

# MICHIGAN PROBATE & ESTATE PLANNING JOURNAL

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Vol. 43 • Winter 2023 • No. 1

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## Estate Planning Considerations for Cannabis Business Owners

By John Fraser and Molly P. Petitjean

Estate planning for business owners always brings certain complexities to the planning analysis and requires attorneys to understand business law. Estate planning for cannabis business owners invites more challenges and additional necessary background knowledge for the estate planner to effectively advise clients. This article focuses on planning hurdles and regulations related exclusively to marijuana businesses, and is not inclusive of industrial hemp businesses, which are regulated using separate state and federal laws.

There are two primary statutory sources of authority for the licensing and regulation of marijuana businesses in Michigan—the Medical Marijuana Facilities Licensing Act (“MMFLA”), MCL 333.27101 *et seq.* and the Michigan Regulation and Taxation of Marijuana Act (“MRTMA”), MCL 333.27951 *et seq.* Particularly important to practitioners advising marijuana businesses are the many defined terms of art in the statutes that impact how these businesses are regulated and administered. These definitions also impact estate planning considerations and concerns related to additional steps for reporting on the death of a business owner.

Both the MMFLA and MRTMA delegate the primary state regulatory and licensing authority to the Michigan Cannabis Regulatory Agency<sup>1</sup> (“CRA”), which is housed within the Michigan Department of Licensing and Regulatory Affairs (“LARA”). The CRA is statutorily charged with promulgating rules for the licensure and regulation of medical and adult-use marijuana businesses.<sup>2</sup> Of particular importance to practitioners is that the CRA requires all Applicants (as that term is defined below) to report any proposed changes of ownership to the CRA for the CRA’s approval prior to any such change taking effect.<sup>3</sup> Accordingly, the CRA’s approval is needed before any proposed transfers of marijuana

ownership interests to any other person or entity, including funding into a trust, can be completed.

In addition to the CRA, both the MMFLA and MRTMA empower local municipalities to regulate and license marijuana businesses.<sup>4</sup> Accordingly, marijuana business in Michigan must secure both state and local municipal licensure in order to operate. Local municipal ordinances regulating marijuana businesses are incredibly varied. Since the state of Michigan has 1773 different municipalities, it is impossible for any practitioner to memorize the nuances of each municipality’s approach to marijuana business licensure and regulation. Practitioners must familiarize themselves with the specific municipalities in which their clients’ businesses are (or are intended to be) located and obtain copies of the applicable municipal ordinances.

While not all owners of a marijuana business face exacting regulatory scrutiny, the reality is that the patchwork of varied local municipal regulations makes it impossible to paint with broad strokes. However, the CRA’s rules and requirements are consistent across the board for all licensees, and many municipalities follow the CRA’s lead on these issues. Therefore, while practitioners must still review and confirm compliance with local municipal requirements, the following definitions are broadly applicable at the state level and provide a guidepost for issue spotting when advising marijuana businesses.

Of critical importance for estate planning attorneys to understand is whether a person or entity meets the definition of “Applicant”<sup>5</sup> within the CRA’s rules. Applicants are subjected to an initial background review by the CRA, which is generally referred to as “prequalification.”<sup>6</sup> In addition, Applicants have continuing reporting obligations to the CRA to report any changes to the information that was originally disclosed to the CRA, in addition to other specific disclosures.<sup>7</sup>

These reporting obligations may be triggered on trust funding or the death of an Applicant. There are strict timelines in the rules for when these disclosures must be made and some reporting obligations require reporting proposed changes to the CRA before the changes can be implemented—such as any proposed conveyance of direct or indirect interest in a marijuana license.<sup>8</sup> As a result, it is critically important that practitioners advising marijuana businesses and their owners understand who is an Applicant.

Generally speaking, an Applicant<sup>9</sup> consists of all of the following:

- 1) the main entity that is applying for the license to operate a marijuana business;
- 2) every person that holds greater than a 10% direct or indirect ownership interest in the marijuana business;
- 3) all managers (in a limited liability company (“LLC”)), directors (in a corporation), and officers (or persons with equivalent titles) of the main entity;
- 4) any person who exercises control over or participates in the management and affairs of the main entity;
- 5) the spouses of all of the people identified in (2)-(4); and
- 6) managerial employees of the main entity.

Note that “managerial employee” is a defined term in the rule and only consists of those employees who have the ability to control and direct the affairs of the business or have the ability to set policy on behalf of the business, or both.<sup>10</sup>

If an Applicant desires to transfer his or her interest into a trust, the Applicant must report the proposed change in ownership to the CRA *prior* to the transfer. The definition of an Applicant as applicable to a trust includes “Trustees, any individual or body able to control and direct the affairs of the trust, and any beneficiary who receives more than 10% of the gross or net profit from the enterprise during any full or partial calendar or fiscal year”<sup>11</sup> and their spouses. If the

trust is a revocable living trust with the grantor and the grantor’s spouse acting as initial trustees and the sole present beneficiaries, the reporting requirements are effectively identical to the initial reporting requirements for an individual Applicant. However, if the trust structure deviates from that structure and names different or additional trustees, trust directors, or beneficiaries, those individuals should be included in the reporting.

Estate planning attorneys advising individuals who qualify as Applicants of a marijuana business should work in close consultation with corporate and regulatory counsel for the marijuana business before finalizing any estate planning to ensure that any needed regulatory approvals are received, such as CRA approval, before a business interest is transferred to a trust. Note that there may also be local municipal regulatory requirements to be satisfied as well. Moreover, conveyances of interests of Applicants might cause the transferee to also meet the definition of an Applicant, which would require the transferee to receive CRA prequalification before the proposed transfer can close. As a result, the timing of these transfers in the broader landscape of the operating business may need to be considered, as a pending transfer of an existing Applicant’s interest in a license may limit or delay the business’s ability to secure licensure for a new location, close an acquisition of another business, or dispose of certain business assets.

The CRA has historically taken the position that all members in a member-managed LLC meet the definition of “Applicant”—regardless of percentage of ownership interest—because all members in a member-managed LLC have the ability to participate in the management and affairs of the business.<sup>12</sup> Accordingly, practitioners in this space should strongly encourage clients to form Manager-Managed LLCs and include appropriate language to that effect in the LLC’s Articles of Organization to give the LLC flexibility to add minority members that do not meet the definition of Applicant.<sup>13</sup>

Practitioners advising marijuana business entities should build in regulatory safeguards directly in the company's operating agreement, bylaws, or other governance documents. For example, while restrictions or limitations on transferability of ownership interests is commonplace in many closely held business entities, this provision takes on new and heightened significance in the marijuana business environment. Because transfers of ownership interests in marijuana businesses require CRA approval,<sup>14</sup> this restriction helps ensure compliance for the business and its owners.

Similarly, practitioners can incorporate certain regulatory compliance provisions directly into the business's governing documents. For example, an LLC operating agreement might include language requiring all proposed additional members of the company to comply with the company and the company's counsel in the submission of a prequalification application to the CRA or any other needed regulatory disclosure information to ensure the company's compliance. Moreover, the company's governing documents might contain a provision requiring existing owners to continue to meet certain applicable licensure requirements to continue to hold their interest in the company. For example, one approach might be to empower the board of managers/directors to make a determination that an owner's conduct jeopardizes the company's continued licensure and provide a mechanism for the company to buy out that owner's interest upon terms specified in the operating agreement. The same approach might ring equally true for an owner that passes away—particularly for owners with minority interests. The company might also consider a buyout option, at the sole election of the company, upon the death of a member to avoid issues regarding regulatory suitability of proposed beneficiaries or successors.

One of the most important considerations for a cannabis business owner is the appointment of a fiduciary in planning documents. Agents under durable power of attorney and successor trust-

ees should be capable of making decisions for the principal regarding the cannabis business, and the estate plan should be drafted to minimize any disruption to the business in the event the client becomes incapacitated. In most cases, a corporate fiduciary is not an option. It is difficult to find a corporate fiduciary to act when a cannabis business asset is involved because cannabis is still classified as a Schedule I substance under the federal Controlled Substances Act. In 2014, the Department of Treasury Financial Crimes Enforcement Network issued guidance to financial institutions wishing to provide services to cannabis businesses.<sup>15</sup> The guidelines set forth the ability for each financial institution to make a decision whether to provide services to cannabis businesses and what services to offer based on certain factors, including the evaluation of risk associated with offering a particular product or service and the financial institution's ability to effectively manage such risks.<sup>16</sup> Banking and financial services are generally available for cannabis businesses since state legalization, but the services offered have not extended to fiduciary or trust services. Cannabis business owners must instead consider a family member, friend, key employee, or business partner for the role of fiduciary. It is prudent to name multiple successors in the event that a successor fiduciary declines to act when called upon given that cannabis remains a Schedule I controlled substance. If a business partner or other individual with an interest in the cannabis business asset is nominated in a fiduciary capacity as either trustee or trust director, the trust drafter should consider the addition of a clause waiving any conflict of interest that the exercise of any fiduciary powers may cause related to that business interest as the fiduciary will also have an interest, whether direct or indirect, in the asset.

If the client has younger beneficiaries, transfer of the cannabis business may not be possible. Under Michigan law, it remains illegal for an individual under the age of 21 to "possess, consume, purchase or otherwise obtain, cultivate,

process, transport, or sell marihuana.”<sup>17</sup> It is also illegal to transfer cannabis or cannabis accessories to an individual under the age of 21.<sup>18</sup> Even if the primary post-death beneficiaries are over the age of 21, there is always the potential for assets to pass to minor contingent beneficiaries instead. This concern and the potential risks related to post-death transfers of cannabis business assets encourages careful business succession planning to ensure an available market of purchasers (the entity and its existing member) for the business asset and prevent saddling the business, fiduciary, or beneficiaries with an impossible distribution pattern unintentionally.

To address concerns over potential changes to the law or inappropriate beneficiaries, a trust director may be appointed in the trust document to provide maximum flexibility. Powers given to a trust director may include: the ability to amend the trust to be administered in a more tax effective manner or to comply with current or future laws and regulations, divide the trust or create a new trust to hold the cannabis business asset to limit its receipt to legally allowable beneficiaries, amend the time periods and durations under which beneficiaries are entitled to take distributions, or appoint a special fiduciary in the event one is necessary to hold and dispose of the cannabis business asset.

Planning for cannabis business assets is a potential quagmire for attorneys inexperienced in the area of licensing and regulation of marijuana businesses. Moreover, given the nascency of the cannabis industry in Michigan, this area of law is still quite unsettled. Indeed, the CRA filed a Request for Rulemaking with the Michigan Office of Administrative Hearings and Rules on May 1, 2023, to reopen its existing administrative rules for reforms, and it is expected that the CRA will promulgate new rules sometime in 2024 that may impact the guidance offered here. Further, the federal government has signaled some willingness to change its approach to cannabis, and any federal changes may further complicate the advice and guidance provided here. Accordingly,

traditional planning techniques may still be used provided transfer of the ownership interest does not jeopardize a business’s license, but practitioners would be well advised to keep abreast of any changes in the area of cannabis regulatory law that may warrant reconsideration of prior estate plans and strategies.

### Notes

1. MCL 333.27206; MCL 333.27957.
2. MCL 333.27206; MCL 333.27957.
3. Mich Admin Code, R 420.14, 420.802, 420.803.
4. MCL 333.27205; MCL 333.27956.
5. Mich Admin Code, R 420.1(1)(c).
6. Mich Admin Code, R 420.3(2).
7. Mich Admin Code, R 420.14, 420.802.
8. Mich Admin Code, R 420.14(3)(e).
9. See Mich Admin Code, R 420.1(1)(c) for a complete definition.
10. Mich Admin Code, R 420.1(1)(p).
11. Mich Admin Code, R 420.1(1)(c)(i)(I).
12. Mich Admin Code, R 420.1(1)(c)(i)(D).
13. MCL 450.4203(1)(d).
14. Mich Admin Code, R 420.14(3)(e).
15. *BSA Expectations Regarding Marijuana-Related Businesses*, FIN-2014-G001 (Feb 14, 2014).
16. *Id.*
17. MCL 333.27954(1)(c).
18. MCL 333.27954(1)(b).



As the Michigan Team Leader of Dykema's Cannabis Practice, John Fraser often serves as the legal "quarterback" for a cannabis business's myriad of issues as part of a multidisciplinary legal team. Whether it's providing rapid feedback on an emerging legal issue or

negotiating a multi-million dollar cannabis brand licensing agreement, John provides effective leadership and counsel so that clients can conduct their business effectively, efficiently, and—most importantly—in compliance with applicable laws. John's knowledge and expertise in the field of Michigan cannabis law has been recognized by his peers and colleagues. He previously served as the Chairperson of the Cannabis Law Section of the State Bar of Michigan. In addition, John is an adjunct professor of law at Cooley Law School where he teaches a course on Michigan Marijuana and the Law. He has been recognized by Super Lawyers as Rising Star in the fields of Cannabis Law and Appellate Law since 2020. He also regularly lectures and presents on cannabis law topics to attorneys and the community.



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