PLANNING FOR UNIQUE AND PROBLEMATIC ASSETS:

ART, GUNS, PLANES AND CANNABIS

Wendy S. Goffe
Stoel Rives LLP
600 University Street, Suite 3600
Seattle, Washington 98101
(206) 386-7565 (direct)
wendy.goffe@stoel.com
www.stoel.com

Wendy S. Goffe is a partner with the law firm of Stoel Rives LLP, Seattle, Washington, with over 30 years of experience counseling clients on estate planning issues. She has been named one of "The Best Lawyers in America" for trusts and estates (2007–2023), Super Lawyers for estate planning and probate, nonprofit organizations (2003–2023), top 50 women lawyers (2006–2019, 2021-2023), and top 100 lawyers (2008–2014, 2018, 2021-2023). She has been listed in Chambers High Net Worth Guide (Private Wealth Law – Washington) (2016–2023), and is a Fellow of the American College of Trust and Estate Counsel (ACTEC), chair of the ACTEC Family Law Task Force, a member of the ACTEC Digital Property Committee, a member of the Fiduciary Litigation Task Force and ACTEC Liaison to the American Academy of Matrimonial Lawyers. She is a member of The International Academy of Estate and Trust Law. She is also an Accredited Estate Planner® (Distinguished) as awarded by the National Association of Estate Planners.

Wendy has many years of experience representing and collaborating with art dealers, private collectors, foundations and museums that need legal counsel relating to the purchase, sale, gifting and recovery of fine art and other creative works.

Wendy is the co-editor of *The Tools & Techniques of Estate Planning for Modern Families, Leimberg Library*, The National Underwriter Company (2019), and the author of the following chapters: "Planning for Unmarried Couples and Cohabitation Agreements," "Planning for Same-Sex Couples," and "Advising and Planning for Transgender Family Members."

She is a Professional Advisor on Estate Planning Law to the American Law Institute Continuing Legal Education (ALI CLE), The Fred Hutchinson Cancer Center Planned Giving Advisory Council, The Seattle Foundation Professional Advisory Council, and the Children's Legacy Council of the Children's Hospital Foundation. She is a former Adjunct Instructor at Seattle University Law School. ln her free time Wendy is a volunteer for Girls on the Run and an avid trail runner.

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Table of Contents

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I. INTRODUCTION

In the course of practice an estate planner may encounter a few unusual and highly regulated assets from time to time, often after the client has died. While the list of unusual assets can be long, this outline examines issues in connection with planning for art, guns, aircraft and cannabis. The rules with respect to handling these assets can vary widely from state to state. this outline is intended to provide a broad overview.

A. Artwork - Issues with Ownership.

Having clear title to artwork is more than just the right to enjoy looking at it. Title includes the unrestricted right to hold, use, sell, donate, exhibit, pledge as financial collateral, or otherwise enter into transactions with the work. Collectors typically assume that they have good title to assets they own and that they aren't subject to conflicting ownership claims. This is not always the case. But there are ways to protect clients and hedge against losses when ownership may be in doubt.

1. Stolen Property.

In the world of art and collectibles, unbeknownst to the purported owner, because of theft, looting, and war crimes, others may have superior claims, even in the most carefully acquired and curated collections. Often these claims only come to light when a family attempts to sell an important work of art at auction, to generate needed liquidity to pay estate tax. This not only creates an added expense and complexity to an estate, but it may subject the personal representative who signed an auction agreement (which typically requires the signer to guarantee good title and to indemnify the auction house for liabilities due to lack of marketable title) to personal liability.

It is important that clients confirm that what they are purchasing or have purchased is neither stolen nor forged. For a fee, a client may obtain information on the title of a work. One such company, Art Title Advisors (www.arttitleadvisors.com), will prepare an Ownership Rights Protection Report that describes the results of their investigations into title using public and private databases.

There are a number of resources for performing due diligence. The International Foundation for Art Research, https://www.ifar.org/authentication.php, and The Art Loss Register, www.artloss.com (a London-based organization), allow a potential purchaser to check that an item has not been registered as stolen, and to record items that have been stolen, to put others on notice.

The FBI also has an online database, the National Stolen Art File, that allows a potential purchaser to check whether an item has been stolen.[1]

In 1993, the Getty Information Institute initiated a collaboration project to develop an international documentation standard for the information needed to identify cultural objects. Object ID was developed in collaboration with the museum community, police and customs agencies, the art

[1] https://www.fbi.gov/investigate/violent-crime/art-theft/national-stolen-art-file.

trade, insurance industry, and appraisers of art and antiques. It sets a standardized procedure to document and describe collections of archaeological, cultural, and artistic objects. By facilitating the identification of these objects, a standardized description can assist their recovery in case of loss or theft.

The Object ID standard defines nine categories of information:

Type of object.

Materials and techniques.

Measurements.

Inscriptions and markings.

Distinguishing features.

Title.

Subject.

Date or period.

Maker.

The nine categories can be completed using the following four steps:

Take photographs of the object.

Identify the information in the nine categories.

Write a short description, including additional information.

Keep the documentation in a secure place.

Art may also be subject to claims of cultural patrimony because it was plundered from an archaeological site or illegally confiscated by a government such as works seized by the Nazis. A number of statutes allow for seizure, recovery, and repatriation. Museum policies regarding the obligation to return works include provisions of the United Nations Educational, Scientific and Cultural Organization ("UNESCO") Convention (discussed below); the Native American Graves Protection and Repatriation Act; and the Endangered Species Act (discussed below). They also include the ICOM Code of Ethics for Museums; and the following publications by the Association of Art Museum Directors ("AAMD"): the AAMD Art Museums and the Restitution of Works Stolen by the Nazis; the AAMD Guidelines on the Acquisition of Archeological Materials and Ancient Art; and the AAMD Report on the Acquisition and Stewardship of Sacred Objects.

2. The HEAR Act.

On December 16, 2016, President Obama signed into law the Holocaust Expropriated Art Recovery Act of 2016 (the "HEAR Act"), which establishes a uniform federal statute of limitations for claims seeking the recovery of artwork and certain other objects that were confiscated between

January 1, 1933 and December 31, 1945 because of Nazi persecution.[2] The intent of the Act is to ensure that claims to artwork and other property stolen or misappropriated by the Nazis are not unfairly barred by statutes of limitations. In *Philipp v. Federal Republic of Germany*, 894 F.3d 406 (D.C. Cir. 2018), vacated and remanded by *Federal Republic of Germany v. Philipp*, 141 S. Ct. 703 (2021), the lower court held that under some circumstances, sales under duress are void and violate international law consistent with the policies of the HEAR Act.[3]

As a result of the HEAR Act, claims must be brought within six years of the claimant's discovery of "(1) the identity and location of the artwork or other property; and (2) a possessory interest of the claimant in the artwork or other property," giving rise to the claim.[4] It is important to note that the statute does not preclude a laches defense.[5]

The HEAR Act applies to all claims filed through 2026, and those pending at the time of enactment. In addition to artwork, the HEAR Act applies to books, archives, musical objects, manuscripts, sound, photographic, and cinematographic archives and media, and sacred and ceremonial objects and Judaica.[6] Claims filed after January 1, 2027 will be subject to the statutes of limitations then under effect and will not be afforded the enhanced statute of limitations of the HEAR Act.

3. The UNESCO Convention.

The 1970 UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property (ratified by the U.S. by the 1983 Convention on Cultural Property Implementation Act) gave the signatories a mechanism to seek the return of illegally obtained cultural objects and antiquities, and a means for the signatories to cooperate to this end.

4. The National Stolen Property Act.

The National Stolen Property Act of 1934 is also used to combat and repatriate illegal cultural heritage looting. It applies within the U.S. to the trafficking of "goods, wares, merchandise, securities, or money" valued at $5,000 or more, which have been "stolen, converted or taken by

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[2] Holocaust Expropriated Art Recovery Act of 2016, Pub. L. No. 114-308, 130 Stat. 1524. *See Amelia K. Brankov & Lily Landsman-Roos, Congress Passes Important Law Governing Nazi-Looted Art Claims,* 156 Tr. & Est. 62 (Mar. 2017), for a thorough examination of this Act.

[3] Cited by *Reif v. Nagy*, M-5280, 2019 NY Slip Op. 60524 (N.Y. App. Div. Jan. 10, 2019), in which the heirs of Viennese actor and Holocaust victim Franz Friedrich (Fritz) Grünbaum are entitled to the return of two Egon Schiele drawings, *Woman Hiding Her Face* (1912) and *Woman in a Black Pinafore* (1911). See also Simrit Hans, *The Unresolved Injustices of Nazi-Looted Art: A look at the 2016 HEAR Act*, Washington J. of Law, Technology & Arts, University of Washington School of Law (Feb. 12, 2020), https://wjlta.com/2020/02/12/the-unresolved-injustices-of-nazi-looted-art-a-look-at-the-2016-hear-act/.

[4] HEAR Act §5(a).

[5] In *Zuckerman v. Metropolitan Museum of Art*, 928 F.3d 186 (2d Cir. 2019), the Second Circuit held that the defendant museum was entitled to a laches defense in response to a HEAR Act claim. *Id.* at 190.

[6] HEAR Act §4(2).

fraud" then transported, transmitted, or transferred in interstate or foreign commerce. The term "goods, wares, merchandise" is not defined but has been interpreted to include the "general and comprehensive designation of such personal property or chattels as are ordinarily a subject of commerce."

5. Domestic Recovery Laws and Other Methods of Recovery.

There are a number of other ways that art and certain objects can be recovered, including replevin, forfeiture criminal prosecution, and domestic recovery laws.

Federally owned and controlled lands as well as tribal lands are subject to the Archeological Resources Protection Act ("ARPA") and the Native American Graves Protection and Repatriation Act ("NAGPRA"). These are only two of the laws that prosecute archeological crimes, including vandalism, looting and theft of cultural property, human remains, antiquities, art, artifacts, and architecture.

The U.S. has also entered into a number of agreements with other countries recognizing a country's right to control exports. There are also a number of other doctrines that apply to looted and stolen art, antiquities, and cultural property. UNESCO maintains a database of cultural heritage laws, available at https://en.unesco.org/cultnatlaws, that can be useful as a starting place to determine whether another country may have a right to claim ownership.

The U.S. also regulates the importation of antiques and endangered species under the Endangered Species Act (the "ESA"). Generally, the ESA allows "the importation and other activities without an ESA permit of an antique article (referred to as an 'ESA antique') that: A. Is not less than 100 years of age; B. Is composed in whole or in part of any endangered species or threatened species listed under section 1533 of the Act; C. Has not been repaired or modified with any part of any such species on or after December 28, 1973; and D. Is entered at a port designated for the import of ESA antiques." All importation must also meet the standards under the African Elephant Conservation Act, the Marine Mammal Protection Act, and the Wild Bird Conservation Act. An appraisal submitted as documentary evidence of an article's eligibility under the ESA antique exception must meet certain criteria, similar to those that apply to qualified art appraisers, which are available at https://www.fws.gov/policy/do210A1.pdf.

B. Title Insurance.

One way to hedge against the possibility of purchasing property subject to later title disputes is title insurance.[7] Provenance documents the history of a work's ownership, but it doesn't establish clear title. A work may have well-documented provenance, but anywhere along the chain of ownership someone may not have had clear title, putting subsequent individuals in the chain of ownership at risk of not having clear title.

[7] See Charles Danziger & Thomas Danziger, *An Ounce of Prevention*, 35 Art + Auction 73 (Dec. 2011), http://www.danziger.com/brothersinlaw/2011-12.pdf, for a discussion concerning art title insurance.

In most sales of art, whether handled privately or through an auction house or a gallery, the seller must represent and warrant in the sales or consignment document that the seller (whether an individual or fiduciary) has clear legal title to the offered work. Similarly, the donor or lender to a charitable institution must provide such warranties. After the transaction, if an actual or alleged title defect or challenge arises, the trust, estate, and beneficiaries can be liable for indemnity to the buyer or recipient under the contractual guarantee of clear legal title to the art. Failure to possess good title could result in a sale or donation being unwound and sale proceeds disgorged. For example, Sotheby's provides a guaranty of good title to a purchaser for five years from the date an item is purchased at auction. A title policy can mitigate some of these inherent risks.

For example, ARIS Title Insurance Corporation (owned by Argo Group)[8] offers two types of policies: (i) an owner's policy for pending sales or existing collections, and (ii) a lender's policy for lenders facilitating clients borrowing against their art. Title insurance for art and collectibles typically covers four categories of risks: theft, import and export defects, liens and encumbrances, and illegal or unauthorized sales. A typical policy covers the legal costs of defending a title or dispute and compensates holders if they lose an ownership dispute.[9] ARIS charges a one-time premium based on the work covered, its provenance risk profile, and value.

Until recently unheard of, as collectors more frequently use their art as collateral, the use of title insurance is gaining popularity and becoming more common.

II. GUNS AND GUN TRUSTS

When an estate includes firearms, a fiduciary must be careful to avoid violating federal, state, and local firearms laws. The regulation of firearms is based on the legal status of the owner, the person in possession (actually or constructively), the type of firearm, and the state of residence of those involved.[10]

A. Regulatory Scheme.

First, an understanding of the basic regulatory scheme under federal and state law governing firearms is helpful. Federal firearms laws, codified under the Gun Control Act of 1968 (GCA), categorize weapons as either Title I firearms or Title II firearms.

Title I of the GCA, 18 U.S.C. ch. 44, regulates the interstate disposition of rifles, shotguns, and handguns, which make up the vast majority of guns privately owned in the United States.[11] State

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[8] ARIS, Art Title Protection Insurance, https://www.argolimited.com/aris/product/art-title-protection-insurance/.

[9] See https://www.argolimited.com/aris/product/art-title-protection-insurance/ for a list of types of losses covered.

[10] For a summary of state and federal rules published by the ATF, *see State Laws And Published Ordinances - Firearms* (34th Ed.) available at https://www.atf.gov/firearms/state-laws-and-published-ordinances-firearms-34th-edition (last reviewed November 30, 2023).

[11] *See* Gun Control Act of 1968, Pub. L. No. 90-618, 82 Stat. 1213, codified at 18 U.S.C. §§921–931.

law generally regulates the intrastate transfer of Title I firearms.[12]

The National Firearms Act of 1934 (NFA), 26 U.S.C. ch. 53, regulates Title II firearms (also referred to as "NFA weapons"), which include automatic firearms (machine guns), silencers, short or short-barreled (that is, sawed-off) shotguns, short or short-barreled rifles, destructive devices (such as missile bearing rockets, grenades, and bombs), and "any other weapon."[13]

The NFA Branch of the Bureau of Alcohol, Tobacco, Firearms, and Explosives (referred to as the "BATFE" or "ATF") administers the National Firearms Registration and Transfer Record (NFA Registry).[14] The transfer or possession of an unregistered Title II weapon is a criminal act covered by Code §5861(e).

The NFA prohibits possession, transfer and access to certain weapons, and bars certain persons from owning or having access to firearms. Under the NFA, Title II weapons are subject to strict registration, transfer, and tax requirements.[15] It is illegal for any person to possess an NFA weapon that is not registered to that person in the NFA Registry. Possession may be actual or constructive.[16] The U.S. Supreme Court has held, "Constructive possession is established when a person, though lacking such physical custody, still has the power and intent to exercise control over the object."[17] Failure to comply with these laws may result in criminal liability, fines and forfeiture of any weapons involved.[18]

B. Transfer of an NFA Firearm.

Transferring an NFA weapon without complying with several NFA transfer rules or possessing such a weapon is also illegal.[19] Transfer of an NFA firearm includes "selling, assigning, pledging, leasing, loaning, giving away, or otherwise disposing of" an NFA firearm.[20] When an individual transfers or purchases an NFA weapon, the Chief Law Enforcement Officer (CLEO) of the city or

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[12] See Wikipedia, Gun Laws in the United States by State, https://en.wikipedia.org/wiki/Gun_laws_in_the_United_States_by_state (revised April 10, 2019) and Giffords Law Center to Prevent Gun Violence, https://lawcenter.giffords.org/search-gun-law-by-state/, for a state by state summary of gun regulations.

[13] *See* I.R.C. §5845(a)–(h); 27 C.F.R. §479.11. The definition of "any other weapon" includes smooth-bore rifles, muzzle-loading cannons, and other somewhat exotic firearms.

[14] 27 C.F.R. §479.101.

[15] *See* I.R.C. §5861(d) (requiring the registration of certain particularly dangerous weapons under the NFA); *see also id.* §5845(a) (listing those weapons that require registration under 18 U.S.C. §5861(d)).

[16] *See* I.R.C. §5861(d). Other federal law prohibits possession of any machine gun not registered with BATFE by May 19, 1986. *See* 18 U.S.C. §922(o).

[17] *Henderson v. United States*, 135 S. Ct. 1780, 1784 (2015). Under the NFA, constructive possession will be treated the same as actual possession. *See United States v. Turnbough*, 114 F.3d 1192 (table), 1997 WL 264475 (7th Cir. 1997) (unpublished opinion).

[18] *See* I.R.C. §5872; 27 C.F.R. §479.182.

[19] *See* I.R.C. §5861(b), (e).

[20] *Id.* §5845(j).

county where the individual resides must sign a document called a Form 4, Application for Tax Paid Transfer and Registration of Firearm.[21] Title II has a broad definition of *transfer*.

Any transfer is also subject to a transfer tax, and the transferor must submit and attach to the form a photo of the transferee, as well as the transferee's fingerprints in duplicate.[22] A Form 4 is also required for the transfer to a trust.[23] The transfer by a fiduciary requires the filing of Form 5, Application for Tax Exempt Transfer and Registration of a Firearm.

Finally, under federal law certain persons cannot possess or receive any firearms (whether Title I or Title II).[24] These excluded individuals include convicted felons, persons either adjudicated as a "mental defective" or committed to a mental institution, and persons convicted of misdemeanor domestic violence offenses.[25] However, the list also includes categories that may not be so self-evident, including users of any illegal drug, dishonorably discharged veterans, and persons who have renounced their U.S. citizenship.[26]

What happens when a person previously permitted to own a firearm is no longer qualified to do so? In a May 2015 decision, the Supreme Court unanimously held that while a convicted felon is prohibited from possessing a firearm, nothing strips the individual of his property interest in the firearm, and thus he retains the right to sell or otherwise dispose of it.[27] In addition, the Court held that 18 U.S.C. §922(g) does not bar such a transfer if the court is satisfied that the recipient will not give the felon control over the firearm, so that he could either use it or direct its use.[28] In other words, the felon will not need to turn over his firearm to law enforcement; instead he may dispose of it by giving it to a friend or family member (a provision that could be inserted into a trust, discussed below).

C. Fiduciaries and Firearms.

1. Federal Law.

Fiduciaries need to determine the registration status of firearms coming into their possession. Retroactive registration may not be an option, putting the fiduciary in the position of having to turn over an unregistered weapon to law enforcement. Transfers of firearms to satisfy bequests

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[21] *Id.* §5812; 27 C.F.R. §§479.84–.85. Available at https://www.atf.gov/firearms/docs/form/form-4-application-tax-paid-transfer-and-registration-firearm-atf-form-53204.

[22] *See* 27 C.F.R. §479.85.

[23] Until June 13, 2016, Form 4 did not require a photo or fingerprints, discussed below.

[24] *See* 18 U.S.C. §922(d), (g).

[25] *Id.* §922(g).

[26] *Id.* §922(g)(3), (6)–(7); *see also* Nathan G. Rawling, *A Testamentary Gift of Felony: Avoiding Criminal Penalties from Estate Firearms*, 23 Quinnipiac Prob. L.J. 286 (2010) (discussing who may possess firearms, the various restrictions on transfer, and penalties for impermissible transfers).

[27] *Henderson v. United States*, 135 S. Ct. 1780, 1786-87 (2015).

[28] *Id.*

could subject a fiduciary, an heir, or both, to criminal penalties.[29] The situation is more complicated for both the fiduciary and an heir if the fiduciary unlawfully transfers an NFA weapon to an out-of-state heir.[30] Federal law makes it unlawful for certain categories of persons to ship, transport, receive, or possess Title II firearms. These categories include convicted felons, wanted fugitives, users of illegal controlled substances, individuals adjudicated as mentally defective or those committed to any mental institution, undocumented immigrants, those who have renounced U.S. citizenship, and individuals dishonorably discharged from the military.[31]

2. Washington Law.

Effective July 1, 2019, when a person is attempting to purchase a semiautomatic assault rifle the chief of police or sheriff where the purchaser lives is required by RCW 9.41.090 to perform an enhanced background check. The purpose of the enhanced background check is to determine whether the person is legally eligible to possess a firearm. Only certain transactions are exempt from the enhanced background check: bona fide gift transfers between immediate family members, sales or transfers of an antique firearm, transfers or sales to a law enforcement agency, or temporary transfers in life-or-death situations are a few of the exemptions from these requirements.[32]

Accordingly, Washington law exempts the transferee (presumably a personal representative or trustee) of "a firearm other than a pistol" from its provisions where the firearm was acquired by operation of law upon the death of the former owner.[33] The transferee who acquires a pistol upon the death of the former owner, however, must either lawfully transfer it (i.e., through a Federal Firearm Licensee (FFL)), or notify the Department of Licensing that "he or she is in possession of the pistol and intends to retain possession of the pistol, in compliance with all federal and state laws."[34] So, in theory, a fiduciary can transfer a long gun without having to notify the Department of Licensing, but not a pistol (unless the transferee takes it to an FFL to effect a transfer). Answers to FAQs prepared by the Office of the Attorney General for the State of Washington can be found at https://www.atg.wa.gov/firearms-faq. A directory of FFL's can be found at: http://fflgundealers.net/.

Effective June 13, 2016, the Department of Justice added a new section to 27 C.F.R. Part 479 to address the possession and transfer of NFA items registered to a decedent. The new section clarifies that the executor, administrator, personal representative, or other person authorized under state law to dispose of property in an estate may possess a firearm registered to a decedent during the term of probate without such possession being treated as a "transfer" under the NFA. It also

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[29] *See* 18 U.S.C. §922(d).

[30] *See* I.R.C. §5861(b), (e).

[31] 18 U.S.C. §922(d), (g).

[32] *See* Initiative 1639 updating scattered sections of RCW ch. 9.41, available at https://www.sos.wa.gov/_assets/elections/initiatives/finaltext_1531.pdf. *See also* RCW 9.41.113(4)(h).

[33] RCW 9.41.113(4)(h).

[34] See https://www.dol.wa.gov/business/firearms/fawhatsnew.html for requirements for transferring semi-automatic assault rifles and https://www.dol.wa.gov/forms/652001.pdf for the form to do so, effective July 1, 2019.

specifies that the transfer of the firearm to any beneficiary of the estate may be made on a tax-exempt basis. Because of the importance of this section, it is reproduced below:

> (a) The executor, administrator, personal representative, or other person authorized under State law to dispose of property in an estate (collectively "executor") may possess a firearm registered to a decedent during the term of probate without such possession being treated as a "transfer" as defined in §479.11. No later than the close of probate, the executor must submit an application to transfer the firearm to beneficiaries or other transferees in accordance with this section. If the transfer is to a beneficiary, the executor shall file an ATF Form 5 (5320.5), Application for Tax Exempt Transfer and Registration of Firearm, to register a firearm to any beneficiary of an estate in accordance with §479.90. The executor will identify the estate as the transferor, and will sign the form on behalf of the decedent, showing the executor's title (e.g., executor, administrator, personal representative, etc.) and the date of filing. The executor must also provide the documentation prescribed in paragraph (c) of this section.
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> (b) If there are no beneficiaries of the estate or the beneficiaries do not wish to possess the registered firearm, the executor will dispose of the property outside the estate (i.e., to a non-beneficiary). The executor shall file an ATF Form 4 (5320.4), Application for Tax Paid Transfer and Registration of Firearm, in accordance with §479.84. The executor, administrator, personal representative, or other authorized person must also provide documentation prescribed in paragraph (c) of this section.
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> (c) The executor, administrator, personal representative, or other person authorized under State law to dispose of property in an estate shall submit with the transfer application documentation of the person's appointment as executor, administrator, personal representative, or as an authorized person, a copy of the decedent's death certificate, a copy of the will (if any), any other evidence of the person's authority to dispose of property, and any other document relating to, or affecting the disposition of firearms from the estate.[35]

While federal law provides a safe harbor to the fiduciary, state and local laws may complicate the fiduciary's job. Several states have assault weapons bans that make it illegal to own some Title I weapons (mostly certain semi-automatic rifles, pistols, and shotguns) that would be legal to

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[35] 27 C.F.R. §479.90a.

possess under federal law.[36] States or localities might further regulate or prohibit ownership of NFA weapons. State law must be reviewed for proper compliance, before transferring any weapon to another person.

RCW 9.41.113, also known as the Firearms Transfer Act, provides that when either the seller/transferor or buyer/transferee is in Washington at the time of the transfer, all firearms sales or transfers must be conducted by a federally licensed firearms dealer. Unless specifically exempted by state or federal law, prior to the sale the firearms dealer will facilitate a National Instant Criminal Background Check System (NICS) background check for the transferor and transferee.[37]

3. Oregon Law.

Transfers within Oregon by unlicensed persons are governed by ORS 166.435.[38] Oregon uses a bill of sale for private firearm transaction, which must be conducted through a licensed dealer.,[39] and follow the transfer procedure under federal law, including a background check. Oregon has a number of exceptions to the definition of transfer, set forth in ORS 166.435(4), which includes a transfer in the context of an estate administration. It is important to note that this exception only applies to transfers by a personal representative or a trustee of a testamentary trust and does not apply to any transfer from a revocable trust. Such a transfer requires completion of a bill of sale and transfer through a licensed dealer. Failure to comply with these requirements is a Class A misdemeanor.[40]

4. Beneficiary Receipts.

Because of the potential liability a fiduciary faces when transferring a firearm to a beneficiary, a fiduciary may want to consider adding special provisions to a receipt when releasing a firearm to a beneficiary, such as the following:

> I certify that I possess a valid, current [State] Weapons Carry License; I am legally entitled to receive, own, possess and use the Gun[s], under all applicable federal, state and local laws and regulations; I have no knowledge of, and I have never been informed of, any restrictions or prohibition on my right to receive, own, possess or use the Gun[s] or other such firearms; and I will fully comply with all federal, state and local laws and regulations

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[36] Assault weapons legislation in the United States, https://en.wikipedia.org/wiki/Assault_weapons_legislation_in_the_United_States.

See https://www.fbi.gov/services/cjis/nics/resources-for-federal-firearms-licensees for more information on this database.

[38] For an in-depth examination of Oregon gun laws and in various municipalities, see http://tinyurl.com/yc4nymx4 (rev. Nov. 8, 2022).

[39] ORS 166.427 Register of transfers of used firearms.

[40] ORS 166.435(5)(a). If the transferor has certain previous convictions, failure to comply may be a Class B felony.

regarding my ownership, possession and use of the Gun[s].

D. Appraisals.

Appraisals, an integral part of any estate administration, can be problematic. Fiduciaries should only use appraisers who are licensed to take possession of the weapons to be appraised. Appraisers are usually licensed gun dealers/FFLs. Before returning a weapon, an appraiser may ask the fiduciary to confirm that he or she is lawfully able to possess a firearm. If the fiduciary is not, then the appraiser may not return the weapon.

E. Gun Trusts.

Individuals may transfer NFA weapons to, and fiduciaries may purchase NFA weapons in, an entity, such as a corporation, limited liability company (LLC), or revocable trust, to avoid some of the rules that otherwise regulate such transfers. Individuals often opt for trusts because they avoid annual filing fees, public disclosure, or a separate tax return.[41] A trust designed specifically for the ownership, transfer, and possession of an NFA weapon may be known as a gun trust, NFA Trust, Firearm Trust, or Title II Trust. While a gun trust could be used to hold both Title II and Title I firearms, doing so could unwittingly subject Title I firearms to rules that would otherwise only apply to Title II firearms. (Ownership and transfer of Title I firearms can generally be handled through a standard revocable trust.)

According to IRS Info. Ltr. 2015-0039 (Dec. 24, 2015), a gun trust is still considered a "trust" for tax purposes under Treas. Reg. §301.7701-4 even when there are no ascertainable beneficiaries.[42] The trust at issue allowed the grantor to add or remove trust property, and the power to appoint and remove trustees. The agreement did not identify any ascertainable beneficiaries. And it provided that the duty of the trustees was to maintain the trust property, the firearms, in serviceable, useful and economic condition. Because of the broad powers of the grantor, the Service concluded that the grantor qualified as a beneficiary. While the Service concluded, "[a]n actual trust with different provisions might lead to a different conclusion," this analysis provides an excellent starting point for drafting a gun trust agreement.

While NFA firearms can only be transported and used by their registered owner, a trust can name numerous trustees, each of whom may lawfully own the weapon without triggering transfer requirements. Once a weapon becomes a trust asset, any beneficiary may use it (including a trustee, but only if named as a beneficiary and not solely in a trustee capacity). Conversely, if an individual owner allowed another individual owner subject to trustee approval to use an NFA weapon not held in a trust, that use could be considered an unlawful transfer or constructive possession, subject to criminal penalties. The trust can name minors as beneficiaries, and hold

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[41] David Goldman, an attorney in Jacksonville, Florida, is credited with drafting the first gun trust, which he refers to as an NFA firearms trust, in 2007. *See* Margaret Littman, *Florida Lawyer Fashions Gun Trust (and Niche Practice)*, ABA J. (Feb. 2011), http://www.abajournal.com/magazine/article/in_goldman_guns_trust. See Brian M. Thompson, *Firearms in Estate Administration: Gun Trusts*, Or. Est. Plan. & Admin. Newsl., Mar. 2017, at 1, for an excellent discussion regarding gun trusts and gun trusts in the context of Oregon law.

[42] Available at https://www.irs.gov/pub/irs-wd/15-0039.pdf.

them subject to any state mandated use restrictions, until they are old enough to possess the weapon outright. Moreover, the grantor can be a life beneficiary—although not the sole beneficiary (or the doctrine of merger will cause the trust to be disregarded).

A grantor may fund the trust to provide education on gun safety, marksmanship and firearms laws.

The trust agreement can direct the disposition of NFA weapons in the event an owner becomes an excluded person by, for example, providing that upon a felony, the felon will lose all ability to have direct or indirect use of the weapons in the trust and that the weapons will pass outright or in trust to the contingent beneficiaries.

Gun trusts have been popular historically because of the ability to avoid federal laws requiring an NFA trust to submit fingerprints or seek CLEO approval required for individual firearm purchases or transfers. Instead, the federal government would verify and investigate the application.[43]

Effective June 13, 2016, the Department of Justice amended the regulations of the BATFE regarding the making or transferring of a firearm under the NFA.[44] This final rule, referred to as "41F," defines a new term, "responsible person." A "responsible person" is any individual who possesses the power to direct the management and policies of a gun trust and includes persons with such power and those who have the power to receive, possess, ship, transport, deliver, transfer or otherwise dispose of a firearm for or on behalf of the trust.[45] Responsible persons include settlors, trustees and trust protectors of gun trusts. The purpose of this rule change was to apply identification and background check regulations uniformly to individuals, trusts and other entities.[46]

41F also requires *each* responsible person, in connection with a trust or legal entity holding an ATF firearm, to complete ATF Form 5320.23, entitled "Responsible Person Questionnaire," and to submit photographs and fingerprints when the trust or legal entity files an application to make an NFA firearm a trust asset. It requires that a copy of all applications be forwarded to the CLEO of the locality in which the applicant/transferee or responsible person is located. But it eliminates the requirement for a certification signed by the CLEO. The purpose of the new form is to ensure that the purported responsible person is not in fact a "prohibited person" who may not possess an NFA firearm.

Any new responsible persons added to the trust now must submit Form 5320.23. If a trust was executed and funded prior to the new rules coming into effect, new beneficiaries may be added without having to comply with the responsible person questionnaire filing requirement.

A thorough discussion concerning the unique provisions of an NFA gun trust is beyond the scope of this article, but the provisions are numerous and complex. A standard revocable trust form is

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[43] *See* 18 U.S.C. §923; 28 C.F.R. §25.1.

[44] 27 C.F.R. pt. 479, *as amended by* 81 Fed. Reg. 2658 (Jan. 15, 2016).

[45] 27 C.F.R. §479.11.

[46] 81 Fed. Reg. at 2658.

wholly inadequate in this context. The trust agreement should specifically state that its purpose is to own, possess, manage, and dispose of NFA firearms. The settlor need not be a trustee; however, the settlor may not use a trust-owned firearm unless also named as a trustee. Where multiple persons will use trust property, each should be named as a trustee. To avoid confusion, the trust should define relevant terms such as NFA firearm, gun and pistol, using state and federal definitions.[47]

Gun trusts may be irrevocable, but generally they are revocable so that the settlor may retain the power, among other things, to add or remove trust property, as well as add and remove beneficiaries.

A trustee has an obligation to safeguard firearms owned by a gun trust. The trust agreement should include details that provide guidance to the trustee and beneficiaries to assist them in avoiding unintentional violations of the NFA rules. Specifically, the trust agreement should provide which trustees and beneficiaries can have access to firearms and ammunition, under what circumstances, and what happens if a trustee, successor trustee, trust protector, or beneficiary becomes a "disqualified person." Persons who are not allowed to buy or own firearms cannot serve as trustees. The trust agreement should also require trustee compliance with any applicable transfer rules.

One advantage of a gun trust is that if the current trustee becomes incapacitated as a result of dementia or other disabling illnesses, the gun trust can provide for a successor (permit holding) trustee to assume legal title to the guns (for the equitable benefit of the disabled owner). The firearms can then be safely stored and preserved. As owners of guns age, they many no longer recognize their family members or caregivers and consider them intruders. Gun trusts are one legal solution to this concern.

The risk created by new 41F is that a successor trustee appointment becomes effective, and the new trustee is not aware of the need to qualify as a responsible person, thus failing to comply with 41F. Similar situations could arise for beneficiaries or for people later appointed to a trust containing firearms subject to 41F. New trusts should also contain guidance and savings language with respect to "responsible persons," to avoid noncompliance with 41F.

The trust may not permit the transfer of a firearm to a person who may not lawfully buy or own firearms. The transfer of an NFA firearm into a trust or other entity will be subject to a transfer fee. Accordingly, a trustee often purchases NFA weapons directly to avoid the second transfer fee that would accrue if an individual purchaser purchased a weapon and then transferred it to the trust. While the transfer of an NFA weapon to an heir in satisfaction of a bequest is exempt from the transfer tax, such a transfer still requires the filing of Form 5. Any distribution of a Title II firearm should not be permitted until approval of Form 5 has been obtained.

The trustee's power to change the trust name should be limited. Because a firearm is registered in the trust's name in the NFA Registry, a change in trust name would require re-registration of the

[47] See RCW 9.41.010 for Washington State's relevant definitions.

firearms and payment of a transfer tax.

Because each state has different laws and local ordinances regulating firearms, unlike revocable trusts used for general estate planning purposes, trusts used to hold NFA firearms are not necessarily portable.[48] A gun owner desiring to cross state lines must still provide advance notice to the BATFE and receive approval. Transportation of most NFA firearms requires prior approval using Form 5320.20. Generally, the BATFE will approve a 365-day period for multi-state use.

When drafting a gun trust, using a prohibition against the sale of a gun should be carefully considered and not simply included in the boilerplate. Some states have abolished the rule against perpetuities, allowing for perpetual trusts, but only if the trustee has the power of sale. Those states may consider a trust void if it eliminates the power of alienation of trust property for longer than the perpetuities period. And even in some states without a rule against perpetuities, there may be a separate rule against the suspension of alienation.[49]

F. Capacity Issues.

As discussed above, gun trusts can be useful as a tool where dementia is a concern. As America ages we have a growing accumulation of firearms in the homes of aging adults with declining or impaired judgment. Forty-two percent of Americans age 65 or older live in a household with guns, and nine percent of Americans age 65 or older have been diagnosed with dementia.[50] A survey conducted in the State of Washington found that about 5 percent of respondents 65 and older reported both some cognitive decline and having firearms in their home.[51] The study suggests that about 54,000 of the state's more than 1 million residents 65 and older say they have worsening memory and confusion — and access to unlocked and loaded weapons.

As advisors we are in a position to recommend ways to keep our clients safe. Gun trusts can be drafted to allow the transfer of ownership for the equitable benefit of the owner when a beneficiary/owner becomes incapacitated.

Where a gun trust is not an option, or in addition to a gun trust, there are other ways of dealing with this growing problem. A few states allow the temporary transfer of firearms to a family member without a background check. Some law enforcement agencies will temporarily store guns in the event of a potential threat. Dealers are often willing to purchase or take weapons on consignment. In many states law enforcement can seek a court order to temporarily seize guns

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[48] *See* NFA Gun Trust Lawyer Blog, http://www.guntrustlawyer.com (compiling applicable state laws).

[49] *See, e.g.*, N.C. Gen. Stat. §41-23 (trust may be voided if it suspends the power of alienation of trust property for longer than the applicable rule against perpetuities period).

[50] Kenneth M. Langa, et al., *A Comparison of the Prevalence of Dementia in the United States in 2000 and 2012*, 177 JAMA Intern. Med. 51 (2017).

[51] JoNel Aleccia, *Washington State Date on Cognitive Impairment and Firearm Storage*, Kaiser Health News available at https://assets.documentcloud.org/documents/4554345/WASHINGTON-STATE-DATA-on-COGNITIVE-IMPAIRMENT.pdf.

from a person who exhibits dangerous behavior.[52] In a few of those states, including California, Washington and Oregon, family or household members can also initiate these gun-seizure requests, some of which may only be temporary, however, depending on state law.[53]

By federal law, a person loses the right to buy or own a gun if a judge deems them mentally incompetent to make decisions. But this requires a court appointed guardian to take control of the guns. This is both costly and time -consuming when neither money nor time are available.

Some clients are willing to sign a directive that would allow family members to deny access to firearms when the owner becomes incapacitated. The following is one suggested form of a directive:

> Firearm Agreement for Dementia Patients
>
> I, [patient name], understand that I have been diagnosed with dementia and that my ability to make safe decisions regarding firearms may be compromised. I hereby agree to allow my family members or caregivers to control the possession of my firearm(s) when I can no longer make the best safety decisions. I understand that this agreement is voluntary and that I may revoke it at any time.
>
> Signed: _____ Date: _____
>
> Witnessed by: _____ Date: _____

For clients willing to enter into a more comprehensive plan, the Firearm Life Plan,[54] developed at the University of Colorado and the Rocky Mountain Regional VA Medical Center in Denver is a tool to help gun owners and family members plan for safe use and transfer. It is essentially an advance directive for guns. An agreement should be signed before symptoms become too severe. It is also recommended that caregivers ensure that guns are securely locked so that the owner cannot have access without supervision. At a minimum, they should reduce risks of gun injury by making firearms less lethal — removing ammunition from the home, storing firearms unloaded or having trigger mechanisms removed.

Gun trusts are not a panacea. They do not avoid constructive possession, which can occur when a gun owner leaves a firearm where a prohibited person or any other individual not allowed to possess the firearm resides or has access to such weapon. Gun trusts do not bypass rules regarding waiting periods, nor do they avoid criminal liability if prohibited parties are allowed to use

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[52] Known as an Extreme Risk Protection Order in Washington. RCW §7.94.030(1), §7.94.020(2).

[53] Cal. Penal Code §18150; 2017 IL HB 2354, 430 Ill. Comp. Stat 67/35(a) ; Mass. Gen. Laws, ch. 140 §131T; Md. Code, Pub. Safety §5-603 ;N.J. Stat. Ann. §2C:58-23 (eff. Sept. 1, 2019); Or. Rev. Stat. §166.527(1); and RCW §7.94.030(1), §7.94.050(1).

[54] Available at https://firearmlifeplan.org/

firearms.

Even with a gun trust, the trustee is responsible for determining the capacity of the beneficiary and the federal, state, and local laws that apply to the individual before allowing a beneficiary to use a trust weapon or distributing an NFA weapon to a beneficiary. Unlike a traditional revocable trust, which can be revoked at any time by the grantor, BATFE must approve termination of the gun trust and distribution of its assets to its beneficiaries, as it would any other transfer. Nor may a trustee or beneficiary transport any of the assets across state lines where registered, without prior BATFE approval.

III. AIRCRAFT

Aircraft ownership and registration is a technical area not typically familiar to the average estate planning attorney. The following is by no means a thorough examination of the laws applicable to aircraft owners. Rather, it outlines considerations for the attorney advising aircraft owners with respect to estate planning, and fiduciaries who find themselves in possession of aircraft.

Aircraft include airplanes, rotorcraft, gliders, and anything else that may become airborne and is required to be registered with the Federal Aviation Administration ("FAA"). Planning should also cover an interest in a fractional ownership program, hangar leases, long-term service contracts, expensive aviation equipment, and certain aircraft components and parts. Beyond estate planning, one should also be aware that most aircraft require additional levels of planning as well. These may include flight operations, maintenance, Department of Transportation compliance and crew management. With all of the above, we should be aware that many business jets are similar in revenue, expense and liability to a fully functioning five-plus employee company.

Because aircraft are generally depreciating assets and expensive to use and maintain, they are not ideal assets for lifetime gifting. However, they often show up on the inventory of a high-net-worth decedent's estate. Because aircraft can be quite valuable, illiquid and subject to multiple regulatory schemes, they can make an estate administrator's job extremely complex. They also have unique needs, such as specific maintenance requirements. Running afoul of an aircraft's required maintenance can greatly affect its value. Couple this with significant changes in pre-owned aircraft valuations since 2008 and we have more reasons to suggest you seek competent and specialized advice. There are advisors, CPAs and attorneys who work only in private aviation, and it is wise to seek them out. The National Business Aviation Association is a good resource for finding them (https://www.nbaa.org/).

Federal excise tax, as well as state sales and use tax, while not discussed in detail below, must also be addressed when advising clients regarding the purchase or lease of aircraft.

Like cars, weapons and cannabis (in states where legal), aircraft are highly regulated. The FAA's Aircraft Registration Branch regulates aircraft registration and transfers. Aircraft owners must be registered with the FAA civil aircraft registry.[55] Records required for registration include original signed documents filed with the FAA, a bill of sale transferring title (reflecting the chain of title

[55] 49 U.S.C. §44102; 14 C.F.R. §47.3.

from the last registered owner) and an Aircraft Registration Application (AC Form 8050-1), which requires detailed information regarding the aircraft, the owner, and proof of citizenship of the individual owners or the underlying owners of an entity (for trusts, all trustees and beneficiaries must be U.S. citizens unless a "non-U.S. citizen trust" is used, in which the beneficiary is not a U.S. citizen but the trustee-owner is). Owners may include individuals and entities, including trusts. Where an owner is a non-U.S. citizen, specialized trusts or corporations are required. Failing to follow the strict regulations of the FAA can result in an invalid registration, leading to a cascade of further problems, including loss of insurance coverage and the grounding of the aircraft. Nevertheless, owners should be aware that much of the personal information required by the FAA can find its way into the public eye. As such, owners should ask their advisors what phone numbers, addresses and even signatures to use in this process.

A. Taxation Basics.[56]

Many states impose a personal property sale or use tax on transfers of aircraft, in addition to annual excise taxes. For example, information regarding registration and taxation of aircraft in Washington is found at http://www.wsdot.wa.gov/aviation/registration/register3steps.htm.[57] Washington imposes an annual excise tax on any aircraft, with limited exceptions, used within the state.[58]

If an aircraft is first delivered in a state without a sales tax, it still may be subject to use tax if later brought into a state that imposes one. If sales tax was previously paid, use tax may be imposed on the difference between the state's sales or use tax and the tax paid to the state where the sale occurred. A fiduciary delivering aircraft to a beneficiary in another jurisdiction must keep these potential taxes in mind when completing the transfer.

Keep in mind that some states, like Washington, consider an aircraft owned by a nonresident to be based in-state if it has spent more than 90 days in the state during any 12-month period, subjecting the aircraft to use tax in that state.[59] This is true even if the aircraft is legally based and pays tax in another state.

Most states consider transfers of aircraft to a revocable trust not to be a taxable event.[60] Nevertheless, in some jurisdictions, taxes may be imposed when ownership is restructured and even when ownership of the aircraft is transferred to a trust simply for estate planning purposes.[61] Moreover, some jurisdictions tax the transfer of a plane by a corporation or partnership to one of

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[56] A good resource for taxes applicable to aircraft owners is maintained by the Aircraft Owners and Pilots Association (AOPA): The Pilot's Guide to Taxes, http://www.aopa.org/Pilot-Resources/Aircraft-Ownership/The-Pilots-Guide-to-Taxes.aspx .

[57] Washington State Dept. of Transportation, Three Basic Steps to Register Your Aircraft, http://www.airweb.faa.gov/Regulatory_and_Guidance_Library/rgAD.nsf/MainFrame?OpenFrameSet.

[58] RCW 82.48.020, 82.48.100.

[59] RCW 8.48.100(3).

[60] *See, e.g.*, Cal. Rev. & Tax Code §6285(b); 68 Okla. Stat. tit. 68, §6003(17).

[61] *See, e.g.*, 35 Ill. Comp. Stat. 157/10-15.

its affiliates solely for liability protection purposes.[62]

B. Ownership Through an Entity.

An LLC or corporate entity is often used to hold aircraft and shelter the owner's other assets from the high possibility of owner or operator liability. For estate planning purposes, revocable trusts are commonly used simply for probate avoidance, but they do not afford liability protection. To obtain both liability protection and probate avoidance, a revocable trust may hold interests in the entity to which the aircraft is registered, but raises new issues, discussed below.

C. Trusts.

A trust holding an airplane is a type of purpose trust.[63] Similar to the structure of an Illinois Land Trust, the trustee is the titled and registered owner of the aircraft, but the beneficiary has the right to dissolve the trust at any time and return possession of the aircraft back to him- or herself or to a qualified third party. Furthermore, the FAA has the right to obtain information directly from the owner/operators because, despite the trust structure, they have nondelegable regulatory obligations to the FAA. Typically, the beneficiary will be the one to insure the aircraft, and to operate and maintain it in accordance with FAA requirements.

Also like an Illinois Land Trust, title to the aircraft can be transferred at any time from the trustee to any party designated by the beneficiary using an FAA form bill of sale. This, however, would have the effect of cancelling the aircraft's registration. The trustee cannot sell the aircraft without the beneficiary's direction. While this is an inherent aspect of a trust holding aircraft, it should be specifically provided in the trust instrument.

The trust agreement should create an affirmative duty on the part of the aircraft operator (where the operator is not the beneficial owner) to regularly maintain and provide current information regarding the aircraft and its operations.

The FAA imposes a number of requirements for trusts holding aircraft. Under Federal Aviation Regulation ("FAR") §47.7(c), each trustee must be either a U.S. citizen or a resident alien.[64] The trustee must also submit an Affidavit of Citizenship from each trustee, a copy of the trust agreement, and an Aircraft Registration Application to the FAA. If the trustee does not want to make a representation regarding the citizenship of the beneficiary, the beneficiary must provide a separate affidavit of citizenship.

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[62] *See, e.g.*, Fla. Admin. Code r. 12A-1.007(25)(d). *But see* 23 Va. Admin. Code §10-220-5 (transfer to corporate affiliate is exempt).

[63] A purpose trust exists to carry out a specific objective, in this case holding and maintaining aircraft, rather than for the benefit of individual beneficiaries. In Rev. Rul. 58-190, 1958-1 C.B. 15, and Rev. Rul. 76-486, 1976-2 C.B. 192, the IRS considered the income tax consequences of a nongrantor purpose trust without beneficiaries and a pet trust, respectively, and in both instances the IRS concluded that even though the trusts lacked beneficiaries, if valid under state law, they would be recognized as trusts for federal tax purposes pursuant to Treas. Reg. §301.7701-4.

[64] "U.S. citizen" is defined for FAA purposes under 14 C.F.R. §47.2.

Again, states may subject the transfer of title to a special purpose entity to sales or use tax.

D. Advising the Trustee.

If a trust was established during the grantor's lifetime, a successor fiduciary should, immediately upon appointment, confirm that registration with the FAA and airworthiness directives ("ADs") are all in good standing. There is a saying in aviation that "when one buys a plane, they are really buying the logbook"—i.e., they are buying the ledger where all maintenance actions are recorded. What this means is that if one cannot prove that the required maintenance has been performed correctly and on time, it will affect the aircraft's value. ADs are legally enforceable regulations issued by the FAA in accordance with 14 C.F.R. part 39 to correct an unsafe condition in a product. Part 39 defines a product as an aircraft, engine, propeller or appliance. Note that ADs[65] are delivered electronically or by paid subscription, so a search of the grantor's email may be necessary. (A periodic review of the FAA website by product name for applicable ADs is also a prudent practice.) If ADs are not timely acted upon, registration may lapse. Given the complexity of an aircraft's maintenance needs, you should consider hiring a reputable aircraft maintenance facility to oversee this process. Just as with automobiles, there are both independent maintenance facilities and "dealer" shops around the country and the world (such as Gulfstream and Bombardier) that perform these duties.

Aircraft can be registered to a single applicant as trustee, or to several applicants as co-trustees. To register, the trustee(s) must submit:[66]

- An affidavit showing that each beneficiary under the trust is either a U.S. citizen or a resident alien. This includes each person whose security interest in the aircraft is incorporated in the trust. If any beneficiary is not a U.S. citizen or a resident alien, the trustee must provide an affidavit stating that the trustee is not aware of any reason or relationship that would give the noncitizen a share of control greater than 25% to influence or limit the exercise of the trustee's authority. Furthermore, the trust agreement must provide that those persons together may not have more than 25% of the aggregate power to direct or remove a trustee for cause.[67]

- A certified copy of the complete trust instrument and a "copy of each document

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[65] The FAA's Airworthiness Directives, both current and historical, may be found here: http://www.airweb.faa.gov/Regulatory_and_Guidance_Library/rgAD.nsf/MainFrame?OpenFrameSet.

[66] For more information, download the FAA's form at Information to Aid in the Registration of U.S. Civil Aircraft, AC Form 8050-94 (Feb. 2009) available at https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/media/8050-94.pdf.

[67] 14 C.F.R. §47.7(c)(3). While the CFRs do not define "cause," the FAA's Notice of Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations Involving Non-U.S. Citizen Trustors and Beneficiaries, 78 Fed. Reg. 36,412 (June 18, 2013) available at http://debeegilchrist.com/wp-content/uploads/2013/09/NCT-Final-Policy-Clarification-78-Fed.-Reg.-36412-6-18-13-312667.pdf, refers to the Restatement of Trusts as illustrative of the definition, and suggests that willful misconduct and gross neglect satisfy this limitation.

legally affecting a relationship under the trust."[68]

- An original signed bill of sale from the present registered owner to the trustee(s).
- An original application for registration showing the trustee(s) as applicant, signed by the trustee(s).
- A $5.00 registration fee payable to the FAA.

If a client prefers to use an existing trust or a trust organized for a different purpose to own the aircraft, the trust agreement will need to be amended in order to satisfy the FAA requirements mentioned above. The FAA must approve all trust agreements used to register an aircraft. Because the agreement will be shared with the FAA, confidentiality of the terms regarding other assets held in a trust will be lost. Where confidentiality is a concern, clients should use a single-purpose trust for aircraft.

Finally, like in a family cabin trust, the grantor should be encouraged to fund the trust with either a substantial endowment or a life insurance policy to fund the maintenance and operation of the aircraft in the future. Without this sinking fund, it is not likely that multiple family members will be able to agree upon how to maintain and utilize the aircraft, and it will likely be sold. One option that should be considered is the use of an aircraft management company. For example, when one buys a business jet they have two choices as to who will "manage" the aircraft. Using our small business example from earlier, "managing" an aircraft includes human resources duties for the pilots, maintenance, fuel, flight planning, catering and charter (if FAR part 135 applies). They could allow the pilots to perform all of these duties (creating an ad hoc "flight department") or they could hire an aircraft management company to perform them. It is often wise to use an aircraft management company over the pilots. As with the "division of labor," I'd rather hire the pilots to be pilots and let the management company tackle the other tasks.

E. Corporations and LLCs.

It is important that a client have a clear understanding of the type of conduct qualifying as commercial versus noncommercial use. FAA regulations classify aircraft into various categories, generally commercial and noncommercial, and grant airworthiness certificates authorizing aircraft for flights under one of these categories. An owner who operates aircraft for personal use must hold a certificate under 14 C.F.R. part 91 of the FAA regulations. The personal use regulations impose significantly less stringent operational and maintenance standards than those applicable to charter carriers, which may include family offices (under 14 C.F.R. part 135) and airline carriers (under 14 C.F.R. part 121). For example, while JetBlue et al. only access about 500 airports nationwide, there are 5,000-plus airports that private aircraft can access; however, airports with shorter runways can only be used if the aircraft is flying under FAR part 91.

The inclination in estate planning is to use an entity—a corporation or LLC—to own property with which risk is associated, to shield a client from liability. However, where the sole purpose for an

[68] 14 C.F.R. §47.7(c)(2)(i).

entity's existence is to hold title to aircraft, there is a risk that this will be considered a commercial arrangement, subject to the more stringent rules applicable to charter carriers under 14 C.F.R. part 135.

Under part 91, the owner/user of the aircraft is responsible for full control over the operation of the aircraft. The flight crew may not operate the plane for compensation. Practically speaking, the owner must also be the operator. The mere fact that the owner/operator funded the expenses of a flight crew brings the operator within the definition of a commercial operator and will no longer be covered by part 91. The practical solution to this problem is typically to have the owner/operator enter into a "dry lease" arrangement with an entity, which provides support services, including pilots, crew and maintenance.

The FAA classifies aircraft leases as either "dry leases" or "wet leases."

Under a dry lease, the aircraft owner provides only the aircraft and no crew to the lessee.[69] An entity may be formed for the sole purpose of ownership of an aircraft by the lessor. It may lease that aircraft without a crewmember or any other amenities to a related company or party, the lessee. The lessee is considered to be in "operational control" of the aircraft in a dry lease arrangement, and provides its own flight crew, maintenance, and any other amenities. Dry leasing is not considered a commercial operation from the FAA's perspective as long as the pilots do not have a financial or employment relationship with the lessor.

A wet lease is a leasing arrangement, defined under FAR §91.501(c)(1), whereby the lessor of an aircraft provides the aircraft, crew, maintenance and any other services required by the lessee. The lessee typically pays the lessor based on hours operated. The lessee may also be required to cover the cost of fuel, airport fees and any other fees.

Operation under the wrong certificate is subject to steep fines.[70] On top of the fines, insurance coverage is contingent on the aircraft being operated in compliance with FAA regulations, and may be lost if an operator is not covered by the proper certificate.

It is important to note that a power of attorney used to transfer ownership in an aircraft must either contain a stated expiration date or expire by its own terms three years from the date it was signed.[71]

F. Private Foundations.

When families use their aircraft for personal or business use as well as their private foundation business it is imperative that the foundation bear its pro rata cost of travel.

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[69] 14 C.F.R. §91.1001(b)(2).

[70] 14 C.F.R. §13.305(d) (providing for fines of $11,000 for each violation of operating under a part 91 certificate rather than a part 135 certificate).[13.305 is reserved]

[71] *See* FAA, Form REGAR-94, Information to Aid in the Registration of Imported Aircraft ¶ 33 (last modified June 1, 2018), https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/media/REGAR-94.pdf.

The IRS has addressed self-dealing with respect to private foundations and public foundations.

In one case involving the rental of a charter aircraft by a disqualified person to a private foundation, the IRS ruled that the rental was an act of self-dealing even if the rate charged is comparable to rates charged by other aircraft companies.[72] But in another case, the IRS ruled that a disqualified person may provide free use of a plane to a private foundation, which is not an act of self-dealing.[73] In this case, the furnishing of "goods, services or facilities" by a disqualified person to the foundation was not self-dealing because the airplane was furnished without charge, and even though the foundation paid for its transportation cost in using the airplane, those costs were paid to an unrelated party and no portion of such cost was reallocated or credited back to any disqualified person.[74]

G. Practical Alternatives to Aircraft Ownership.

Some families are attached to their planes, especially those with historic, sentimental or collectible value. However, for the client who strictly wants to provide the convenience of private travel to her heirs, she might consider the advantages of fractional ownership, charter or a jet card.[75] The testator needs to realize that once a plane passes to multiple heirs, it cannot be in two places at once, making its use even harder to allocate than the family cabin, which at least stays in one place. Either arrangement—fractional ownership, charter or a jet card (akin to an expensive Starbucks card)—can provide the family with on-demand transportation with less cost, liability and opportunity for family strife.

Finally, it is critical to realize that not all fractional operators, charter brokers or other private aircraft providers are created equal. Aircraft are more complex to operate safely than the vacation homes, yachts or ranches that one may typically use. The providers you choose should be carefully vetted. There are various safety and aviation advisory companies that one should investigate. Familiarize yourself with their standards for pilot training, pilot experience (i.e., number of hours flown in that specific type of aircraft), maintenance standards, etc. and confirm that any provider you use is up to snuff. Some of these companies are Wyvern Ltd. (https://www.wyvernltd.com/wingman-charter-operator-directory) and ARGUS Research (https://www.argus.aero).

IV. CANNABIS

Since 1970, cannabis is considered a Schedule I substance under the federal Controlled Substances Act (CSA)—up there with heroin, LSD, peyote, and cocaine. Unauthorized cultivation,

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[72] Rev. Rul. 73-363, 1973-2 C.B. 383.

[73] P.L.R. 9732031 (May 14, 1997).

[74] Treas. Reg. §53.4941(d)-3.

[75] Some of the more popular fractional ownership companies include NetJets, FlexJet and FlightOptions, and popular charter or jet card arrangements are provided through companies such as Solairus Aviation, AirPartner and VistaJet.

distribution, or possession of cannabis[76] and knowingly or intentionally manufacturing, distributing, or dispensing it are federal crimes, unless used for federally approved research.[77] Depending on the quantities involved and other factors, penalties for violating the CSA can range from five years to life in prison.[78]

Notwithstanding its position on cannabis, in September 2018, the DEA moved prescription cannabidiol (CBD) drugs with Tetrahydrocannabinol (THC) content below .01% to a Schedule V drug, provided the drug has been approved by the Federal Drug Administration. This change was prompted by the Federal Drug Administration's approval of Epidiolex, a drug intended to be used for rare forms of epilepsy. As a result, the FDA treats the sale and marketing of CBD-infused food and dietary supplement in interstate commerce as unlawful because CBD was approved as a drug by the agency before it was marketed as a food or a dietary supplement. Medical cannabis facilities are no longer able to distribute CBD infused products with a content above .01% through what have become the mainstream/nonprescription channels, and CBD products will instead have to be obtained by prescription from a physician.

Federal law also makes illegal certain financial transactions connected to unlawful activity, including transferring monetary instruments or funds with the intent to promote the carrying on of specified unlawful activity, including the manufacture, importation, sale, or distribution of a controlled substance.[79]

Nevertheless, as of January 2024, more than two-thirds of the states, Guam, Puerto Rico, and the District of Columbia permit the legal use of cannabis for medical reasons, and more than half, Guam and the District of Columbia for recreational purposes.[80] Retail sales are permitted in over a dozen states and Guam. Washington, D.C. permits recreational use, but not on federal property, which significantly limits availability.[81] (Consumption on all federal land and some Indian

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[76] The terms "marijuana" and "cannabis" are often used interchangeably. Some consider the term "marijuana" to have a pejorative connotation. For background on the derivation and meaning of these terms see Jon Gettman, *Marijuana vs. Cannabis: Pot-Related Terms to Use and Words We Should Lose*, High Times (Sept. 10, 2015), http://hightimes.com/culture/marijuana-vs-cannabis-pot-related-terms-to-use-and-words-we-should-lose/.

[77] Controlled Substances Act, 21 U.S.C. §831(a). Very narrow exceptions to the federal prohibition do exist. For example, one may legally use cannabis if participating in a Federal Drug Administration-approved study or in the Compassionate Investigational New Drug program.

[78] 21 U.S.C. §841(b)(1)(A)-(B), §960(b).

[79] Money Laundering Control Act of 1986, 18 U.S.C. §§1956, 1957.

[80] *See* https://disa.com/marijuana-legality-by-state (Jan. 3, 2024), http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx (the current status of the law concerning medical use, by state), https://en.wikipedia.org/wiki/Legality_of_cannabis_by_U.S._jurisdiction (the current status of the law for medical and recreational use, cultivation, transportation and legal penalties by state) and Michael Rosenblum & Barry Weisz, *Cannabis State-By-State Regulations*, Thompson & Coburn (updated Oct. 2023), https://www.thompsoncoburn.com/docs/default-source/acartha/cannabis-state-by-state_2023.pdf?sfvrsn=f10429ea_1.

[81] Initiative 71, also known as the Legalization of Possession of Minimal Amounts of Marijuana Personal Use Act of 2014. See also https://www.leafly.com/learn/legalization/washington-dc (updated June 13, 2023).

reservations is illegal.[82]) Although Washington D.C.'s laws do not allow the retail purchase of cannabis in a traditional buyer-seller exchange, they allow the purchase of another item, good, or service—and then receive a free cannabis product that is "gifted" or donated by the vendor, instead. Gifted items may include stickers, shirts, cups, and other trinkets.

The following states still prohibit all use of cannabis in all forms: Idaho, Indiana, Kansas, Mississippi, Nebraska, North Carolina, South Carolina and Wyoming

As of January 2022, the state-licensed cannabis industry employed over 428,000 full-time employees, adding 280 new jobs per day.[83] The legal cannabis industry was valued at $30 billion in 2022, expected to surpass $35 billion in 2023 once data is fully analyzed.[84] The adult-use market is predicted to reach a value of $37 billion by 2026.[85]

While beyond the scope of this outline, it should be recognized that numerous studies have shown that both alcohol and cannabis use by minors can affect cognitive abilities, cannabis more than alcohol and cannabis used with alcohol even more so. One study, released in 2018, collected data from 3,826 seventh graders and studied their substance use patterns and cognitive maturation continuously for 5 years.[86] The cannabis data showed that the average cannabis use lead to lower working memory performance, perceptual reasoning, and inhibition, and that higher instances of cannabis use lead to impairment in delayed recall memory. The alcohol data showed that alcohol use was linked to lower spatial working memory performance, perceptual reasoning, and trouble exhibiting inhibitory control. These results, along with existing data on neuroplasticity of cannabis users, imply that adolescent cannabis use is related to more long-term consequences on cognitive functions than alcohol.

Because legalized and decriminalized cannabis is a national issue and is becoming an international one, estate planners consider cannabis as an asset, and sometimes an investment, perhaps the way we might currently plan for a wine collection, except for the fact that, unlike wine, cannabis is still illegal under federal law.

The path to how some states have navigated these punitive statutes and passed legislation allowing the medical and even the recreational use and sale of cannabis is not a straight line. Below is a

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[82] Monty Wilkinson, Director of the Executive Office for U.S. Attorneys, Policy Statement Regarding Marijuana Issues in Indian Country (Oct. 28, 2014), https://www.justice.gov/sites/default/files/tribal/pages/attachments/2014/12/11/policystatementregardingmarijuanaissuesinindiancountry2.pdf.

[83] Norml, Report: Legal Marijuana Industry Employs Over 428,000 Full-Time Workers (Feb. 23, 2022), Report: Legal Marijuana Industry Employs Over 428,000 Full-Time Workers - NORML.

[84] New Frontier Data, https://www.globenewswire.com/en/news-release/2023/03/22/2632475/0/en/U-S-Cannabis-Sales-Could-Total-71B-in-2030-Without-Federal-Legalization.html (March 22, 2023).

[85] Statista, https://www.statista.com/markets/415/topic/2436/cannabis/#overview.

[86] Jean-François G. Morin, B.A., Mohammad H. Afzali, Ph.D., Josiane Bourque, M.Sc., Sherry H. Stewart, Ph.D., Jean R. Séguin, Ph.D., Maeve O'Leary-Barrett, Ph.D., Patricia J. Conrod, Ph.D., *A Population-Based Analysis of the Relationship between Substance Use and Adolescent Cognitive Development*, 176 The Amer. J. of Psychiatry 98, (Feb. 2019) available at https://doi.org/10.1176/appi.ajp.2018.18020202.

description of the major points on that path. But, it is not yet clear that the path is a completely legal one. For the brave, yet cautious, the following is a general overview of the federal and state legal landscape and discussion of the estate planning, tax, and ethical considerations for attorneys giving advice where cannabis is part of an estate plan or probate.

A. Federal Law.

At the federal level, the Biden administration has taken steps to ease restrictions on cannabis, following the President's statement in 2022 asking the Secretary of Health and Human Services and the Attorney General to initiate the administrative process to review how cannabis is scheduled under federal law.[87]

In a letter to the Drug Enforcement Agency (DEA) dated August 29, 2023 (attached as Exhibit A), a top official at the Department of Health and Human Services (HHS) recommended moving cannabis to Schedule III predicated on the FDA's scientific and medical evaluation of cannabis bason on a statutorily required eight-factor analysis.[88] This letter was only made available in response to a Freedom of Information Act request.[89] See email exchange dated January 11, 2024, leading to the disclosure at https://ondrugs.substack.com/p/update-on-hhs-foia-litigation (attached as Exhibit B). The eight-factor analysis includes: 1) cannabis's actual or relative potential for abuse; (2) scientific evidence of its pharmacological effect, if known; (3) the state of current scientific knowledge regarding the drug or other substance; (4) its history and current pattern of abuse; (5) the scope, duration, and significance of abuse; (6) what, if any, risk there is to the public health; (7) its psychic or physiological dependence liability; (8) whether the substance is an immediate precursor of a substance already controlled under the Controlled Substances Act.[90]

The DEA is still conducting its final review, with a decision likely to come out this year. If cannabis is moved from schedule I to schedule III of the Controlled Substance Act, the tax burden on business would be reduced and an increase in research on the health effects of cannabis could be conducted.

Rescheduling would eliminate the draconian impact Section 280E of the Internal Revenue Code has had on cannabis companies. Section 280E disallows any "deduction or credit . . . for any amount paid or incurred . . . in carrying on any trade or business if such trade or business . . . consists of trafficking in" a Schedule I or II controlled substance which is prohibited by Federal or applicable state law.[91]

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[87] Statement from President Biden on Marijuana Reform (Oct. 26, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/10/06/statement-from-president-biden-on-marijuana-reform/.

[88] Letter available at https://www.nytimes.com/interactive/2024/01/12/us/2023-01171-supplemental-release.html.

[89] Christina Jewett & Noah Weiland, Federal Scientists Recommend Easing Restrictions on Marijuana, New York Times (Jan 12, 2024), https://www.nytimes.com/2024/01/12/health/marijuana-fda-dea.html?campaign_id=60&emc=edit_na_20240112&instance_id=0&nl=breaking-news&ref=headline&regi_id=107304284&segment_id=155151&user_id=3e6b25c1483abe010800d32a4b93d290.

[90] 21 U.S.C. 811(c).

[91] I.R.C. 280E.

B. Treasury Department Guidance.

In addition to the guidance issued by the DOJ, the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department, issued its own guidance in 2014 to clarify the Bank Secrecy Act ("BSA"), which imposes its own regulations on banks and other financial institutions, including money services businesses, to file reports of large cash transactions and other suspicious transactions under the Bank Secrecy Act BSA. FinCEN's guidance clarified its expectations for financial institutions seeking to provide services to cannabis-related businesses in light of state initiatives to legalize certain cannabis-related activity.[92] Under the BSA, a financial institution must file reports of cash deposits or withdrawals exceeding $10,000 and any suspicious activity that might indicate money laundering, tax evasion, or other criminal activity. The reports are submitted to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), which collects and analyzes the information to support law enforcement investigative and prosecutorial efforts. In 2018 FinCEN issued additional guidance in which it reiterated the need to file a SAR, as well as the ongoing obligation to regularly update cannabis-related SARs, which presents significant compliance obligations on financial institutions.[93]

While the guidance does not prohibit financial institutions from accepting cannabis-related customers, it requires expensive and onerous paperwork from financial institutions about such customers under its anti-money-laundering regulations. In assessing the risk of providing services to a cannabis-related business, a financial institution is obligated to conduct customer due diligence that includes: (i) verifying with the appropriate state authorities whether the business is duly licensed and registered; (ii) reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its cannabis-related business; (iii) requesting from state licensing and enforcement authorities available information about the business and related parties; (iv) developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the types of customers to be served (*e.g.*, medical versus recreational customers); (v) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (vi) ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and (vii) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.[94]

The 2014 FinCEN guidance points out that the decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution. These factors may include its particular business objectives, an evaluation of the risks associated with offering a particular product or service, and its capacity to manage those risks effectively.[95] In addition, under the FinCEN guidance, a financial institution

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[92] FinCEN Guidance: BSA Expectations Regarding Marijuana-Related Businesses, FIN-2014-001 (Feb. 14, 2014).

[93] FinCEN Guidance: Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions, FIN-2018-G001 (April 3, 2018) available at https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf.

[94] *Id.*

[95] *Id.*

that provides financial services to a cannabis-related business would be required to file a Suspicious Activity Report ("SAR") if the financial institution knows, suspects, or has reason to suspect that a transaction involves funds derived from a cannabis-related business.

The most important development in banking is that the SAFER Banking Act passed out of the Senate Banking Committee in September 2023, receiving votes from both parties. If signed into law, the SAFER Banking Act would extend protections to financial institutions – such as bank accounts and commercial lending – to state-licensed cannabis businesses. Under the status quo, many licensed cannabis businesses have been forced to operate as cash-only, resulting in these businesses being targeted for crime.

C. Cryptocurrency.

Cryptocurrency is a type of virtual currency that uses cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.[96] Units of cryptocurrency are generally referred to as coins or tokens, although viewed by the IRS as a capital asset.[97] Distributed ledger technology uses independent digital systems to record, share, and synchronize transactions, the details of which are recorded in multiple places at the same time with no central data store or administration functionality. Because of the limitations caused by FinCen, cannabis businesses are awash in cash some have turned to carrying on business using cryptocurrency instead of cash.[98] As a result of the banking regulation intended to help track criminal activity, cannabis transactions have moved to a platform that is virtually impossible to track. Bitcoin, first introduced in 2009, is just one example of a virtual currency. There are at least five cryptocurrencies intended specifically for the cannabis marketplace: PotCoin, CannabisCoin, DopeCoin, HempCoin and CannaCoin.[99] The exchange of the virtual currency allows for peer-to-peer online payments or digital cash to be sent directly from one party to another (whether individuals or business entities) without the transaction going through a traditional banking institution.

A business owner likely needs to insure cryptocurrency separately. Few policies cover its loss. This is due in part from the ongoing debate as to whether it is currency or a security.[100]

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[96] For detailed background see, Gerry Beyer, *What Estate Planners Need to Know About Cryptocurrency*, Estate Planning Journal (June 2019); Margaret Scott & Jake Kaplan, INSIGHT: Transfer Tax and Estate Planning Considerations for Clients With Cryptoassets (Pt. 2), Tax Management Weekly (Jan. 22, 2020), available at https://www.alston.com/-/media/files/insights/publications/2020/01/scott-kaplan--crypto-estate-planning-part-2-12220.pdf.

[97] Conlon, Stevie D. Vayser, Anna Schwaba, Robert, *Valuation of Cryptocurrencies and ICO Tokens for Tax Purposes*, 12 Est. Plan. & Cmty. Prop. L.J. 25 (2019).

[98] https://www.fool.com/investing/2018/02/15/marijuana-and-blockchain-a-match-made-in-heaven.aspx.

[99] https://www.investopedia.com/news/top-marijuana-cryptocurrencies/.

[100] Michael Menapace, et. al, *Holding Cryptocurrency – is our Wallet Hot? Consider Whether Your Assets Are Insured Under A Homeowner's or Commercial Policy*, The National Law Review (Feb. 20, 2020), available at https://www.natlawreview.com/article/holding-cryptocurrency-your-wallet-hot-consider-whether-your-assets-are-insured.

Clearly work needs to be done to reform banking and Treasury prohibitions and restrictions.

D. State Law.

In spite of the many federal roadblocks, the sale and use of recreational cannabis first became legal after voters approved an amendment to the Colorado Constitution in the November 2012 elections. Many states had legalized small amounts of medical cannabis before 2012, starting with California in 1996, and many have legalized both recreational and medical use since then.[101] Generally, states limit possession, use, and ownership of retail licenses based on age, residency, and criminal history.

The business and its regulation can be broken down into 5 categories: (i) growers and cultivation facilities, (ii) manufacturing facilities—the processors that turn plants into bud, extracts, and other cannabis products, (iii) testing facilities to make sure products meet quality control requirements established by the state, (iv) wholesalers that purchase in bulk and sell to licensees; and (v) retail stores that sell products to adults 21 and over.

Each state's laws differ. The following is a summary of the laws currently in effect in Washington, and Oregon.

E. Washington.[102]

1. Medical Cannabis. On November 3, 1998, Washington voters approved Ballot Initiative 692,[103] making small amounts of cannabis legal for medical purposes. The Washington Supreme Court ruled in 2010 that "I-692 did not legalize cannabis, but rather provided an authorized user with an affirmative defense if the user shows compliance with the requirements for medical cannabis possession."[104]

Two years later, Washington voters approved Ballot Initiative 502, an initiative amending state law to provide that the possession of small amounts of cannabis by individuals over the age of 21 is not a violation of Washington law. In addition, the initiative provided that the "possession, delivery, distribution, and sale" by a validly licensed producer, processor, or retailer, in accordance with the regulatory scheme administered by the Washington State Liquor and Cannabis Board (formerly known as the Washington State Liquor Control Board) (WSLCB), is not a criminal or civil offense under Washington state law.[105] Nevertheless, an employer is under no obligation to

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[101] *See, e.g.*, Melia Robinson, *It's 2017: Here's Where You Can Legally Smoke Weed Now*, Bus. Insider (Jan. 8, 2017), http://www.businessinsider.com/where-can-you-legally-smoke-weed-2017-1.

[102] For FAQs on current legislation see Washington State Liquor and Cannabis Board FAQs, https://lcb.wa.gov/mj2015/faqs_i-502, and Washington State Liquor and Cannabis Board, Know the Law, http://lcb.wa.gov/mj-education/know-the-law.

[103] Codified at RCW ch. 69.51A.

[104] *State v. Fry*, 168 Wn. 2d 1, 10, 228 P.3d 1, 6 (2010).

[105] Wash. Ballot Initiative 502, §4 (2012). See Washington State Liquor and Cannabis Board, Know the Law, http://lcb.wa.gov/mj-education/know-the-law, and FAQS on Marijuana, http://lcb.wa.gov/mj2015/faqs_i-502, for detailed explanations of Washington cannabis law.

accommodate the medical use of cannabis in any place of employment. Additionally, an employer may terminate an employee based on a failed drug test even where employee is a qualifying patient engaged in only at-home use of medical cannabis.[106]

The initiative established a three-tier production, processing, and retail licensing system, similar to Colorado's that permits the state to retain regulatory control over the commercial life cycle of cannabis.[107] As with alcohol after Prohibition, those in the cannabis industry are barred from complete vertical integration.

The WSLCB has also adopted detailed rules for implementing the initiative, including cannabis license qualifications and an application process, application fees, cannabis packaging and labeling restrictions, recordkeeping and security requirements for cannabis facilities, reasonable time, place, and manner advertising restrictions, and taxation.

Prior to the passage of I-502, a qualifying patient or designated provider could lawfully use, produce, possess, or administer cannabis to treat a terminal or debilitating illness. A qualifying patient or designated provider could not be arrested, prosecuted, or subject to other criminal sanctions or civil consequences for possession, manufacture, or delivery of, or possession with intent to manufacture or deliver cannabis under state law. Qualifying patients could possess amounts of cannabis in various forms as specified under the statute.

In 2015, SB 5052 brought medical cannabis under the system and rules of I-502 (discussed below).[108] In 2017, the Washington legislature closed a gap in the law caused by the merger of the two systems. Medical cannabis patients could grow cannabis for personal use, but had no legal pathway to acquire plants. Engrossed Substitute SB 5131 (ESSB 5131), signed by Governor Inslee on May 16, 2017, and effective July 23, 2017,[109] allows qualifying patients and their designated caregivers to purchase plants and cultivate plants for personal use, and join state-registered medical cannabis cooperatives to grow cannabis with up to four other patients. Those who hold a recognition card issued by the state are able to grow and purchase larger quantities.

2. Retail Sale of Cannabis. Washington requires all cannabis businesses to be at least 1,000 feet from certain structures enumerated in WAC 314-55-050(10), which include any elementary or secondary school, playground, recreation center or facility, childcare center, public park, public transit center, library, or game arcade that allows minors to enter. That distance may be reduced to as low as 100 feet by city and county ordinance, except with respect to schools and playgrounds.[110]

Both Washington and Oregon require licensees to track certain information. One purpose of the

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[106] RCW 69.51A.060(7).

[107] RCW 69.50.325.

[108] Adopts a comprehensive act that uses the regulations in place for the recreational market to provide regulation for the medical use of cannabis.

[109] Amending scattered sections of RCW ch. 69.50 and RCW ch. 69.51A and other sections of the RCW.

[110] WAC 314-55-050(11).

tracking is to comply with the Cole memoranda and demonstrate that the state is complying with the federal directive to protect the state's legal cannabis operations from federal prosecution. In accordance with WAC 314-55-083(4), Washington cannabis licensees must track cannabis from seed to sale to prevent diversion, promote public safety, and collect tax revenue.

ESSB 5131, discussed above, added a number of additional restrictions on producing, processing, and selling cannabis in Washington, including intellectual property disclosure requirements, restrictions on advertising, restrictions on the term "organic," and changes in the number of licenses and stores an individual or entity may own, making it the most highly regulated of the states permitting recreational cannabis.[111]

In an attempt to make edibles less attractive to minors, the state has issued an interim policy to "further clarify the procedures and processes for packaging, labeling, and product decisions for marijuana infused edible products."[112] This policy, effective January 1, 2019, represents a retreat from its earlier attempt to ban all edibles.[113]

3. Enforcement. I-502 legalized cannabis use for adults; however, there are still a number of restrictions, the violation of which may be subject to strict penalties:

(a) Adults 21 years of age or older may legally possess up to one ounce of cannabis (the harvested flowers), 16 ounces of cannabis-infused product in solid form (edibles), 72 ounces of cannabis-infused product in liquid form, and 7 grams of cannabis concentrates.[114]

(b) Possession of cannabis in amounts above the limits (see the previous question) remains criminal. Growing or selling cannabis without a license from the state remains criminal, except for qualifying patients or designated providers who grow or possess cannabis in accordance with the applicable provisions of RCW ch. 69.51A.

(c) Possession by adults of over one ounce to 40 grams (about 1.5 ounces) results in a misdemeanor. Possession of more than 40 grams is a Class C Felony. Quantities of cannabis that exceed the allowed limits may be seized. If the quantity possessed is within the allowed limits, law enforcement cannot seize the cannabis and further searches of the person are not lawful.

(d) Public consumption is illegal. RCW 69.50.445 provides as follows: "It is unlawful to open a package containing marijuana, useable marijuana, marijuana-infused

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[111] The bill may be found at http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/Session%20Laws/Senate/5131-S.SL.pdf.

[112] Liquor and Cannabis Board Interim Policy BIP-10-2018, clarifying WAC 314-55-105 Packaging and labeling requirements. The requirements include an approved list of colors, gradients, backgrounds, accent colors, and shapes.

[113] The policy statement, indicating which colors, shapes, and sizes may be used for packaging and labeling may be found at https://lcb.wa.gov/sites/default/files/publications/rules/2018%20Proposed%20Rules/BIP_10_2018_MJ_Labeling_MIE_Colors_REVISED_FINAL_Signed.pdf.

[114] See RCW 69.50.4013 and 69.50.360.

products, . . . or consume marijuana, useable marijuana, [or] marijuana-infused products, . . . in view of the general public . . .. A person who violates this section is guilty of a class 3 civil infraction under chapter 7.80 RCW."

(e) RCW 46.61.502 provides a standard for driving under the influence of cannabis (above the threshold limit of five nanograms of THC per milliliter of blood). If officers believe someone is driving under the influence and impaired, laws similar to those applicable to driving under the influence of alcohol apply.

4. Commercial Licenses. The WSLCB is prohibited from issuing a license to: (i) an individual under the age of 21 years; (ii) a person doing business as a sole proprietor who has not lawfully resided in the state for at least six months prior to applying for a license; (iii) a partnership, employee cooperative, association, nonprofit corporation, or corporation, unless it is formed under the laws of the state, and unless all of the members thereof are qualified to obtain a license; or (iv) a person whose place of business is conducted by a manager or an agent, unless the manager or agent possesses the same qualifications required of the licensee.[115] Applicants must have been Washington residents, a term that is not clearly defined, for six months prior to submitting their application.[116]

The WSLCB may conduct a criminal background information check, and consider any prior criminal conduct of the applicant, including an administrative violation history record with the WSLCB.[117]

Washington cannabis business licenses must be held in the names of a, "true parties of interest. WAC 314-55-035(1) lists those who qualify as TPOIs:

(1) **True parties of interest** - For purposes of this title, "true party of interest" means:

True party of interest	Persons to be qualified
Sole proprietorship	Sole proprietor and spouse.

[115] RCW 69.50.331(1)(b).

[116] WAC 314-55-020(10); RCW 69.50.331(1)(b)(ii). The WSLCB's regulations define the term "residence" as a place where a person physically resides, but only in the context of the rule that cannabis licenses cannot be issued to businesses located in a personal residence. While the terms "resided" and "residency requirement" are used in WAC 314-55-020(10), they are not defined. The statutory definitions serve only to confuse the issue. RCW 69.50.331(1)(b)(ii) provides that an applicant must have "lawfully resided in the state for at least six months prior to applying" for a cannabis business license, without providing guidance as to what "lawfully resided" means. Furthermore, *all* prospective owners and operators of that entity, as well as their spouses, must demonstrate residency in Washington State for six months prior to submitting their application for business ownership. This means that, whether the prospective licensee is a single person, a partnership, cooperative, association, nonprofit, privately held corporation, or any other business entity, every single member must meet the six-month residency requirement. Additionally, licensees must maintain such residency in order to remain in compliance with the WAC.

[117] WAC 314-55-020(6); RCW 69.50.331(1)(a).

General partnership	All partners and spouses.
Limited partnership, limited liability partnership, or limited liability limited partnership	• All general partners and their spouses. • All limited partners and spouses.
Limited liability company	• All members and their spouses. • All managers and their spouses.
Privately held corporation	• All corporate officers (or persons with equivalent title) and their spouses. • All stockholders and their spouses.
Publicly held corporation	All corporate officers (or persons with equivalent title) and their spouses. All stockholders and their spouses.
Multilevel ownership structures	All persons and entities that make up the ownership structure (and their spouses).
Any entity or person (inclusive of **financiers**) that are expecting a percentage of the profits in exchange for a monetary loan or expertise. Financial institutions are not considered true parties of interest.	Any entity or person who is in receipt of, or has the right to receive, a percentage of the gross or net profit from the licensed business during any full or partial calendar or fiscal year. Any entity or person who exercises control over the licensed business in exchange for money or expertise. For the purposes of this chapter: • "Gross profit" includes the entire gross receipts from all sales and services made in, upon, or from the licensed business. • "Net profit" means gross sales minus cost of goods sold.
Nonprofit corporations	All individuals and spouses, and entities having membership rights in accordance

	with the provisions of the articles of incorporation or the bylaws.

All TPOIs are required to submit to a criminal background investigation in order to determine whether he or she is qualified for licensure. The WSLCB imposes a point system when evaluating an applicant's criminal history based on the types and number of convictions he or she previously suffered, as well as the date of the crime. A sufficient number of points – more than 8 – may prohibit an applicant from obtaining a cannabis license.[118]

Unless applicants are able to capitalize a business with cash, they face harsh regulations regarding financing. Washington requires that all capital contributed to a business must be declared before a license will be issued. Any additional contributions to capital or loans (except loans from chartered financial institutions) must be approved by the WSLCB. As a result, unlike other commercial operations in Washington, cannabis businesses need to maintain large cash reserves to create a safety net for the unexpected.

Washington also strictly governs the operation of a business of a deceased or incapacitated license holder:

> WAC 314-55-140: Death or incapacity of a marijuana licensee.
>
> (1) The appointed guardian, executor, administrator, receiver, trustee, or assignee must notify the WSLCB's licensing and regulation division in the event of the death, incapacity, receivership, bankruptcy, or assignment for benefit of creditors of any licensee.
>
> (2) The WSLCB may give the appointed guardian, executor, administrator, receiver, trustee, or assignee written approval to continue marijuana sales on the licensed business premises for the duration of the existing license and to renew the license when it expires.
>
> (a) The person must be a resident of the state of Washington.
>
> (b) A criminal background check may be required.
>
> (3) When the matter is resolved by the court, the true party(ies) of interest must apply for a marijuana license for the business.[119]

(a) Taxes. The recreational use of cannabis is regulated and taxed in a manner similar to alcohol, although at a significantly higher rate.[120] Retail licensees are required

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[118] WAC 314-55-040.

[119] WAC 314-55-140.

[120] RCW ch. 69.50.

to collect and remit to the WSLCB an excise tax of 37% on all taxable sales of cannabis, cannabis concentrates, useable cannabis, and cannabis-infused products.[121] In addition, Washington's business and occupation tax and sales tax also apply. Because both the cannabis and sales taxes are based on the price charged by the retailer, recreational customers in Seattle end up paying almost 50% in taxes that are added at the register.[122]

F. Cannabis in the Estate Plan.

It is likely that more and more estate planners will find themselves in the position of advising clients with cannabis-related assets, and how to handle the potentially tremendous revenue in light of federal banking, money-laundering, and other regulations.

The first hurdle will be the client intake procedure. There are two general categories of potential clients in the cannabis arena: (i) clients that have direct contact with cannabis because they manufacture, distribute, or sell cannabis in compliance with state law, and (ii) third parties that assist or advise on cannabis topics and refer clients to the businesses with direct contact. These include doctors, bankers, investors, lawyers, landlords, real estate brokers, accountants, and ancillary service providers. The first category carries more risk.

Where a beneficiary of a cannabis-related asset may be a minor, it is important to contemplate how that beneficiary may benefit from inherited assets without running afoul of the many laws preventing minors from possessing or owning any such assets outright. While the laws in each state will differ and the following has not yet been tested, perhaps the following limitation may allow a trustee to hold such an asset during the minority of a beneficiary (if not longer):

> Distribution of Cannabis Assets. Any beneficiary who has not reached the age of majority at the time of my death may not receive outright any cannabis-related assets, licenses, permits, interest in entities, or other related property ("cannabis assets"). Instead, he or she may receive financial benefits, in the sole discretion of my trustee, from cannabis assets, which may include a legally operated cannabis-related business so long as the trustee manages the funds generated by such assets until said beneficiary reaches the age of majority. Once such beneficiary reaches the age of majority, he or she must obtain the appropriate licenses and permits and comply with all applicable regulations to qualify to legally own the cannabis assets outright and free of trust.

At the document drafting stage, testators and grantors often wish to limit gifts based on certain conditions, one of which is often the use of illegal drugs. Drafters will now need to carefully specify when the restriction applies, what law applies (if state law, then which one, or federal law), and whether cannabis is included as an illegal drug. One option would be to refer instead to abuse of "mind-altering drugs, whether legal or illegal." The following is an example of a clause making

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[121] RCW 69.50.535; WAC 314-55-089.

[122] The 37% cannabis excise tax plus Seattle's 10.25% sales tax rate equal an overall rate of 47.25% in taxes that are collected from the customer.

distributions conditional on drug use:

> Suspension of Distributions. If the trustee at any time suspects that a beneficiary is using any substance (including, without limitation, drugs, chemicals, or alcohol) in an abusive manner or is engaging in any abusive addictive behavior, the trustee is authorized to request that the beneficiary submit to one or more examinations determined to be appropriate by a licensed and practicing physician, psychiatrist, or other appropriate health care professional selected by the trustee. The trustee may request the beneficiary to consent to full disclosure by the examining doctor or facility to the trustee of the results of all such examinations, and the trustee may totally or partially suspend or withhold all distributions until the beneficiary consents to one or more examinations and disclosure to the trustee, and those examinations indicate no such use or behavior.

What can be done during the estate planning process to diminish the risks associated with post-death transfers? Individuals who own cannabis licenses or interests in entities that own such licenses should carefully consider business succession planning strategies to avoid transfers to individuals not qualified to become owners.

When a cannabis business is owned by two or more unrelated entities, the owners should investigate cross-purchase plans, buy-sell agreements, or entity purchase plans. Through careful planning, individuals may be able to avoid some of the more difficult issues related to the transfer of cannabis licenses.

A testamentary instrument transferring any interest in cannabis (or any other highly regulated asset) should consider allowing the fiduciary to appoint an independent fiduciary to carry out those duties the appointing fiduciary may not. Ideally, the independent trustee would be permitted and willing to deal with any regulated assets that a conventional fiduciary is not able to administer because of state law or other circumstances that prevent that fiduciary from administering such assets. Whether a fiduciary may invest in cannabis securities in light of fiduciary investment standards, cannabis-related securities concerns under federal criminal statutes and the prudent investor rule is still an issue without a clear answer.[123]

The following is a provision identifying only a partial list of tasks for an independent trustee:

> Independent Trustee – Special Powers. In addition to all other powers as trustee, an independent trustee shall have the following powers and authority: (i) to amend the trust as the independent trustee deems necessary to carry out my intent in establishing the trust or to otherwise allow the trust to be administered in a more administrative or tax efficient manner given current or future federal or state laws; provided that any amendment may not affect the beneficial enjoyment of the trust estate; (ii) in general, to avail the trust and beneficiaries of opportunities under existing and future laws that may require extraordinary action such as, but not

[123] For an examination of this issue see Fein, Melanie L., Fiduciary Investments in Cannabis Securities (January 30, 2019). Available at SSRN: https://ssrn.com/abstract=3326205 or http://dx.doi.org/10.2139/ssrn.3326205.

> limited to: division of trusts into separate shares, creation of new trusts for the purposes of holding specific property or interests, and limiting distributions from a new trust to an ascertainable standard or to permissible recipients; and (iii) to deal with any regulated assets that a fiduciary is not able to administer because of state law or other circumstances, which prevent such fiduciary from administering such assets. All actions taken by an independent trustee hereunder should be consistent with, though not necessarily in literal compliance with, the dispositive scheme of the trust. An independent trustee shall be under no duty to exercise any power granted under this section and shall be held harmless and indemnified against any liability, claim, judgment, expense, or cost arising from or attributable to his or her exercise or failure to exercise any power granted under this section, except as provided in [section re trustee standard of care].

Once it is established that a testamentary instrument may legally transfer ownership the next step will be to determine whether the beneficiary may take ownership. How a cannabis-related asset will be delivered to a beneficiary by a fiduciary needs to be carefully considered. The laws governing the transfer of assets by a decedent are those of the decedent's domicile prior to death. But the law of the beneficiary's domicile will apply to determine whether or not he or she may take possession. As a Schedule I drug, using the U.S. Postal Service is a federal crime, punishable by monetary fines and imprisonment, even where recreational or medical use is legal.[124] So, the traditional delivery by mail of an asset to a beneficiary is yet another challenge for the fiduciary.

Each state's procedures to transfer ownership of a license are different, but the goal is the same: to ensure that the transferee is qualified to hold a license. For estate planners, understanding these rules is critical to ensure that a license holder has a viable business succession plan in place.

Washington requires approval from the WSLCB for a transfer to anyone other than a surviving spouse.[125] To date, no state anticipates ownership of a license by a trust, nor is there guidance for a fiduciary that may be tasked with managing a cannabis license.

In Oregon, two rules, in particular, must be followed when a change in ownership occurs: OAR 845-025-1160(5) provides that

> (5) Change of Ownership. A new application must be submitted in accordance with OAR 845-025-1030 (Application Process) if:

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[124] 18 U.S.C. §1716. *See Sansouci v. USPS*, P.S. Docket No. MLB 18-9 (Apr. 13, 2018) ("Where the federal government has regulated a product and deemed it to be a Schedule 1 substance, the United States Postal Service, as a federal entity, must adhere to that determination, until either Congress, or a court of appropriate jurisdiction, determines otherwise. See United States Postal Service, Publication 52, Hazardous, Restricted, and Perishable Mail, §453.31 (Aug. 2017) ('If the distribution of a controlled substance is unlawful under 21 U.S.C. §§801–971 or any implementing regulation in 21 CFR Chapter II, then the mailing of the substance is also unlawful under 18 U.S.C. §1716.')").

[125] RCW 69.50.339.

(a) A business proposes to add or replace a licensee of record; or

(b) A business proposes a change in its ownership structure that is 51 percent or greater. For the purposes of this rule, a change is considered to be 51 percent or greater if natural persons who did not hold a direct or indirect interest in the business at the start of the license year will collectively hold a direct or indirect interest of 51 percent or greater..[126]

When an estate or a trust includes a retail, processor, or producer cannabis license, a named fiduciary first must determine whether he, she, or it is willing to serve, given cannabis's status as a Schedule I controlled substance. While an individual may be comfortable relying on the enforcement priorities outlined in Cole II, it is likely that a named corporate fiduciary will decline its appointment when the trust or estate includes a cannabis license. In addition, given the FinCEN guidance, described above, a fiduciary should consider whether a financial institution will even work with a trust or an estate that includes property related to or derived from the production or sale of cannabis.

Presumably, the death of the holder of a license and the appointment of a personal representative or trustee would be considered a 51% or greater change in ownership. Whether the new applicant is the fiduciary or the beneficiary (if that can even be established immediately following the death of a license holder), a new license must be applied for and issued. In light of these strict rules, it may be a good business practice to make sure that an entity is structured so that no single owner has more than a 51% interest. Other states have similar statutes that must be carefully followed.

Where a business is an asset of the estate, whether the new applicant is the fiduciary or the beneficiary (if that can even be established immediately following the death of a license holder), a new license may need to be applied for and issued before the fiduciary or the beneficiary can legally stand in the shoes of the decedent. In light of these strict rules, it may be a good business practice to put in place a well-thought-out business succession plan.

If a fiduciary agrees to serve and is qualified to do so, he or she must then determine whether the estate, any trusts, and individually named beneficiaries are eligible to own licenses under applicable state laws. Both Washington and Oregon impose age, residency, and criminal history requirements on license ownership.[127] It is unclear how those requirements will be interpreted if a trust or an estate becomes the owner of a license. The fiduciary will need to work with the state or local licensing authority to determine whether a trust or an estate is eligible for a license.

G. Fiduciary Duties and Cannabis

Trustees and other fiduciaries are subject to fiduciary duties that may make the investment of fiduciary assets in cannabis securities particularly difficult. A trustee or other fiduciary may risk committing a breach of fiduciary duty if it fails to exercise proper care, skill, and caution regarding any assets; cannabis-related securities raise new and unresolved issues.

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[126] OAR 845-025-1160(5) (Jan. 12, 2024)

[127] RCW 69.50.331; OAR 845-025-1115.

The fiduciary duties of trustees are set forth in detail in several primary sources, each of which have been adopted to some extent by the states. Thus this is a general discussion and does not apply to any one state. The primary sources include the Restatement (Third) of Trusts, the Uniform Prudent Investor Act, and the Uniform Trust Code. A fiduciary contemplating an investment in cannabis securities must also comply with the federal reporting of suspicious transactions involving cannabis proceeds discussed above, and generally available investor alerts warning of the risks of investing in cannabis securities.

The first issue a fiduciary needs to consider is whether the purposes of a trust are lawful and not contrary to public policy. The Restatement (Third) of Trusts provides that "A trustee has a duty not to comply with a provision of the trust that the trustee knows or should know is invalid because the provision is unlawful or contrary to public policy."[128] If a trust provision is invalid if (i) compliance would be unlawful, (ii) compliance is impossible, or (iii) circumstances have changed so that compliance would no longer be permitted due to public policy.[129]

The Uniform Trust Code (the "UTC") similarly provides that: "A trust may be created only to the extent its purposes are lawful, not contrary to public policy, and possible to achieve."[130]

Once establishing that a trust purpose is permissible, the trustee's most basic duties are to hold title to and manage trust property pursuant to the terms of the trust instrument, which must be done with the utmost loyalty, good faith, and honesty. The most important fiduciary duties applicable to a trustee are: (i) the duty of loyalty, which includes the duty to remain impartial to all trust beneficiaries, to avoid conflicts of interest, and to follow trust terms; and (ii) the duty of prudence, which includes the duty to exercise care and skill in managing the trust assets and administering the trust, and the duty to report and account.

1. Duty of Loyalty.

The trustee's fiduciary duty of loyalty is the "duty of a trustee to administer the trust solely in the interest of the beneficiaries."[131] A Trustee is in a fiduciary relationship as to the beneficiary and as to matters within the scope of the relationship the trustee has a duty to act solely in the best interests of the beneficiaries and cannot engage in activities that may result in increased benefit to himself. Such transactions would constitute a breach of the trustee's duty of loyalty, may expose the trustee to personal liability, and may be voided by the beneficiaries.[132] Further, the duty of loyalty requires the trustee to "communicate to [all beneficiaries] all material facts" in connection

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[128] *Restatement (Third) of Trusts §72* (2003).

[129] *Restatement (Third) of Trusts §29*.

[130] *Uniform Trust Code §404* (last revised or amended 2010).

[131] Austin W. Scott & William F. Fratcher, *Scott on Trusts* §170 (4th ed. 1987). See also *Restatement (Third) of Trusts* §170.

[132] *See Restatement (Third) of Trusts* §170 cmt. b.

with the administration of the trust.[133]

Also fundamental to the duty of loyalty is the obligation to comply with the terms of the trust instrument itself and to undertake all actions in accordance with applicable law.[134] On acceptance of the trust, the trustee has the duty to administer the trust according to the trust instrument and, except to the extent properly waived by the trust instrument, state law.

2. The Duty of Prudence and the Prudent Investor Rule.

The duty of prudence, along with the duty of loyalty, is the foremost duty of a trustee or other fiduciary. The duty of prudence with respect to the investment of trust assets is known as the "prudent investor rule."

(a) Restatement (Third) of Trusts.

The Restatement (Third) of Trusts provides that a fiduciary is required to use the reasonable care, skill, prudence, and diligence of an ordinarily prudent person engaged in similar business affairs while considering the purposes, distribution requirements and other circumstances of the trust.[135] A lay trustee must use the reasonable skill, care, and caution that a prudent person acting in a similar capacity would use to accomplish the purpose of the trust. A professional trustee is held to a more stringent standard and is required to apply the superior knowledge and competence ordinarily possessed by professionals under similar circumstances.

The modern prudent investor rule deviates from the prior notion that some investments are absolutely prohibited and permits a trustee to invest in any kind of property or type of investment, as long as the trustee exercises reasonable care, skill and caution. A trustee's investment decisions are not evaluated in isolation, but rather as part of the entire portfolio of investments and in light of the trustee's overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.

(b) The Uniform Prudent Investor Act.

The Uniform Prudent Investor Act ("UPIA") is a codification of the prudent investor rule that has been adopted in some form by all of the states.[136] Section 2 of the UPIA sets forth the standard of care for prudent investing as follows:

> i. A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and

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[133] *Restatement (Third) of Trusts* §170.

[134] *Restatement (Third) of Trusts* §76.

[135] *Restatement (Third) of Trusts* §227.

[136] *Unif. Prudent Investor Act* (1995).

caution.

ii. A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

iii. Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries: (1) general economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of investment decisions or strategies; (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property; (5) the expected total return from income and the appreciation of capital; (6) other resources of the beneficiaries; (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

iv. A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

v. A trustee may invest in any kind of property or type of investment consistent with the standards of this [Act].

vi. A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.[137]

A trustee also is generally required to diversify trust investments: "A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special

[137] UPIA §2.

circumstances, the purposes of the trust are better served without diversifying."[138]

Under the UPIA, "no particular kind of property or type of investment is inherently imprudent" as long as the investment is "part of an overall investment strategy having risk and return objectives reasonably suited to the trust."[139]

(c) Application of the Rules.

Although there appears to be no specific prohibition in the Restatement or the UTC that would prevent a fiduciary from investing in cannabis securities, an investment of trust assets in cannabis securities might raise a question as to whether the trust is valid and whether the trustee has acted properly in making the investment.

Assuming that the trust has a valid purpose in investing in cannabis securities, the fiduciary duty of care requires a trustee to invest trust assets "as a prudent investor would" in light of the purposes, terms, distribution requirements, and other circumstances of the trust. An investment of fiduciary assets in cannabis securities would not be a *per se* violation of the prudent investor rule.

Even if a trustee is authorized to invest in cannabis securities, however, the trustee is not relieved of the duty to invest prudently. The duty of prudence still requires a trustee to invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust, and to do so with reasonable care, skill, and caution.

The UPIA also emphasizes the importance of risk and return analysis as an element of prudent investing.[140] Thus, before investing in cannabis securities, a trustee must consider the risk tolerance of a particular trust, taking into consideration the relevant financial and other circumstances of the beneficiaries. The trustee must be able to demonstrate that the investment is part of an overall investment strategy with risk and return objectives reasonably suited to the trust that otherwise comply with the prudent investor rule.

Under the UPIA's consolidated portfolio approach for evaluating investment decisions, even if a fiduciary investment in individual cannabis securities were imprudent on a standalone basis, the investment might not be improper if part of a portfolio of securities that on the whole meets the prudent investor standard. Because cannabis securities are new and few, a trustee will need to exercise heightened due diligence to evaluate the risk of such securities.

A trustee must exercise care, skill and caution when investing, refrain from making investments that are illegal or contrary to public policy. If the cannabis-related activities of an issuer are legal, the fiduciary must apply the principles of trust law and the prudent investor rule before investing in the issuer's securities. Those principles generally require a fiduciary to invest and manage

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[138] UPIA §3. The UPIA also sets forth a duty of loyalty: "A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries." UPIA §5.

[139] UPIA §2, comment.

[140] UPIA §2, comment.

fiduciary assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust, and to exercise reasonable care, skill, and caution in doing so.

The Controlled Substances Act generally makes it unlawful for any person who derives income from illegal drug activity to invest such income in any enterprise engaged in interstate commerce.[141] Accordingly, a trustee should ensure that it knows the source of the assets under its control. Federal law imposes criminal penalties on any person who conducts a financial transaction knowing that the transaction is designed in whole or in part to conceal or disguise the nature, location, source, ownership, or control of the proceeds of the unlawful activity derived from unlawful activity. A fiduciary that knowingly invests illicit drug profits could be deemed to be aiding and abetting illegal activity.

It is not a breach of fiduciary duty for a fiduciary to invest in cannabis securities in all circumstances. But, a breach of fiduciary duty could occur if the fiduciary fails to satisfy general fiduciary prudence principles and the requirements of the prudent investor rule, along with related duties.

3. HIPAA

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") required the U.S. Department of Health and Human Services to adopt national standards for electronic health care transactions and code sets, unique health identifiers, and security. Consequently, Congress incorporated into HIPAA provisions that mandated the adoption of Federal privacy protections for individually identifiable health information.

Those rules have been updated to provide national standards for protecting the confidentiality, integrity, and availability of electronic protected health information.

Title II of HIPAA sets policies, procedures, and guidelines to maintain patient security and privacy over "protected health information" ("PHI"), and puts notification requirements and civil and criminal penalties in place for breaches under its rules. PHI is health data created, received, stored, or transmitted by HIPAA-covered entities and their business associates in relation to the provision of healthcare, healthcare operations, and payment for healthcare services. The fact that cannabis is illegal under federal law does not take it outside of the purview of HIPAA. A medical cannabis dispensary may be a healthcare provider.

When a fiduciary comes into possession of a medical cannabis business, the fiduciary needs to be aware of HIPAA and ensure that it is being followed.

H. Federal Income and Estate Tax Considerations.

Because cannabis remains illegal under federal law, few business deductions are allowed on

[141] 21 U.S.C. §854.

federal tax returns, and the gross revenue is taxable.[142] In some instances, the cost of goods sold (costs incurred for the purchase, conversion, materials, labor, and allocated overhead incurred in bringing the cannabis inventories to their present location and condition) may be deductible under I.R.C. §280E,[143] but the ordinary and necessary expenses related to sale, including inventory, rent, advertising, and employee salaries are not.[144] However, in some cases, expenses in connection with ancillary businesses still may be deductible.

Successful cannabis entrepreneurs need to keep in mind that even illegal property has a value. The IRS has held that the fact that a market is illicit does not obviate the existence of that market for estate tax valuation purposes.[145]

To make matters more complicated, under the Electronic Federal Tax Payment System, since January 11, 2011, tax payments may not be made in cash.[146] A 10% penalty may be imposed for each cash payment, although exceptions may be made for certain taxpayers unable to obtain bank accounts.[147]

I. Valuation.

Valuation of cannabis and cannabis businesses is anything but straightforward. The industry is expected to generate significant revenue. But high startup and operating costs, the fact that past revenue information generally applies to the medical cannabis industry, which has existed for longer than recreational cannabis, and the significant infrastructure expenses make historical valuation metrics largely irrelevant. As a result, valuations are typically based on forward looking multiples, which reflect a company's early-stage growth potential. Even this approach to valuation cannot take into account the uncertainty in an industry still illegal under federal law. While the tobacco and alcohol industries can provide similar historical data to a point, while heavily regulated, they are legal. Adjustments need to be made for differences in the state of maturity of the industries, customers, cost of production and heightened inherent risks.

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[142] I.R.C. §280E, enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, provides:

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

[143] Jeffrey Gramlich & Kimberly Houser, *Marijuana Business and Sec. 280E: Potential Pitfalls for Clients and Advisers*, The Tax Adviser (June 30, 2015), http://www.thetaxadviser.com/issues/2015/jul/houser-jul15.html.

[144] *Alterman v. Comm'r*, T.C. Memo. 2018-83 (June 13, 2018) (holding that I.R.C. §280E operates to disallow a cannabis business's tax deductions); *see also Loughman v. Comm'r*, T.C. Memo. 2018-85 (June 18, 2018) (holding that I.R.C. §280E disallows the deduction of wages paid to S corporation shareholders).

[145] *Browning v. Comm'r*, 61 T.C.M. 2053 (1991) (the fair market value of cannabis based on the wholesale street market value); *see also* William J. Turnier, *The Pink Panther Meets the Grim Reaper: Estate Taxation of the Fruits of Crime*, 72 N.C. L. Rev. 163 (1993).

[146] Treas. Reg. §31.6302-1(h)(3).

[147] I.R.M. §20.1.4.2.2.

As with any business valuation, there are three possible approaches:

(1) Adjusted Net Asset Approach. This methodology estimates the fair market value of a company by subtracting liabilities from the total assets of the entity, after adjusting the balance sheet to fair market value. This valuation methodology does not typically capture the value of intangible assets such as goodwill.

(2) Market Approach. The market approach is premised on the theory that businesses can be valued with reference to transactions involving comparable companies in an open and unrestricted market. Valuations are based on publicly traded company information and publicly available transaction information. Various multiples are applied to the company being valued to arrive at its fair market value.

(3) Income-Based Approach. The income-based approach determines the value of a business based on future cash flow and earnings, discounted at a particular rate of return that reflects the inherent risks, size of the market, operating costs and opportunity costs.

While the valuation approaches still apply to the cannabis industry, the factors to be applied are largely unknown. What is known is that the cost of cannabis businesses carries a premium at every stage. This is due to several factors, including:

(1) Regulation. Regulations also increase operating costs to meet the requirements at every state of business including agricultural regulations, packaging and product testing.

(2) Market Size. There is great uncertainty concerning the size of the market. While a surge in demand is expected as legalization occurs, and a new customer base is developed there is no historical data to determine the size and growth rate of the market.

(3) Pricing. Pricing depends on demand and must also compete with the illegal market. Pricing can also be affected by the number of crops in the ground, the growth cycle, and crop failures. And an entire crop cycle can be wiped out by testing failures.

(4) Funding. Access to funding may be limited because of the risks, making access to capital more difficult than for other startup sectors.

(5) Skilled Personnel. It will take time to develop experienced employees and management teams because of the novelty and complexity of the industry.

(6) Availability of revenue generating tangible assets for cultivation and processing. Cultivators and growers are particularly capital

intensive because of the legal standards they must comply with. This will also impact the ability to grow the distribution channels.

(7) Real estate. There are limited real estate due to strict zoning laws; landlords add a premium to rents to offset the risk they are taking on by renting to a business that grows, processes, or distributes a federally illegal substance; interest rates on loans are at a premium, making it difficult to purchase commercial property; and for those who rent they may be required to pay nonrefundable deposits that are forfeited if a license isn't obtained.

(8) Licenses. Obtaining a license takes time and impacts the timeline for a company to begin operations and generate revenue. In many states, cannabis cultivators, processors, and dispensaries may not obtain cannabis licenses unless they have secured property for their operations before they submit their license applications. The businesses may have to pay rent while they wait to see if their applications for licenses are approved.

(9) Business expenses. Unlike any other business there is currently the lack of a deduction or credit for most business expenses under I.R.C. §280E as discussed above.

(10) Ancillary businesses. It will be necessary for the ancillary businesses - the companies supporting the industry - to grow to scale and a pace at the necessary pace.

No one methodology is appropriate to value a cannabis business. An accurate valuation will require an in-depth due diligence review to analyze the quantitative and qualitative factors driving each business to determine is operational strength and long-term potential, which is much more informative than short-term profit forecasts. For now, the income approach (future income expectations, reduced to present value) is the preferred metric for valuing cannabis companies, largely because most companies have not yet reached a point of stabilized profitable operations, and they are growing rapidly and/or are expected to continue to do so.

J. Insurance Issues.

Cannabis and insurance can intersect in many ways. Issues that intersect only with estate planning are summarized below.[148]

1. Life Insurance.

The most common type of insurance in the estate planning context is life insurance. When a potential insured is applying for life insurance, the underwriter will inquire about cannabis use.

[148] For a broader examination of this topic see Francis Joseph Mootz & Jason Horst, *Cannabis and Insurance*, 23 Lewis & Clark Law Review 893 (June 30, 2019), available at https://ssrn.com/abstract=3412595.

Recreational use and medicinal use are considered differently. Additional underwriting considerations, if use is disclosed, include "details of marijuana use, quantity, frequency and method of ingestion, use of alcohol or other drugs including prescription drugs with abuse potential, identification of associated psychiatric and medical conditions, social and occupational factors and level of functioning will be beneficial for accurate risk classification."[149] In general, life insurance companies look at use based on frequency, using the following terms (which are defined differently among companies): rare or experimental; intermittent; moderate; and heavy.[150] Depending upon frequency of use and the existence of other underlying conditions, use of cannabis recreationally or medicinally may not preclude even a "Preferred Plus Non-Smoker" rating.[151]

Because of the frequency of use of life insurance in the estate planning context, planners need to be sensitive to the potential that use may jeopardize a plan: clients may not be willing to share information about their consumption; rates may be higher than expected because of cannabis use, which is not known by other family members; and clients may be concerned enough about privacy to avoid insurance planning entirely.

2. Business Insurance.

For the client in the cannabis business, one of the biggest challenges is obtaining appropriate insurance. The types of coverage a cannabis business may wish to obtain depends on the type of business it is in, but may include commercial general liability, real property insurance employment practices, workers' compensation, directors & officers, property casualty, product liability, commercial vehicle, business interruption, key person liability, employee liability, crime and theft coverage, products liability, and crop insurance. Generally, if the purpose of insurance is illegal, a carrier may not provide or may ultimately deny coverage under a policy. As a result, most traditional insurance companies have declined to write insurance policies for the commercial cannabis industry, both because of the federal illegality and because of the increased risk of theft and burglary. Those that do include broad exclusions, limiting the utility of the policies issued. Those exclusions may include any of the following: (i) seeds, seedlings, vegetative plants, flowering plants, or harvested material that is not yet finished stock; (ii) bodily injury and property damage arising directly or indirectly from alcoholic beverages; (iii) volunteers and employment practices liability; (iv) business owners; (v) nutraceutical substances such as essential oils; and (vi) vaporizing devices.[152]

States possess the power to issue insurance licenses and regulate the types of insurance

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[149] Marianne E. Cumming, *Marijuana use: implications for life insurance*, at 5 (Mar. 2015), http://www.aaimedicine.org/annualmeetingpresentations/documents/Cannabis-SwissReClaimsarticle.pdf.

[150] Natasha Cornelius, *How Does Marijuana Use Affect Life Insurance Rates?*, Quotacy (Apr. 26, 2018), https://www.quotacy.com/marijuana-life-insurance/.

[151] *Id.*

[152] John Bench, *Anatomy of a Cannabis Insurance Policy: Exclusions*, Canna Law Blog (Feb. 13, 2020) available at https://www.cannalawblog.com/anatomy-of-a-cannabis-insurance-policy-exclusions/.

arrangements available within their borders.[153] But even in those states where legal, insurance commissioners have been reluctant to issue licenses for cannabis-related insurance for fear that it would invite scrutiny by the DOJ. In May of 2018, the California Department of Insurance approved the first Lessor's Risk policy issued by a traditional insurance company. Many in the cannabis industry have turned to captive insurance.[154]

A captive insurance company is generally a company that operates outside of the commercial insurance marketplace and is wholly owned and controlled by its insureds. Its primary purpose is to insure the risks of its owners.

While captive insurance is not available in Washington or California, in those states where it is available, it is a tool that should be considered for the client involved in any aspect of the cannabis industry where conventional insurance is not available.[155]

1. Title Insurance.

Title companies, in addition to issuing title insurance, often handle the closing of a real estate transaction. Title insurers have become concerned that their mere involvement in transactions involving real property that is somehow connected to the cannabis industry may expose them to criminal charges under federal law. While some companies will issue policies, they likely will decline to serve as the escrow for the transaction because of this concern. And even where insurance is available, it will likely exclude civil and criminal forfeiture under the Controlled Substances Act.

Underwriters who have agreed to insure cannabis real estate transactions will have exceptions on their title commitments for cannabis related title policies similar to the following:

> Without limiting, modifying, abridging or negating any provision of the Exclusions From Coverage stated in this Policy or any other exception included in this

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[153] The McCarran-Ferguson Act of 1945, 15 U.S.C. §§1011-1015, exempts the business of insurance from most federal regulation.

[154] *See* Gloria Gonzalez, *Captives an option as marijuana sector seeks coverage*, Bus. Ins. (Mar. 14, 2018), http://www.businessinsurance.com/article/20180314/NEWS06/912319839/Captives-an-insurance-option-as-marijuana-sector-seeks-coverage; Matthew Queen, *The Growing Cannabis Industry and Captive Insurance*, Ins. J. (Oct. 16, 2017), https://www.insurancejournal.com/magazines/mag-features/2017/10/16/467075.htm.

[155] Unlike a mutual insurance company, where the policyholders do not control the company, the policyholders of a captive insurance company put their own capital at risk when forming the company and jointly control the company. Captive insurance companies also shift back to themselves the benefit from the underwriting profits on their own insurance risks that would have otherwise been paid to a commercial insurance company. According to Jay Adkisson "Vermont remains, hands-down, the 'gold standard' leader for captives within the United States and now trails only Bermuda worldwide for captives. . . . Beginning somewhere around 2005, the offshore tide reversed and ever since the vast bulk of captives have been domiciled within the United States, where a solid majority of states have now adopted captive-enabling legislation. Now at least a dozen states very actively and competitively make a market for captive formation and management services." LISI Asset Protection Planning Newsletter #370 (June 26, 2018), http://www.leimbergservices.com. *See Syzygy Insurance Co., Inc. v. Comm'r*, T.C. Memo 2019-34 (April 10, 2019), https://ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11907, for a discussion regarding the nonexclusive list of characteristics of captive insurance companies.

> Schedule B, and as a supplement and addition thereto, this Policy does not insure or provide title insurance coverage directly or indirectly for or against any and all consequences and effects, legal, equitable, practical or otherwise, civil or criminal, of any violation or alleged violation of any United States federal, state, county, municipal or local laws, statutes, ordinances or regulations or any actual or threatened action, court order or mandate for the enforcement thereof, relating to or governing the use, processing, manufacture, growth, possession, distribution, sale or any other activity on, about, or relating to or concerning the land, title thereto or any interest therein, of any Schedule I drug as defined by the United States Controlled Substances Act, including, without limitation, marijuana and/or cannabis, and any component, derivative or product thereof. [156]

A purchaser may even be required to sign a sworn affidavit stating that the property was not and would not be used in any capacity for the growing, producing, distribution or dispensing of any type of cannabis or cannabis products. Where these activities do take place on the property the title company will have an argument to refuse to pay claims under the policy.

2. Minimum Insurance Requirements in Washington State.

Washington law contains a number of statutory minimum insurance requirements for a cannabis licensee:[157] The purpose of the mandatory insurance is to protect consumers. Licensees should also consider other types of business insurance, including D&O insurance, employment practices insurance, worker's compensation insurance, and products completed liability insurance, depending upon the type of business they ae conducting.

V. CONCLUSION

While many practitioners will go an entire career without running into certain regulated assets, chances are that one or two will pop up now and then. This outline is intended to provide a starting point for ways of dealing with just a few. Unless the practitioner asks about the existence of these assets, their existence may never even be disclosed. Therefore, it is important to ask questions about whether these assets exist and whether the named fiduciaries and beneficiaries are qualified to own them. Without this inquiry, both the fiduciary and the fiduciary's adviser may encounter additional and otherwise avoidable complexities as a result of the strict regulations in place.

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[156] See https://www.tokentitlegroup.com/posts/cannabis-real-estate-deals-marijuana-and-title-insurance

[157] WAC 314-55-082. See also RCW ch. 48.15 and WAC ch. 284-14 for additional insurance rules in Washington.

EXHIBIT A

DEPARTMENT OF HEALTH AND HUMAN SERVICES Office of the Secretary

Office of the Assistant Secretary for Health
Washington, D.C. 20201

August 29, 2023

The Honorable Anne Milgram
Administrator
Drug Enforcement Administration
U.S. Department of Justice
8701 Morrissette Drive
Springfield, VA 22152

Dear Anne Milgram:

Pursuant to the Controlled Substances Act (CSA), 21 U.S.C. 811(b) and (c), I, the Assistant Secretary for Health, am recommending that marijuana, referring to botanical cannabis (*Cannabis sativa L.*) that is within the definition "marihuana" or "marijuana" in the CSA, be controlled in Schedule III of the CSA.

Upon consideration of the eight factors determinative of control of a substance under 21 U.S.C. 811(c), the Food and Drug Administration (FDA) recommends that marijuana be placed in Schedule III of the CSA. The National Institute on Drug Abuse has reviewed the enclosed documents (which were prepared by FDA's Controlled Substance Staff and are the basis for FDA's recommendation) and concurs with FDA's recommendation. Marijuana meets the findings for control in Schedule III set forth in 21 U.S.C. 812(b)(3).

Based on my review of the evidence and FDA's recommendation, it is my recommendation as the Assistant Secretary for Health that marijuana should be placed in Schedule III of the CSA.

Should you have any questions regarding this recommendation, please contact FDA's Center for Drug Evaluation and Research, Office of Executive Programs (cderexsec@cder.fda.gov), at (301) 796-3200.

Sincerely,

Rachel L. Levine, M.D.
ADM, USPHS
Assistant Secretary for Health

Enclosure

EXHIBIT B

Update on HHS FOIA Litigation

I win

MATT
JAN 11, 2024

♡ 24 💬 5 Share

Zorn, Matt

From: [redacted]@usdoj.gov>
Sent: Thursday, January 11, 2024 1:45 PM
To: Zorn, Matt
Cc: [redacted] (HHS/OGC); [redacted] (HHS/OGC)
Subject: RE: Zorn v. HHS, 23-2894 (RC)

Good afternoon and thank you for your email and for your patience.

The agency has advised that it will release the letter and its enclosures in their entirety.

Your motion for summary judgment will be moot once the agency makes this release.

This is nothing to me. Impossible just takes a few weeks. I do this in my sleep.

This could mean, by the way, that a rescheduling is imminent[1]—or not.

Back to your regularly scheduled programming and your $MSOS stock trades.

1 A Federal Register notice announcing rescheduling would attach the letter and its enclosures.