2016), https://www.scribd.com /document/264980279/State-by-State-Laws-Report-2015. State laws vary considerably in their details concerning permissible quantities, licensed dispensaries, and other supply chain considerations, user registration, and other relevant details. *See id.* In addition, a number of additional states permit the medical use of low THC marijuana or cannabis oil. *See id.* at 17.

21. *See* Aaron Smith, *10 Things to Know About Legal Pot*, CNN MONEY (May 26, 2017), http://money.cnn.com/2017/04/19/news/legal-marijuana-420/index.html. The Vermont legislature enacted a statute that would have legalized, to a limited extent, the possession and growth of marijuana. However, the legislation was vetoed by Governor Scott. The veto was not prompted by a principled opposition to marijuana legalization but by objections to the particulars of the legislation. *See* Jon Kamp, *Vermont Pot Bill is Vetoed by Governor*, WALL ST. J., May 25, 2017, at A3.

22. Nat'l Conference of State Leg., *Same-Sex Marriage Laws* (June 26, 2015), http://www.ncsl.org/research/human-services/same-sex-marriage-laws.aspx.

and one woman.[23] Consequently, same-sex couples who were legally married under state law were not treated as married for federal tax purposes and could not qualify for a host of federal benefits or programs.[24] The statute has been subject to numerous legal challenges and the Obama administration chose not to defend it.[25] The Supreme Court, in *Windsor v. United States,*[26] a case that involved the denial of the estate tax marital deduction to the estate of the deceased for property bequeathed to her same-sex spouse, struck down DOMA on Fifth Amendment equal protection grounds.[27]

The Court had the opportunity to hold that states could not deny same-sex couples the right to marry but it declined to do so in *Hollingsworth v. Perry.*[28] That case involved a constitutional challenge to California's Proposition 8, a voter-approved ballot initiative that amended the California constitution to preclude the recognition of same-sex marriage.[29] The Court dismissed the challenge on procedural grounds.[30] Finally, on June 26, 2015, the Supreme Court, in *Obergefell v. Hodges,* held that the Equal Protection Clause of the Fourteenth Amendment requires a state to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed by another state.[31] In the marriage context, at least, the federal government

23. Defense of Marriage Act, Pub. L. 104-1099 (1996) (invalidated by United States v. Windsor, 133 S. Ct. 2675 (2013)).

24. Andrew Koppelman, *Beyond Levels of Scrutiny: Windsor and "Bare Desire to Harm,"* 64 CASE W. RES. L. REV. 1045, 1063 (2014).

25. *See* Roberta A. Kaplan & Julie E. Fink, *The Defense of Marriage Act: The Application of Heightened Scrutiny to Discrimination On The Basis Of Sexual Orientation,* 2012 CARDOZO L. REV. DE NOVO 203 (2012).

26. Windsor v. United States, 133 S. Ct. 2675 (2013).

27. *Id.* at 2695–96. Federal tax law provides an unlimited deduction for estate tax purposes for the value of property passing to a surviving spouse provided that certain conditions are met. *See* I.R.C. § 2056 (2012). By no means was DOMA's reach limited to federal tax issues. The Court noted that over 1,000 federal statutes were impacted by the legislation. *Windsor*, 133 S. Ct. at 2690.

28. Hollingsworth v. Perry, 133 S. Ct. 2652 (2013).

29. *Id.* at 2660.

30. *Id.* at 2668. After the California Supreme Court rejected a procedural challenge to the amendment, two same-sex couples filed suit in federal district court claiming that Proposition 8 violated the Due Process and Equal Protection Clauses of the Fourteenth Amendment. *Id.* at 2659–60. The named defendants, Governor Arnold Schwarzenegger, Attorney General Jerry Brown, and several other government officials, refused to defend the amendment. *Id.* at 2660. The district court allowed the petitioners, the official proponents of the ballot initiative, to intervene as defendants and held that Proposition 8 was unconstitutional. *Id.* The Court held that the petitioners did not have standing to bring the suit, either in their own right or in a representational capacity. *Id.* at 2662–67.

31. Obergefell v. Hodges, 135 S. Ct. 2584 (2015).

listened to, and learned from, the states—albeit through the action of the judicial branch.

Despite these similarities, DOMA did not implicate Supremacy Clause or Tenth Amendment issues.[32] Federal law did not prohibit or in any way invalidate same-sex marriage but merely denied any federal benefits to same-sex couples.[33] The incongruence between federal and many state laws regarding marijuana do implicate these issues.

B. Supremacy Clause and Tenth Amendment Issues

The Supremacy Clause, intended to rectify defects in the Articles of Confederation, provides that federal law is the "supreme law of the land."[34] Thus, so long as a federal statute is constitutional, it will preempt any conflicting state laws.[35] The determination of whether state law conflicts with federal law is easily resolved if Congress chooses to occupy the field with respect to the object of regulation.[36] Otherwise, whether a state law is preempted by federal law depends on the operation and effects of state law.[37]

The Controlled Substances Act did not occupy the field with respect to drug regulation. To the contrary, the statute states that

> [n]o provision of this subchapter shall be construed as indicating an intent on the part of Congress to occupy the field in which that provision operates, including criminal penalties, to the exclusion of any State law on the same subject matter which would otherwise be within the authority of the State, unless there is a positive conflict between that provision of this subchapter and that State law so that the two cannot consistently stand together.[38]

It is not clear whether state laws expressly legalizing an activity made criminal under federal law create a positive conflict with federal

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32. Defense of Marriage Act, Pub. L. 104-1099 (1996) (invalidated by United States v. Windsor, 133 S. Ct. 2675 (2013)).

33. *Id.*

34. U.S. CONST. art. VI, cl. 2. *See* THE FEDERALIST NO. 44, at 323 (James Madison) (B. Fletcher ed., 1996) ("all the authorities contained in the proposed Constitution . . . would have been annulled, and the new Congress would have been reduced to the same impotent condition with [the Articles of Confederation]" without this provision).

35. U.S. CONST. art. VI, cl. 2.

36. Gade v. Nat'l Solid Wastes Mgmt. Ass'n, 505 U.S. 88, 98 (1992).

37. *Id.* at 107.

38. 21 U.S.C. § 903 (2012).

law. It is certainly arguable that a state law imprimatur to an activity that is criminal under federal law creates a positive conflict with the objectives of federal law. However, courts have interpreted the preemptive effect of the Controlled Substances Act very narrowly. State law is deemed to cause a positive conflict with the Act only if compliance with state and federal law is a physical impossibility.[39] In essence, only state laws that require its citizens or its officials to violate the Controlled Substances Act would be preempted.[40] It is conceivable that the Controlled Substances Act preempts state laws that legalize marijuana if such laws pose an obstacle to the enforcement of the federal statute. However, as Professor Chemerinsky and others have noted, obstacle preemption is particularly difficult to sustain in a field that is traditionally regulated by the states or in circumstances indicating that Congress was well aware of the operation of state law and resigned itself to the inevitable tensions that may ensue from regulation by dual sovereignties.[41] Moreover, it is not entirely clear that state legalizing and regulating regimes are at odds with the purposes of the Controlled Substances Act.[42]

Federal preemption of state law, in any event, may have little practical effect on drug enforcement. Despite Congress's expansive power to act pursuant to its Commerce power and to preempt the field when it does so act, the Tenth Amendment imposes limitations on federal power. Any law that "commandeers the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program" exceeds Congress's constitutional power.[43] Consequently, Congress "lacks the power directly to compel the States to require or prohibit" acts which the federal government sees fit to require or prohibit.[44] In effect, Congress can tell states what they cannot do but

39. *See* Chemerinsky, *supra* note 8, at 105–06 (citing to S. Blasting Servs. v. Wilkes Cty., 288 F.3d 584, 591 (4th Cir. 2002) (concerning legislation dealing with explosives that contained preemption language similar to that used in the Controlled Substances Act), Gonzales v. Oregon, 546 U.S. 243, 290 (Scalia, J., dissenting), and Solorzano v. Superior Court, 13 Cal. Rptr. 2d 161, 169–70 (Cal. Ct. App. 1992)).

40. *Id.* at 106–07.

41. *Id.* at 107–10.

42. *See id.* at 110–13. Note that similar issues arise with respect to whether state laws violate U.S. treaty obligations that concern drug control. *See generally* Biju Panicker, *Legalization of Marijuana and the Conflict with International Drug Control Treaties*, 16 CHI. KENT J. INT'L & COMP. L. 1 (2016); *see also* Mystica M. Alexander & William P. Wiggins, *The Lure of Tax Revenue and Recreational Marijuana: At What Price?*, 15 U.C. DAVIS BUS. L.J. 131, 167–72 (2015).

43. Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 283, 288 (1981).

44. New York v. United States, 505 U.S. 144, 166, 180 (1992).

cannot tell them what they must do. Thus, Congress can prohibit a state from legalizing marijuana but cannot compel a state to criminalize the substance.[45] This so-called anti-commandeering doctrine recognizes the constitutional system of dual sovereignty and, in part, is intended to preserve political accountability on federal officials by preventing them from making policy choices and passing the proverbial buck to state officials.[46] The scope of the anti-commandeering doctrine is not entirely clear, but the Court's precedents leave little doubt that federal preemption of state marijuana laws could not compel states to assist federal law enforcement officials in their enforcement of Controlled Substances Act.

In *Hodel v. Virginia Surface Mining & Reclamation Association*, the Court upheld a federal statute that established certain standards for coal mining operations and required states that wished to assume regulatory authority over such operations, among other requirements, to enact laws that implemented the standards set forth in the federal statute.[47] If a state declined to participate then the federal government would assume regulatory responsibilities.[48] The Court noted that federal law did not compel the states to adopt the federal standards, did not require them to expend state funds, and did not otherwise coerce them into participation in the federal program.[49] The Court later stated that because Congress could have chosen to preempt the field entirely the legislation in question "merely made compliance with federal standards a precondition to continued state regulation in an otherwise pre-empted field."[50] In *F.E.R.C. v. Mississippi*, the Court upheld a federal requirement, imposed on state utility commissions, that mandated such commissions to consider, but did not mandate, the enactment of certain standards for energy efficiency.[51] Despite the fact that federal law commandeered state resources to consider the energy standards, the Court upheld the law because it did not require the implementation of such standards and was merely "only one step beyond *Hodel*."[52]

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45. *See* NCAA v. Christie, 730 F.3d 208, 227–29 (3d Cir. 2013) (involving the constitutionality of a federal statute that prohibited states from sanctioning sports gambling). *See infra* notes 241–60 and accompanying text.

46. *New York*, 505 U.S at 168; *see also* Printz v. United States, 521 U.S. 898, 930 (1997) (striking down provisions that required states to "absorb the financial burden of implementing a federal regulatory program" and "tak[e] the blame for its . . . defects.").

47. *Hodel*, 452 U.S. at 271.

48. *Id.* at 272.

49. *Id.* at 288.

50. *Printz*, 521 U.S. at 926.

51. F.E.R.C. v. Mississippi, 456 U.S. 742, 746, 769–70 (1982).

52. *Id.* at 764.

Federal prohibitions on state actions or federal requirements on states to enact regulations have been upheld if such prohibitions or requirements do not implicate a state's control over its regulation of private parties or if they merely subject a state to the same requirements applicable to private parties. Thus, federal laws prohibiting a state from issuing bonds in bearer form and prohibiting state motor vehicle departments from divulging private information about its citizens did not violate the Tenth Amendment.[53]

In *New York v. United States*, the Court struck down a federal law designed to regulate and encourage the orderly disposal of low-level radioactive waste.[54] The law included a "take-title" provision which mandated that a state take title to radioactive waste at the request of the waste generator if such state had not been able to arrange for the disposal of the waste by a certain time.[55] According to the Court, "Congress may not simply 'commandeer the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program,'"[56] In the Court's opinion, the take-title provision "crossed the line distinguishing encouragement from coercion."[57] The Court applied similar reasoning to invalidate the provisions of federal gun control legislation—the Brady Act—that required local authorities of certain states to run background checks on gun purchasers.[58] Congress "may neither issue directives requiring the States to address particular problems, nor command the States' officers . . . to administer or enforce a federal regulatory program."[59]

Congress cannot compel state cooperation to enforce the Controlled Substances Act but, through its spending power, it can obtain such cooperation. A plethora of federal programs dispense an enormous amount of funds to the states, often with strings attached.[60] However, the use of the spending power as a carrot to obtain state cooperation has its

53. *See generally* Reno v. Condon, 528 U.S. 141 (2000); South Carolina v. Baker, 485 U.S. 505 (1988). *But see* David S. Schwartz, *High Federalism: Marijuana Legalization and the Limits of Federal Power to Regulate States*, 35 CARDOZO L. REV. 567, 616–26 (2013) (questioning whether these precedents would override federal preemption and bar some compulsion on state law enforcement officials to assist federal enforcement efforts).

54. New York v. United States, 505 U.S. 144, 149–54 (1992).

55. *Id.* at 153–54 (citing 42 U.S.C.A. § 2021e(d)(2)(C) (West 2017)).

56. *Id.* at 161 (quoting Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 283, 288 (1981)).

57. *Id.* at 167, 175.

58. *See* Printz v. United States, 521 U.S. 898 (1997).

59. *Id.* at 935.

60. *See* Andrew B. Coan, *Commandeering, Coercion, and the Deep Structure of American Federalism*, 95 B.U. L. REV. 1, 12 (2015).

own limits, both constitutionally and politically. In *South Dakota v. Dole*, the Court set forth the conditions under which such an exercise of the spending power is constitutionally permissible.[61] The federal spending in question must advance the general welfare, conditions imposed upon the receipt of funds must be stated unambiguously and such conditions must relate to the federal interests sought to be advanced, and such conditional spending cannot be prohibited by another constitutional provision.[62] Moreover, the Court held that the Tenth Amendment precludes financial inducements that are so coercive that they compel states to accept such inducements.[63] In that case the Court upheld the constitutionality of the National Minimum Drinking Age Act which caused a state that did not adopt a legal drinking age of at least twenty-one to lose five percent of federal highway funds.[64] According to the Court the financial inducement in this case was not coercive but merely a form of "relatively minor encouragement."[65]

In *National Federation of Independent Business v. Sebelius*, the Court upheld the constitutionality of the Patient Protection and Affordable Care Act's individual health insurance mandate pursuant to Congress's taxing power.[66] However, the Court ruled against the government on two issues in that case.[67] First, it held that the individual health insurance mandate was beyond Congress's power to regulate interstate commerce.[68] Second, it held that the expansion of Medicaid under the statute impermissibly compelled the states to enact or administer a federal program.[69] The Court recognized that the federal government may induce states, through the spending power, to enact or

61. South Dakota v. Dole, 483 U.S. 203, 207 (1987).

62. *Id.* at 207–08.

63. *Id.* at 211.

64. *Id.* at 211–12.

65. *Id.* at 211.

66. Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519 (2012). This was the first case in a trilogy of cases before the Court that concerned the Patient Protection and Affordable Care Act, commonly referred to as ObamaCare. In 2014, the Court held that, pursuant to the Religious Freedom Restoration Act, the requirement to provide certain contraceptive coverage could not be enforced against three closely held corporations. Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014). In 2015, the issue before the Court was whether federal tax credits made available by the statute were made available to qualified individuals who purchase health insurance on either Federal or State Exchanges or whether such credits are limited to qualified individuals who purchase health insurance on State Exchanges. The Court held that the Act makes available tax credits to qualified individuals who purchase health insurance on Federal Exchanges. King v. Burwell, 135 S. Ct. 2480 (2015).

67. *Sebelius*, 567 U.S. at 588.

68. *Id.* at 555–58.

69. *Id.* at 581–85.

administer programs.[70] However, otherwise permissible financial inducements become impermissible when a state is left with no practical choice but to comply with federal dictates, when, in the Court's words, "pressure turns into compulsion."[71] Under the statute, a state that refused to expand its Medicaid program faced a loss of all federal Medicaid funding.[72] In theory, a state had the option to refuse and lose a great deal of federal funding. Practically, given the amount of money at stake, a state had no choice.

Under *Dole* and *Sebelius,* Congress could condition federal funds for state law enforcement on certain state actions with respect to marijuana activities. However, the amount of funds subject to such conditions could not reach a level that is coercive.[73] At precisely what point the amount at stake for a state leaves it with a choice that is more illusory than real is unknown. In any event, from a political standpoint, it is unlikely that Congress will choose this path. More states allow medical marijuana use than do not and the trend is pointing in one direction.[74] Public opprobrium at the federal government may be somewhat muted by Congress's failure to amend a law that long predates state legalization statutes. Such opprobrium is likely to be more vocal if Congress takes affirmative steps to derail enacted state policy preferences. In light of the number of states that have chosen to break with federal policy, it is also likely that presidential politics—swing state considerations—will serve to keep the federal government at bay.[75]

Therefore, the federal government must either enforce federal law against activities that are legally sanctioned in a state and concomitantly expend the resources to do so or ratchet back enforcement as a paean to state policy choices. Thus far, the federal government has chosen the latter course of action, albeit rather fitfully. In the aftermath of the 2008 election, the Department of Justice gave notice to U.S. Attorneys that federal resources should not be expended in pursuit of persons whose actions are in compliance with state medical marijuana laws.[76] Shortly

70. *Id.* at 576.

71. *Id.* at 580 (citations omitted).

72. *Id.* at 581.

73. South Dakota v. Dole, 483 U.S. 203, 211 (1987).

74. *State Medical Marijuana Laws*, Nat'l Conference of State Leg. (Sept. 14, 2017), http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx.

75. *See generally* David S. Schwartz, *Presidential Politics as a Safeguard of Federalism: The Case of Marijuana Legalization*, 62 BUFFALO L. REV. 599 (2014) (presenting an interesting discussion of the role of presidential politics in protecting federalism).

76. Memorandum from David W. Ogden, Deputy Att'y Gen., to Selected U.S. Att'y: Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana (Oct.

thereafter, in the midst of the campaign in California to legalize recreational use of marijuana, Attorney General Eric Holder indicating that federal tolerance of medical uses of marijuana would not extend to recreational use of the substance.[77] Three years later, the Department of Justice updated its guidance to U.S. Attorneys by serving notice that enforcement of federal marijuana prohibitions was not a priority in states whose marijuana regulations did not hinder certain federal priorities, such as the prevention of criminal elements from entering the business, prevention of diversion of the product to other states, and prevention of legal marijuana businesses from serving as a front for illegal narcotics activities.[78] The Consolidated Appropriations Act of 2017 prevents any funds appropriated for the Department of Justice for the current fiscal year to be used to prevent states from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana.[79] The defunding of the Department of Justice with respect to medical marijuana enforcement has been in force since the fiscal year 2015 and has prevented federal actions taken against individuals and state legalized dispensaries.[80] However, the appointment and confirmation of former U.S. Senator Jeff Sessions as Attorney General

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19, 2009), https://www.justice.gov/opa/blog/memorandum-selected-united-state-attorneys-investigations-and-prosecutions-states.

77. *See* John Hoeffel, *Holder Vows Fight Over Prop 19*, L.A. TIMES, Oct. 16, 2010, at A4.

78. Memorandum from James M. Cole, Deputy Att'y Gen. for all United States Att'ys: Guidance Regarding Marijuana Enforcement (Aug. 29, 2013), https://www.justice.gov/iso/opa/resources/305201382913275685746 7.pdf. There are constitutional restraints to executive branch non-enforcement of the law. However, significant judicial deference is afforded to prosecutorial enforcement choices. *See generally* Bradley E. Markano, *Enabling State Deregulation of Marijuana Through Executive Branch Nonenforcement*, 90 N.Y.U. L. REV. 289, 301–10 (2015) (discussing case law and practical enforcement realities).

79. Consolidated Appropriation Act of 2017, Pub. L. No. 115-31, Div.B, § 537 (2017).

80. *See* Consolidated Appropriations Act of 2016, Pub. L. 114-113, § 542, 129 Stat. 2242, 2332–33 (2015); Consolidated and Further Continuing Appropriations Act of 2015, Pub. L. 113-235, § 538, 128 Stat. 2130, 2217 (2014). In *United States v. Marin Alliance for Medical Marijuana*, 139 F. Supp. 3d 1039 (N.D. Ca. 2015), the court held that this provision prevented the federal government from enforcing an injunction against a medical marijuana dispensary. The Ninth Circuit, in a case that consolidated ten interlocutory appeals and petitions for writs of mandamus, remanded the cases back to the district courts, holding that the Department of Justice cannot prosecute the parties without a showing that the parties had violated state law. United States v. McIntosh, 833 F.3d 1163, 1179 (9th Cir. 2016). The Ninth Circuit held that the respondents had standing to challenge the spending of unauthorized funds by the Department of Justice, a violation of the Appropriations Clause set forth in article I, section 9, clause 7 of the Constitution. *Id.* at 1173–75.

has called into question whether federal law enforcement efforts with respect to marijuana may change. Although he did not indicate whether he would change the Department of Justice's enforcement priorities during his confirmation hearing, Attorney General Sessions had been a vocal advocate of vigorous drug enforcement in the past.[81]

State sanctioned marijuana enterprises can take some, but not too much, comfort in the federal government's asserted enforcement priorities. Regardless of whether federal enforcement policy remains constant under the current administration, the continued illegality of marijuana under the federal statute comes with collateral consequences. These consequences present significant obstacles to businesses seeking to operate a business that is sanctioned under state law.

III. POTEMKIN FEDERALISM: THE COLLATERAL CONSEQUENCES OF THE CONTROLLED SUBSTANCES ACT

There are a number of consequences to engaging in a business whose subject matter violates a federal statute. From a commercial standpoint, the most significant consequences to a marijuana enterprise involve such enterprise's ability to bank, its ability to prosper despite the imposition of federal tax burden unique to such enterprises, and its ability to enforce contracts. These are the most significant, but not the only, consequences that stem from current federal law concerning marijuana.

A. Banking

State licensed marijuana businesses face difficulty in accessing the banking system. The Money Laundering Control Act prohibits financial institutions from knowingly engaging or attempting to engage in monetary transactions in criminally derived property of a value greater than $10,000.[82] The manufacture, importation, sale, or distribution of a

81. *See* Todd Ruger, *Porn, Weed and Other Takeaways from Sessions Hearing*, ROLL CALL (Jan. 17, 2017), http://www.rollcall.com/news/policy/porn-weed-takeaways-sessions-hearing. Further confusing the situation is the fact that the Trump administration has not settled on a consensus approach to drug policy. *See* Beth Reinhard, *Drug Policy Has Split Personality*, WALL ST. J., April 1, 2017, at A4. For an interesting analysis of whether federal drug enforcement policy with respect to marijuana can support the defenses of equitable estoppel or reliance to prosecution see Mary D. Fan, *Legalization Conflicts and Reliance Defenses*, 92 WASH. U. L. REV. 907, 941–55 (2015).

82. 18 U.S.C. § 1957(a) (2012). This is not the only activity prohibited under the statute. Among other prohibited activities are financial transactions involving the known proceeds of specified unlawful activities that a financial institution knows is designed to conceal or disguise the nature, location, source, ownership, or control of the proceeds of a

controlled substance, such as marijuana, is an unlawful activity for this purpose.[83] The Bank Secrecy Act requires financial institutions to maintain programs designed to verify the identity of its prospective customers and for higher risk accounts, the purpose of the accounts, the source of funds in the accounts, and the customers' line of business.[84] Various reporting obligations are imposed on financial institutions with respect to suspicious activities, including those activities that involve funds derived from illegal sources.[85] Federal regulators have made clear that activities conducted by state authorized marijuana businesses are subject to the reporting requirements.[86] Despite the fact that federal regulators have indicated that marijuana related financial crimes will be enforced pursuant to the enforcement priorities previously announced with respect to marijuana activities, these priorities are subject to change.[87] In any event, financial institutions incur significant costs and risks by catering to state authorized marijuana businesses.

Financial institutions regulated by state authorities are not immune from the reach of federal law. Virtually all state chartered financial institutions are federally insured by either the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund.[88] Maintenance of federal deposit insurance requires insured institutions to comply with federal money laundering statutes and other federal laws and subjects institutions to risk management protocols.[89] Similarly, a

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specified unlawful activity or to avoid transaction reporting requirements. 18 U.S.C. § 1956(a)(1)(B) (2012).

83. 18 U.S.C. §§ 1957(c);1957(f)(3) (2012).

84. 31 U.S.C.A. §§ 5318(h); 5318(l) (West Supp. 2017); 31 C.F.R. § 1020.220 (West 2014).

85. *See* 31 C.F.R. §1020.320 (West 2014).

86. *See* FIN. CRIMES ENF'T NETWORK, DEP'T OF THE TREASURY, FIN 2014-G001, BSA EXPECTATIONS REGARDING MARIJUANA RELATED BUSINESSES (2014), http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf. The Bank Secrecy Act is enforced by the Financial Crimes Enforcement Network, a unit of the Treasury.

87. *See generally* Memorandum from James M. Cole, Deputy Att'y Gen. to United States Att'ys (Feb. 14, 2014), http://www.dfi.wa.gov/documents/banks/dept-of-justice-memo.pdf. *See supra* notes 77–81 and accompanying text for a discussion of federal law enforcement priorities with respect to marijuana businesses.

88. After the savings and loan crisis of the 1980s, all states require their state chartered banks to obtain federal deposit insurance. A few states do not require that state chartered credit unions obtain federal deposit insurance. *See* Julie Andersen Hill, *Marijuana, Federal Power, and the States: Banks, Marijuana, and Federalism*, 65 CASE W. RES. 598, 617–18 (2015). This article also discusses the potential application of the insurers' rules and regulations to insured institutions doing business with state sanctioned marijuana businesses. *See id.* at 617–25.

89. *See* George H. Brown, *Financial Institution Lawyers as Quasi-Public Enforcers*, 7 GEO. J. LEGAL ETHICS 637, 676–77 (1994).

state chartered institution that is a member of the Federal Reserve System must comply with federal banking laws.[90] Financial institutions that are not members of the Federal Reserve System that seek access to the federal payment systems operated by the Federal Reserve must adhere to the terms and conditions imposed by the Federal Reserve.[91]

The Departments of Justice and Treasury have signaled a permissive attitude toward financial institutions doing business with state sanctioned marijuana businesses.[92] However, these are informal policy positions subject to political whims and few financial institutions want to incur the costs and risks of doing business with state authorized marijuana businesses.[93] Thus, many marijuana businesses are faced with the unpleasant choice of doing business in cash or to bank stealthily. The former choice exposes the businesses to physical danger and increases the risk to the government of tax evasion while the latter choice exposes the businesses to money laundering charges. Attempts have been made to form financial institutions immune from federal regulation, such as cooperatives, and the success of these attempts remains to be seen.[94]

B. Taxes

Generally, an argument advanced in support of legalization of an activity is that legalization brings that activity above ground, subjects it to regulation and, of course, eases the government's ability to collect any taxes due to it. However, marijuana businesses that operate legally under state law arguably pay more than their fair share in federal income taxes—and perhaps state income taxes—due to the Controlled Substances Act. The current status of marijuana as a Schedule I narcotic has draconian federal income tax consequences for businesses engaged its manufacture, sale, or distribution. Moreover, deleterious

90. *See* Hill, *supra* note 88, at 625–26.

91. *Id.* at 627–30.

92. *See* Memorandum from Cole, Guidance Regarding Marijuana Related Financial Crimes, *supra* note 87.

93. According to a marijuana industry website, the Financial Crimes Enforcement Network reported that less than 300 financial institutions do business with state sanctioned marijuana business. However, it appears that a number of small, state-chartered institutions do welcome this business. *See* Bruce Barcott, *Shh! Here's How Cannabis Companies are Banking Legally on the Down Low*, LEAFLY (Dec. 30, 2015), https://www.leafly.com/news/politics/shh-heres-how-cannabis-companies-are-banking-legally-on-the-down.

94. *See* Hill, *supra* note 88, at 638–43 (discussing Colorado's attempt to form a state-chartered cooperative).

consequences will ensue with respect to state income taxes in states that couple their income tax base to the federal tax base.[95]

For over seventy years, expenditures that frustrate public policy have been tax-disfavored. Until 1969, the denial of federal income tax deductions for such expenditures was the result of judicial doctrine that predicated the deduction's denial on the frustration of a sharply defined public policy.[96] However, the application of the doctrine was uneven as evidenced by companion cases decided by the Court in 1958.[97] In one case, the Court denied the taxpayer a deduction for fines paid for violations of certain truck weight rules and stated that expenditures that are illegal under state law are the most direct evidence that deductibility of such expenditures would frustrate public policy.[98] However, in the other case, the Court allowed the taxpayers a deduction for rent, the payment of which was itself illegal, incurred by an illegal gambling establishment.[99] In a case decided less than a decade later, the Seventh Circuit denied a deduction for lawful kickbacks.[100] In light of the uncertainty caused by the courts' inconsistency, Congress addressed the issue statutorily with the enactment of the Tax Reform Act of 1969.[101] This statute amended Internal Revenue Code (I.R.C.) section 162, the provision that authorizes deductions for business expenses.

I.R.C. section 162(c) denies deductions for any illegal bribes or kickbacks paid directly or indirectly to a government official or employee, payments that are illegal under the Foreign Corrupt Practices Act, and any bribes, rebates, and kickbacks, whether or not illegal, made in connection with the conduct of Medicare or Medicaid programs.[102] In addition, no deduction is allowed for any payment that constitutes an illegal bribe or kickback, or any other payment that is illegal under a generally enforced federal or state law.[103] The statutory provisions

95. For individuals, federal adjusted gross income and federal taxable income comprise the tax base for twenty-seven and six states, respectively. For corporations, forty-one states couple their tax base to federal taxable income. *See* Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (Mar. 8, 2017), https://taxfoundation.org/federal-tax-reform-the-impact-on-states/.

96. *See* Comm'r v. Heininger, 320 U.S. 467, 473 (1943).

97. *See* Comm'r v. Sullivan, 356 U.S. 27 (1958); *see also* Tank Truck Rentals v. Comm'r, 356 U.S. 30 (1958).

98. *Tank Truck Rentals*, 356 U.S. at 35.

99. *Sullivan*, 356 U.S. at 28–29.

100. *See* United Draperies, Inc. v. Comm'r, 340 F.2d 936 (7th Cir. 1964).

101. Tax Reform Act of 1969, Pub. L. No. 91-172, § 902(b)–(c), 83 Stat. 487, 710 (1969).

102. I.R.C. §§ 162(c)(1);162(c)(3) (2012).

103. I.R.C. § 162(c)(2) (2012).

displaced the common law doctrine of frustration of public policy.[104] In addition, the 1969 legislation added a provision that denies any deduction for fines or penalties paid to a government for the violation of any law.[105] Identical restrictions on deductibility are in force with respect to expenditures incurred in an activity undertaken for the production of income that does not rise to the level of a trade or business.[106]

The aforementioned statutory restrictions on tax deductions apply to expenditures that, in and of themselves, are illegal or fall within the confines of the statute. These restrictions have no application to legal expenditures incurred in the operation of an illegal enterprise, a point made clear by the Tax Court in 1981 when it allowed a drug dealer to deduct his otherwise legal operating expenses.[107] However, in 1982 Congress added section 280E to the I.R.C.[108] This provision disallows a deduction or credit for any expense paid or incurred in carrying on a trade or business that consists of trafficking in a Schedule I or II substance under the Controlled Substances Act which is prohibited under federal or any State law in which the business is conducted.[109] The legislative history is clear that, due to constitutional concerns, section 280E does not apply to expenditures that are deductions from gross receipts—i.e. cost of goods sold.[110] Therefore, under the statute a state sanctioned marijuana seller can deduct the cost of the product sold from

104. *See* 26 C.F.R. § 1.162-1(a) (1993); S. REP. NO. 91-552, at 274 (1969). However, the statutory restrictions do not apply to losses deductible under I.R.C. § 165. The application of the common law doctrine continues to apply to determine whether or not such losses are deductible. *See, e.g.*, Stephens v. Comm'r, 905 F.2d 667 (2d Cir. 1990); Holmes Enterprises v. Comm'r, 69 T.C. 114 (1977); Rev. Rul. 77-126, 1977-1 C.B. 47.

105. I.R.C. § 162(f) (2012).

106. *See* 26 C.F.R. § 1.212-1(p) (1975). A related provision affects the customers of medical marijuana dispensaries. Medical expenses are deductible by individuals. Included in medical expenses are drugs. I.R.C. § 213(b) limits amounts deductible for drugs to amounts paid for prescription drugs or insulin. Moreover, Treasury regulations make clear that only the costs of drugs that are legally procured are deductible. *See* Treas. Reg. § 1,213-1(e)(2) (1979). The effect of this restriction will vary from taxpayer to taxpayer. For taxpayers that do not itemize deductions the prohibition is meaningless because such taxpayers do not deduct medical expenses. For taxpayers that do itemize deductions, medical expenses are deductible only to the extent that such expenses exceed ten percent of such taxpayer's adjusted gross income. *See* I.R.C. § 213(a) (2017).

107. Edmondson v. Comm'r, 42 T.C.M. 1533 (1981) (superseded by statute as stated in Californians Helping to Alleviate Med. Problems, Inc. v. C.I.R. 128 T.C. No. 14 (2017). *See also* Accardo v. Comm'r, 942 F.2d 444 (7th Cir. 1991).

108. Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, § 351, 96 Stat. 324, 640 (1982).

109. I.R.C. § 280E (2012). The statute does not define the term "trafficking." Presumably, this term refers to distribution activities that violate the Controlled Substances Act.

110. S. REP. NO. 97-494, vol.1, at 309 (1982).

its gross receipts but other legal expenses, such as rent, payroll, utilities, and the like, are not deductible.

However, Treasury regulations do not allow any amounts to be included in the cost of inventory if the expenditure would be disallowable under I.R.C. section 162(c).[111] As discussed above, I.R.C. section 162(c) applies to payments that are illegal.[112] For example, a legal business that purchased marijuana for a staff party would not be subject to I.R.C. section 280E but would be denied a deduction for such purchase under I.R.C. section 162(c)(2). Presumably, the regulations would deny a cost of goods sold deduction to illegal arms dealers if the purchase of the arms in question was itself illegal. If the purchase of marijuana is illegal under federal law then such purchase would have been subject to I.R.C. section 162(c) if that section applied.[113] The legislative history directly contradicts this reading of the regulations. As noted, the drafters were concerned with the potential constitutional problems in taxing an enterprise's gross receipts.[114] Illegal businesses

111. 26 C.F.R. § 1.471-3(f) (2014).

112. I.R.C. §§ 162(c)(1)–(3) (2012).

113. The possession of marijuana is illegal but the statute does not specifically state that the purchase of marijuana is illegal. The statute does make the purchase of certain substances illegal. *See* 21 U.S.C. §§ 841(a); 844(a) (2012).

114. An analysis of whether a tax on gross receipts is permissible is beyond the scope of this work. Congress's power to tax is expansive but it is not unlimited. In addition to the constitutional limitations applicable to the exercise of any federal power, there are structural limitations specific to the taxing power. First, certain taxes must be uniform. Congress has the power "[t]o lay and collect taxes, duties, imposts, and excises . . . but all duties, imposts, and excises shall be uniform throughout the United States." U.S. CONST. art. I, § 8, cl. 1. The precise contours of the uniformity requirement was subject to some debate during the first century of the republic but it now refers simply to geographic uniformity—federal tax rates must be the same throughout the United States. Knowlton v. Moore, 178 U.S. 41, 83–106 (1900). The uniformity requirement rarely surfaces as a point of contention, perhaps due to the political difficulties that would be encountered in enacting a provision that overtly disfavored a particular geographic region, but on occasion the issue does arise. *See, e.g.*, United States v. Ptasynski, 462 U.S. 74, 86 (1983) (stating that an exemption from an oil profits tax for certain Alaskan oil did not provide Alaska with an undue preference over other states). By the time of the New Deal, the Court defined the term expansively as an exaction "imposed upon a particular use of property or the exercise of a single power over property incidental to ownership." Bromley v. McCaughn, 280 U.S. 124, 136 (1929).

Second, Congress is expressly prohibited from imposing any taxes on exports or any duties on ships that depart from a port in one state and arrive at a port in another state. U.S. CONST. art I, § 9, cls. 5–6. The Court has interpreted the prohibition on laying taxes on exports to prohibit Congress from imposing a tax on bills of lading for export items, a stamp tax on export insurance, and a tax on charter ships carrying export cargo. *See* Thames & Mersey Marine Ins. Co. v. United States, 237 U.S. 19, 25 (1915); United States v. Hvoslef, 237 U.S. 1, 17 (1915); Fairbank v. United States, 181 U.S. 283, 294 (1901). One limitation on Congress's power to tax is, thankfully, truly a dead letter. A tax

other than narcotics trafficking can deduct their otherwise legal expenditures. The application of the regulations on top of I.R.C. section 280E would effectively deny narcotics businesses any reduction of gross receipts from the tax base.

The Ninth Circuit recently rejected a taxpayer's argument that, because the provision was enacted in 1982, Congress did not intend for I.R.C. section 280E to apply to state authorized marijuana dispensaries.[115] It also rejected the taxpayer's assertion that the 2015 spending bill, prohibiting the use of certain federal funds to prevent states from implementing laws concerning medical marijuana, precluded the application of I.R.C. section 280E.[116] The court held that the application of I.R.C. section 280E was not within the prohibitions in the spending bill.[117] The effects of I.R.C. section 280E are dramatic. Unlike other businesses, marijuana enterprises that operate legally under state law are subject to federal income tax on their gross, not net, income.[118] Depending on the level of the business's operating expenses, this result could be devastating. Moreover, the effects of the statute could be exacerbated if the taxpayer's state income tax base is coupled to the federal income tax base.[119]

Possible solutions are unsatisfactory. I.R.C. section 263A, the so-called uniform capitalization rules, sets forth rules for the capitalization of costs attributable to real or personal property produced by a taxpayer or to real or personal property acquired by a taxpayer for resale.[120] Under

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or duty on imported slaves cannot exceed ten dollars per slave. U.S. CONST. art I, § 9, cl. 1. Finally, a capitation, or other direct, tax must be apportioned among the states according to population. U.S. CONST. art I, § 2, cl. 2; art 1, § 9, cl. 4. However, taxes on incomes may be imposed without apportionment among the states and without regard to population, although they must be imposed uniformly. U.S. CONST. amend. XVI. Income taxes are subject to the uniformity requirement. *See* Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 18 (1916). Therefore, certain taxes—duties, imposts, excises, and income taxes—must be uniform and direct taxes must be apportioned. With the exception of a head tax, a tax cannot be both uniform and apportioned according to population. As a result, depending on the type of tax in question, it must be either uniform or apportioned. Direct taxes have been confined to capitation taxes, taxes on real property, and taxes on personal property. Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 570–71 (2012).

115. Olive v. Comm'r, 792 F.3d 1146, 1150 (9th Cir. 2015).

116. *Id.* at 1150–51.

117. *Id.* A similar provision was inserted into the 2017 appropriations bill. *See* Consolidated Appropriation Act of 2017, Pub. L. No. 115-31, Div.B, § 537 (2017).

118. I.R.C. § 280E (2012).

119. *See* Kaeding & Pomerleau *supra* note 95 and accompanying text. Oregon has amended its law to expressly allow deductions disallowed by I.R.C. § 280E. *See* OR. REV. STAT. § 316.680(i) (West Supp. 2017).

120. I.R.C. §§ 263A(a)–(b) (West Supp. 2017).

the statute, both direct and indirect costs are subject to capitalization.[121] Prior to the enactment of this provision, inventorial costs were determined under regulations issued under I.R.C. section 471.[122] These regulations contain rules for both producers and resellers of property that, for all practical purposes, require the application of traditional cost accounting principles.[123] The uniform capitalization rules did not fundamentally alter the cost accounting principles applicable to inventory costing, but they did expand the category of costs that are required to be capitalized.[124] The regulations also provide taxpayers some, but not much, flexibility in allocating more or less costs to inventory.[125] Typically, taxpayers seek to allocate as little cost as possible to inventory. Marijuana businesses, in contrast, would seek to capitalize to inventory as many expenditures as possible.

At best, this strategy merely lessens, to a small degree, the draconian effects of I.R.C. section 280E. At worst, this strategy may be unavailable. The Internal Revenue Service ("I.R.S.") has issued guidance that the uniform capitalization rules do not apply to a trade or business that is subject to I.R.C. section 280E.[126] The basis for this guidance is that the additional costs that may be capitalized under the uniform capitalization rules could transform an otherwise nondeductible expenditure into a capitalizable cost.[127] The statute states that only otherwise deductible expenses are subject to capitalization.[128] Accordingly, the capitalization of costs that would have otherwise been nondeductible is prohibited. Therefore, marijuana businesses must apply the inventory costing rules as they existed prior to the enactment of I.R.C. section 263A.[129] The I.R.S.'s position is questionable. Congress made clear when it enacted section 280E that the cost of goods sold of a

121. I.R.C. § 263A(a)(2) (West Supp. 2017).

122. I.R.C. § 471 (West Supp. 2017).

123. *See generally* 26 C.F.R. §§ 1.471-3(b)–(c) (2014); 26 C.F.R. 1.471-11 (1993).

124. A detailed analysis of the uniform capitalization rules is beyond the scope of this work. Among the additional costs that these rules capture are purchasing, handling, and storage expenses of resellers and, for both resellers and producers, a portion of their service costs, such as payroll, legal, personnel costs. *See generally* 26 C.F.R. §§ 1.263A-2–3 (2014).

125. For example, various simplified methods of allocation may be elected and these methods may produce different results than traditional methods of allocation. *See generally* 26 C.F.R. §§ 1.263A-2(b) (2014) (setting forth rules for the application of a simplified production method); 1.263A-3(d) (2014) (setting forth rules for the application of a simplified resale method).

126. I.R.S. Chief. Couns, Mem. 2015-04-011 (Jan. 23, 2015).

127. *Id.* at 6–7.

128. I.R.C. § 263A(a)(2) (West Supp. 2017).

129. I.R.S. Chief Couns., Mem. 2015-04-011, *supra* note 126, at 7.

narcotics business are deductible from gross receipts to determine gross income.[130] The I.R.S. asserts that Congress intended cost of goods sold to be determined under the rules that existed when Congress enacted I.R.C. section 280E, approximately four years before the enactment of the uniform capitalization rules.[131] This reasoning was expressly rejected by the Ninth Circuit in *Olive v. Commissioner*.[132] In that case, the taxpayer argued that in 1982 Congress could neither have foreseen, nor intended I.R.C. section 280E to apply to state legalized marijuana enterprises.[133] According to the court, if indeed Congress did not, or does not, intend for I.R.C. section 280E to apply to state sanctioned marijuana businesses then it can amend the statute.[134] Congress did not amend I.R.C. section 280E when it enacted section 263A. It seems that similar reasoning should apply here—if I.R.C. section 263A is inapplicable to businesses subject to I.R.C. section 280E then Congress should say so.

It may be possible for marijuana businesses to segregate their operations so that only a portion of the business falls within the confines of I.R.C. section 280E—the actual trafficking operation—while other operations escape its reaches. This could alleviate the effects of section 280E for some operations. The Tax Court sanctioned the segregation of costs among different trades or businesses in *California Helping to Alleviate Medical Problems, Inc. v. Commissioner*.[135] In that case the taxpayer operated a business that provided medical marijuana to patrons and a business that provided extensive counseling and caregiving services.[136] The Ninth Circuit more recently held against a taxpayer on a similar issue but, in that case, the non-trafficking activities of the taxpayer were minimal and provided free of charge.[137] Accordingly, the court held that the taxpayer was not engaged in a trade or business separate from the sale of medical marijuana.[138] The court, however, did not dispute the notion that a marijuana dispensary could engage in more than one trade or business for purposes of I.R.C. section 280E.[139]

130. *See* I.R.C. § 280E (West Supp. 2017).
131. I.R.S. Chief Couns., Mem. 2015-04-011, *supra* note 126, at 6–7.
132. Olive v. Comm'r, 792 F.3d 1146, 1150 (9th Cir. 2015).
133. *Id.*
134. *Id.*
135. Cal. Helping to Alleviate Med. Problems v. Comm'r, 128 T.C. 173 (2007).
136. *Id.* at 174–77.
137. *Olive*, 792 F.3d at 1149–50.
138. *Id.* at 1149.
139. *Id.*

One scholar has suggested that legal marijuana businesses operate as I.R.C. section 501(c)(4) organizations.[140] An I.R.C. section 501(c)(4) organization, or social welfare organization, is a tax exempt entity that must operate exclusively for the promotion of social welfare.[141] According to treasury regulations, such an organization "is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community."[142] These organizations have become very prominent—and controversial—as political actors.[143] It is not clear whether the I.R.S. will grant such entities tax exempt status and, in any event, such status precludes the organization from being organized or operated for profit, thus rendering such a form impractical for most entrepreneurs.[144]

C. Contract Enforcement

In the aftermath of the Civil War, the Court had occasion to decide a case that involved the sale of certain goods from a seller located in Confederate territory.[145] This sale violated a legislatively authorized presidential proclamation and a treasury regulation that implemented that proclamation.[146] The Court issued a forceful statement regarding the unenforceability of illegal bargains.

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140. Benjamin Moses Leff, *Tax Planning for Marijuana Dealers*, 99 IOWA L. REV. 523 (2014).

141. *Id.* at 527.

142. 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (1990).

143. These organizations may engage in unlimited lobbying activities that are related to their exempt purpose and may also engage in political campaigns, provided that such activity does not constitute the organization's primary activity. 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii) (1990); *see also* Rev. Rul. 81-95, 1981-1 C.B. 332. Several I.R.C. § 501(c)(4) organizations, such as the AARP and the National Rifle Association (NRA), are well known for their lobbying prowess and wield considerable political influence. The political prominence of these organizations has been aided by the fact that these organizations are not subject to expenditure and donor disclosure requirements. *See* I.R.C. § 6104(d)(3) (2017) (providing that only private foundations and political organizations must disclose donor names and addresses). An I.R.C. § 501(c)(4) organization must file Form 990 with the I.R.S., and Schedule B of such form requires the identification of donors who contributed $5,000 or more to the organization. However, donor information is not available for public inspection. *See* I.R.S., Schedule B (Form 990, 990-EZ, or 990-PF) (2012) at 5, http://www.irs.gov/pub/irs-pdf/f990ezb.pdf.

144. *See* 26 C.F.R. § 1.501(c)(4)-1(a)(1) (1990).

145. Coppell v. Hall, 74 U.S. (7 Wall.) 542 (1868).

146. *Id.* at 555–56.

> The instruction given to the jury, that if the contract was illegal the illegality had been waived by the reconventional demand of the defendants, was founded upon a misconception of the law. In such cases there can be no waiver. The defense is allowed, not for the sake of the defendant, but of the law itself. The principle is indispensable to the purity of its administration. It will not enforce what it has forbidden and denounced. The maxim, *ex dolo malo non oritur action*, is limited by no such qualification. The proposition to the contrary strikes us as hardly worthy of serious refutation. Whenever the illegality appears, whether the evidence comes from one side or the other, the disclosure is fatal to the case. No consent of the defendant can neutralize its effect. A stipulation in the most solemn form to waive the objection, would be tainted with the vice of the original contract, and void for the same reasons. Wherever the contamination reaches, it destroys. The principle to be extracted from all the cases is, that the law will not lend its support to a claim founded upon its violation.[147]

The Restatement (Second) of Contracts frames the issue of enforceability on broader public policy grounds and not the narrower grounds of illegality.[148] However, the Restatement does state that an agreement made unenforceable by legislation cannot be enforced.[149] To be sure, there is a distinction between the legality of a bargain and its affront to public policy. Although it is possible to craft an argument that illegality, *per se*, is not conclusive evidence that a bargain violates some public policy, the courts have treated legality as a subset of a jurisdiction's public policy. In other words, it is common for courts to refuse to enforce bargains that violate no law, as was the case in the famous *Baby M* case, but the reverse is not true.[150] Despite the possibility that a cogent argument may be put forth that the law, in a rare instance, does not reflect public policy, the Court's language in *Coppell* leaves such an argument with little possibility of success.[151] After all, if the denial of enforcement is predicated on the protection of the law itself, as

147. *Id.* at 558–59.

148. RESTATEMENT (SECOND) OF CONTRACTS § 178 (AM. LAW INST. 1981).

149. *Id.* § 178(1); §178 cmt. a.

150. The *Baby M* case involved a surrogate mothering contract. At the time, New Jersey had no law dealing with such contracts. The New Jersey Supreme Court held that the contract was not enforceable because it violated the public policy of the state. The court found evidence of the state's public policy in other statutes, such as the state's adoption and baby selling statutes. *See In Re* Baby M, 537 A.2d 1227 (N.J. 1988).

151. *Coppell*, 74 U.S. (7 Wall.) at 555–56.

asserted by the Court, then it is highly unlikely that a bargain whose terms violate a clear legislative prohibition will be enforceable.[152]

Agreements to "knowingly open, lease, rent, use, or maintain" property for the manufacturing, storing, or distribution of controlled substances are unlawful under the Controlled Substances Act.[153] Moreover, it is unlawful to aid and abet the commission of a federal crime.[154] As a result, agreements for the sale of marijuana and agreements with a marijuana business, whose subject matter are otherwise non-objectionable, violate federal law. For example, in *Haeberle v. Lowden*, the Colorado District Court held that a contract for the sale of medical marijuana products, legal under Colorado law, was nonetheless unenforceable because the Controlled Substances Act preempted state law.[155] An Arizona court denied relief to two lenders who each sought repayment of a $250,000 loan they had extended to a Nevada corporation for the purpose of financing a retail medical marijuana sales and growth center located in Colorado.[156] The court rejected the plaintiffs' argument that the loans themselves could have been enforced without any proof of an illegal purpose.[157] According to the court, the loans were in clear violation of federal law and, accordingly, void and, moreover, not subject to an order of equitable relief.[158] Recently, however, a federal district court refused to grant summary judgment to an insurance company that refused to honor a claim for marijuana crop damage.[159] The insurer argued that the policy excluded coverage for contraband and that the policy should not be enforced on public policy grounds.[160] The court ruled that the policy's definition of contraband was ambiguous and that the federal government's inconsistent enforcement policy with respect to marijuana precluded it from voiding the policy on public policy grounds.[161] A federal district court in Hawaii came to the opposite conclusion in an earlier case concerning property insurance coverage.[162]

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152. *Id.* at 558–59.

153. 21 U.S.C. § 856(a)(1) (2012).

154. 18 U.S.C. § 2 (2012).

155. Haeberle v. Lowden, No. 2011CV709, 2012 WL 6123439 (D. Colo. 2012).

156. Hammer v. Today's Health Care II, No. CV2011-051310, 2012 WL 12874349 (Sup. Ct. Az. 2012).

157. *Id.* at 2.

158. *Id.*

159. Green Earth Wellness Ctr., LLC v. Attain Specialty Ins. Co., 163 F.Supp.3d 821 (D. Colo. 2016).

160. *Id.* at 832.

161. *Id.* at 832–35.

162. Tracy v. USAA Cas. Ins. Co., No. 11-00487 LEK-KSC, 2012 WL 928186 (D. Haw. Mar. 16, 2012).

The inability to enforce contracts presents significant problems for state sanctioned marijuana businesses. Various approaches to mitigate such problems offer, at best, limited relief. Cash sales, for example, avoid enforcement issues but such sales are impractical for large transactions and also leave a buyer with little post-transaction contractual protections, such as warranties for the sale of goods.[163] A counterparty to an agreement with a marijuana business will be reticent to enter into long-term agreements, such as leases or supply contracts. Obviously, after the case discussed above, potential lenders willing to do business with such enterprises will be few.

Perhaps just as damaging, marijuana businesses may very well have trouble attracting talented employees, a fact that may prevent such businesses from achieving substantial size. The Colorado Supreme Court held that an employee was not wrongfully terminated for his state-legalized use of medical marijuana.[164] The court refused to interpret a state statute that protected employees from being terminated for lawful activities as referring only to lawful activities under state law.[165] It may also be difficult for marijuana enterprises to offer a standard menu of employee benefits, such as I.R.C. section 401(k) plans and medical insurance, if the providers of such benefits refuse to do business with such firms.[166] Lack of otherwise available job protections and employee benefits affect rank and file employees but lack of contractual protections will have a chilling effect on the ability to attract managerial talent.

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163. Remedies for breach of warranties under the Uniform Commercial Code would be unavailable to a buyer if the contract for purchase is not enforceable. Claims for breach of express warranties and the implied warranties, particularly the implied warranty of merchantability, would be fruitless. *See* U.C.C. §§ 2-312–2-315 (AM. LAW INST. & UNIF. COMM'N 2002).

164. Coats v. Dish Network, LLC, 350 P.3d 849 (Colo. 2015).

165. *Id.* at 852–53. According to data from one of the largest workplace testing laboratories the percentage of workers testing positive for marijuana has increased in recent years and the rate of increase was significantly higher in states that have legalized marijuana. *See* Lauren Weber, *Tests Show More American Workers Using Drugs*, WALL ST. J., May 17, 2017, at B1.

166. Difficulty in obtaining providers for employee benefits can present significant problems for the employer. If the employer has affiliated businesses in more traditional lines of business, then the existence of employees in the marijuana business may impact its employee benefit plans in those traditional businesses. For example, qualified pension and profit-sharing plans, including I.R.C. § 401(k) plans, have strict coverage requirements and those requirements are imposed on all related businesses, as statutorily defined. *See generally* I.R.C. § 414(c) (West Supp. 2017) (requiring that all employers under common control be treated as a single employer). In addition, the Patient Protection and Affordable Care Act requires employers that employ fifty or more full-time or full-time equivalent employees to provide affordable health insurance coverage to its employees or incur a penalty. *See generally* I.R.C. § 4980H (West Supp. 2017).

Deferred compensation arrangements, whether payable in cash or equity, will not likely be an acceptable part of a compensation package if their enforcement is doubtful.[167] Moreover, a firm should be reticent in granting equity to an employee if any concomitant shareholder, partnership, or LLC operating agreements regarding such equity are not enforceable.[168]

In 2013, Colorado passed legislation that states that, as a matter of public policy, a marijuana contract, legal under state law, is not void or unenforceable.[169] However, it is not clear whether this or similar statutes will be preempted by the Controlled Substances Act. In *Coats*, the Supreme Court of Colorado rejected the petitioner's wrongful termination claim that asserted that the protection of employees for the engagement in lawful activities should be interpreted to protect employees from the engagement in activities that are lawful under state law.[170] The court based its decision on its belief that the term "lawful," as used in the statute, was ambiguous and that the term's meaning, as commonly understood, is not restricted to lawful activities under state law.[171] However, the court did not discuss whether it would respect an express statutory limitation of the term to lawful activities under state law. Based on my reading of the case, the court appeared to imply that such a restriction would have been respected. *Coats* should not provide proponents of this type of legislation much comfort, however.

Whatever implication that may be drawn from this case, it involved an employee protection measure that, in and of itself, did not implicate the Controlled Substances Act. There is no provision in the Controlled Substances Act that precludes the retention of an employee who has violated the Act. It is quite another matter to signal to a court that it

167. Deferred compensation arrangements are used, among other reasons, by employers as a tool for employee retention. For employees, deferred compensation represents nothing more than a contractual claim against the employer. If the employer sets aside assets to satisfy its deferred compensation obligation, then such deferred compensation is taxable under the doctrine of constructive receipt. *See* Rev. Proc. 92-65, §3(d), 1992-2 C.B. 428. This rule also applies if assets are set aside due to a change in the employer's financial condition whether or not such assets are subject to claims of creditors. *See* I.R.C. § 409A(b)(2) (West 2012)

168. In closely held businesses, these agreements contain provisions that specify permissible transfers of equity by the equity holders, buy-sell provisions, and other terms governing the rights and obligations of the owners to the company and to each other.

169. COLO. REV. STAT. ANN. § 13-22-601 (West 2016). Oregon enacted a similar statute. *See* Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act, OR. LAWS ch. 1, §12 (West 2015) ("No contract shall be unenforceable on the basis that manufacturing, distributing, dispensing, possessing, or using marijuana is prohibited by federal law.").

170. Coats v. Dish Network, LLC, 350 P.3d 849, 849 (Colo. 2015).

171. *Id.* at 852–53.

should enforce a contract whose performance would directly violate federal law. I believe that a state court could reasonably limit public policy considerations to the express policy positions of the state. The fact that, for the time being, Congress has refused to appropriate funds to the Department of Justice for enforcement of federal law against state law-abiding activities adds support for such a position.[172] However, until state courts consistently do so, there is little comfort to be derived in what may be done.

Insertion of protective contractual language in agreements provides assurances that probably are more psychic than real. As noted by the Court in *Coppell*, waivers of illegality defenses are not enforceable.[173] Forum selection clauses in agreements have limited utility. These clauses will be effective only if the parties are assured that the courts in the selected forum will enforce the agreement. It is possible that statutes like those enacted in Colorado and Oregon will be enforced by state courts, but these statutes will provide comfort only in the states that have enacted them, and only if, and when, they are enforced.[174] Similarly, waivers of the right to federal diversity jurisdiction have limited utility. To be sure, it is more likely that a state court will look only to a state's asserted public policy with respect to marijuana than would a federal court. However, until state courts show that they will enforce marijuana related contracts the avoidance of a federal court achieves little.

In *Buckeye Check Cashing, Inc. v. Cardegna*, the Court held that arbitration provisions are enforceable despite the claim that the contract in which such provisions are contained is illegal.[175] According to the Court, only challenges to the validity of the arbitration provisions themselves are appropriate grounds to bypass arbitration for court resolution of a dispute.[176] Thus, mandatory arbitration provisions in a marijuana related contract will be respected despite the underlying illegality of the contract itself. However, mandatory arbitration provisions, although they may provide some comfort that an agreement will be upheld by the arbitrator, do not assure that a court will not overrule the arbitrator on public policy grounds, particularly a public policy that is expressed so clearly by federal law.[177] As the Supreme

172. *See supra* notes 79–80 and accompanying text.

173. Coppell v. Hall, 74 U.S. (7 Wall) 542, 558 (1868).

174. *See supra* note 169 and accompanying text.

175. Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006).

176. *Id.* at 444–49.

177. *See generally* Judith Stilz Ogden, *Do Public Policy Grounds Still Exist for Vacating Arbitration Awards?* 20 HOFSTRA LAB. & EMP. L.J. 87 (2002); Ann C. Hodges, *Judicial Review of Arbitration Awards on Public Policy Grounds: Lessons from the Case Law*, 16 OHIO ST. J. ON DISP. RESOL. 91 (2000).

Court has stated, "in any event, the question of public policy is ultimately one for resolution by the courts. . . . Such a public policy, however, must be well defined and dominant, and is to be ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.'"[178]

D. Other Consequences

In addition to the difficulties state legalized marijuana businesses have in accessing the banking system, obtaining assurance that their contracts are legally enforceable, and prospering under a tax regime that sets a gross income tax base, these businesses face other difficulties. Among those difficulties are the unavailability of the protections of bankruptcy, difficulty in accessing adequate legal services, and meager intellectual property law protections. In April, 2017, Clifford White, the Director of the Executive Office for United States Trustee issued a directive to all Chapter 7 and Chapter 13 Trustees to inform them that marijuana assets cannot be administered under the bankruptcy code.[179] Courts have come to the same conclusion.[180] Under the American Bar Association's Model Rules of Professional Conduct, adopted by all fifty states and the District of Columbia, attorneys may not knowingly facilitate the criminal conduct of a client.[181] Attorneys drafting and reviewing contracts for marijuana businesses and assisting in the formation of entities involved in such businesses place themselves in ethical jeopardy with the state bar. Thus far, state bar committees have

178. W.R. Grace & Co. v. Local 759, Int'l Union of United Rubber Workers, 461 U.S. 757, 766 (1983) (first quoting Muschany v. United States, 324 U.S. 49, 66 (1945); then citing Int'l Bhd. of Teamsters v. Wash. Empl'rs, Inc., 557 F.2d 1345, 1350 (9th Cir. 1977); Local 453 v. Otis Elevator Co., 314 F.2d 25, 29 (2d Cir. 1963); Lewis B. Kaden, *Judges and Arbitrators: Observations on the Scope of Judicial Review*, 80 COLUM. L. REV. 267, 287 (1980)).

179. Directive from Clifford J. White III, Dir., Exec. Office for U.S. Tr., to Chapter 7 and Chapter 13 Trs. (Apr. 26, 2017), https://www.justice.gov/ust/file/marijuana_assets.pdf/download. Bankruptcy court judges may dismiss a case under Chapters 7, 11, and 13 for cause. *See* 11 U.S.C.A. § 707 (West Supp. 2017); 11 U.S.C. 1112(b) (2012); 11 U.S.C. § 1307 (2012). Moreover, any plan of reorganization under Chapter 11 must be proposed in good faith and not by any means forbidden by law. Similar provisions apply to plans proposed by debtors under Chapter 13. *See* 11 U.S.C. § 1129(a)(3) (2012); 11 U.S.C.A. 1325(a)(3) (West Supp. 2017).

180. *See* Steven Mare, Note, *She Who Comes Into Court Must Not Come with Green Hands: The Marijuana Industry's Ongoing Struggle with the Illegality and Unclean Hands Doctrine*, 44 HOFSTRA L. REV. 1351, 1363–65 (2016) (discussing several recent cases that have been dismissed by the courts).

181. MODEL RULES OF PROF'L CONDUCT r.1.2(d) (AM. BAR ASS'N 1983).

sent mixed signals in this respect.[182] Finally, Professors Kamin and Moffat have set forth the difficulties that marijuana businesses have in obtaining and enforcing trademark and patent claims.[183] These difficulties stem from the illegal status of marijuana transactions under federal law, the uncertainty of enforcement of rights in a federal court, and the impediments to the obtainment of effective counsel to assist in intellectual property matters.[184] Alternative approaches to the protection of intellectual property, including those available under state law, are not effective substitutes for federal protections available to businesses generally.[185]

One cannot help but notice certain similarities between the federal approach to marijuana and, prior to *Windsor,* same-sex marriage. In theory, states are free to enact their own policy preferences. In reality, federal law denies or denied residents who participated in state sanctioned activities the ability to realize the full potential of their choices. To be sure, federal treatment of same-sex marriage inflicted a visceral, more personal harm because such treatment not only held back federal benefits, but also delivered a message that one's lifestyle was not acceptable. This harm had constitutional dimensions and, quite appropriately, was found impermissible by the Court.[186] Although federal marijuana prohibitions have been held to be constitutional it is conceivable that, at some point, the continued refusal to sanction medical marijuana may be found irrational. Certainly, one can envision a time in the near future when all fifty states, with vocal support from the medical profession, have legalized marijuana for medical purposes. At this point—and possibly before—it may be reasonable to ask whether congressional stubbornness, political inertia, or some other justification no longer provides any rational basis for the status quo.

Until such time arrives, however, the current state of affairs with respect to marijuana is one in which federal law expressly prohibits what the states have sanctioned, the federal government winks and nods at its enforcement responsibilities, and the ensuing collateral consequences

182. *See* Chemerinsky, *supra* note 8, at 95–96 (noting that Colorado precludes attorneys from providing such legal services while Arizona does not).

183. Sam Kamn & Viva R. Moffat, *Trademark Laundering, Useless Patents, and Other IP Challenges for the Marijuana Industry,* 73 WASH. & LEE L. REV. 217 (2016).

184. *Id.* at 244–56, 260–67. Copyrights are available to marijuana businesses because, due to the nature of copyrights, refusal to issue copyrights due to the nature of the message raises First Amendment issues. However, copyright protection has limited utility for the marijuana industry and, in any event, it is not certain whether a federal court will provide relief to a business engaged in an illegal activity. *Id.* at 274–75.

185. *Id.* at 256–59, 267–70.

186. United States v. Windsor 133 S. Ct. 2652, 2884 (2013).

hinder state sanctioned businesses. This it is not classic federalism; it is Potemkin federalism.

IV. COOPERATIVE FEDERALISM

Federal law should make possible what some scholars have termed cooperative federalism, "a partnership between the States and the federal government, animated by a shared objective."[187] For example, federal law could provide states with an opt-out of the federal restrictions if state law complies with federal guidelines.[188] Cooperative federalism has been implemented with respect to environmental policy and health care.[189] Federal gambling legislation offers an interesting example of both cooperative federalism and federal preemption.

A. Federal Gambling Regulation as an Illustrative Example

Gambling and marijuana use share certain attributes. Both activities are perceived to create or exacerbate social ills, both activities have been, and are, undertaken in the face of legal prohibitions, and both activities have their virtues. Gambling long has generated consternation and disdain, historically rooted on religious grounds, and, when permitted, is subject to regulation.[190] In modern times, opprobrium toward gambling activities is due to the host of negative externalities such activities create, and the belief that such activities yield little societal benefits. A report issued by the National Gambling Impact Study Commission in 2009 concluded that gambling is a contributing factor to a host of societal problems, including divorce, domestic abuse, child neglect, crime, substance abuse, and financial hardships.[191] The use of the internet to

187. Chemerinsky, *supra* note 8, at 116 (quoting Arkansas v. Oklahoma, 503 U.S. 91, 101 (1992)); *see also* Sam Kamin, *Cooperative Federalism and State Marijuana Regulation*, 85 U. COLO. L. REV. 1105, 1120–22 (2014).

188. Chemerinsky, *supra* note 8, at 116.

189. *Id.* at 117–18 (describing provisions of the Clean Air Act, the Clean Water Act, and the Patient Protection and Affordable Care Act).

190. Gambling was not condemned by all religions. The monotheistic religions opposed it because, among other reasons, of the fear that such activities provided competition for religious dogma and eroded the Protestant work ethic. *See generally* Per Binde, *Gambling and Religion: Histories of Concord and Conflict*, 20 J. of Gambling Issues, June 2007, at 145.

191. NAT'L GAMBLING IMPACT STUDY COMM. FINAL REP. 7-1–7-28 (2009), http://govinfo.library.unt.edu/ngisc/reports/fullrpt.html. The Commission was created by Congress in 1996 to conduct a study of the societal impact of gambling in the United States. National Gambling Impact Study Commission Act, Pub. L. No. 104-149, § 2, 110 Stat. 1482 (1996).

facilitate gambling activities has exacerbated the ills associated with gambling.[192] The societal benefits of gambling are primarily economic in nature. The gambling industry has long been a source of jobs, infrastructure development, and tax revenues.[193] Gambling also provides entertainment value.

In light of organized crime's dominance of the illegal gambling industry, modern federal anti-gambling statutes were put in place to assist the states in the enforcement of their gambling prohibitions.[194] Federal law does not create independent prohibitions on gambling activities. Instead, it created a federal offense for certain violations of state law.[195] For the most part, the federal government leaves it to the states to determine whether, and to what extent, to legalize gambling activities.[196] The one notable exception is sports gambling.[197] The following is a brief overview of federal gambling legislation.

The Wire Act imposes criminal sanctions against a person "engaged in the business of betting or wagering [who] knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest."[198] It also prohibits "the

192. The ability to undertake such activities online increases the risk that such activities are undertaken by minors, exacerbates the problems associated with pathological gamblers, attracts disreputable operators and criminal elements, and facilitates money laundering. Internet gambling also has caused a decline in workplace productivity. *See* Anthony Vecchione, Comment: *Fantasy Sports–Has Recent Anti-Gambling Legislation Dropped the Ball by Providing a Statutory Carve-out for the Fantasy Sports Industry?*, 61 S.M.U. L. REV. 1689, 1698 (2008) (reporting the results of a study conducted by Challenger, Gray, & Christmas, a consulting firm).

193. Gambling activities have financed public works throughout history, including the Continental Army during the Revolutionary War. *See* Dallis Nicole Warshawm, comment, *Breaking the Bank: The Tax Benefits of Legalizing Online Gambling*, 18 CHAP. L. REV. 289, 291 (2014) (citing WILLIAM N. THOMPSON, LEGALIZED GAMBLING: A REFERENCE HANDBOOK 5–6 (2d ed. 1997); CHARLES T. CLOTFELTER, THEORY AND PRACTICE OF EXCISE TAXATION: SMOKING, DRINKING, GAMBLING, POLLUTING, AND DINING 84–85 (Sijbren Cnosson ed. 2005)).

194. Federal anti-gambling legislation dates to the mid-nineteenth century when Congress passed legislation in 1868 to prohibit the use of the mails for the promotion of state lotteries. Additional anti-lottery legislation followed later in the nineteenth century. *See* Kaitlyn Dunphy, Note: *Following Suit with the Second Circuit: Defining Gambling in the Illegal Gambling Business Act*, 79 BROOK. L. REV. 1295, 1311–15 (2014).

195. *Id.* at 1310.

196. *Id.* at 1323–26.

197. *Id.* at 1321.

198. 18 U.S.C.A. § 1084(a) (West 2017). Violations are subject to fines, imprisonment for no longer than two years, or both. *Id.* Although originally enacted to prohibit telegraph transmissions, the statute also applies to internet communication. *See* United States v. Cohen, 260 F.3d 68, 76 (2d Cir. 2001). Cohen, a U.S. citizen, was convicted of

transmission of a wire communication which entitles the recipient to . . . money or credit as a result of a bets or wagers, or information assisting in the placing of bets or wagers."[199] The statute exempts from its strictures any transmission in interstate or foreign commerce of information that assists in the placing of bets or wagers on any sporting event or contest if the transmission originates in a state or foreign country in which sports betting is legal and has its terminus in a state or foreign country in which sports betting is legal.[200]

Until 2011, it was unclear whether the Wire Act limited its prohibitions to sports gambling. Two courts reached different conclusions with respect to this issue.[201] The Department of Justice had interpreted the statute to apply to all forms of bets and wagers.[202] However, in response to inquiries from New York and Illinois concerning the applicability of the Wire Act to the sale of lottery tickets to in-state purchasers, the Department of Justice's Office of Legal Counsel concluded that the Wire Act does not prohibit wagering or betting activities that do not involve sporting events or contests.[203]

Wire Act violations stemming from his operation of a sports betting web site that was maintained in Antigua and Barbuda. For purposes of the statute the term "state" means any state, territory, or possession of the United States and the District of Columbia. 18 U.S.C. § 1084(e) (2012).

199. 18 U.S.C. § 1084(a) (2012).

200. 18 U.S.C. § 1084(b) (2012). In addition, the transmission of news reports of sporting events or contests in interstate or foreign commerce are exempt. *Id.* Intrastate activities are not covered by the Wire Act but it is not clear whether internet communications between residents of one state that cross state lines in transmission are covered by the statute. The Department of Justice had the opportunity to clarify this issue in 2011 but failed to do so. The Department of Justice was queried by two states about this issue in connection with intrastate lottery games. The Department's Office of Legal Counsel responded that the Wire Act did not apply to non-sports wagering activities and, accordingly, did not address this issue. *See infra* note 207 and accompanying text.

201. *Compare In re* Mastercard Int'l, Inc., 313 F.3d 257 (5th Cir. 2002) (holding that the Wire Act applies only to sports betting), *with* United States v. Lombardo, 639 F. Supp. 2d 1271 (D. Utah 2007) (holding that the Wire Act's prohibition on the transmission of money or credit or information that assists in the placement of bets was not limited to sports gambling).

202. *See* Charles P. Ciaccio, Jr., *Internet Gambling: Recent Developments and State of the Law*, 25 BERKELEY TECH. L.J. 529, 538 (2010).

203. Memorandum from Virginia A. Seitz, Assistant Atty. Gen. to Assistant Atty. Gen., Criminal Div. 1–2 (Sept. 20, 2011), https://www.justice.gov/olc/opinion/whether-proposals-illinois-and-new-york-use-internet-and-out-state-transaction. The Interstate Horseracing Act of 1978 and amendments thereto appear to exempt off-track betting from the strictures of the Wire Act but this exemption may not be as clear as it appears. *See* Anthony Cabot, *Betting on the Budget: Can State Legislatures Go All In or Will the Federal Government Force Them to Fold: The Absence of a Comprehensive Federal Policy Toward Internet and Sports Wagering and a Proposal for Change*, 17 VILL. SPORTS & ENT. L.J. 271, 285–90 (2010).

> Pursuant to the Travel Act, anyone who
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> > travels in interstate or foreign commerce or uses the mail or any facility in interstate or foreign commerce, with the intent to distribute the proceeds of an unlawful activity; or commit any crime of violence to further any unlawful activity; or otherwise promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on of any unlawful activity may . . .

be fined, imprisoned, or both.[204] For purposes of the statute, an unlawful activity includes any business enterprise that involves gambling that either violates the law of the state in which the violation was committed or federal law.[205] Unlike the Wire Act, this statute could apply to wagering activities that are legal under state law if federal law prohibits such activity—the Unlawful Internet Gambling Enforcement Act or Professional and Amateur Sports Protection Act (PASPA), for example.[206]

The Illegal Gambling Business Act prohibits anyone from "conduct[ing], financ[ing], manag[ing], supervis[ing], direct[ing], or own[ing] all or part of an illegal gambling business."[207] An illegal gambling business is a gambling business that involves five or more persons who conduct, manage, supervise, direct, or own such business, has been or remains in substantial continuous operation for more than thirty days, has gross revenue of at least $2,000 in any single day, and is

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204. 18 U.S.C.A. §§ 1952(a)(1)–(3) (West Supp. 2017). Violations of the statute may result in imprisonment for no more than five years unless the violation consists of the commission of a crime of violence in which case the violation may result in imprisonment for no more than 20 years. If the violation results in a death, then the violation may result in life imprisonment. 18 U.S.C.A. §§ 1952(a)(3)(A)–(B) (West Supp. 2017).

205. 18 U.S.C.A. § 1952(b) (West Supp. 2017). A state, for this purpose, includes the District of Columbia and possessions and territories of the United States. *Id.*

206. *See infra* notes 224–233 and accompanying text.

207. 18 U.S.C.A. § 1955(a) (West Supp. 2017). Violators are subject to a fine, imprisonment for no longer than five years, or both. *Id.* The Wire Act, the Travel Act, and this statute were found by the Appellate Body of the World Trade Organization to have violated the United States' obligation to allow market access to Antigua and Barbuda under the General Agreement on Trade in Services. The United States did not respond to the Appellate Body's findings leading the World Trade Organization to authorize Antigua and Barbuda to suspend certain obligations with respect to intellectual property rights. *See* Jordan Hollander, *The House Always Wins: The World Trade Organization, Online Gambling, and State Sovereignty*, 12 RUTGERS J.L. & PUB. POL'Y 179, 202–09 (2015).

in violation of the law of the state or political subdivision in which such business is conducted.[208]

The Interstate Transportation of Wagering Paraphernalia Act (the Paraphernalia Act) prohibits anyone from "knowingly carry[ing] or send[ing] in interstate or foreign commerce any record, paraphernalia, ticket, certificate . . . token, paper, writing, or other devise [that is, or will be,] used or adapted, devised, or designed for use in (a) bookmaking; or (b) wagering pools with respect to a sporting event, or (c) in a numbers, policy, bolita, or similar game."[209] This statute does not apply to "the transportation of betting materials to be used in the placing of bets or wagers on a sporting event into a state" in which such bets or wagers are legal under state law.[210]

Internet gambling drew concern from federal authorities. The Wire Act, initially wielded by the Department of Justice to prosecute operators of online gambling sites, is of marginal utility in this respect because it later was limited to sports gambling.[211] Voluntary efforts by credit card companies to deny authorization for transactions on gambling websites proved inadequate to curb the growth of online gambling.[212] As a result, the Unlawful Internet Gambling Enforcement Act (UIGEA) was enacted

208. 18 U.S.C.A. § 1955(b)(1) (West Supp. 2017). A state, for this purpose, includes the District of Columbia and possessions and territories of the United States. 18 U.S.C.A. § 1955(b)(6) (West Supp. 2017). Bingo games, lotteries, and similar games of chance conducted by I.R.C. § 501(c)(3) organizations are exempt from the statute if certain conditions are met. *See* 18 U.S.C.A. § 1955(e) (West Supp. 2017). I.R.C. § 501(c)(3) organizations are organizations operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational, to foster certain amateur sports, or to prevent cruelty to children or animals. I.R.C. § 501(c)(3) (West Supp. 2017).

209. 18 U.S.C.A. § 1953(a) (West Supp. 2017). Violators are subject to a fine, imprisonment for no longer than five years, or both. *Id.* The prohibition does not apply to transportation by a common carrier in the usual course of business. *Id.*

210. 18 U.S.C.A. § 1953(b) (West Supp. 2017). A similar exemption applies to pari-mutuel betting equipment, tickets, and equipment. *Id.* A state, for this purpose, includes the District of Columbia and possessions and territories of the United States. 18 U.S.C.A § 1953(d)(6) (West Supp. 2017). Also exempt is the carriage or transportation of newspapers or similar publications. 18 U.S.C.A. § 1953(b) (West Supp. 2017).

211. *See supra* note 203 and accompanying text. Several bills were introduced in Congress that would have amended the Wire Act to capture on-line gambling in general within its purview but the bills failed to win passage. *See* S. 474, 105th Cong. (1997); S.692, 106th Cong. (1999); H.R. 4777, 109th Cong. (2006).

212. Gamblers routinely used other payment mechanisms, including checks and wire transfers. *See* U.S. GEN. ACCOUNTING OFFICE, GAO-03-89 4, INTERNET GAMBLING: AN OVERVIEW OF THE ISSUES 20–30 (2002), http://www.gao.gov/new.items/d0389.pdf.

in 2006.[213] The statute's objective is to restrict the flow of funds to online gambling operators.[214]

The UIGEA prohibits any person engaged in the business of betting or wagering from knowingly accepting, in connection with the participation of another person in unlawful internet gambling, any credit, the proceeds of credit, an electronic funds transfer, "funds transmitted by or through a money transmitting business . . . a check, draft, or similar instrument . . . drawn on or payable through a financial institution, or the proceeds of any other financial transaction" prescribed by the Secretary of the Treasury or the Board of Governors of the Federal Reserve System.[215] In addition, the statute requires that the Treasury Department and the Federal Reserve promulgate regulations to require designated payment systems and all participants therein to establish policies and procedures that are reasonably designed to identify, block, or otherwise

213. Pub. L. No. 109-347, 120 Stat. 1884 (2006) (codified at 31 U.S.C. § 5361-57 (2016)).

214. Another statute, the Illegal Money Transmitting Business Act of 1992, makes it a criminal offense to conduct, control, manage, supervise, direct, or own all or part of an unlicensed money transmitting business. 18 U.S.C. § 1960(a) (2012). An unlicensed money transmitting business is defined as a money transmitting business that affects interstate commerce in any manner and fails to comply with either state law licensing requirements or federal registration requirements, or "otherwise involves the transportation or transmission of funds that are known to the defendant to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity." 18 U.S.C. § 1960 (b)(1) (2012). In addition, 18 U.S.C.A. § 1956 (West Supp. 2017), a general anti-money laundering provision enacted as part of the USA Patriot Act, could capture payment processors, such as PayPal, and facilitators of illegal gambling activities. *See* Yochi J. Dreazen, *E-Commerce (A Special Report): The Rules - Money Transfers: Too User-Friendly? Legislation Aimed at Stopping Terrorism Could Have a Devastating Impact on an Innocent Bystander: PayPal*, WALL ST. J., Oct. 21, 2002, at R9.

215. 31 U.S.C. § 5363 (2012). Violations are punishable by fine, imprisonment for not more than five years, or both. 31 U.S.C. § 5366(a) (2012). A financial transaction provider, interactive computer service, or telecommunication service may be liable for violations of the statute if such provider or service has "actual knowledge and control of bets and wagers" and has engaged in certain operational activities or owns or controls persons who engage in those activities. *See* 31 U.S.C. § 5367 (2012). This provision has been broadly interpreted. *See* United States v. Rubin, 743 F.3d 31 (2d Cir. 2014) (holding that an individual hired to disguise payments from gamblers as payments from non-existent legitimate businesses violated the statute). The legislation does not prohibit any activity that is permitted under the Interstate Horseracing Act of 1978, does not disturb the relationship between the Interstate Horseracing Act of 1978 and other federal statutes, and does not preempt any state law that prohibits gambling. 31 U.S.C. § 5362(10)(D) (2012). Moreover, the UIGEA expressly provides that its provisions shall not be construed to alter, limit, or extend federal or state law that prohibits, permits, or regulates gambling. 31 U.S.C. § 5361(b) (2012).

prevent or prohibit the acceptance of transactions that are prohibited by the statute.[216]

The statute defines unlawful gambling as the placement, receipt, or otherwise knowing transmission of "a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law [in the place] in which such bet or wager is initiated, received, or otherwise made."[217] Bets or wagers that are initiated and received, or otherwise made exclusively in one state, do not constitute unlawful internet gambling if such bets are expressly authorized in the state by laws or regulations that include reasonably effective "age and location verification requirements" and appropriate data security safeguards.[218]

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216. 31 U.S.C. § 5364(a) (2012). Regulations issued by both the Department of the Treasury and the Federal Reserve provide a set of due diligence procedures as a safe harbor for payment system participants. Rules are set forth for credit and debit card issuers, operators, merchants, third party processors, financial institutions that originate or receive ACH or wire transfers, banks within the check clearing system, and money transmitters. *See generally* 12 C.F.R. §§ 233.1–233.7 (2008); 31 C.F.R. §§ 132.1–132.7 (2008).

217. 31 U.S.C. § 5362(10)(A) (2012). The term "bet or wager" is defined as the staking or risking of "something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance" and the purchase of a chance or opportunity to win a lottery or prize if the opportunity to win is determined predominately by chance. 31 U.S.C. §5362(1)(A)–(B) (2012). A bet or wager also includes any other scheme that is prohibited by PASPA. 31 U.S.C. § 5362(1)(c) (2012). See *infra* notes 228–29 and accompanying text for a discussion of prohibited activities under PASPA. Excluded from the definition are securities and commodity transactions, over-the-counter-derivative instruments, insurance, indemnity and guarantee contracts, deposit accounts, participation in games or contests in which participants risk nothing other than their personal efforts or points or credits provided by the sponsor that are useable only for participation in such games or contests. 31 U.S.C. §§ 5362(1)(E)(i)–(viii); 5362(10)(A) (2012). In addition, a bet or wager does not include the "participation in any fantasy or simulation sports game" in which no fantasy team is based on the current membership of a professional or amateur sports organization, as defined by PASPA. 31 U.S.C. § 5362(1)(E)(ix) (2012). Moreover, the winning outcome may be based neither on the score, point-spread, or the performance of any single real-world team or combination of such teams nor solely on the performance of an individual athlete in any single event. 31 U.S.C. § 5362(1)(E)(ix)(III) (2012). All prizes and awards must be established and made known to participants prior to the game or contest and the value of such prizes and awards cannot be determined by the number of participants or the amount of fees paid by such participants. 31 U.S.C. § 5362(1)(E)(ix)(I) (2012). In addition, all winning outcomes, determined by the accumulated statistical results of individual performances, must reflect the relative knowledge and skill of the participants. 31 U.S.C. § 5362(1)(E)(ix)(II) (2012).

218. 31 U.S.C. § 5362(10)(B)(i)–(ii) (2012). A state, for this purpose, includes the District of Columbia and possessions and territories of the United States. 31 U.S.C. § 5362(9) (2012). The statute makes clear that the intermediate routing of data does not determine the location "in which a bet or wager is initiated, received, or otherwise made." 31 U.S.C. § 5362(10)(E) (2012). Moreover, the bet or wager cannot violate PASPA, the

In general, the aforementioned statutes do not prohibit specific intrastate gambling activities. Ironically, UIGEA expressly sanctions certain fantasy sports activities regardless of whether state law prohibits such activities.[219] These statutes represent classic cooperative federalism. Policy choices are made at the state level and federal assistance is provided to enforce such preferences. This is not the case with respect to sports gambling. As noted earlier, the Wire Act applies exclusively to sports gambling but it only targets sports wagering activities that violate state law.

In response to the growth of state-sponsored sports gambling and the concomitant erosion of public confidence in the integrity of professional and amateur sports contests, Congress enacted the Professional and Amateur Sports Protection Act (PASPA) in 1992, a statute that significantly restricts state sanctioned sports gambling.[220] The statute manifested Congress's belief that "[t]he moral erosion [sports gambling] produces cannot be limited geographically" because a race to the bottom would ensue among other states.[221] The professional sports leagues and the National Collegiate Athletic Association supported this legislation—a position that they recently have reconsidered. [222] The legislation

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Gambling Device Transportation Act, the Interstate Horseracing Act of 1978, or the Indian Gaming Regulatory Act. 31 U.S.C. § 5362(10)(B)(iii) (2012). One state law ban on internet gambling was challenged by a state resident as violative of the dormant commerce clause. *See supra* note 13 for a discussion of the dormant commerce clause. The Supreme Court of Washington held that the state statute that prohibited internet gambling did not discriminate in favor of in-state interests and that the burden imposed by the ban on interstate commerce was not excessive in relation to the legitimate state interests that the legislation sought to advance. *See* Rousso v. Washington, 239 P.3d 1084 (Wash. 2010).

219. *See supra* note 218.

220. Pub. L. No. 102-559, 106 Stat. 4227 (1992) (codified at 28 U.S.C. §§ 3701–04 (2011)); S. REP. NO. 102-248, at 5 (1992). A separate federal statute criminalizes sports bribery.

> Whoever carries into effect, attempts to carry into effect, or conspires with any other person to carry into effect any scheme in commerce to influence, in any way, by bribery any sporting contest, with knowledge that the purpose of such scheme is to influence by bribery that contest, shall be fined under this title, or imprisoned not more than 5 years, or both.

18 U.S.C.A. § 224 (West 2017).

221. S. REP. NO. 102-248, at 5.

222. The potential erosion of television revenues due to, among other factors, technological developments and the potential for new revenue streams from gambling, has prompted these proponents of the legislation to reevaluate their stance on legalized sports betting. *See* Brad Reagan & Chris Kirkham, *Leagues Warm Up to Legal Betting*, WALL ST. J., Apr. 1, 2017, at A1. A bill has been introduced in Congress recently that would provide states with a four-year window, from January 1, 2017 to January 1, 2021,

exempted Nevada and other states that already had legalized some form of sports gambling.[223]

> PASPA makes it unlawful for
> a governmental entity to sponsor, operate, advertise, promote, license, or authorize by law or compact . . . a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly . . . on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games.[224]

It is also unlawful for "a person to sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity" the aforementioned activities.[225] The Attorney General of the United States or an amateur or a professional sports organization whose competitive game is the basis of the statutory violation may bring civil actions to enjoin violations of the statute.[226]

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to enact sports wagering schemes. Sports Gaming Opportunity Act of 2017, H.R. 783, 115th Cong. (2017).

223. S. REP. NO. 102-248, at 8 (noting that Oregon, Delaware, and Nevada had legalized sports wagering in some form).

224. 28 U.S.C. § 3702 (2012). A government entity is a state, including territories or possessions of the United States, or political subdivisions thereof, and entities or organizations that have governmental authority over territories of the United States, including certain Native American entities or organizations. 28 U.S.C. §§ 3701(2)–3701(5) (2012).

225. 28 U.S.C. § 3702(2) (2012).

226. 28 U.S.C. § 3703 (2012). An amateur sports organization is any person or governmental entity, or league or association of such persons or governmental entities, "that sponsors, organizes, schedules, or conducts a competitive game in which one or more amateur athletes participate." 28 U.S.C. § 3701(1) (2012). A professional sports organization is identically defined except that such organization "sponsors, organizes, schedules, or conducts a competitive game in which one or more professional," as opposed to amateur, athletes participate. 28 U.S.C. § 3701(3) (2012). Parimutuel animal racing, horseracing and greyhound racing, for example, and jai-lai games are exempt from the statute's prohibitions. 28 U.S.C.A. § 3704(a)(4) (West 2017). Parimutuel is a term that describes the betting system utilized in animal racing activities. *See Parimutuel Betting,* BLACK'S LAW DICTIONARY (5th ed. 1979). The legislation also exempts certain casino activities. An activity otherwise prohibited by the statute is permitted if such activity is not a lottery and is conducted exclusively in a casino located in a municipality and such activity or similar activity was authorized to be operated in the municipality not later than one year after the effective date of the statute. 28 U.S.C. § 3704(a)(3)(A) (2012). Moreover, any commercial casino gaming scheme operated by a casino located in a municipality, other than a lottery, is permissible if such scheme was in operation in the municipality throughout the ten-year period preceding the effective date of the statute and is subject to comprehensive state regulation applicable solely to such municipality. 28 U.S.C. § 3704(a)(3)(B) (2012).

Two general grandfather rules are provided in the statute. First, lotteries, sweepstakes, and betting, gambling and wagering schemes operated in a state or other governmental entity are permitted if such schemes were conducted by the state or governmental entity at any time between January 1, 1976 and August 31, 1990.[227] This provision appears to permit activities conducted by the state or governmental authority itself during the statutory reference period. This rule has been interpreted narrowly by the Third Circuit in a case involving Delaware's plan to institute a sports betting scheme in 2009.[228] On September 1, 2009, Delaware intended to commence a sports betting scheme that would allow single game wagers in professional and amateur sports except for sporting events that involved a Delaware college or university or a Delaware amateur or professional sports team.[229] In 1976, Delaware had operated a professional football sports betting scheme under which three types of games were offered, all of which required a player to pick a winner in multiple games.[230]

The Third Circuit, reversing the district court, held that Delaware's proposed scheme violated PASPA.[231] The court rejected the state's assertion that the grandfather rule should be applied broadly to allow any sports lottery and, instead, held that the grandfather rule applied only to schemes that the state had actually conducted in 1976.[232] While conceding that the grandfather rule did not require that permissible games be identical in every respect to games offered in the past, the court held that any differences between proposed and past games must be *de minimis* and not substantial.[233] Delaware's plan to allow wagers to be placed on single football games and on sporting events that did not involve the National Football League teams were not *de minimis* changes to the 1976 scheme.[234] Accordingly, the statute limited Delaware to offering parlay bets on three or more professional football games.[235]

A second grandfather rule exempts lotteries, sweepstakes, and betting, gambling and wagering schemes operated in a state or other

227. 28 U.S.C. § 3704(a)(1) (2012).

228. Office of the Comm'r of Baseball v. Markell, 579 F.3d 293 (3d Cir. 2009), *rev'g* C.A. No. 08-538(GMS), 2009 WL 2450284 (D. Del., Aug. 10, 2009).

229. *Id.* at 296.

230. *Id.*

231. *Id.* at 304.

232. *Id.*

233. *Id.* at 303–04. According to the court, differences between the proposed and past games with respect to the location at which tickets may be purchased or in the teams that exist and, therefore, may be bet upon, are permissible *Id.* at 304.

234. *Id.*

235. *Id.*

governmental entity that were authorized by statute in effect on October 2, 1991 and that were actually conducted in the state or other governmental entity at any time between September 1, 1989 and October 2, 1991.[236]

The State of New Jersey challenged the constitutionality of PASPA.[237] The voters of New Jersey approved an amendment to the state's constitution that permitted the state legislature to enact legislation authorizing sports gambling.[238] The New Jersey Legislature subsequently enacted such a measure but the legislature failed to meet the deadline set forth in the grandfather provision.[239] The National Collegiate Athletic Association and various professional sports leagues brought suit to enjoin the state from licensing sports betting. The district court rejected the state's claims that the plaintiffs lacked standing to assert a claim and that PASPA was unconstitutional.[240] The Third Circuit affirmed the district court's decision.[241]

New Jersey raised three constitutional claims.[242] First, the state asserted that PASPA exceeded Congress's power to regulate interstate

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236. 28 U.S.C. § 3704(a)(2) (2012).

237. NCAA v. Governor of N.J., 730 F.3d 208 (3d Cir. 2013), *aff'g*, 926 F. Supp. 2d 551 (D. N.J. 2013), *cert. denied*, 134 S. Ct. 2866 (2014).

238. *Id.* at 217.

239. *Id.*

240. *Id.* at 214–15.

241. *Id.* at 215.

242. The court held that the sports leagues and the NCAA had standing to bring suit to enforce PASPA. The threat of reputational harm is a legally cognizable injury and sufficient evidence was presented to support the conclusion that such harm would, in fact, occur. *See id.* at 218–24. The requirement of standing, rooted in Article III of the Constitution, also has a prudential dimension.

> Apart from this minimum constitutional mandate, this Court has recognized other limits on the class of persons who may invoke the courts' decisional and remedial powers. First, the Court has held that when the asserted harm is a "generalized grievance" shared in substantially equal measure by all or a large class of citizens, that harm alone normally does not warrant exercise of jurisdiction. . . . Second, even when the plaintiff has alleged injury sufficient to meet the "case or controversy" requirement, this Court has held that the plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties. . . . Without such limitations—closely related to Art. III concerns but essentially matters of judicial self-governance—the courts would be called upon to decide abstract questions of wide public significance even though other governmental institutions may be more competent to address the questions and even though judicial intervention may be unnecessary to protect individual rights.

Warth v. Seldin, 422 U.S. 490, 499–501 (1975). For an excellent critique of the Supreme Court's standing jurisprudence see Richard E. Epstein, *Standing or Spending—The Role of Legal and Equitable Principles*, 4 CHAP. L. REV. 1 (2001).

commerce.[243] Citing *United States v. Lopez*, the court held that "Congress may regulate an activity that 'substantially affects interstate commerce' if it 'arise[s] out of or [is] connected with a commercial transaction'" and both wagering and national sports are economic activities that substantially affect interstate commerce.[244]

The state also asserted that PASPA impermissibly commandeers the states to enforce a federal regulatory program.[245] Because PASPA does not require a state to do anything and, instead, merely prevents a state from doing what the statute prohibits it from doing, the court held that this principle is inapplicable.[246] PASPA, according to the court, does not even prohibit a state from repealing anti-gambling laws provided that the state does not affirmatively authorize or license sports gambling.[247] Finally, the court rejected the state's assertion that PASPA singled out Nevada for favorable treatment and, therefore, violated the equal sovereignty of the states.[248]

The Third Circuit was not through with this issue. In 2014, New Jersey enacted legislation that, in effect, permitted casinos and racetracks to engage in sports wagering without a state imprimatur.[249] The Third Circuit had occasion to opine on whether this law violated PASPA and, if so, whether PASPA's application in this case violated the anti-

243. *NCCA v. Governor of N.J.*, 730 F.3d at 214.

244. *Id.* at 224 (quoting United States v. Lopez, 514 U.S. 549, 559 (1995)). The court, in a footnote, did acknowledge Fed. Baseball Club of Balt. v. Nat'l League of Prof'l Base Ball Clubs, 259 U.S. 200 (1922), the case that granted professional baseball an exemption from the Sherman Antitrust Act on the grounds that professional baseball is not in interstate commerce. *See NCAA v. Governor of NJ*, 730 F.3d at 225 n.7. The court further noted that if PASPA does reach purely local activities, such as casual bets among family members, then Congress had a rational basis for concluding that such activities, when combined with like conduct by other similarly situated people, affects interstate commerce. *Id.* at 225–26 (citing Wickard v. Filburn, 317 U.S. 111 (1942).

245. *NCCA v. Governor of N.J.*, 730 F.3d at 227.

246. *Id.* at 227–29.

247. *Id.* at 232.

248. *Id.* at 237–40. The equal sovereignty doctrine is rooted in Article IV, section 4 of the U.S. Constitution and the Tenth Amendment thereto. *See* Shelby County v. Holder, 133 S. Ct. 2612, 2623 (2013); Coyle v. Smith, 221 U.S. 559, 566–67 (1911). According to the court, this doctrine does not prohibit Congress, in the exercise of its commerce power, from differentiating among states. *NCAA*, 730 F.3d at 238–39. Moreover, if the doctrine did indeed constrain Congress then the invalidation of the grandfather rule that favors Nevada is the appropriate action to cure PASPA's equal sovereignty violation and not the invalidation of the entire statute. *Id.* at 239. The court's reasoning in this respect is not without its critics. *See* Michael Welsh, *Betting on State Equality: How the Expanded Equal Sovereignty Doctrine Applies to the Commerce Clause and Signals the Demise of the Professional and Amateur Sports Protection Act*, 55 B.C. L. REV. 1009 (2014).

249. N.J. STAT. ANN. § 5:12A-7 (West 2014), *invalidated by* NCAA v. Governor of N.J., 832 F.2d 389 (3d Cir. 2016).

commandeering principle.[250] The Court held that the allowance of casino sports gambling in the midst of myriad prohibitions of sports gambling amounted to state authorization thereby causing the law to violate PASPA. [251] The law, in essence, channeled sports gambling to particular venues.[252] As a result, the statute violated PASPA.[253] Although the court did not categorically state that a partial repeal of a prohibition, as opposed to a total repeal, amounts to state authorization of the activity to which the partial appeal applies, in this case it did.[254] For this reason—and for the reasons set forth in the earlier case—the court held that the anti-commandeering principle was not violated.[255] The dissenting judges believed that the repeal of a pre-existing prohibition is not tantamount to state authorization and took exception to the majority's assertion that partial repeal of prohibitions may, in some cases, amount to authorization.[256] The state petitioned the Supreme Court and, on June 27, 2017, the Court granted certiorari.[257]

Whatever one's opinion is about the efficacy of federal gambling legislation, it does have the virtue of clarity with respect to federalism. With the exception of PASPA, federal gambling legislation is a form of classic cooperative federalism. States enact the policies that suit the needs of their citizens and the federal government provides assistance to the states when needed. PASPA clearly is not an exercise in federalism. The federal government preempted state policy preferences with respect to sports gambling.

B. The Need for Reform

The federal government's approach to marijuana enforcement needs a legislative fix. Categorical refusals to enforce federal law are not costless. If the social benefits of non-enforcement exceed its cost, then non-enforcement is justifiable. However, with respect to state legalized marijuana, the benefits of non-enforcement are attenuated due to the collateral consequences of marijuana's current status under the Controlled Substances Act, but the costs of non-enforcement remain.

250. NCAA v. Governor of N.J., 832 F.3d 389 (3d. Cir. 2016) (*en banc*), *aff'g*, 61 F. Supp. 3d 488 (D. N.J. 2014), *cert. granted*, Christie v. NCAA, 137 S. Ct. 2327 (2017).
251. *Id.* at 396–98.
252. *Id.* at 397.
253. *Id.*
254. *Id.* at 400–02.
255. *Id.*
256. *Id.* at 402–06 (Fuentes, J., dissenting, joined by Resterpo, J.); *Id.* at 406–08 (Vanaskie, J., dissenting).
257. Christie v. NCAA, 2017 U.S. LEXIS 4279 (2017).

Marijuana legalization should be left to the states and, similar to non-sports gambling activities, the federal government should provide assistance to states when needed.

Federal legislation governing marijuana on the PASPA model is not workable. Other than Nevada, only two states had authorized sports gambling to a very limited degree at the time of PASPA's enactment.[258] Therefore, the grandfather rule discussed above poked limited holes in the federal scheme.[259] A PASPA type approach would prevent states, prospectively, from legalizing marijuana and, based on the Third Circuit's reasoning in *NCAA v. Governor of State of New Jersey*, from exempting marijuana from their current drug prohibitions.[260] However, at this point, more than half the states have legalized marijuana in some form.[261] Moreover, it is unlikely that the absence of a grandfather rule would pass legal or political hurdles. The anti-commandeering principle would prevent the federal government from forcing a state to repeal existing marijuana legislation.[262] As noted previously, federal preemption of state laws governing marijuana would be politically difficult—particularly if such preemption only applies to the fewer than half the states that have not yet legalized marijuana.[263]

Numerous bills have been introduced in Congress and none advocate for a PASPA approach. Instead, the bills would enact regimes similar to those put in place by traditional gambling legislation or attempt to remove some of the collateral effects of the current regulatory structure.[264] Whether Congress should defer to the states entirely with

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258. S. REP. NO. 102-248, at 8 (1992) (noting that Oregon, Delaware, and Nevada had legalized sports wagering in some form).

259. 28 U.S.C. § 3704(a)(1) (2012).

260. *NCAA v. Governor of N.J.*, 832 F.3d at 396–402 (*en banc*).

261. *See* MARIJUANA POLICY PROJECT, STATE-BY-STATE MEDICAL MARIJUANA LAWS: HOW TO REMOVE THE THREAT OF ARREST, *supra* note 20 and accompanying text.

262. *See supra* notes 43–46 and accompanying text.

263. *See* MARIJUANA POLICY PROJECT, STATE-BY-STATE MEDICAL MARIJUANA LAWS: HOW TO REMOVE THE THREAT OF ARREST, *supra* note 20 and accompanying text.

264. *See e.g.*, Marijuana Revenue and Regulation Act, S. 776, 115th Cong. (2017) (decriminalizing marijuana, establishing a federal permit system, and imposing a federal excise tax on marijuana); LUMMA, H.R. 714, 115th Cong. (2017) (providing for the use of medical marijuana in accordance with state law); Ending Federal Marijuana Prohibition Act of 2017, H.R. 1227, 115th Cong. (2017) (deregulating marijuana, removing it from drug schedules, and limiting certain transportation of the product); H.R. 2020, 115th Cong. (2017) (requiring the rescheduling of marijuana from Schedule I to Schedule III, thereby allowing it to be prescribed); Small Business Tax Equity Act, S.777, 115th Cong. (2017) (amending I.R.C. § 280E to allow tax deductions and tax credits for expenditures in connection with marijuana sales in compliance with state law); Secure and Fair Enforcement Banking Act, H.R. 2215, 115th Cong. (2017) (protecting

respect to marijuana or establish some sort of minimal standards is an important policy choice, one that implicates a number of issues. Among these issues is whether the federal government is willing to cede to the states the treatment of recreational use of marijuana or merely medical uses of marijuana, whether marijuana becomes a federal revenue source, and whether the Food and Drug Administration will obtain jurisdiction over the product. Moreover, a cooperative federal-state regulatory model must consider the effects of state legalization on states that choose to ban the product. States that retain their prohibitions on marijuana use should be able to employ reasonable mechanisms, without running afoul of Dormant Commerce Clause doctrines, for reducing the possibility that the substance finds its way into their states from neighboring states that have chosen to legalize marijuana.[265]

The Controlled Substances Act, in form, pays fealty to federalism but, in substance, it does violence to its underlying principles in two respects. First, despite the fact that the Controlled Substances Act allowed states the space in which to pursue their own policy preferences, its treatment of marijuana as a Schedule I substance imposes difficult practical obstacles for alternate state treatment of the substance. Whatever policy choices are made at the state level, marijuana is an illegal substance under federal law—a fact whose consequences cause the Controlled Substances Act to occupy the field in many practical respects. The Controlled Substances Act pays lip service to state authority.

Second, tolerance for violation of federal law, whether by state or federal authorities, is a sign of open disrespect for federal law. Cultural norms have a significant influence on the level of voluntary compliance with the law. The existence of effective deterrents to non-compliance and the reputational harm attendant to such non-compliance are critical—and often reinforcing—components of an effective legal scheme that is predicated, in large part, on voluntary compliance.[266] Reputational harm

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financial institutions that provide financial services to state sanctioned marijuana businesses).

265. See *supra* note 13 and accompanying text for a discussion of state attempts to reduce such spill-over effects from other states. This is an issue that arose about a century ago with alcohol and was solved legislatively. *See* Brannon P. Denning, *State Legalization of Marijuana as a "Diagonal Federalism" Problem*, 11 FIU L. REV. 349, 355–56 (2016) (noting that Congress passed two pieces of legislation that disabled the dormant commerce clause with respect to state alcohol regulations).

266. With respect to federal income taxes, one scholar believes that high tax penalties increase compliance through deterrence, separation, and signaling. Separation refers to the propensity for high penalties to prompt taxpayers to self-identify as compliant thereby permitting the government the ability to observe non-compliant groups. Signaling refers to the reputational enhancing benefits to taxpayers in signaling their compliance. *See*

is, in turn, dependent upon cultural norms and transparency.[267] Because the U.S. tax system depends, to a great extent, on voluntary compliance by taxpayers, it offers an example of the effects of a cultural norm of compliance predicated, for the most part, on deterrence.

Levels of voluntary tax compliance are high in the United States and one would expect that this fact has contributed to a strong cultural norm of compliance, thereby heightening the reputational harm of non-compliance.[268] In fact, anecdotal evidence suggests that, absent deterrence, levels of voluntary compliance would be quite low. For the most part, the third-party reporting requirements with respect to wages, interest, dividends, and many other forms of income ensures an extremely high detection rate for noncompliance.[269] Certain segments of the taxpayer population whose noncompliance is not easily detected are notorious for noncompliance—small businesses, for example. Such taxpayers have non-compliance rates of approximately fifty percent. [270]

Susan C. Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675, 681–83 (2012). By nudging cultural norms toward compliance, deterrence can, over time, heighten the reputational harm of non-compliance. *Id.* at 685–86. Conversely, significant reputational damage is a further deterrent to non-compliance because it increases the cost of such non-compliance if such non-compliance is discovered. *Id.* The size of the sanctions for non-compliance and the probability of detection are key variables with respect to the efficacy of the deterrents. These two variables have mutually dependent properties because the probability of detection should influence the size of the sanctions. *See generally* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 193 (1968). In the tort realm, support for punitive damages is based, in part, on analogous reasoning. *See e.g.*, W. Kip Viscusi, *The Challenge of Punitive Damages Mathematics*, 30 J. LEGAL STUD. 313, 315 (2001) (noting that this rationale can be traced to the writings of Jeremy Benthem); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 194, 203 (3d ed. 1986) For example, if there is 100% certainty of detection, then a penalty that slightly exceeds the benefits gained from noncompliance should be sufficient to deter non-compliance. Alternatively, sanctions must be set higher if the detection rate is ten percent in order to overcome the low probability of detection. Criminal sanctions, particularly the possibility of imprisonment, serve this function. *Id.* at 205–08.

267. *See* Morse, *supra* note 266, at 685–86, 692.

268. *Id.* at 679 (citing a 2006 Department of the Treasury report). *See also* I.R.S. News Release IR-2012-4 (Jan. 6, 2012) (estimating a compliance rate in 2006 of approximately 83 percent, a rate that was virtually unchanged from the compliance rate estimated in 2001).

269. *See e.g.*, I.R.C. § 6041 (2012) (requiring persons engaged in a trade or business to report payments of wages, salaries, rents, and certain other items); I.R.C. § 6042 (2017) (requiring the reporting of dividend payments); I.R.C. § 6045 (West Supp. 2017) (requiring brokers to report gross proceeds derived by customers); I.R.C. § 6049 (2012) (requiring the reporting of interest payments). The I.R.S. estimated that the rate of underreporting of wage and salary income in 2006 was one percent.

270. Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, *Closing the Tax Gap: Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 39 (2009).

Historically, income generated from foreign financial accounts has not been subject to third party reporting, and non-reporting of such income was endemic.[271] The I.R.S. estimated a gross tax gap of approximately $450 billion in 2006, the vast majority of which was attributable to underreported income.[272] Income not subject to third party reporting was misreported at a fifty-six percent rate in that year.[273] The I.R.S. issued an update to its 2006 report that estimated the annual tax gap at approximately $458 billion during the years 2008 to 2010 and a sixty-three percent rate of misreporting by taxpayers not subject to third party income reporting.[274]

The prevalence of strong cultural norm of tax compliance faces several obstacles. The fact that tax information is confidential inhibits the effects of reputational harm.[275] High profile criminal prosecution or media attention to the tactics of publicly-traded corporations does focus attention on reputational harm, but such cases are rare and, in any event, may not cause reputational harm. In the face of consumer protests over its tax tactics in the United Kingdom, Starbucks recently decided to move its European headquarters there.[276] However, Starbucks' response

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271. Matthew A. Melone, *Penalties for the Failure to Report Foreign Financial Accounts and the Excessive Fines Clause of the Eighth Amendment*, 22 GEO. MASON L. REV. 337, 339–57 (2015) (discussing taxpayer reporting obligations with respect to foreign financial accounts, I.R.S. initiatives to encourage compliance, and the draconian penalties for noncompliance); *see also* Laura Saunders, *The Tax Man Cometh and, Holy Cow, He Means Business*, WALL ST. J., June 3, 2017, at B3 (reporting on the government's aggressive enforcement efforts with respect to funds held in offshore accounts).

272. *See* I.R.S. News Release 2012-4, *supra* note 268.

273. *Id.*

274. I.R.S., *Tax Gap Estimates for Tax Years 2008–2010* (Apr. 2016), https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf.

275. Tax returns and tax return information were made confidential in the aftermath of the Watergate scandal and the Nixon administration's enlistment of the I.R.S. to further its political goals. *See* I.R.C. § 6103(a) (West Supp. 2017). Statutory exceptions to the confidentiality requirement are scarce and include limited disclosures for state tax and state and local law enforcement, disclosures to Committees of Congress, disclosures for statistical use, disclosures pursuant to presidential requests, and confirmation of Presidential appointees to executive and judicial branch positions. I.R.C. §§ 6103(d); 6103(f); 6103(j); 6103(g)(1)–(2) (West Supp. 2017). Willful unauthorized disclosures are punishable by fines, incarceration, and dismissal from office and civil actions may be brought against the United States for knowing or negligent unauthorized disclosures. I.R.C. §§ 7213(a) (West Supp. 2017); 7431(a)(1) (2012). In addition, anti-browsing provisions were enacted in response to evidence that I.R.S. employees were browsing taxpayer records for no legitimate purpose. I.R.C. §§ 7213A(a) (West Supp. 2017).

276. Peter Evans, *Starbucks to Move Europe Base to U.K.*, WALL ST. J., Apr. 17, 2014, at B6.

was aberrational. Apple, in contrast, perceived little reputational harm stemming from its aggressive tax strategies.[277]

The current legal state of affairs with respect to marijuana serves to diminish respect for federal law in general. The fact that many states have made policy choices inapposite to long-standing federal policy is neither unusual nor troublesome. What is problematic is the federal government's response to states' disparate policies. Throughout the nation's history, state responses to federal law with which they disagree often have been confrontational. State attempts to nullify federal law can be traced as far back as the late eighteenth century and over the course of our history have implicated, *inter alia*, the Alien and Sedition Acts of 1798, taxation of the bank of the United States, embargoes during the war of 1812, tariffs during the early part of the nineteenth century, and the Fugitive Slave Act.[278] In modern times, states have attempted to thwart school desegregation and federal gun control legislation.[279] However, in such cases the federal government vigorously defended its prerogatives, either in court or with threats of force.[280] It is arguable that state law legalization of marijuana is tantamount to nullification. Although state legalization does not purport to invalidate federal law, such laws do explicitly sanction actions that the federal government does not. In and of itself, this is not troubling and, in fact, is an example of federalism at work.[281]

The federal government's response, however, is troubling. Instead of defending federal law—or quietly acquiescing to state policy—the federal government has chosen to openly disregard its own law as evidenced by the Department of Justice memorandums to the U.S. Attorneys.[282] Moreover, Congress itself has passed legislation that bars

277. Apple had a highly publicized tussle with a congressional committee over its aggressive tax avoidance practices. Apple, unlike Starbucks, defended its practices vigorously. *See* Janet Cook & Danny Yadron, *Apple CEO, Lawmakers Square Off Over Taxes*, WALL ST. J., May 22, 2013, at A1.

278. *See* Michael T. Morley, *Reverse Nullification and Executive Discretion*, 17 U. PA. J. CONST. L. 1283, 1289–1304 (2015) (describing, in some detail, numerous instances of state nullification).

279. *Id.* at 1304–07, 1311.

280. *Id.* at 1289–1307, 1311 (describing various court cases, legislation to authorize force, and executive branch threats of force).

281. Jeffrey Rosen, the President of the National Constitution Center, wrote, in a recent essay, that the current dysfunction and polarization present in Washington has encouraged the citizenry to seek local responses to contentious issues. "'A rich diversity of preferred lifestyles can only be achieved at the local level.' Elevating such issues to the national level is a recipe for 'more contentiousness, bitterness, and gridlock.'" Jeffrey Rosen, *Divided We Rise*, WALL ST. J., May 20, 2017, at C1–C2 (quoting Georgetown law professor Randy Barnett).

282. *See supra* notes 76, 78, and 87 and accompanying text.

the Department of Justice from using funds to enforce the Controlled Substances Act against activities that are sanctioned under state law.[283] The notion that a federal law enforcement authority categorically announces it will not enforce a law under particular circumstances and Congress defunding any such efforts, is disquieting—particularly in this instance.

The exercise of prosecutorial discretion is commonplace and may be motivated by a number of factors such as resource constraints, laws whose effects in a particular case are unintended or the result of poor legislative language, or societal shifts that command public support for such discretion.[284] The latter reason provides all the more justification in the face of a dysfunctional legislature that is incapable of reacting in a timely fashion to societal changes.[285] It appears that federal enforcement policy with respect to marijuana is a reaction to significant changes in social norms with respect to marijuana usage, as reflected by the number of states that have legalized marijuana to some extent.[286] Non-enforcement of laws under such circumstances may be desirable if the societal benefits exceed the cost of lack of action. There is a cost of non-enforcement. Such actions cannot help but erode citizens' respect for federal law. In effect, the federal government itself is signaling that federal law is not necessarily binding.

However, the benefits derived by current federal policy towards marijuana are minimal because it is, at best, a half-measure. To be sure, state actors can take comfort in a reduced fear of criminal prosecution. This comfort, however, does not extend to the assurance that contracts will be enforceable, to the ability to bank like other businesses, to the imposition of the same tax burden as taxpayers in general, or to the availability of bankruptcy protection.[287] The collateral effects of the Controlled Substances Act diminish, if not overwhelm, the discretion exercised by the Department of Justice and the defunding of any efforts by the department not in keeping with such discretion.

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283. *See supra* notes 79–80 and accompanying text.

284. Morley, *supra* note 278, at 1331. Lack of enforcement of federal law by federal authorities often is countered by what Professor Morley terms "reverse nullification," the enforcement of materially comparable or identical state laws by state authorities. *Id.* at 1285. In fact, Professor Morley argues that federal preemption doctrine should be designed so as not to inhibit state efforts in this respect. *Id.* at 1331–34. Obviously, reverse nullification does not describe the current federal-state approach to marijuana enforcement.

285. *Id.* at 1331.

286. *See supra* notes 20–21 and accompanying text.

287. *See supra* notes 82–83 and accompanying text.

So what has federal policy accomplished? It has disregarded federal law, yet it has maintained a host of infirmities on state sanctioned marijuana businesses. Moreover, federal policy is inviting state judges, sometimes at the urging of state legislatures, to ignore federal law in their determination of public policy.[288] Federal officials should exercise great caution in this respect because if a state judge can ignore federal law due to the actions of federal officials in the marijuana context, they can do so in other contexts. Moreover, I would imagine that once state judges have crossed this Rubicon it becomes more likely that they do so again.

V. CONCLUSION

Current federal policy regarding marijuana ostensibly pays homage to state policy preferences. However, the continued status of marijuana as a Schedule I narcotic significantly impairs the ability of state policy preferences to come to full fruition. If, as I and many believe, state preferences with respect to marijuana should be respected, then the appropriate response is to amend federal law, not ignore it, and defund federal law enforcement efforts. The refusal to take legislative action and, instead, to resort to politically more expedient means that openly diminish the force of federal law can have dangerous, and broader, implications. The tax system evidences the difficulties caused by the failure to entrench a norm of compliance not driven by deterrence, and policy makers should be careful in believing that the tax system is somehow *sui generis*. The controversy over the enforcement of federal immigration laws and the open defiance of such laws by some state and local authorities should give Congress and the Executive branch pause before taking any actions that encourage the belief that the law, in the right circumstances, is appropriately ignored.[289] Sometimes Congress gets lucky and avoids having to make politically-charged choices. The Supreme Court bailed out Congress on the matter of same-sex marriage.[290] It is unlikely that the Court will do the same here.

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288. COLO. REV. STAT. ANN. § 13-R2-601 (West. 2016). One court did ignore federal law in upholding an insurance contract. Green Earth Wellness Ctr., LLC v. Attain Specialty Ins. Co., 163 F. Supp. 3d 821, 837 (D. Colo. 2016).

289. Spencer E. Amdur, *The Right of Refusal: Immigration Enforcement and the New Cooperative Federalism*, 35 YALE L. & POL'Y REV. 87, 103–11 (2016) (chronicling the current impasse and the emergence of sanctuary spaces).

290. *See* Obergefell v. Hodges, 135 S. Ct. 2584 (2015).