December 4, 2018

New Jersey Poised to Legalize Recreational Cannabis Use, but Federal Criminal Prohibition Remains in Place

On November 26, the New Jersey Cannabis Regulatory and Expungement Aid Modernization Act (the Act) was released from committee in both the State Assembly (as A-4497) and the Senate (as S-2703). The Legislature could approve the Act by as early as December 17 and send it to the governor on that day. As discussed below, the Act creates a new set of regulated activities around "legalized" cannabis, but cannabis remains a controlled substance under federal law, with significant potential criminal sanctions for illegal production, sale, possession, and use of this product.

How the Act Operates

The Act would permit a variety of so-called "Cannabis Establishments," including a cannabis grower (cultivation facility), a manufacturing or processing facility, a wholesaler, or a retailer. Retailers, in addition to selling cannabis, could operate "Cannabis Consumption Areas." Cannabis Consumption Areas would be retail establishments operated by a licensee where customers can consume cannabis purchased on-site or brought into the facility. Each type of Cannabis Establishment would be licensed differently. A newly established state Cannabis Regulatory Commission will be responsible for licensing and regulation of Cannabis Establishments. Significantly, 10 percent of each license type and 25 percent of the overall number of licenses must be issued to "microbusinesses." For these purposes, a microbusiness would be one that employs no more than 10 employees, occupies no more than 2,500 square feet, possesses no more than 1,000 plants per month, and processes or acquires no more than 1,000 pounds of dried product each month.

The Act would legalize under state law the possession and use of one ounce or less of cannabis by persons 21 years of age or older. Possession of cannabis by persons under 21 would remain illegal under New Jersey law. Municipalities would be permitted to restrict the use of cannabis in public in the same manner as the use of alcohol or tobacco is currently regulated. As discussed below, the Act, if passed, will not legalize cannabis possession, sale or distribution under federal law, and the activities permitted and regulated under the Act constitute federal crimes, most of which are serious felonies.

The Act would permit municipalities to enact ordinances to govern the hours of operation, location, manner and number of Establishments and would provide for civil penalties for municipal ordinance violations. Moreover, the Act would permit municipalities to prohibit any one or more of the classes of Establishments. However, if a municipality wishes to prohibit cannabis production or use completely, it would have to officially opt out of the Act within 180 days of the adoption of regulations promulgated under the act by the Commission. If a municipality missed the 180-day deadline, growing, cultivating, processing and selling of cannabis would be permitted in all industrial zones, and retail sales would be a conditional use in all commercial or retail zones, subject to any zoning conditions or variances. More than 50 municipalities have already opted out, but as the Act is written, those municipalities would need to opt out all over again after the Act becomes law.

The Act also would impose several other noteworthy restrictions aimed at maximizing the state's capture of revenue from cannabis-related industry. Property on which cannabis is grown will not qualify for farmland assessment, and home-grown cannabis would be prohibited. Licensees would not be eligible to receive state or local economic incentives, and retail cannabis outlets could not be within urban enterprise zones. Municipalities would be permitted to assess and collect a 2 percent excise tax on sales of cannabis products by any licensed cannabis establishment. Under the Act, cannabis arguably could be taxed by municipalities at each of the production, wholesale and retail levels. The Cannabis Establishment would

collect the sales tax and remit it directly to the municipality. In addition, the state would collect a 12 percent tax, which includes the current sales tax. At a combined state and local 14 percent tax rate at each of the three points of taxable events (production, wholesale and retail), cannabis products would bear a significant tax burden.

Cannabis Remains a Controlled Substance Under Federal Law

The cultivation, production, sale and possession of cannabis in New Jersey remain federal criminal offenses. Therefore, engaging in these activities, although they would be legal under New Jersey state law, could expose the actor to prosecution by federal authorities. In addition to criminal penalties, under federal law there can be a civil forfeiture of property in connection with cannabis-related crimes.

In addition to potential federal criminal liability and punishment, the current federal prohibition on cannabis cultivation, production, sale and possession poses challenges to the operations permitted pursuant to the Act. The remittance of taxes may pose a dilemma because most cannabis establishments would be all-cash businesses. Many financial institutions may be loath to conduct business with cannabis-related enterprises for fear they might be viewed as aiding and abetting criminal activity or engaging in money-laundering. Thus, Establishments would likely make the tax remittances in cash or cash equivalents. For the same reasons, Cannabis Establishments might find it difficult to obtain financing and insurance.

Conclusion

Those interested in forming Cannabis Establishments under the Act should consult with counsel, even if the Act legalizes these businesses under New Jersey law.

Authors



Christopher John Stracco
Of Counsel

Parsippany, NJ | (973) 966-8220

cstracco@daypitney.com



Katharine A. Coffey
Partner

Parsippany, NJ | (973) 966-8323

kcoffey@daypitney.com



Rachel A. Gonzalez
Partner

Parsippany, NJ | (973) 966-8201

New York, NY | (212) 297-5800

rgonzalez@daypitney.com